

Using Property Tax Incentives To Achieve Affordable Rental Housing Goals

Analyzing possibilities for “4d” program tax breaks to unsubsidized affordable rental properties

INTRODUCTION AND SUMMARY

Minnesota provides a property tax break, currently amounting to 40%, to subsidized rental properties under the Low Income Rental Classification Program (LIRC), commonly referred to as the “4d “ program. There is the potential, however, to extend 4d eligibility to certain currently unsubsidized affordable properties, without changing current law. This is because the LIRC/4d statute defines eligible properties as those which meet two conditions : the owner of the property agrees to rent and income restrictions (serving households at 60% AMI or below) and receives “financial assistance” from federal, state or local government. This presents the possibility of creating a “Local 4d “ program in which qualifying properties receive the 4d tax break in return for agreeing to conditions which meet certain local government policy goals.

The impetus for exploring this “Local 4d “ strategy was the possibility this could create a tool for local governments to address a growing concern in areas like transit corridors. The fear is that escalating property values will lead to rapidly increasing rents in unsubsidized affordable rental properties, leading in turn to the involuntary displacement of lower income residents. A recent report, “The Space Between,” emphasized the need to pay more attention to the valuable resource of unsubsidized affordable rental units that most low income households depend upon, and recommended the Local 4d strategy as one meriting further investigation.

After obtaining input from property owners and local government officials, what we found was that the initial idea prompting this work ran into some challenges, but that other uses of a Local 4d strategy could be more immediately applicable. As to the initial idea, we concluded there is uncertainty about whether a narrowly targeted Local 4d program could effectively restrain rents in gentrifying areas. The only way to determine this would be through a demonstration program, along the lines suggested herein. The primary reason to test this idea is the lack of alternative policy tools to address the prospect of eventual widespread loss of affordability in this part of the rental market.

But apart from testing a model 4d program to voluntarily restrain rents, this report finds other more immediately promising ways that 4d eligibility could be selectively extended to certain properties, in order to create incentives for current owners to participate in achieving other local policy goals. In particular, we think local use of 4d could help with local rent subsidy programs, mixed income/inclusionary housing strategies, multifamily rehabilitation or energy efficiency investments, or to help with affordability for nonprofit acquisition of unsubsidized affordable properties.

The Central Corridor Funders Collaborative and Twin Cities LISC funded the research project producing this report, in order to further develop the idea of creatively extending 4d. A working group of city and county staff, property owner representatives, and housing advocates, led by the Housing Preservation Project, met regularly over seven months to work through a set of issues. This report embodies that work.

BACKGROUND ON THE LIRC / 4d PROGRAM ¹

The Minnesota Legislature first enacted the Low Income rental Classification (LIRC), or 4d program, in 1999. A reduced tax rate was provided for two types of qualifying properties : “deemed properties” (subsidized) and “pledged properties” (unsubsidized but where the owner voluntarily agreed to rent and income restrictions in order to participate in the program). As part of a larger tax reform effort, the 4d program was repealed by the Legislature in 2003, and then later restored in 2005, but only for what has generally been understood to encompass subsidized properties. “Pledged ” properties were no longer included in the restored version of the 4d program.

It appears that at least part of the reason pledged properties were left out was based on the conclusion that there was little evidence that any public policy goals had been achieved by offering this tax break to pledged properties. In 2001, the Legislative Auditor concluded that there was no evidence the rent ceiling of 60% AMI was having any practical impact since most market rate rents were not approaching that ceiling. In effect, landlords were obtaining tax cuts without the public obtaining anything in return. The rent cap really presented two problems—not only was it too high to be meaningful, but its one size fits all standard did not account for varying local markets.²

The 4d program currently provides that a “low income rental property” will be subject to the class 4d tax rate if it meets two basic conditions. Minn. Stat. 273.128 Subd. 1. The first is that the project is subject to a Section 8 contract, participates in the Low Income Housing Tax Credit program or the USDA Rural Development housing program, *or* “the units are subject to rent and income restrictions under the terms of financial assistance provided to the rental housing property by the federal government, or the state of Minnesota, *or a local unit of government.*” (emphasis added). Generally speaking, as far as we know, almost all currently participating 4d properties qualify by virtue of federal or state assistance. Assistance through local units of government appears to have been rarely utilized as a means to qualify for 4d, but it remains available. Significantly, “financial assistance,” is not defined in the statute, raising the possibility that even very modest forms of “financial assistance” could trigger 4d eligibility.

¹ For simplicity sake, this paper refers to the “4d program” though it should be noted that for marketing purposes, the former pledged properties part of 4d avoided the term “program.” How to refer to any Local 4d construct would be part of any marketing effort.

² An additional reason for the unpopularity of the pledged properties part of 4d was that the list of eligible properties varied considerably from year to year, causing administrative challenges for county and city assessors.

Besides receiving government provided “financial assistance,” the property must be subject to rent and income restrictions serving households at 60% AMI or below. At least 20% of the units in a project must qualify. Properties meeting those two conditions apply to the Minnesota Housing Finance Agency (MHFA) for certification as a 4d eligible property. If MHFA determines the property meets the eligibility conditions, it will certify the property to the appropriate city or county assessors who will adjust the tax rate, effective the following tax year.

THE IMPETUS FOR THIS RESEARCH PROJECT

If the 4d property tax break can incent owners of affordable unsubsidized properties to participate in efforts to meet public policy goals, then the question is, where is the best match of policy goal and owner interest? The policy goal that initially prompted this study was the need for additional tools to avoid the involuntary displacement of low income households from gentrifying areas like transit corridors.

Displacement Risks Along Transit Corridors

As the Twin Cities Region continues to build out a network of fixed rail transit corridors, development opportunities along those corridors are expected to provide significant opportunities to build and revitalize communities, and to expand access to jobs, schools and other “opportunity assets” in the Region for many, including low income households who have been isolated from access to many of these regional assets. Many fear, however, that as land values escalate along these corridors, and as more affluent households flock to opportunities to live adjacent to transit lines, low income households will get crowded out, or will be forced out by rising rents. While it is too soon to know the extent of this harm along Twin Cities transit corridors, there is ample reason for concern. The Dukakis Center conducted an extensive national study of gentrification along transit corridors, and concluded that in nearly three quarters of transit rich neighborhoods, rents increased faster than in other parts of the same metro area. “Maintaining Diversity in America’s Transit-Rich Neighborhoods : Tools for Equitable Neighborhood Change.” Dukakis Center for Urban and Regional Policy at Northeastern University (October 2010).

A 2012 study, “Before the Train, “ focused on the affordability of the supply of unsubsidized rental units along the Central Corridor LRT Line, then still under construction. Approximately 22,000 private unregulated rental units were located along the Corridor, between the two downtowns. Three quarters of those units were “affordable,” in the sense they were affordable to households at 60% AMI. Among landlords with units located within a quarter mile of the LRT, 40% reported plans to increase rents (though the sample reporting was small.) In a 2014 report, “Central Corridor Tracker,” issued by the Central Corridor Funders Collaborative, rent increases were noted as an issue to watch, with median rents along the Corridor increasing

by 24% over the last four years, with the largest rent increases coming in Downtown Minneapolis and the University area, with other areas seeing increases between 17-24%.³

Similar concentrations of unsubsidized affordable rental units are located along the Southwest LRT Line, particularly near station areas in Hopkins and St. Louis Park. A 2011 study, “Affordable Rental Opportunities in a Changing Suburb,” (Perch Consulting, March 2011), focused on rental buildings in the vicinity of the Blake Road Station Area in Hopkins. The author surveyed rents and owner plans for their buildings and attempted to develop a means to identify those buildings most likely to “gentrify,” that is, shift from affordable rents to unaffordable (for lower income households). The report concluded that there were five projects in the immediate vicinity of the Blake Road station, with a combined total of well over 1000 units, that were at high risk for gentrifying. There is some difference of opinion on the extent of the risk, however. “The Southwest LRT Housing Gaps Analysis,” prepared for the SW LRT Community Works Project (September 2014) concluded that there are approximately 6700 currently affordable unsubsidized rental units along the LRT corridor, and that those properties were positioned for substantial rent growth in the coming year and beyond. However, the analysis also concluded that the majority of those properties were older, with structural/market obsolescence issues that would effectively limit their ability to reposition themselves with a higher rent structure.⁴

One conclusion from all this might be, we need to continue to monitor rents but not take action beyond building new affordable units and where possible acquiring high priority at risk affordable properties where the opportunity arises. The risk is that the scale of what we can produce or acquire will be outmatched by the erosion in affordability of the existing unsubsidized affordable rental supply. What if we able to build and acquire several hundred affordable units along the SW Corridor but a third of the 6700 naturally affordable units lose substantial affordability at the same time? This is probably the best argument for testing out the Local 4d rent restraint model, in case it can work.

If voluntary participation in a narrowly targeted Local 4d program can provide an incentive for owners to limit rent increases, this could provide a valuable tool in stabilizing rents in hot market areas. Although a local government must provide “financial assistance” to render properties eligible, the statute does not define “financial assistance.” This raises the possibility that a minimal or modest level of assistance could qualify. This kind of Local 4d program would not be a resurrection of the pledged properties program (though some of the properties formerly eligible could become eligible under this Local program), but a much narrower and selective extension of 4d. It would also have to be designed in a way that avoids as much as possible the problems with the pledged properties program.

³ We have not examined this issue for the Hiawatha Light Rail Line, because there are significantly fewer unsubsidized affordable rental units located along most of its station areas.

⁴ The Analysis suggests that even assuming annual rent increases of 3-4% over the next 3-5 years, these properties should generally remain affordable to households at 60% AMI, since many of them are well below 60% AMI affordability now. The analysis does not appear to acknowledge, however, the substantial erosion of affordability, and the many households who would be priced out, by a movement of rents well below 60% AMI, up to that level.

Other Policy Objectives

Minimizing displacement along transit corridors is not the only policy objective where a Local 4d program could help; indeed, we found that 4d might work better in achieving other goals—see discussion below. These goals include increasing the affordability of unsubsidized units, facilitating more mixed income projects, encouraging physical rehabilitation or energy efficiency investments, and helping with nonprofit acquisition of unsubsidized affordable buildings.

Questions This Research Project Addressed

This research project sought to answer the following questions :

- a. An earlier version of the 4d program provided a tax break to properties like this, but was eventually repealed. The State Auditor concluded in a study that there was little evidence the public had received anything in return for providing the tax break, since few of these properties had rents which ever approached the program's rent ceiling (affordable to 60% AMI). How would we design a local 4d program to ensure we were getting a meaningful public benefit ?
- b. How do we determine the right balance of restrictions versus tax benefit to attract sufficient owner participation ? Is the tax break a sufficient incentive by itself or must it be combined with other incentives ?
- c. What could be the source of "financial assistance" necessary to trigger eligibility ? Do fee waivers count ?
- d. How do we design the program so that it is administratively simple for both local governments and landlords while still assuring that rent and income restrictions are being followed, and that benefits do not go to substandard properties ?
- e. Should the program be limited to transit corridors, and if so, would that be politically acceptable within local jurisdictions ?
- f. Would a multi-jurisdiction corridor-wide 4d program make sense, and what would be the benefits/complications ?
- g. How do we assess the impact of the foregone property tax revenues on the taxing jurisdictions ?

Finally, to the extent answers to these questions suggested the concept was viable, we committed to proposing a demonstration project to test out the theory. The purpose of the

demonstration project would be to determine if the concept deserved a more permanent and broader application.

FINDINGS / CONCLUSIONS

- 1. It is uncertain if a Local 4d program to voluntarily restrain rents would work, and the concept would need to be tested through a demonstration program.***

Given the perception that the previous 4d coverage of ‘deemed properties’ failed to achieve a public purpose, there is an understandable wariness about extending this tax break to such properties again. We only recommend adoption of a Local 4d program if there is a reasonable confidence of a clear public benefit.

Would the inducement of a 40% property tax reduction for participating units cause landlords along transit corridors to forego rent increases they would have otherwise enacted? In considering participation, owners will compare anticipated revenue from future rent increases they think likely/feasible, and will not sign up if they think the revenue from those increases will exceed the benefit of participating (tax break plus “financial assistance” provided). On the other end of the spectrum, there may be owners not contemplating significant increases who will sign up to get the tax break, knowing they aren’t giving anything up. The only way this program would accomplish anything is if there are a group of owners/properties in the middle, who decide to forego increases they likely would have enacted in order to get the benefit of participating.⁵ One thing we did learn from property owners is that many of them operate in an atmosphere of uncertainty about how far they can push rents; a tax benefit may be sufficient to induce them to trade an uncertain opportunity for a certain benefit, particularly where they can offset restrained rents with higher rents elsewhere in the same building.

This, of course, involves speculation on the future, both by owners and by anyone designing a Local 4d program. An important question is, how do we know if a Local 4d program designed to restrain rents is having that impact? We believe that the best way to tell would be to enact a demonstration program in which owners would sign up a portion of the units in any building under 4d, and leave the rest unrestricted. Over time, a comparison of rents on 4d units and non-4d units should answer the question of whether 4d coverage did,

⁵ It may be possible to devise a Local 4d condition that would limit participation by those on the “low end” who wouldn’t have raised rents anyway. For example, there may be a way to define buildings with structural/market obsolescence barriers to significant rent increases.

in fact, restrain rents.⁶ The Appendix to this report sets out a proposal for a demonstration program which would be designed to test this theory.⁷

How long would the demonstration program have to last to produce meaningful results? The longer the program is in effect, the more meaningful the results, but it would probably have to be at least five years. This term would coincide with the commitment required of owners of pledged properties under the previous version of the 4d program.

Opinion over the value of pursuing this model was split within the workgroup. Some felt that given the uncertainty of the outcome, and the complexity, time and cost of the demonstration program, enacting the program is not justified. Others acknowledged all these issues, but given the urgency of the concern about rent increases, and the lack of tools to currently address the situation, a project to test the concept was felt to be worth it.

Representatives of two local governments, St. Paul and St. Louis Park, couldn't recommend the allocation of local funds to support a demonstration program. The majority of St. Paul's federal and local funding program restrictions would not permit payments to landlords as an incentive to control rents. Administration of the program would be complex and St. Paul doesn't believe it has staff capacity to administer such a program. There is concern about sustainability—that the demonstration program would have to continue for some time to demonstrate impact, particularly if significant rent increases don't show up for some time. The view expressed by St. Louis Park staff was that there would likely be a political reluctance by policymakers to simply provide landlords with a check (the "financial assistance") when what was being obtained in return was so uncertain.

Given these reactions, if a demonstration program is deemed worth implementing, funding would likely have to come from some combination of non-local governmental sources (Hennepin County's Affordable Housing Incentive Fund, Met Council or Minnesota Housing) and philanthropic sources. Funds would be needed to cover both the "financial assistance" portion of the program, as well as administrative costs to run the demonstration program. See proposed Demonstration program in Appendix to this report.

2. Other applications of a Local 4d program appear more immediately promising.

⁶ A participating landlord could decide to focus his rent increases on the non-4d units, which over time could create a greater gap between 4d and non-4d rents, and could potentially lead to a greater range of tenant incomes within the building. This could be a positive outcome for many communities interested in encouraging more mixed income housing.

⁷ One way to address the problem with the pledged properties "one size fits all" 60% AMI rent cap would be to start instead with current rents, and permit annual increases pursuant to an inflation factor, such as those used in HUD programs.

We also identified four situations where adding a Local 4d component to policy initiatives should enhance the effectiveness of each of those initiatives. These extensions of 4d appear to carry neither the complexity nor uncertainty of the rent restraint model discussed above.

A. Facilitating a Local Rent Subsidy Program

One such situation would be where a local government decides to provide a local rent subsidy to an existing property in order to write down rents on an agreed number of units. This strategy is recommended in *The Space Between* report and has been either implemented or is under discussion among several cities and counties in the Metro area. It can be a particularly useful tool to add affordable units in circumstances where building new affordable developments is challenging. In some cases market rate project owners might be reluctant or uncertain about creating affordable units in their buildings, even where the local government is providing ongoing subsidies to reduce the rents. The 4d tax break on the affordable units could serve as an inducement for private owners to participate.

Meeting 4d eligibility would be straightforward, since the two main conditions can be easily satisfied—rent and income restrictions (necessarily part of the terms of a rent subsidy program) and financial assistance (the rent subsidy). There are a number of complex issues in sorting out a rent subsidy program, but in the event a jurisdiction does decide to develop such a program, adding 4d eligibility as an incentive for landlord participation would appear to be fairly simple. Note, however, that for 4d eligibility, the rent subsidy program would probably have to be project-based rather than tenant-based, since Minnesota Housing has taken the position that accepting section 8 voucher-holders as tenants does not make a building eligible for 4d.

B. Making it easier to do Mixed Income Developments

A second situation where 4d could serve as a “deal sweetener” is where cities seek to encourage or require market rate developers to produce mixed income housing by including affordable units in market rate developments. There is growing interest in the Region right now in encouraging more mixed income developments. In some cases this means removing financing barriers where new multifamily developments are trying to combine public resources for affordable units with market rate units and financing. In other cases it means providing market rate developers with some combination of expectations and incentives to include affordable units without drawing upon public resources. Efforts are currently under way on both these fronts.

In both such cases it is worth considering whether extending 4d coverage to the affordable units will work and will enhance the goal. Of course, in the case where federal or state subsidies are being accessed, presumably 4d coverage will be available in the same way 4d coverage would apply to a 100% publicly subsidized development. But what about where

affordable units are created by the developer without public subsidies, through some form of inclusionary policy, or negotiations between the developer and the city? The 4d tax break could be one of the financial incentives the local government could offer the developer to increase the financial feasibility of including affordable units.

Of course, to access 4d eligibility, the government must provide “financial assistance.” Cities typically have several forms of financial assistance that could be applicable in such situations. For example, market rate developments will frequently seek Tax Increment Financing (TIF) from cities, and this would be an obvious situation where the city is offering financial assistance under circumstances making it reasonable to expect the developer to include affordable units. Several local jurisdictions now routinely require inclusion of affordable units in such circumstances.

Two other 4d eligibility conditions could limit the flexibility of local Mixed Income policies, however. The 4d statute requires that at least 20% of the building’s units qualify in order to access 4d. Also, the qualifying units must have rent and income restrictions pegged to 60% AMI. Thus, to qualify for 4d eligibility, Inclusionary requirements would have to call for at least 20% of the units affordable to 60% AMI. These parameters will likely be reasonable and financially feasible in some circumstances; perhaps not in others. But the addition of the tax break should at least marginally increase the financial feasibility of including affordable units.

C. Incenting owner to engage in Multifamily rehabilitation and/or energy efficiency investments

There are situations where local governments sometimes offer multifamily owners access to rehabilitation or energy efficiency programs. Providing owners sufficient incentive to participate in these programs is often a challenge. In the right circumstances, the 4d tax break might help tip the balance. In order to access 4d, though, the program would have to be structured so that “financial assistance” is provided, and is coming from a “local government.” For example, if private financing was being offered at favorable rates as an inducement, if the financing was passed through a local or state governmental entity, 4d eligibility could be accessed (presuming the owner was also able and willing to meet the rent and income requirements).

D. Helping with Nonprofit acquisition of unsubsidized affordable properties

Finally, policymakers have been discussing how they can facilitate the strategic acquisition of unsubsidized affordable rental properties by preservation oriented non-profits, particularly in gentrifying areas. In the event governmental or philanthropic funds are dedicated to financing the acquisition of these properties, it is worth considering the

potential applicability of 4d. To the extent acquisition funds can be considered to be “state” or “local” financing, 4d eligibility can be triggered, which would significantly benefit the new nonprofit owner seeking to keep the property as affordable as possible. To the extent the financing provided comes from a source other than state or local government, it may be worth considering passing those funds through a state or local entity in order to access 4d eligibility.

3. *While finding ways to address the mismatch between unsubsidized affordable units and lower income households is important, applying 4d to this goal becomes problematic.*

One potential goal for the 4d tool is to address the Region’s mismatch between the supply of unsubsidized affordable rental units and occupancy by lower income households who need them the most. In the Metro Area, 42% of units with rents affordable at 50% AMI are occupied by households who could afford to pay more. “*The Space Between*,” p. 6. That amounts to nearly 72,000 units that could be affordable to lower income households if they could only access them. If the 4d tax benefit could create an incentive for owners to address the mismatch, this could make more affordable units available to lower income households without having to build or fund them. One way to accomplish this is that when relatively higher income households vacate units in affordable buildings, the landlord agrees to earmark that now vacant unit to a lower income household.

In this situation, we think the financial benefit of the tax break plus modest financial assistance could well be sufficient incentive for a landlord to participate. However, we identified serious barriers to making this work on a practical level. If we only want to provide the tax break to landlords who can demonstrate a unit has converted from a higher income occupant to a lower income occupant, the identification and reporting gets quite complicated, both from the viewpoint of the owner and from the agency verifying eligibility. In addition, because units regularly turn over, the number of units a landlord would be certifying as 4d eligible under this model would be changing every year. The Hennepin and Ramsey County Assessors advised us that they are very opposed to any extension of 4d which would cause lists of eligible units to vary from year to year. Those variations apparently cause significant problems for them. Finally, there is a fairness issue in offering the tax break to landlords who begin making more units available to lower income households when other landlords have been doing that all along. As a result, our group concluded that although incenting landlords to address the mismatch through 4d was promising in concept, in practice it was problematic.

4. *The 4d property tax break by itself is insufficient incentive for landlords to participate in these policy initiatives, thus requiring more than minimal “financial assistance” or some other incentive.*

Ideally, the 4d tax break would be sufficiently attractive to landlords that they would sign up without the financial assistance accompanying the tax break being more than a minimal payment. However, from what we learned from a focus group of property owners gathered by the Minnesota Multi Housing Association, the tax break by itself is not likely to generate much interest.⁸ We asked what level of monthly per unit benefit would be necessary to induce landlords to sign up based on the rent restraint 4d model. The consensus of the group was that a monthly per unit total benefit (tax savings plus payment) in the range of \$75-100 /unit/month, would be necessary.

For purposes of this study, we examined what savings would result for a typical Minneapolis apartment building with rents in the range affordable to households at 60% AMI. Those per unit per month savings would currently be approximately \$40.⁹ Thus, in order to package sufficient financial benefit to attract landlord interest, the gap between \$40 and \$75-100 could be viewed as the necessary level of financial assistance needed to make the program work. While this gap payment of \$35-60/unit/month is not large, it is certainly more than the minimal or modest financial assistance payment we had hoped for. What local governments would be doing in this situation is using their resources (or those of a more regional nature) to leverage the tax benefit in order to accomplish a larger affordable housing goal.

Note that this issue plays out differently depending upon the policy goal being pursued. The gap payment required above is in the context of getting owners to agree to restrain rents. The incentives necessary for landlord participation will vary depending on the various policy initiatives discussed above.

5. The impact of the foregone taxes on taxing jurisdictions from a narrowly targeted and modestly scaled Local 4d program do not appear to be significant.

If a Local 4d program is created, participating properties pay less in taxes. Since the taxing jurisdictions which share those property tax revenues receive less taxes from those properties, the resulting reduction in revenue must be spread across the remaining local tax base to generate the same amount of revenue needed by the taxing jurisdictions. The question we sought to answer was whether the resulting shift in tax burden would have a noticeable impact on taxpayers. Generally speaking, the answer appears to be no.

To answer this question, we looked at two areas with respect to the proposed 4d rent restraint model—the St. Paul portion of the Central Corridor light rail line, and the St. Louis Park section of the Southwest LRT Line. We calculated the likely number of eligible

⁸ Due to the narrowing of the difference between 4d rates and normal multifamily residential tax rates, the 4d savings is not as great as it was in earlier years.

⁹ The per unit per month tax savings will, of course, vary from building to building and community to community. Several people indicated that they were anticipating tax increases on multifamily properties in the next several years, so this per unit tax savings could well increase in the near future.

properties, and then made two alternative assumptions about the percentage of eligible properties that would sign up—one assumption was 50% would enter the program, the other was 15%.¹⁰ We then calculated the total tax impact in these two alternative scenarios and asked local revenue officials to assess for us the impact of shifting this portion of tax revenues to taxpayers in the remaining part of the tax base.

For Ramsey County (Central Corridor), at a 50% unit participation rate, the annual tax increase on St. Paul homes was more significant, ranging from \$4.69 to \$18.40, for Ramsey county taxpayers the range was a \$1.00 increase up to a \$4.03 increase. The impact of a 15% participation rate is much lower, of course, with the impacts ranging from \$1.40 annual increase/home to a high of \$5.51 annual increase/home. In the case of St. Louis Park, the scenario in which 50% of eligible units participate amounts to 1% of the city's tax revenue, leading to an annual tax increase of \$7/single family home. The impact of the 15% participation scenario was deemed "minimal."

Of course, the tax shifting impact will vary depending on the scale of the program and the rate of participation. But at least given the assumptions used above, Local 4d programs at that scale do not appear to cause a significant impact. It should be noted that should this become a concern, there should be no reason a local government could not structure their Local 4d program with a cap on the number of participating units/properties, or narrow eligibility conditions, in order to limit tax impacts.

6. Ensuring compliance with Local 4d requirements requires balancing administrative simplicity for both local governments and landlords, with avoiding misuse of the program.

Keep it simple—we heard that both from local governments seeking to limit administrative burdens and landlords wanting to keep the paperwork to a minimum. The challenge is keeping the compliance process simple for both sides while maintaining mechanisms to ensure the program is not misused.

Informal conversations with those involved in monitoring compliance with the pledged properties program suggest the compliance process was frustrating for those charged with ensuring compliance. Recordkeeping by owners was uneven, and in some cases haphazard, making compliance checks difficult. There was concern that there were compliance problems out there that no one had the resources to really identify. Given the goal of simplicity, this probably means having to tolerate some level of noncompliance, which hopefully could be kept to a minimum.

¹⁰ By way of comparison, when 4d covered both pledged and deemed properties, at one point 16% of projects state wide participated in 4d.

Depending on the jurisdiction, there are two or three key rules we want to ensure are followed. Rents for participating units need to stay within program limits, and monitoring agencies need to have access to sufficient information to feel confident rents are appropriate. Similarly, tenants in qualifying units need to have incomes below certain levels, so reporting must be done on tenant incomes. While, rent reporting is fairly straightforward, income reporting is another matter. Simply defining what is income is complicated, and the fact that tenant incomes constantly change is another challenge. Fortunately, a number of local governments administer housing programs with similar limitations, so they should be able to borrow procedures from those programs. As to the problem of changing incomes, it should be sufficient to document incomes at the time of the initial 4d application, and not require taking into account changes in the incomes of qualifying tenants.

We also heard from Minneapolis and St. Paul of an additional compliance concern—not providing this tax break to substandard properties. Presumably the local government could also condition eligibility on having a rental license in good standing (for those jurisdictions that require licenses) and no pending code violations.

7. The geographic scope of the Local 4d program will depend on the program’s objective, but it would not necessarily have to be linked to the entire jurisdiction.

In some cases there will be good reason to define the geographic eligibility area as less than the entire local jurisdiction. A prime example is a program seeking to restrain rents in areas likely to gentrify. Since one goal would be to avoid offering 4d benefits to properties unlikely to experience significant rent increases, geographic boundaries should focus on those areas which are of greatest concern, such as transit corridors or other areas likely to exhibit hot market conditions. It’s also important with the rent restraint model to keep in mind the target part of the market—where there is a significant supply of unsubsidized rental units that are currently affordable but at risk of losing that status. Examples would be the significant supplies of this kind of housing along the St. Paul sections of Central Corridor between Midway and Downtown St. Paul, and the large number of such units along SW LRT station areas in Hopkins and St. Louis Park.

Applying this concept to transit corridors raises the question of whether there should be a corridor wide Local 4d program. There are two questions here—whether properties along the entire corridor should be eligible to apply (assuming they meet other eligibility conditions) and whether the entire corridor should be responsible for bearing the costs of this kind of Local 4d program. A good argument can be made, for example, that the unsubsidized affordable rental supply on the SW corridor is a corridor wide asset, and that the cost of preserving that asset (the tax break and the financial assistance) should be spread corridor wide. We know that officials with the City of Hopkins feel particularly strongly about this.

CONCLUSION

Narrowly extending 4d coverage to restrain rents in gentrifying areas, the original impetus for this project, turned out to be challenging. Whether the demonstration project to test out this tool ought to be pursued will depend on the judgment of policy makers and the sense of urgency around developing new tools to preserve affordability. However, other uses of Local 4d recommended herein appear to be much less problematic. In particular, given the current discussions around how to remove barriers to mixed income housing, using the 4d tool where appropriate as an enhancement ought to be actively pursued.

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APPENDIX

1. 4d Demonstration program Rent Restraint model

DEMONSTRATION PROPOSAL

Create two categories of buildings, those with 50 units or less and those with 50 units or more. For purposes of the demonstration program, require that participating buildings register between 25% and 50% of units under 4d, so that there is a sufficient basis for comparison of 4d units and non-4d units within each building. 4d eligible units could “float” within the building, as long as rents and incomes qualified. Apply this to both Central Corridor and Southwest Corridor.

Participating owners would get a combination of reduced taxes and financial assistance in the range of \$75-100/month/unit, and in turn would agree to restrain rents on participating units to levels affordable to households at 60% AMI (alternatively, 50% AMI) or current rents, whichever are lower, subject to an annual inflation factor. Units would only be eligible if occupied by households with incomes below 60% AMI. Owners would agree to these conditions for five years.

The mix of participating buildings would be as follows :

Smaller buildings (50 units or less) assume average bldg. is 40 units, 20 of which are covered by 4d

Central Corridor: 3 buildings/total of 60 units under 4d (20/bldg.)

SW Corridor : 3 buildings/total of 60 units under 4d (20/bldg.)

Larger buildings (51 units or more) assume average bldg. 100 units, with 50 units/bldg. covered

Central Corridor : 3 buildings / total of 150 units under 4d (50/bldg.)

SW Corridor : 3 buildings / total of 150 units under 4d (50/bldg.)

Total units : 120 from smaller buildings., 300 from larger buildings. Total : 420 units under 4d

COST

There are three categories of “costs.” There is the shift in tax revenue but that should be minimal as to not be noticeable to taxing jurisdictions.¹¹ There is the cost of the financial

¹¹ Note the earlier projections of the impact of resulting tax shifts was for the larger scale Local 4d program proposed, not the much smaller demo program discussed here.

assistance necessary to trigger 4d eligibility (and also necessary to create sufficient incentive for landlords to participate). In our Minneapolis building example, the tax savings/unit was \$40/month. In order to make up the difference between that savings and the total benefit necessary to get landlords to participate, the financial assistance in such a case would likely need to be between \$35 and \$60/unit/month. If the assistance is set at \$35/unit/month, that amounts to \$420/unit/year. If set at \$60/unit/month, that amounts to \$720/unit/year. Note that our projected tax savings of \$40/unit/month will vary from community to community and from year to year, so if that savings increases, the financial assistance offered could perhaps be reduced accordingly.

Financial Assistance for 420 units at \$420/unit/year = \$176,400/year. Two years = \$352,800

Financial Assistance for 420 units at \$720/unit/year = \$302,400/year. Two years = \$604,800

If administered for five years, the demonstration program “financial assistance” cost would range from \$882,000 to \$1,512,000.

The final category of cost would be administrative. Local government or someone else would have to provide the staff time to further design and market the program, and perhaps help with compliance. Rents on 4d and non-4d units would have to be tracked over time. Once the local program is set up, 4d applications are submitted by owners to Minnesota Housing and then certified to county assessors.