Twin Cities Mixed-income Housing Case Studies

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Policy brief prepared by MZ Strategies, LLC for the McKnight Foundation Region and Communities Program

Why focus on Mixed-income Housing?

The greater Minneapolis-Saint Paul metropolitan area is fortunate to be among those regions experiencing growth of population and jobs. The Metropolitan Council forecasts that through 2040, the metro area will increase from 2.85 million to 3.63 million residents, with dramatic increases in the number of residents of color and older adults.[1]

The housing market is seeing growth in both property values and new production. The Met Council forecasts that between 2020 and 2030 the regional net growth means that 37,400 low- and moderate-income households will need new additional affordable housing.[2] Meeting this projected need, while simultaneously addressing regional disparities that have resulted in areas of concentrated poverty where at least half the residents are people of color largely clustered in the two central cities and spreading into the inner suburbs will require providing additional affordable housing in higher-income areas of the region, which also tend to be higher opportunity areas. It will also require providing a greater range of market rate housing within areas that currently have a disproportionate percentage of low-income housing. These strategies are reinforced in HUD's Final Rule on Affirmatively Furthering Fair Housing.[3]

KEY FINDINGS

1. **Mixed-income projects happen within -- and despite of – a siloed funding environment.**
2. **Mixed-income projects require subsidy because of their perceived higher risk to investors.**
3. **Early commitment by local governments can play a critical role in expediting projects and reducing finance costs.**
4. **To achieve public policy objectives, more public sector resources need to be committed.**
5. **A mix of 80/20 is the apparent threshold, regardless of whether more market or affordable.**
6. **Scale matters, especially in strong markets.**
7. **Across all income levels there is a growing need for larger units.**
8. **Peer learning and intermediary support can increase the number of mixed-income projects in the Twin Cities metropolitan area.**

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[1] Each of these trends mirrors those in the United States as a whole. However, they diverge slightly from most other areas of the Midwest which are slated for slower or negative growth. http://metrocouncil.org/getattachment/dc10aad8-daeb-493c-a165-c9e481c13e0c/.aspx

[2] Metropolitan Council. March 16, 2015. "2040 Housing Policy Plan"

[3] FR–5173–P–01 Affirmatively Furthering Fair Housing, Final Rule, Issued on July 16, 2015, HUD-2013-0066

Some of the best opportunities to achieving both are to locate affordable housing near the region's expanding transit network where there is growing market interest -- including in many high-opportunity suburban communities -- to take advantage of the increased mobility that light rail and bus rapid transit provide. Jurisdictions in the region are promoting mixed-income housing as another strategy to expand housing opportunity within individual projects or a single neighborhood, often located near transit within the station area.

This white paper was developed through the support of the McKnight Foundation to examine the policy context surrounding mixed-income housing in the Twin Cities region and specifically to spotlight three examples of recent mixed-income projects to better understand the motivations, challenges and policy implications these type of projects entail. Examples were chosen from center city and suburban communities, and illustrate a mix of market and subsidized units to convey the spectrum of ways that mixed-income projects can be financed, designed, and leased. Findings were informed by interviews with those developers, public agency staff and intermediaries involved in affordable housing production.

Housing Affordability Gap

Within the Twin Cities Metro Area there is currently a deficit in attached housing, and small lot housing -- two common types of lower-cost housing (Nelson 2014, 32).[4] At the same time there is a surplus of other housing types, most notably large lot housing which also tends to be the most expensive for buyers. Twin Cities Metro Area 2040 housing trend projections forecast reduced home ownership rates and lower housing demand for detached medium and large lot single family homes (Nelson 2014, 20). Economic changes, such as falling median wages, diminished real-estate appreciation prospects, and higher standards for mortgage financing may also contribute to these reductions.

A number of federal, state, and local programs exist to improve the profitability of low-cost housing, and stimulate the market to provide supply on par with demand. However, local land use regulations may constrict the supply of land for low-cost housing, while local housing standards may obligate higher quality construction, both of which impose extra costs on low-cost housing (Green and Malpezzi 1996, 1817; Enterprise Community Partners 2013). The undersupply of traditional low-cost housing options and the over-supply of higher-cost options in the Twin Cities suggests that local housing and land use policies are imposing extra housing costs which is limiting affordable housing production.

Suburban neighborhoods are desirable for families because of their perceived safety, relative affordability, and high quality of public services, particularly schools. Attempts to locate low or mixed-income housing in suburban neighborhoods can be challenging due to community opposition stemming from negative perceptions regarding the impact of low-income residents on school quality, crime, safety, and real-estate values (Massey 2012). This makes for a politically challenging dynamic, with affordable housing production lagging in many Twin Cities suburban communities. The Met Council's 2040 Housing Plan allocates regional affordable housing targets to help ensure housing for a range of incomes across the metro area. Recent efforts in several suburban jurisdictions such as Edina and St.

[4] http://metrocouncil.org/getattachment/571ff237-6d73-4e26-86bc-3c12978b1b89/.aspx

Louis Park indicate growing local recognition of the need to expand affordable housing options (Weinmann 2015).

What is Mixed-income Housing?

Mixed-income housing is a development that has a deliberate mix of income groups as a "fundamental part" of its financial and operating plans (Brophy and Smith 1997, 5). As shown in Figure 1, mixed-income housing occurs at a range of scale. While it can be used to refer to a mix of units affordable for different income levels, this white paper defines mixed-income housing as that including both income-restricted and market-rate units. Subsidized units are reserved for renters with income at or below a certain percentage of the Area Median Income (AMI), typically 60% AMI as dictated by the Low Income

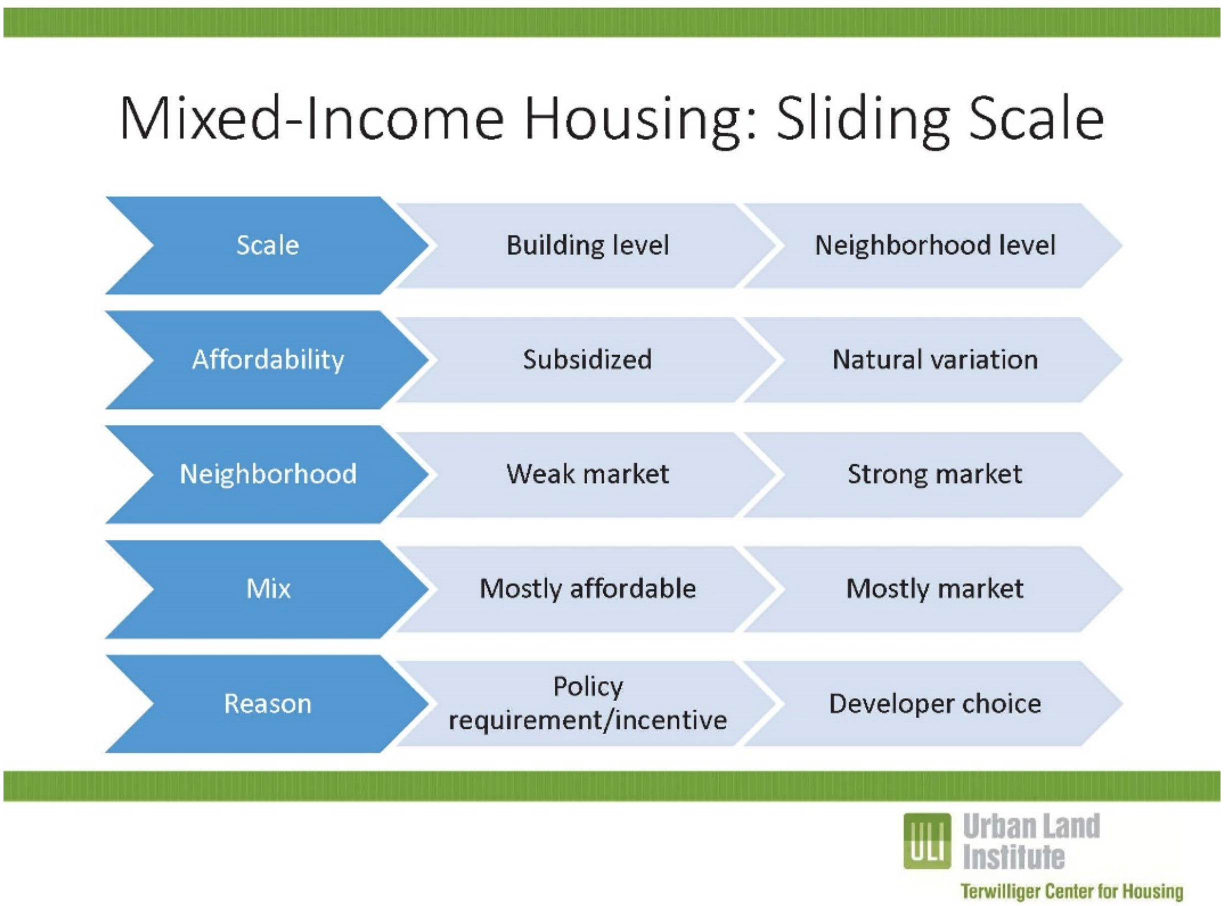

Figure 1. Graphic taken from presentation by Michelle McDonough Winters , ULI Terwilliger Center for Housing, July 2015.

Housing Tax Credit.

This mix can be within a single project, or it can occur at a neighborhood or station area scale with an affordable housing project being located adjacent to a market-rate project.

In the 1990's, federal policy shifted away from large-scale exclusively low-income housing developments towards programs such as HOPE VI which aimed to de-concentrate the urban poor and provide a higher standard of affordable housing (United States Government 2000). Other programs designed to move the poor to low-poverty areas included Section 8 Housing Choice Vouchers and the Moving to Opportunity for Fair Housing Demonstration Project. It also included policies such as mixed-income housing incentives to try and add market rate renters to inner-city projects. HUD hoped that de-concentration would ameliorate the problems of the urban poor, but relied heavily on local governments to allocate the grant money to projects, and on the private sector to use the grants and their private capital to build and operate those projects.

Mixed-income housing has gained popularity among local governments as a policy objective. It is included in the 2040 Housing Policy Plan, and many local jurisdictions and counties have policy statements, housing plans, or resolutions in support of mixed-income housing. The Met Council encourages preservation of naturally-occurring mixed-income neighborhoods, reduced institutional barriers to building mixed-income developments, and funding to build them (Metropolitan Council 2014b, 2). Mixed-income housing is seen not only as a tool to provide physical housing and neighborhood choice to low and medium-income residents, but as a vehicle for other initiatives such as transit-oriented development, energy efficient building, and racial integration (Metropolitan Council 2014b, 96).

Mixed-income housing is often advocated because of its benefits for low-income residents but it is not a silver bullet for solving social ills or the cycles of urban poverty (Chaskin, Joseph, and Webber 2007, 373). The following benefits are purportedly accrued through increased interpersonal social interactions and improved structural access:

- Interaction with higher-income neighbors may introduce low-income residents to new networks of resources, information, and employment.
- Informal social control by higher-income neighbors may introduce or improve adherence to social norms, making the neighborhood safer and more orderly.
- Low-income individuals may also be inspired or influenced to make personal changes by higher-income residents who model alternate lifestyles.
- Finally, higher income residents may exert more influence over political processes and businesses, and bring a higher level of goods and services to the neighborhood, which then become available to low-income residents (Chaskin, Joseph, and Webber 2007, 377-78).

Despite these anticipated benefits, there are a number of structural challenges that make mixed-income housing more difficult and more expensive to implement. One is the higher perceived risk by investors, whether of adding market rate or affordable housing to a project. This often increases capital reserve requirements, up-front costs and makes capital harder to access in general. The reduced availability of private capital forces developers to explore a wider range of public sources of debt capital, equity capital, cash, and credit. These disparate sources of financing often have extensive requirements, which add complication, time, and associated legal costs to a project.

"Mixed-income is best used as a catalytic project to get people to think a little differently about their middle-income neighborhood. To me that is the only justification to subsidize market units. If we want to use it as a bigger and broader tool, than we need to make some policy requirements that say every rich neighborhood has to have its fair share of affordable housing." ~ Developer quote from project interviews.

Mixed-income housing requires subsidies to be financially viable. Many jurisdictions provide subsidies to promote expanding affordable housing production to meet local and regional need. There are many different subsidies available, with a wide variety of conditions, but some of the most common in the Twin Cities Metro Area are listed in Appendix A.

Operations can also be complicated by different expectations of market-rate renters and the property management or social service needs for subsidized renters.[5] Increasingly market rate projects include additional high-end amenities such as work-out facilities, granite counters, recreation and lounge spaces, concierge services, etc. adding costs to a project that cannot be recaptured from subsidized rents. Developers interviewed for this project shared the view that it can be easier to add a few subsidized units to a market rate project than adding market-rate units to majority affordable projects given the perceived challenge of attracting or maintaining moderate or upper income renters in weak housing markets that may suffer from broader community disinvestment, crime and safety issues, or lack of neighborhood amenities.[6]

Given these challenges, there is a perceived trade-off for affordable housing investors, advocates and policy makers: whether to invest scarce resources in mixed-income housing to provide affordable housing in otherwise prohibitive markets; or to build more units in projects that are all affordable. Given the unmet demand and the strengthened federal guidance to Affirmatively Further Fair Housing in higher-cost markets, mixed-income housing should be seen as one of many tools in the affordable housing toolkit. Regardless, **policy makers need to recognize that wishing or mandating mixed-income housing does not make it happen. Financial, staff and policy resources are required.**

[5] Throughout this project, those interviewed were asked if property/residential management was an issue in mixed income projects. None responded that they had encountered problems. This was most often credited to not including housing for extremely low, homeless or other renters who may have greater need for specialized services.
[6] Lower-than-expected market-rate occupancy rates or rents can financially compromise a mixed-income project. In weak real-estate markets, units designated as market-rate may only support low or moderate rent, and represent a lost opportunity to receive Federal subsidies for building those units.

Regional Mixed-income Housing Case Studies

Three case studies are used to highlight the experience of developers and cities in providing mixed-income housing in the Twin Cities. The case studies represent mixed-income housing experience at different scales and markets, mix of affordability, and geographic location.

Project Name (Developer)	**Location**	**Number of Units**	**Affordability Mix**
515 on the Park (Fine Associates, LLC)	Minneapolis, MN	259	50% Market Rate / 50% Affordable
2700 University (Flaherty & Collins Properties)	Saint Paul, MN	248	80% Market Rate / 20% Affordable
The Ridge (Duffy Development)	Minnetonka, MN	64	20% Market Rate / 80% Affordable

Each of the three case studies is discussed in the following pages with information pulled from financial materials, news articles and interviews with developers, city staff and other involved funding partners.

Five15 on the Park (Minneapolis)

The Five15 project is located at 515 15th Avenue South in the Cedar Riverside neighborhood near downtown Minneapolis, not far from the University of Minnesota.[7] The developer, Fine Associates, LLC is best known for luxury corporate housing but initiated this project out of a strong personal motivation by its owner, Dr. Bianca Fine. The 259 unit, six-story mixed-income project includes 6,000 square feet of retail, office, community and restaurant space and 124 underground parking spaces.

Figure 2. Architect's rendering of 515 on the Park. (Source: BKV Group)

The project required engagement with the City of Minneapolis, Metropolitan Council, Minnesota Housing and other affordable housing partners to obtain financing. There were at least 16 separate city council actions over a 10 year period. Few projects could have withstood the holding and entitlement costs resulting from this delay but the developer was committed to seeing the development happen and intervened early to assemble property and remove legal

[77] The project's website advertises "Luxury living at an affordable price, in a market rate and Section 42 apartment community." http://www.515onthepark.com/

encumbrances. She saw the project as an important economic bridge between the fast growing markets of downtown and the West Bank campus, and an opportunity to expand on her firm's legacy of creating catalytic properties.[8]

Over the course of the project, financing assumptions changed both regarding what potential sources may be used and the composition of market to subsidized housing. In the end, 50% of units in the $52.5 million project are market rate, 30% are affordable to renters earning 60% of the area median income (AMI), and 20% are affordable to those earning 50% of the AMI.[9]

FIVE15 ON THE PARK				
PROJECT SUMMARY				
Number of Units				259
Total amount of parking (# spaces)		242	Prkg per unit	0.93
Land Area	1.78 acres		Units Per Acre	145.5
Mean Unit Size (SF)				1,023.80
Total Housing (Gross SF)				265,165
Total Retail (Gross SF)				4,996
Total Area (SF, parking and common spaces included)				270,161
UNIT MIX	**Market Rate**	**Affordable 60%**	**Affordable 50%**	**Total**
Studios	6	6	4	16
1 BR (794 SF)	62	38	25	125
2 BR (1091 SF)	48	26	18	92
3 BR (1335 SF)	13	8	5	26
Total Units	**129**	**78**	**52**	**259**
Percentage	50%	30%	20%	

Figure 3. Five15 on the Park Project Summary

The Cedar Riverside neighborhood in which Five15 is located has seen significant investment over the past decade with the introduction of light rail transit in 2004, the $65 million renovation of the Riverside Plaza by George Sherman completed in 2012, and smaller scale investments by residential and commercial property owners.[10] The Five15 project (formerly Currie Park Lofts) happened in tandem with these developments and was part of the larger catalyst to restore the neighborhood that is home to a significant number of low-income and immigrant families. The City of Minneapolis working with private and non-profit developers, HUD and other partners were committed to improving infrastructure in the

[8] A May 2014 article on Fine Associates, LLC discusses the motivations and history of the luxury developer in the Minneapolis market: http://www.startribune.com/minneapolis-developer-bianca-fine-bucking-the-high-rent-trend/260860451/

[9] CommonBond Communities has a two-year master lease agreement for a portion of the market rate units.

[10] With refinancing costs, the Riverside Plaza was a $132 million project.

neighborhood to both improve existing affordable housing for current residents and to hopefully introduce market rate housing and attract middle-income households to the area.

Despite this policy desire by the City, the project encountered numerous limitations of city tools and some community opposition most notably to the removal of an historic building as part of the redevelopment. A significant challenge for the developer was in securing early project funding to leverage other financing sources. Fine Associates contacted the city in 2005 to inquire about use of tax increment financing (TIF) to finance the affordable housing element of the project.

SOURCES OF FUNDS			
Senior Debt	$	28,487,504	54%
Tax Credit Equity (4%)	$	6,712,110	13%
TIF	$	4,955,600	9%
Grants	$	3,087,000	6%
Other Loans (Mezzanine)	$	2,920,000	6%
Owner Capital	$	6,316,509	12%
TOTAL	$	52,478,723	
FUNDING DETAIL			
4% Tax Credit Equity	$	6,712,110	
City AHTF	$	1,200,000	
Mpls TIF Note	$	4,955,600	
Family Hsg Fund Grant	$	250,000	
First Mortgage (HUD Tax Exempt Bond, NOI Supported)	$	28,487,504	
GP Equity and Deferred Development Fee	$	6,316,509	
Hennepin HOME Funds	$	-	
Met Council HLAF Funds	$	1,720,000	
Met Council LCDA Grant	$	433,771	
Met Council LCDA TOD	$	993,229	
Met Council LHIA Grant	$	400,000	
MHFA EDHC Forgiveable Loan	$	250,000	
Hennepin TOD Grant	$	760,000	
TOTAL SOURCES	$	52,478,723	

Figure 4. Five15 on the Park Source of Funds

Unlike the other case study jurisdictions where TIF commitments were secured early and then leveraged to secure other funding, Minneapolis takes a more judicious approach to TIF approval, typically not committing funds until late in the project finance process. This complicated and delayed project funding. In fact, the $5 million TIF note approved by the Council in 2013 was the last City financing component. In total, over a dozen funding sources were used. As one person involved with the project noted, “You fill out multiple applications for funding and see what sticks.” The Minneapolis Affordable Housing Trust Fund was an important funding component which the City committed to early in its process.

Small funding sources from the Metropolitan Council were important sources of early funding. As the project changed in respond to funding limitations and rising costs over its ten year development history, the developer had to seek to amend grant agreements with the Met Council in 2013 because of the reduction in overall affordable units from what was originally projected. Grants provided 6% of overall funding.

A unique funding source came from the AFL-CIO Housing Investment Trust who purchased short-term, cash collateralized, tax-exempt bonds issued by the City of Minneapolis and a Ginnie Mae mortgagebacked security. The HIT worked closely with Oak Grove Commercial Mortgage on structuring financing for the project. The project had a number of soft costs associated with entitlements and securing financing. Acquisition costs associated with securing multiple parcels over several years accounted for 11% of total project cost. Soft costs accounted for 23% of projects costs, while hard costs associated with construction where roughly two-thirds of project cost.

PROJECT COST SUMMARY				
		Total	COST PSF	COST/UNIT
Acquisition Costs		$ 5,812,908		
Soft Costs		$ 12,175,598	$ 45.07	$ 47,010.03
Hard Costs (Residential)		$ 34,151,892	$ 126.41	$ 131,860.59
Hard Costs (Commercial)		$ 338,325	$ 1.25	$ 1,306.27
Total Project Costs		$ 52,478,723	$ 194.25	$ 202,620.55
USES OF FUNDS				
	Acquisition	$ 5,812,908		
Architecture & Engineering		$ 845,500		
	Construction	$ 32,838,619		
	Legal Fees	$ 200,000		
	Non-Housing	$ 338,325		
	Other Costs	$ 2,723,864		
	Developer Fee	$ 3,950,000		
Construction Contingency		$ 1,313,273		
	Carrying/Operating	$ 1,826,035		
TOTAL DEVELOPMENT COST		$ 49,848,524		
	Required Reserve	$ 2,630,199		
	TOTAL USES	$ 52,478,723		

Figure 5. FIve15 on the Park Project Cost Summary

The project is slated to open in 2015 offering some of the newest affordable housing and commercial space in the neighborhood. In undertaking the project Fine Associates intended for the housing to serve growing demand by lower income and immigrant families who call the neighborhood home but would like to have better housing options. Even prior to marketing the project, the developer reported strong market interest with strong demand at the 50% AMI or less and for 3 bedroom units.

2700 University (Saint Paul)

The 2700 University project is located in Saint Paul adjacent to the newly opened Green Line light rail offering access to both downtowns and the University of Minnesota. This proximity to transit was a key motivator for the developer, Flaherty & Collins Properties, to undertake this complex project and providing mixed-income transit oriented development was a key motivation for the City's involvement as well. The project's green elements including LEED Silver certification and high-frequency transit access are among the many amenities boasted in marketing the project.[11]

Figure 6. Computer generated rendering of 2700 University emphasizing access to LRT (Source: Flaherty and Collins)

The 2700 University project is designed to attract middle to upper-income renters and the project consists of 80% market rate at rents projected for $1.91 per square foot and 20% affordable for 50% area median income or below.

2700 UNIVERSITY, St. Paul MN			
PROJECT SUMMARY			
PROGRAM SUMMARY- NEW CONSTRUCTION			
Affordability profile			
Land Area (Acres)		1.80	
Number of Parking Stalls		207	
	Market Rate	**Affordable**	**Total**
Number of Units	198	50	248
Units per Acre			1.20
Average Unit Size (SF)	860	804	
Total Housing (Gross SF)	170,213	40,210	210,423
Total Retail (Gross SF)	3,000	-	3,000
Total SF	**173,213**	**40,210**	**213,423**
UNIT MIX	**Number**	**Number**	
	Market Rate	**Affordable**	Total
Studios		15	15
1 BR	155	25	180
2 BR	43	10	53
TOTAL UNITS	**198**	**50**	**248**
PERCENTAGE OF TOTAL	**80%**	**20%**	**100%**

[11] The project website created by the developer highlights access to high quality transit including frequent bus and light rail service, http://preview.flco.com/company-properties/2700-university/

The project includes many high-end amenities that Twin City market-rate units have come to expect but which set it apart from other housing projects along the corridor. Even the affordable units within the building are of high standard and their residents will have access to the project's amenities which include a heated saltwater pool, fitness center, bike shop with indoor parking, clubroom with billiards, community play area and Wi-Fi, among other things. Incorporating these elements add obvious cost but one that is necessary to attract higher-end market renters.

Figure 7. A rendering of the salt water pool and common space (Source: Flaherty and Collins)

The project encountered significant accounting and finance challenges in assigning costs, construction design, and contracting. However, its increased density and reduced parking also resulted in a very low per-unit total development cost.

The 2700 University project incorporated a number of unique and challenging aspects putting policy

PROJECT COST SUMMARY				
	Market Rate	**Affordable**	**Total**	**Cost/Unit**
Acquisition	$ 2,695,000.00	$ 805,000	$ 3,500,000	$ 14,113
Hard Costs	$ 28,157,552.00	$ 9,121,871	$ 37,279,423	$ 150,320
Soft Costs	$ 7,420,647.00	$ 5,294,664	$ 12,715,311	$ 51,271
Financing Costs	$ -	$ -	$ 354,648	$ 1,430
Total Project Costs	$ 38,273,199.00	$ 15,221,535	$ 53,494,733	$ 215,705
USE OF FUNDS				
Acquisition	$ 2,695,000	$ 805,000	$ 3,500,000	
Architecture & Engineering	$ 1,270,000	$ 280,000	$ 1,550,000	
Construction Period Costs				
Real Estate Attorney	$ 277,000	$ 59,000	$ 336,000	
Title, Recording & Lender Inspections	$ 139,120	$ 41,685	$ 180,805	
Construction Interest	$ 1,034,697	$ 214,619	$ 1,249,316	
TIF Interest	-	$ 958,136	$ 958,136	
Bond Cost	-	$ 427,100	$ 427,100	
Finance Fee	-	$ 41,271	$ 41,271	
Furnishings and Equipment	$ 354,648	$ -	$ 354,648	
Other Period Costs	$ 1,342,519	$ 382,136	$ 1,725,355	
Development Contingency	$ 780,130	$ 456,094	$ 1,236,223	
ODR/TIF Reserve	-	$ 695,204	$ 695,204	
TOTAL USES	**$ 38,273,199**	**$ 15,221,535**	**$ 53,494,733**	

Figure 8. 2700 University Project Cost Summary

goals into practice all in a single project: transit oriented development, mixed-income housing, mixed-use development -- making it one of the more complex housing projects to be undertaken recently in the region. Given the complexity there are few developers who have the capacity or the commitment to undertake this type of project, particularly given that the final project financing included relatively low profit projections. The site location, construction and design including underground parking all made this an expensive project, but pushing costs further were the financial requirements that accompany use of affordable housing funds including higher labor rates for the entire project.

The project's affordable units are scattered throughout rather than concentrated or stacked in one area. This was desired from a policy perspective to further mix incomes and not make low-income residents feel alienated. However, it complicated construction and created a number of legal and cost ramifications, several of which are evident in the preceding table (Figure 8).

Perhaps the biggest project hurdle and cost factor was the need to condo the market-rate units and create two separate but parallel ownership structures, financing structures and legal descriptions in order to satisfy investor concerns regarding risk between affordable and market rate. The condo element caused the deal to change many times creating a higher legal bill since attorneys had to go back and review several times. One construction contract was developed with two different schedule of values, two cost accounts, and two separate capital stacks so the respective funders can review and manage draws. There are a limited number of developers who could take on this complexity or have the financial resources and portfolio to satisfy investor risk.

SOURCES OF FUNDS					
		Market Rate	**Affordable**	**TOTAL**	
Tax Exempt Bonds	12.49%	$ -	$ 6,680,000	$ 6,680,000	
Construction Loan/Market	52.34%	$ 28,000,000	$ -	$ 28,000,000	
Construction Loan / Perm Affc	3.07%	$ -	$ 1,640,000	$ 1,640,000	
Tax Credit Equity	8.68%	$ -	$ 4,645,373	$ 4,645,373	
LISC (Mezzanine Debt Loan)	9.35%	$ 5,000,000	$ -	$ 5,000,000	
HOME FUNDS (City of St. Paul)	1.87%	$ -	$ 1,000,000	$ 1,000,000	
Met Council LCDA TOD grant	3.64%	$ 1,944,774	$ -	$ 1,944,774	
General Partner Loan	1.75%	$ -	$ 938,617	$ 938,617	
Developer Cash Contribution	2.80%	$ 1,500,000	$ -	$ 1,500,000	
Deferred Sources	4.01%	$ 1,828,425	$ 317,545	$ 2,145,970	
Total Sources	**100%**	**$ 38,273,199**	**$ 15,221,535**	$ 53,494,734	
Mezzanine Interest Revenue		$ 1,260,000			
Average TDC/UNIT	$215,704.57				

Figure 9. 2700 University Source of Funds

As shown Figure 9, numerous funding sources were needed to make the project happen with almost every source tied specifically to either affordable or market rate. Sources included a new mezzanine debt finance tool created by the Twin Cities Local Initiatives Support Corporation (LISC) to fund equity or debt financing gaps needed to advance new construction or preservation of affordable housing projects. LISC provided $5 million and a $1,260,000 capitalized interest reserve in mezzanine debt with BMO

Harris. LISC also provided credit enhancement funding with special resources to cover the top 20% loan loss of the LISC loan portion as a pooled first loss.[12] This new finance source made the deal possible, but also added increased complexity and cost particularly since this was the first time it had been used by Twin Cities LISC who noted that, “People understood this was a new type of transaction and that the next deal would be more efficient. This was a real learning curve with things being negotiated later into the process given the new transaction type.”[13]

An additional contributing factor to making project finance happen was the strength of partnerships and trust between all of the players. The City came in early with a general commitment that was contingent on a specific number after project financing numbers and interest rates on bonds were finalized. This early commitment was essential and staff worked with the developer and investors to make the project happen. The developer saw LISC and NEF affiliate as a good community partner who would work with them in a more problem-solving way than a profit-driven mezzanine partner. And the prime funding partner, BMO Harris played three different investor roles including on the mezzanine and senior loan.

Total Effective Income				
	Market	Affordable		Annual
Parking Income	$ 179,100			$ 179,100
Retail Space Income				$ 77,700
Miscellaneous	$ 181,437	$ 3,030		$ 184,467
Effective Other Income				$ 346,967
Total Effective Income	$ 3,761,135	$ 416,452		$ 4,177,587
Net Operating Income	$ 2,472,620			
Economic Value Calculation				
Total Operating Expenses	$ 1,652,867			
Net Operating Income	$ 2,472,620			
Market Capitalization Rate		5.20%		
Income Based Value	$ 47,550,386			

Figure 10. 2700 University Economic Value Projections

Despite the complexity and higher overall project costs, the cost per unit ($215,704.57) is actually lower than on other smaller scale 100% affordable TOD projects.[14] The City suspects the cost savings may in part be a scale issue given that many of the structural costs associated with TOD (i.e. higher real

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[12] For more information on this new debt tool, visit Twin Cities LISC’s website: http://tclisc.org/PDFs/2700university.pdf

[13] Observation made by Amy McCulloch, LISC during July 2015 interview.

[14] In August 2015, City staff completed an analysis comparing 2700 University and a 100% affordable project on University Avenue. They found higher costs for the affordable units than the market rate units primarily due to the soft costs associated with the affordable side. The affordable side of the project funded the construction of 100% of the structured parking for the building and allocated the majority of the parking cost to the market rate side, proportionate to the number of market rate parking spaces. The analysis also illustrated the cost of the mixed-use affordable units was less than the cost of a smaller scale 100% affordable project.

estate values and structured parking) are spread across a larger number of units given the increased density. All projects have different site conditions, design constraints and costs. In the case of 2700 University, the land was already cleared and contamination cleanup was not required.

The cost savings from having 50 affordable units spread across the total number of units was identified by the general contractor in explaining benefits to investors. For the City, the per unit cost savings reinforce the value of pushing for affordable units within a market rate project.[15] In the City's analysis they also found that development costs per market rate unit are comparable for apartments in downtown Minneapolis back in 2012 and the project's development costs are also comparable. "With 198 units of market rate housing, cost per unit for some of the typically more expensive amenities is less burdensome for a developer than it would be in a smaller development."[16]

For the developer, it may be too soon to tell if the benefits will outweigh the risks. Flaherty and Collins has strong community development roots developing large market rate and affordable housing projects so they were able to bring considerable experience in both. Return on investment is calculated differently between affordable and market rate. For developers doing affordable projects are evaluated on a fee basis. Up front developer fees are the carrot yet for this project all fees were deferred through construction. On the market rate side projects are often evaluated on a build to yield basis. The 2700 University project has a lower yield basis than typically desired by a developer. Given the number of different investors and types of financing, the project contains an unusually high number guarantees and at risk capital in comparison to the financial risk / reward profile of the project which is low. That said, all parties involved see this as a possible model for future mixed-income opportunities where there is strong market demand for housing.

[15] Observation made by Marie Franchett, City of Saint Paul during July 2015 interview.
[16] Internal City of Saint Paul memo comparing development costs between 2700 University and Hamline Station, August 19, 2015.

The Ridge (Minnetonka)

Figure 11. The Ridge offers convenient multi-modal access to a number of community and regional socio-economic opportunities (Photo credit: Mariia Zimmerman)

The Ridge is located at 12708 Wayzata Boulevard in Minnetonka. Near I-394 and Ridgedale Mall, the Duffy Development mixed-income project is the result of a close partnership between the developer and the City of Minnetonka to support the redevelopment of two small vacant properties into a 64-unit mixed-income apartment building providing long-term affordability. As depicted in Figure 12, a fifth of the units are market-rate and four-fifths are affordable to renters at 50% AMI. The project opened in October 2013 and has been fully occupied since that time.

One of the motivations for the city was the need to increase the supply of affordable housing. The project's location near large-scale commercial and retail made it a challenge to redevelop, but this same proximity is attractive to those working in service jobs. The frequent nearby express bus service and other local bus routes provide low-cost transportation options convenient to affordable housing.

Duffy Development primarily does affordable housing projects but were interested in mixed-income projects at the 20% market rate threshold. The Minnetonka project includes $8.5 million in LIHTC equity. Previously, Minnesota Housing provided incentive points in allocating 9% tax credits to mixed-income projects. This was an incentive for Duffy and other developers involved with past projects, but this practice was eliminated a few years back.[17]

[17] This change was noted by several who were interviewed for this white paper as reducing their interest and ability to successfully finance these projects without that critical source of funding.

The Ridge by Duffy Development (12708 Wayzata Blvd. Mtka)			
PROJECT SUMMARY			
PROGRAM SUMMARY- NEW CONSTRUCTION			
Land Area (Acres)	1.75 acres		
Total amount of parking (# of spaces)	133.00		
Parking per Unit	2		Required by City: 2
	Market Rate	**Affordable**	**Total**
Number of Units	13	51	64
Units per Acre			37.00
Average Unit Size (SF)	1,149	1,096	
Total Housing (Gross SF)	14,939	55,903	70,842
Total Retail (Gross SF)	-	-	-
Total SF (inc common spaces)			**112,956**
UNIT MIX	**Number**	**Number**	
	Market Rate	**Affordable**	**Total**
1 BR (794 SF)	2	10	12
2 BR (1,091 SF)	6	23	29
2 BR (993 SF)	0	4	4
3 BR (1,335 SF)	2	14	16
3 BR (1,378 SF)	3	0	3
TOTAL UNITS	**13**	**51**	**64**
PERCENTAGE OF TOTAL	**20%**	**80%**	

Figure 12. The Ridge Project Summary

The project includes multiple funding sources, though fewer than the two other projects highlighted in this white paper (see Figure 13). One of the more critical source of funding came from the City of Minnetonka. Staff with the City had the foresight to use a unique funding tool to help finance and expedite the project: pooled TIF funding.

Minnesota's tax increment finance laws allow cities that have a balance in one TIF district to use up to 35% of those dollars for affordable housing projects located anywhere in the city. Minnetonka had done a redevelopment in the 1990s that included a mix of commercial and housing units which a decade later had created substantial tax increment. Instead of decertifying the project when the bonds were paid off, the City uses these funds to support its affordable housing goals. For Duffy Development this provided almost $1 million, which was noted as being an essential part of making the financing work and a powerful demonstration of the City's commitment to working with the developer. Minnetonka is unique

SOURCES OF FUNDS			
SOURCES SUMMARY			
Senior Debt (MHFA)	$	2,718,592	21%
Tax Credit Equity - 9%	$	8,560,000	66%
City of Minnetonka TIF Note	$	985,000	8%
Hennepin County HOME Funds	$	700,000	5%
TOTAL SOURCES OF FUNDS	**$**	**12,963,592**	

Figure 13. Source of Funds for The Ridge

in its innovative use of this authority. City staff noted that it can be a challenge to get support from elected officials to maintain the TIF tool beyond the project pay-off. However, given the growing need for affordable housing and limitations of other finance tools it has proven to be a very powerful and agile source of funding for targeted, smaller scale projects such as this one.

In addition to land acquisition costs, the site included clean-up costs accounting in total for 9% of project costs. No commercial or retail is included in the project so these are purely residential associated costs as shown in the following chart. The developer had applied for $100,000 in Hennepin County TOD funds to improve access to the nearby transit service but was unsuccessful in receiving funding. Despite this, Duffy did include a bus shelter on the property. The site was attractive to the developer because of its quarter-mile proximity to a transit hub.

Because of the project's location near a large number of retail, service and office jobs and its good transit access, the developer was comfortable with including market rate units in the project. Since its opening, the Ridge has continued to attract renters, both affordable and market rate. The developer did note, however, that their market rate rents are on the slightly lower end of the price spectrum since the use of tax credits prevented the inclusion of amenities often found in higher-rent projects. The project does include a guest suite, fitness room, community room and underground parking but not higher-end construction or design features which would have created a greater funding gap between market rate and affordable units. Even without these, the affordable housing piece ends up slightly subsidizing the market rate to cover the gap created.

PROJECT COST SUMMARY			
	Total	COST PSF	**COST/UNIT**
Soft Costs	$ 3,235,545	$ 53,041.72	$ 50,555.39
Hard Costs (Residential)	$ 8,277,520	$ 116.84	$ 129,336.25
Total Project Costs	$ 12,707,390	$ 179.38	$ 198,552.97
USES OF FUNDS			
Acquisition	$ 1,171,230		
Clean Up	$ 23,005		
Construction	$ 8,277,520		
Financing Costs	$ 569,715		
Marketing	$ 34,751		
Architecture & Engineering	$ 290,865		
Tax Credit Fees	$ 66,905		
Title & Recording	$ 50,479		
Other Soft Costs (inc Developer Fee)	$ 2,222,830		
TOTAL DEVELOPMENT COST	**$ 12,707,300**		
Required Reserve	$ 275,000		
TOTAL USES	**$ 12,982,300**		

Figure 14. The Ridge Project Cost Summary

Duffy has found that 50-unit projects appear to be the de facto breaking point for use of tax credits given the $1 million threshold unless a board waiver is received. This supports 48-51 units at roughly 200,000 per unit total cost which can pencil out in suburban locations like Minnetonka but not in higher rent or land value areas in downtown or higher rent neighborhoods.

Since opening in 2013, The Ridge has had solid rental activity and Duffy increased rents for 2015. Despite the increase, only 9 units turned over. In addition to providing workforce housing, the project is also within the Wayzata school district which is seen by many tenants as an additional and important attraction. Figure 15 shows initial and current rents between market rate and affordable units. A few of the two and three bedroom units are slightly larger which accounts for the range in rents that are shown in 2015 rates. Demand has been strongest for the three bedroom units and the project includes many households with children. In fact, the percentage of units with families is 56%, many of whom are in the subsidized units where families also benefit from access to a high performing school district.

MR to AH rent differential		
	Rent (MR)	Rent (AH)
1 BR Rent (2014)	$ 950	$ 734
1 BR Rent (2015)	$ 1,020	$ 740
2 BR Rent (2014)	$ 1,150	$ 850
2 BR Rent (2015)	$1,250-$1,300	$867-$885
3 BR Rent (2014)	$ 1,300	$ 980
3 BR Rent t (2015)	$1,400 - $1,475	$1,002-$1,025
Market Rate Rent PSF (Net, 2014)	$ 1.02	$ 0.73
Market Rate Rent PSF (Net, 2015)	$1.107-$1.156	$0.739-$0.753

Figure 15. Rent differentials at the Ridge

Mixed-Income Housing Key Findings

1. **Mixed-income projects happen within -- and in despite of – a siloed funding environment due to commitment by the developer and funding partners.** Every project involves risk, whether market rate or affordable. Yet the complexity and costs of mixed-income development are compounded by funding silos which reflect the greater perceived risk investors see in a non-traditional product. Each of the case studies would not have happened without the developers involved being personally committed to the catalytic nature of their project. Each required patience and capacity to do an unusually complex transaction.

2. **Early commitment by local governments can play a critical role in helping to expedite projects and reduce finance costs.** Each of the three case studies found that whether or not the City committed early to the project influenced their ability to secure private finance. Tax Increment Financing (TIF) is a critical funding tool but timing and flexibility are critical. Beyond funding commitments, cities can advance projects through other supportive actions including providing frequent, on-going and transparent information to the public, the developer and to local

officials.[18] They can help facilitate city approvals and engage other public sector partners at the county or state levels. All of this creates a synergy that is attractive to other lenders.

3. **To achieve public policy objectives, public sector resources for mixed income housing need to be committed.** Increasingly, public policy and planning documents cite the goal of mixed-income housing yet few resources have been committed to make it happen at a notable scale.[19] It is not realistic to ask developers to take all the risk for a public policy objective. The region (including at the state level) does not have a finance tool or grant program specifically targeting or giving preferential consideration for mixed-income type projects. Grant funding is preferable as they do not impact the market rate side of the transaction. Even small funding such as the Met Council's LCDA TOD programs can make an important difference in making a project happen, increasing the percentage of mix, or targeting different income groups or unit sizes. Markets change and not every mixed income deal will work in the long term. When setting policies consider these are 30 year loans, even though tax credits are only 15 years so investors and developers need to balance all parts of the equation.

4. **Mixed-income appears to work best at an 80/20 threshold.** There is no ideal mix of market or affordable but 80/20 projects (either MR/AH or AH/MR) seem to pencil out the best given existing requirements with affordable housing investors, the bond market and the perceived level of risk that market investors and renters are willing to take. Given the importance of the Low Income Housing Tax Credit to funding most affordable housing projects, LIHTC eligibility requirements and limitations create barriers to a greater mix. LIHTC have much lower vacancy rates, typically than the overall rental market causing affordable housing investors to be reluctant to take on greater risk.[20] Projects with a larger mix of market rate can work in lower-income communities but are not likely to attract high-end rents despite amenities that may be offered given larger market bias. Projects with 20% affordable housing in a high-rent market have the best opportunity to pencil out. Funding gaps grow on either end of the equation if land values are too high to absorb larger numbers of affordable units or rents are not sufficient to cover funding gaps.

5. **Scale matters, especially in strong markets.** The two large projects in Minneapolis and St. Paul both take advantage of increased density to help spread total development costs across units. It is notable that the cost per affordable unit at 2700 University was lower than other 100% affordable projects along the University corridor. Further, a relatively small percentage (20%) of units that are affordable within a large project is comparable to the number of units created in

[18] The ULI-Minnesota "(Re)Development-Ready Guide" is a great resource for outlining the steps that local governments can take to attract more private investment: http://minnesota.uli.org/wp-content/uploads/sites/31/2012/04/ULI-MN-ReDevelopment-Ready-Guide-May-2012.pdf

[19] This white paper did not explore policy context such as inclusionary zoning, however, it was a topic that did come up in some interviews with a feeling by developers that creating a level playing field across jurisdictions may help but that funding tools are still necessary to meet policy goals.

[20] The Enterprise Community Partners "Low Income Housing Tax Credits" webpage provides a helpful overview of key elements of the LIHTC http://www.enterprisecommunity.com/financing-and-development/low-income-housing-tax-credits/about-lihtc

other fully affordable projects. The advantage for a mixed-income project in a strong market is that provides greater access to economic, educational and social opportunities.

6. **Across all income levels there is a growing need for larger units.** In the Duffy and Fine Associates properties, demand is strongest for the three-bedroom units. This is true for both suburban and urban locations.[21] It's easy to imagine this trend continuing given demographics changes. Families living in subsidized housing and market-rate empty nesters (who while down-sizing are still seeking larger market rate units) will continue to grow this demand that is currently not being supplied on a large enough scale.

7. **Peer learning and intermediary support can increase the number of mixed-income projects.** Despite the challenges noted, particularly the lack of a specific mixed-income finance tool, developers and cities are finding ways to build mixed-income projects. Last year Finance & Commerce's Twin Cities Apartment Development Tracker listed 14 projects proposed or under construction that have a mix of affordable and market-rate units (Owings 2014). Common ingredients to success include *strong local leadership, a dedicated team committed to making the project happen, early funding commitments and creative thinking on how to finance different elements of a project.* If we want to see more examples across the region of successful projects, we need to increase opportunities for peer learning and involvement by intermediaries whether to help provide funding support such as LISC's mezzanine debt tool or to assist cities with pre-development tasks that can help set the table for development.

[21] 2700 University does not offer three-bedroom units.

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Appendix A. A sample of some of the most common affordable housing funding tools available in the Twin Cities Metropolitan Area

NAME	ORIGINATOR	EFFECT	DETAILS
First Mortgage	United States Department of Housing and Urban Development (HUD)	Subsidizes debt capital	Multiple HUD loan products to reduce loan risk on behalf of developers Mortgage loan guarantees for moderate income rental housing (U.S. Department of Housing and Urban Development d) Loan risk-share in cooperation with state and local HFA's Loan risk-share in cooperation with QPE's (U.S. Department of Housing and Urban Development c) (U.S. Department of Housing and Urban Development f) Loan Insurance in locally targeted redevelopment areas (U.S. Department of Housing and Urban Development e)
Low Income Housing Tax Credit (LIHTC)	United States Department of Housing and Urban Development (HUD)	Raise equity capital	Federal tax credits granted by HUD to state Housing Finance Agencies, and from those agencies to developers (Minnesota Housing Finance Agency d) Limited to making affordable housing projects financially viable, but not profitable (Allocating Housing Tax Credits) Requirement to maintain affordable housing for at least 30 years (20% of the units at 50% of AMI affordability, or 40% at 60% of AMI affordability) Tax credits may be claimed by the recipient, sold directly to an investor, or sold to a syndicate (U.S. Department of Housing and Urban Development g) Prior to the housing crash, it was most common to sell the credits to a syndicate, but it is much harder to find a buyer today (Dye 2014)
TIF Note	Local Government	Raise equity capital	TIF Notes represent the right to receive the TIF revenue stream The notes are sold to third parties, typically investors This allows a government to finance investments in affordable housing, against the resulting future increases in taxes (Council of Development Finance Agencies)
Mezzanine Loan	Local Government	Raise hybrid equity/debt capital	Debt capital with right to convert to equity (ownership) interest in company if loan is not full and on time Treated like equity, reduces technical debt load, improves debt-equity ratio, makes it easier to get conventional bank loans

			Private investors typically require established reputation, charge high interest rate (Attract Capital)
LCDA Grant	Twin Cities Metro Council	Provide cash	Available to projects that make a community more livable Mixed-income housing is explicitly mentioned as an example (Metropolitan Council 2014c, 4) Combination with other goals (intensified land use, relating development to transit, affordable housing in employment growth areas) may make projects more competitive
Amortizing First Mortgages	Minnesota Housing Finance Agency	Provide subsidized debt capital	Two fixed-rate fully amortizing mortgage loan products MAP offers one product for developers to build or substantially rehabilitate, and another for entities to acquire property (Minnesota Housing Finance Agency) LMIR are funded by Agency funds or tax exempt bonds Restrictions on income and rent last the full life of the loan All products come with fees and originate with MHFA (Minnesota Housing Finance Agency)
Housing Vouchers	United States Department of Housing and Urban Development (HUD)	Increase low-income consumer demand for housing	HOPE 6 housing vouchers provide money towards market housing for eligible families (U.S. Department of Housing and Urban Development b) This works in the opposite way of subsidized housing It is assumed that the two approaches cannot be combined for one individual It is possible that a low-income family could choose to pay market rate in a mixed-income development
Operating Subsidy	Minnesota Housing Finance Agency	Provide cash	MHFA also offers an operating subsidy This is often necessary for financial viability, and functionally increases demand (Minnesota Housing Finance Agency)
HOME Funds	United States Department of Housing and Urban Development (HUD)	Provide cash	Home funds are allocated to states and jurisdictions based on an affordable housing needs formula Fund a wide variety of activities, such as land purchase, construction, rehabilitation, or tenant-based rental assistance contracts (U.S. Department of Housing and Urban Development a) Required that of those receiving rental housing assistance, 90% of families' incomes must be 60% of AMI or below If there are more than 4 assisted units, at least 20% of the beneficiaries must have incomes 50% AMI or below

			No households receiving assistance can have income greater than 80% AMI New rental housing must stay affordable for 20 years, and rehabilitated or homeownership housing must stay affordable for 5-15 years These requirements may disqualify some developments, or make compliance more costly than the value of the funds.
Deferred Developer Fee			Many situations where the developer will owe fees, to HUD or HFA's Often requires demonstration of a reasonable expectation that the deferred fee and interest will be repaid during the 15-year LIHTC period Based on the pro-forma, the interest of the PJ in repayment of the loan, and the developer's interest in collecting the deferred fee (City of New York)
FHFA Grant	Federal Housing Finance Agency	Provide cash	AHP competitive application program has banks apply on behalf of a housing sponsor The banks can then provide the subsidy as a grant or as an advance with a reduced interest rate CIP targets development in neighborhoods with below average income, or housing for those with less than 115% AMI. (Federal Housing Finance Agency)
MHFA-EDHC Forgivable loan		Provide hybrid cash/debt capital	A 0% interest, 30-year, forgivable loan It is negotiable and functions more like a grant with conditions