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Financing Urban Resiliency

Innovative Approaches to Deliver Affordable Housing in Chicago

Project Background

As cities across the globe continue to grow at unprecedented rates, the effects of globalization, urbanization, and climate change are having dramatic physical, financial, and social impacts. Today, urban areas house more than half of the world's population and contribute to 80 percent of global GDP.¹ As urbanization increases across the globe, cities need to prepare better for environmental shocks and the stresses attributed to an increase in population. For city leaders, the challenge is to foster social resilience—it will support a city's growth as much as roads, bridges, and tunnels. In recent years, city governments have begun to focus increasingly on the importance of funding and financing social resilience strategies.

Social resilience—ensuring all residents have access to services and opportunities, including competitive jobs, good health care, and quality housing—is crucial to a city's long-term success. However, a city's "neighborhood effect," the phrase popularized by sociologist William Julius Wilson to describe the impacts of concentrated poverty in US urban cores, can impact other social issues and sap the city's overall long-term resilience.² Unfortunately, in many US cities, concentrated poverty and chronic disinvestment have resulted in wide social, economic, and geographic disparities. Meanwhile, these same city centers are being revitalized—and as rents outpace wage growth, quality housing is increasingly difficult for low-income residents to access. Individuals earning less than 80 percent area median income (AMI), the metric used to quantify a region's income distribution, are considered low-income and consistently face an affordability challenge.³

Production of new affordable units has not kept pace with demand in higher-cost areas of the country, and lower-income households, in particular, are struggling to compete for the dwindling supply of naturally occurring affordable housing, as well as the various government- and nonprofit-supported housing options. By 2016, the number of US rental households had increased by 9 million since 2008, up to some

43 million—and of these, 38 percent were reported in 2015 to be cost-burdened, meaning they paid more than a third of their pre-tax income for housing. Another 17 percent of severely rent-burdened tenants pay more than half of their income on rent.⁴

For the cost- and rent-burdened, affordable housing, subsidized at below-market rates by the government, is often the only housing option. Low-income housing assistance grew out of Great Depression-era federal programs and expanded dramatically from the 1960s to the 1990s, but fell off as federal spending priorities changed and the federal government steadily withdrew from direct engagement in urban housing policy, relying instead on programs implemented at the state and local levels.⁵ In Congress, legislators approved 10-year caps on federal spending that resulted, from 2010 to 2013, in \$6.2 billion in cuts (13.3 percent, adjusted for inflation) to housing and voucher assistance. By 2016, expenditures for low-income housing assistance—housing vouchers, tax credits, and public housing—were actually below 2010 levels.⁶ With the Department of Housing and Urban Development's (HUD) budgetary allocations significantly decreased, cities and states are seeking innovative ways to house and help their most vulnerable populations.

The conversation about affordable housing is hardly new, but the discussion has amplified in recent years for several reasons: slow recovery from the 2007–2008 financial crisis, the surge of younger populations into urban areas, old and deteriorating infrastructure, sea level rise and associated property risk in low-lying major metropolitan areas, overbuilding of high-end and luxury residences, and tighter rental markets. Like cities worldwide grappling with issues of urbanization, US cities are recognizing that resilience is key to their survival.

As the third largest US city by population, Chicago faces its own resilience challenges. While the city's urban population has decreased, the most vulnerable populations remain in declining neighborhoods. Rates of crime and violence are high, despite recent improvements, and

infrastructure is rapidly aging and in need of upgrades.⁷ Chicago's downtown construction boom—due in part to an increase in corporate headquarter relocations to the city—has put pressure on surrounding neighborhoods and led to gentrification.⁸ Although Chicago has pushed to improve prosperity for all Chicagoans, city leaders recognize that opportunity is not equally accessible, which exacerbates the city's challenges.⁹

Over the past 50 years, the city has implemented numerous strategies to construct, preserve, and rehabilitate affordable housing; yet, significant challenges remain. On November 15, 2018, the Milken Institute, in collaboration with AECOM, held a Financial Innovations Lab in Chicago to address affordable housing as a case study for innovative financing and public-private investment partnerships in urban resilience projects, both physical and social. Participants discussed the past delivery of affordable housing across the city and future opportunities for innovation. The Lab brought together local and federal policymakers, community stakeholders, developers, housing providers, and finance professionals to discuss solutions to this enduring challenge.

Resilience and Housing Investment in Chicago

Chicago has long placed a high priority on affordable housing. City leaders have implemented numerous strategies, with projects ranging from the construction of new communities to rehabilitation of declining neighborhoods. Leaders have learned lessons over the years; yet, a shortage of quality affordable housing remains. Since the mid-2000s, the gap between the supply of affordable rental units and the demand from low-income residents has remained at approximately 180,000 units.¹⁰

In December 2018, former Mayor Rahm Emanuel released the city's 2019-2023 Five-Year Housing Plan, One Chicago, which includes \$1.4 billion

of city investment in 40,000 residential units.¹¹ In tandem, the city announced that it would launch a new Department of Housing (DOH) to address Chicago’s constantly changing housing needs.¹²

City leaders recognize that the affordability challenge is exacerbated by a lack of equitable access to opportunity. Noting that “discriminatory practices and policies have caused disparities that disproportionately burden Chicago’s most vulnerable residents,”¹³ the city released its first ever resiliency strategy, Resilient Chicago, in February 2019 as part of the Rockefeller Foundation’s 100 Resilient Cities network.¹⁴

These commitments are set to grow under the new administration. Mayor Lori Lightfoot’s Transition Report outlines key initiatives to build inclusive and affordable housing options, encouraging homeownership, addressing gentrification and displacement, and ending chronic homelessness.¹⁵ Strategies include amendments to the city’s Affordable Requirements Ordinance (ARO), Low Income

Housing Trust Fund (LIHTF), and Qualified Action Plan (QAP), and exploring a new Debt and Equity Fund for affordable housing developments.

In an effort to bridge the housing gap, the city has used both federal funding programs (e.g., tax credits and incentives) and homegrown strategies and funding mechanisms. The typical funding process for affordable housing development can be complex and requires different sources of financing for pre-development and development costs.

Figure 1 shows how costs and funding are stacked into two project phases, pre-development and development. Debt is often the easier layer to source and can be supplied by banks, community development financing institutions (CDFIs), and public or private lenders. To source equity, Chicago has historically leveraged the Treasury Department’s Low-Income Housing Tax Credit (LIHTC) program.¹⁶ Of note, Chicago and New York City are the only US cities that have access to both a city and state allocation of federal tax

Figure 1: How Chicago Is Bridging the Affordable Housing Gap

COSTS	FUNDING TYPE/SOURCE
<p>PRE-DEVELOPMENT COSTS</p> <ul style="list-style-type: none"> • Acquisition costs • Legal and marketing costs • Entitlements • Environmental impact statements 	<p>GRANT FUNDING</p> <ul style="list-style-type: none"> • Philanthropic capital • Federal programs, e.g., Community Development Block Grants (CDBGs) <p>NEW IDEA</p> <ul style="list-style-type: none"> • First mortgage enhancement pool • Depreciation value fund • Takeout financing revolving loan fund
<p>DEVELOPMENT COSTS</p> <ul style="list-style-type: none"> • Engineering • Insurance • Construction costs • Soft costs 	<p>FINANCING: DEBT</p> <ul style="list-style-type: none"> • Banks • Community Development Financial Institutions (CDFIs) <p>FINANCING: EQUITY INVESTMENTS</p> <ul style="list-style-type: none"> • Treasury Department: Low-Income Housing Tax Credit • Community Development Financial Institutions <p>NEW IDEA</p> <ul style="list-style-type: none"> • Opportunity Zone equity • Nonprofit housing trust • Tools for operational subsidies • Redevelop the ARO

Source: AECOM and Milken Institute.

credits.¹⁷ The LIHTC program offers tax incentive credits to developers who can then resell the credits to institutional investors for equity to meet affordable housing construction and/or renovation costs. From the state, Chicago accesses nearly 25 percent of the Illinois Affordable Housing Tax Credit program, funding that is administered by the Chicago Department of Housing and Economic Development.¹⁸ However, even with a city and state allotment, LIHTC contributes to less than 10 percent of affordable housing developments in Illinois.¹⁹

In December 2017, the IRS introduced a new category of Opportunity Zone tax incentive, offering tax breaks on deferred capital gains from old investments to investors of Qualified Opportunity Funds targeting “designated economically distressed” communities.²⁰ Of the 327 designated Opportunity Zones across Illinois, 133 are in Cook County.²¹ However, alongside the Opportunity Zone projects, there is concern that revitalization may force longtime residents out of their homes.²² Many of the challenges are neighborhood-specific and require locally focused solutions.

The city’s Affordable Requirement Ordinance (ARO) states that any developer of 10 or more residential units that receives financial assistance from the city, builds on city-owned land, is granted a zoning change for density or new use, or who builds a “planned development” in the downtown area, must set aside 10 percent of its units for long-term affordable housing, or pay an in-lieu fee.²³ The goal of the ARO is to increase the total number of affordable units, either by having market rate developers supply units in their new construction projects or by the city’s use of in-lieu fees for funding. Pilot programs to enhance the ARO are expected to add only 1,800 units.²⁴ While Lab participants did not agree on the best approach to revise the ARO, they generally agreed that it is not making the impact Chicagoans need or expect.

To help catalyze investment, in July 2018, the city partnered with a local CDFI, the Community Investment Corporation (CIC), to launch a \$30

million developer incentive program and an Opportunity Investment Fund that offers low-cost loans to purchasers of multifamily buildings in “high-cost neighborhoods” if they commit to keeping a minimum of 20 percent of the units affordable for 15 years. CIC is administering the program, which is funded in part by the city’s Affordable Housing Opportunity Fund and MB Financial Bank.²⁵ The target is to preserve 300 units of affordable housing.²⁶ Both the ARO and Opportunity Investment Fund represent examples of the local government working alongside the private market to address the affordable housing need. However, the supply from current programs is unlikely to meet the 180,000-unit demand for affordable units.

Lab Highlights

While various themes and viewpoints emerged among the participating developers, policymakers, community stakeholders, and investors, participants generally agreed on the challenges surrounding Chicago’s affordable housing crisis:

- Development across Chicago’s diverse neighborhoods will not succeed with a one-size-fits-all approach.
- There are limited sources of equity financing that are currently being utilized to expand the number of affordable units.
- Early investors carry the greatest risk in “complete” community redevelopment, which is a long-term revitalization of not only the physical but also the social and civic characteristics of a neighborhood.
- Existing capital pools lack flexibility for offering gap or takeout financing.

Recurring themes emerged, particularly in discussions on ways to increase the number of affordable housing units and to build complete communities:

- The city and its partners should concentrate resources and prioritize neighborhood-specific solutions more efficiently.
- The city could better leverage its current policy tools, enabling partnerships and sharing more information about available resources.
- The city could encourage strong anchor businesses by offering enhancements and subsidies.
- Private-sector partners could better identify and help build creative pools of gap or takeout financing.

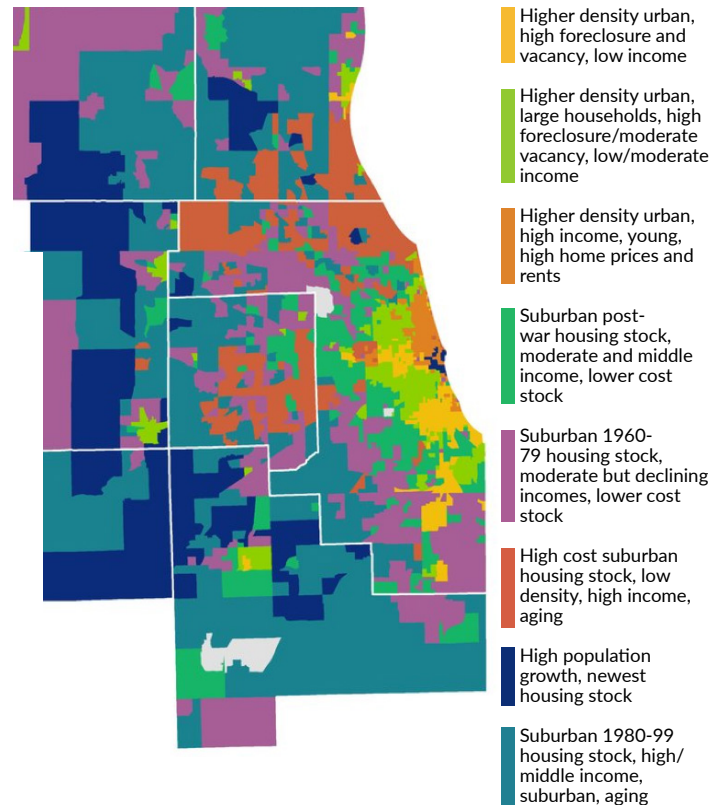
Main Challenges

1. Neighborhood Diversity

Chicago is a diverse city. There are 77 distinct neighborhoods in 50 legislative districts called “wards,” with each ward holding dozens of election precincts and represented by aldermen who sit on the City Council. The population of 2.7 million is racially and economically diverse, and that diversity is captured in the demarcations across the city’s geography.²⁷ DePaul University’s Institute for Housing Studies (IHS) has categorized Chicago Metropolitan Area neighborhoods into eight clusters, based on more than 40 data points for such factors as housing stock and affordability, housing market investment activity, and resident demographics and socioeconomic indicators.²⁸ Two of the clusters are identified as low- to moderate-income; two are high-wealth clusters; one is a cluster of “middle-aged homeowners in communities with moderate sales activities;” one is a cluster of young urban professionals; and two clusters are identified as economically distressed, based on data on employment and

housing subsidies, among other factors. Different approaches will be necessary to address the needs of these diverse neighborhoods.

Figure 2: Regional Housing Solutions Submarkets



Source: Institute for Housing Studies, DePaul University, August 2017.

One of the more intense discussions in the Lab was the debate between preservation of existing housing and new construction. This issue requires different calculations for each cluster where availability of existing housing stock must be considered in terms of historic preservation and rehabilitation or demolition. In higher-income areas, where the housing market is saturated and has driven up land and property values, new-build construction costs are often too high to support affordable rents. In these areas, preservation and rehabilitation of the existing housing stock is often the most economical way to create affordable housing. On average, the cost of building a new unit is double that of preserving an existing one.²⁹ This difference can largely be attributed to high construction costs and the fees

associated with the complexity of financing new developments. Many areas of Chicago have been dramatically affected by neighborhood blight and present opportunities for new construction that could revitalize swaths of neighborhood blocks. As demonstrated in the data points used by IHS, Chicago's neighborhoods vary not only by resident demographics but also by levels of occupancy.

Unfortunately, some clusters show consistent overlap across metrics. Neighborhoods that experience historically low investment activity have high ratios of minority populations. For example, "the Chicago region has consistently ranked in the top 10 highest levels of African American–white racial segregation from 1990–2010," according to the Urban Institute, and ranks fifth in the nation on the Urban Institute's measure of economic and racial segregation.³⁰

Chicago has also experienced the largest exodus of African-American residents of any metropolitan area in the country, according to another study by the Urban Institute, which predicts that by 2030 the city's African-American population will have dropped 17 percent, from 804,190 between 2011–2015 to 665,473.³¹ This trend began in the 1980s³² and has contributed to blighted neighborhoods being left behind. These areas are often overlooked by investment in either infrastructure or social services, and plagued by high crime rates and limited opportunity for upward mobility. City leaders must develop place-based approaches to tackle the challenges presented in each neighborhood.

2. Lack of Equity Investment

One of the greatest challenges in finalizing any real estate transaction is securing all layers of financing. Regardless of whether the project is targeting market rate or affordable housing, it will require different types of investors along its various stages of development. Affordable housing has historically struggled to attract equity investors, and although trends are shifting, Lab participants reiterated that there are still few equity funding sources available to developers of affordable housing.

As noted earlier, developers heavily rely on the Treasury Department's LIHTC program, but these annual credits are in limited supply, and the application process is competitive and extensive. Identifying capital to cover the application and pre-development costs can often be a challenge.

Banks constitute another crucial funding source because the federal Community Reinvestment Act (CRA) requires depository institutions to strive to meet the credit needs of their communities. According to a 2017 study by the Urban Institute, "This reliance on CRA investors as the major tax credit investors not only generates geographic incongruities, but it makes the production of low-income housing heavily dependent on banking economics and regulation, which are completely unrelated to housing need."³³ Also, while CDFIs are generally well acquainted with the specific needs of a community, they have often undercapitalized themselves, without adequate funding to meet all community lending requests. So while these federally supported efforts will continue to be meaningful sources of capital, there is a need to identify and attract new and more diverse forms of equity investment.

3. Attracting Complete Community Development

The level of development and services varies dramatically from one neighborhood to the next. Many of the eight neighborhood clusters identified by the Institute for Housing Studies require significantly more than a single block or two of new housing. Their residents also face the challenges of neighborhood decay, crime, few jobs nearby, and struggling schools. To rehabilitate these areas "completely" requires holistic, multifaceted development. Lab participants discussed the longstanding underinvestment in many neighborhoods that are often deemed too high-risk by investors and business tenants.

4. Missing Gap Financing and the Limitation of Current Programs

Many of the affordable housing developers at the Lab said they rely on federal funding to get their projects up and running. As one might expect, projects that leverage public money function within a higher level of bureaucracy; their timelines

tend to be longer than similar privately funded deals. The delays increase pre-development costs and may even result in lost deals at the pre-development phase. While federal and state tax credits will continue to play an essential role in the market, and the city's public-private-nonprofit partnerships have the potential to be significant, a number of Lab participants argued for policy simplification and more nimble capital. Lab participants also commented on the limited gap financing, criticized the constrained nature of current programs, and expressed the need to identify creative pools of capital.

Development (TOD) ordinance, which offers parking reductions and density bonuses for multifamily development—should be a high priority. Based on an analysis of city data by AECOM, Chicago's TOD zones cover less than 25 percent of the city's land parcels but account for over 70 percent of new construction value since 2006 (based on construction permits issued). The city recently passed an ordinance to expand TOD zones along major arterial bus routes, which will widen the TOD land available. But portions of the ordinance related to affordable housing are still underutilized, despite the increased interest in TOD projects.

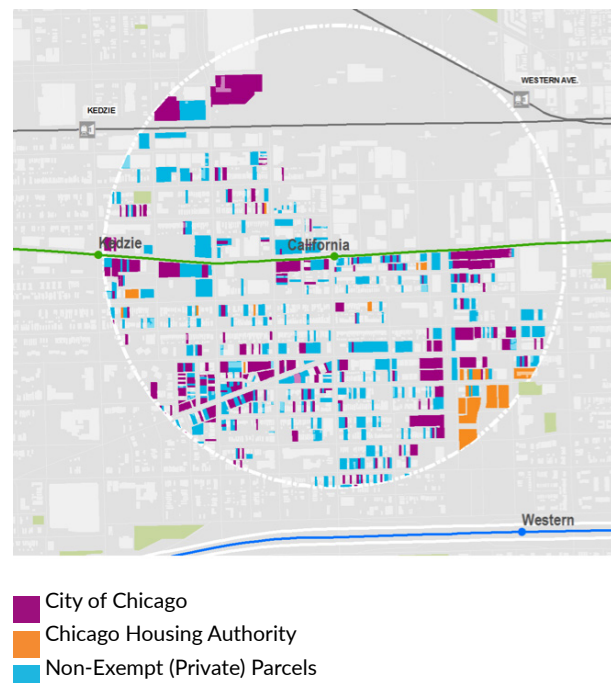
Key Recommendations

1. Prioritize Place-Based Policies and Areas of Focus

Given the range of challenges and opportunities across Chicago's neighborhoods, it is critical that any development strategy be neighborhood-specific. Understanding that there is a limited pool of city resources, a Mayor's Office representative likened its budget to peanut butter spread thin across a slice of bread. Without specific priorities for neighborhoods or an understanding of whether preservation or new construction will be most effective, the city cannot tackle every housing issue effectively. Lab participants discussed how to create metrics to prioritize programs or neighborhoods for funding. It is crucial to note that this strategy would not preclude other neighborhoods from ever accessing funding. Attendees stressed the importance of involving community groups early in the process to incorporate realistic requests and ensure that concerns are being addressed.

Chicago has realized the necessity of taking advantage of coordinated infrastructure investments to provide lower-income neighborhoods with new amenities. Building on existing investment in an area, participants agreed that the city should emphasize projects that fulfill multifaceted community investment requirements. Developments that take advantage of policies already in place—such as the Transit Oriented

Figure 3: Chicago Land Use



Source: Data from 2013 CMAP Land Use and 2015 County Assessor; AECOM.

Prioritizing development of these parcels, which can leverage nearby public transit, benefits not only the affordable housing industry, but also the transportation agencies by driving ridership, and the city by servicing underutilized assets. It is important that the city's policies facilitate triple bottom line returns, positively affecting the community and environment, meeting investors' return targets, and achieving multiple neighborhood benefits.

Resilient Corridors: Leveraging Existing City Programs to Enhance Neighborhoods

As the city learns from past programs and plans for the future, it is important that any neighborhood development facilitates complete communities and catalyzes coordination across public agencies. Programs that help to bring, for example, new infrastructure to communities isolated by a lack of transportation options or enhance civic engagement through new open spaces will be critical to bring back and preserve the vitality of many neighborhoods.

The resilient corridor approach, implemented after the Chicago River flooded in April 2013, targets city-owned vacant lots in flood-affected neighborhoods in the city's West Side. Events like flooding impact communities differently, with already vulnerable communities affected the most. By focusing investments in these higher-risk communities, social, environmental, and economic benefits could be leveraged, overall community resilience increased, and community assets such as open space are improved.

In 2017, construction began to develop storm water landscapes on key city-owned vacant lots using a whole corridor approach. The project will revitalize local shopping districts through the transformed landscape, generate jobs in construction and related sectors, increase safety for all road users, divert water from the city's aging infrastructure to newly created underground storage areas, reduce heating and cooling costs through landscaping, improve air quality, and increase community cohesion.

Figure 4: Residential Resilient Corridor



Source: AECOM.

Many Lab participants referenced the policy launched by the mayor of Detroit, Mike Duggan, which prioritized three neighborhoods using a clustered investment strategy. The Strategic Neighborhood Fund launched in 2016 to concentrate redevelopment in targeted areas by playing to the existing strengths of three selected neighborhoods.³⁴ The neighborhoods were chosen based on a variety of factors, including a combination of current population numbers, strong civic infrastructure, a high ratio of single-family households, existing commercial corridors, an ability to add density that transit could support, and the presence of parks. The neighborhoods also had to be walkable, with all essential business services accessible within 20 minutes on foot.

The fund has been so successful at identifying development projects and capitalizing on existing neighborhood strengths that it has been expanded to seven more neighborhoods.³⁵ Chicago could benefit by studying the lessons Detroit learned along its path of prioritization.

Next Steps:

- Create a city-wide checklist for developers to use when engaging with local community groups throughout the life cycle of a project.
- Maximize and demonstrate benefits across stakeholders for approved projects.
- Develop criteria for what will make individual neighborhoods resilient. The city can leverage the work done in Detroit and adjust the areas of focus for the nuances of Chicago's neighborhoods. Using the criteria, the Mayor's Office can analyze potential communities for pilot programs.
- Ensure that all appropriate city agencies, including those overseeing public infrastructure, are aligned to address complete community objectives.

Resourcefully Identify Equity Capital

2.

Lab participants were in consensus that the equity portion of the capital stack is consistently the most difficult layer to secure. Participants discussed ways to leverage current policy tools to concentrate available equity resources and enable creative partnerships to monetize property depreciation values.

One of the most debated potential policy implementations was the use of Opportunity Zone tax credits as a financing incentive. The Department of Treasury's Opportunity Zone legislation was introduced in 2017 to encourage investment in low- to moderate-income communities through Qualified Opportunity Funds (QOF). A QOF is an investment vehicle set up as a partnership or corporation to invest in eligible property or businesses located in one of the 8,700 nationally designated Opportunity Zones. The QOF is capitalized with realized capital gains that must be 90 percent deployed in Opportunity Zones.³⁶

This federal policy stands to be impactful because all capital invested by a QOF must take the form of equity, providing the most needed layer of the capital stack. QOF real estate transactions can invest directly into a property or in a partnership that owns property. Investors in QOFs receive a temporary deferral of capital gains reinvested into the fund, as well as a basis step-up of 10 percent or 15 percent in capital invested for five or seven years, respectively. Lab participants discussed the possibility for a QOF to help finance part of new affordable or mixed-income housing, but many were skeptical of the details of deal execution, given the untested nature of the legislation. The distinction with an Opportunity Zone benefit is that it is not a subsidy or specific source of gap funding, like LIHTC or New Market Tax Credits. The Opportunity Zone incentive provides investors an enhanced return on a successful project. Investors are required to put equity into a project with the primary benefit related to capital appreciation of the assets in the QOF. Opportunity Zones on their own will not be an answer to financing more affordable housing, but

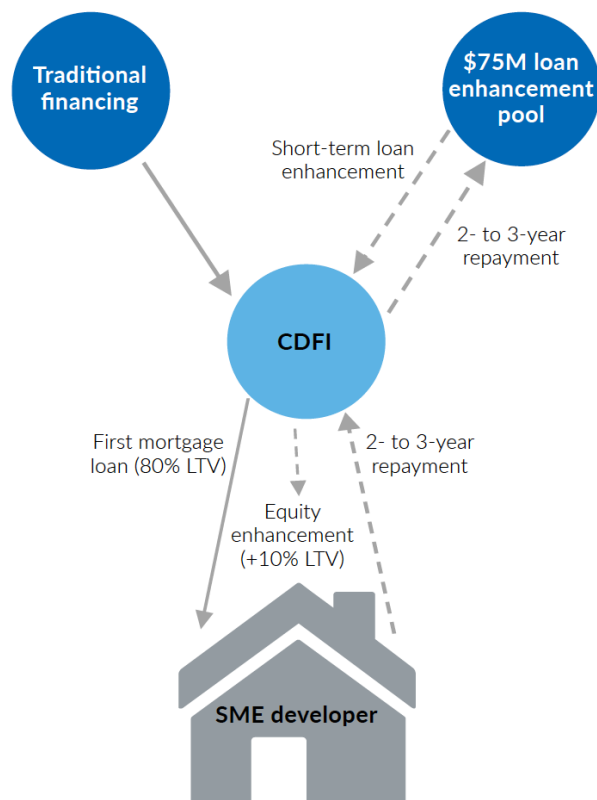
Lab participants were hopeful that they could play a role.

Given the uncertainty around Opportunity Zones, participants also discussed new financing vehicles that can provide much-needed equity. Small and medium enterprise (SME) developers often take advantage of first mortgage debt financing available through CDFIs to reach an 80 percent loan-to-value (LTV) ratio, the standard LTV for loan approval. However, they may still lack enough upfront capital to cover the remaining 20 percent of the financing, which, again, is traditionally the equity layer. Creation of a central loan loss reserve pool that approved CDFIs could leverage would guarantee the balance of the deal, where the enhancement represents the top 20 percent in case of loss.

This acquisition financing would be available for up to two years, while the developer assembles takeout financing. The pool would be funded by the city or state and mission-driven investors. If a government agency holds a stake in the deal, smaller developers may be more likely to secure takeout financing in a timely manner. All parties (i.e., the approved CDFIs) should agree to the underwriting for the acquisition financing pool in advance. This step would facilitate a quick acquisition process for SME developers.

Helping smaller developers to secure additional financing would also allow them to proceed with acquisition bids without raising their LTV ratios and thus their interest rates. Maintaining a lower LTV will keep SME developers competitive with larger private market buyers. Because CDFIs would continue to play a majority role in first mortgage financing, often providing 75–80 percent of a deal, the creation of a \$75 million equity pool for CDFIs to access would be impactful. After a deal is successfully underway and the developer has access to takeout financing, this equity could be recycled back into the pool.

Figure 5: First Mortgage Enhancement Model



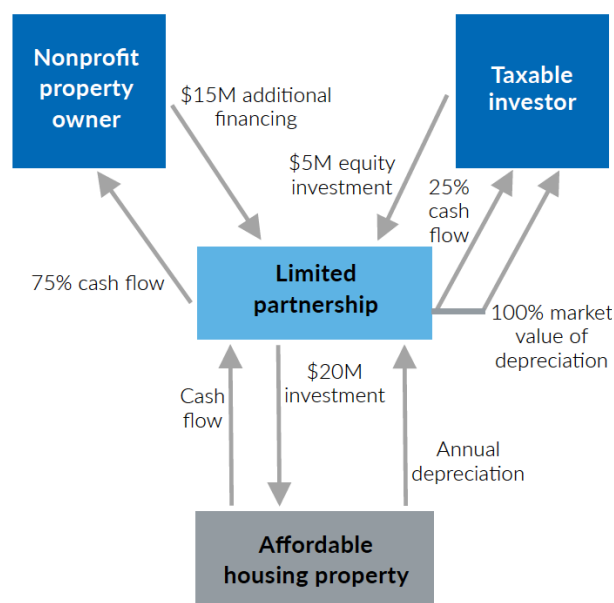
Source: Milken Institute.

With new sources of equity expected to flow into Chicago from QOF investors or innovative financing options, high priority should be given to streamlining the process of matching equity with higher-impact projects, as occurred in Detroit. Another priority should be creating a toolkit to help SME developers across the city who miss out on deals as they struggle to identify available pools of capital. Helping them will also help local communities. Successfully putting these future equity pools to work will require all entities operating in these communities to work collaboratively.

Participants debated additional funding pools that could meet equity needs and reduce reliance on government subsidies. Because they are tax-exempt, nonprofits that own buildings cannot monetize the annual property depreciation value, which can total millions of dollars a year. Lab participants discussed other examples of tax equity mechanisms, similar to what is used in renewable energy projects, such as emissions trading.

They agreed that more work is needed to assess the best structuring for realizing depreciation value. One suggestion was that collaboration be structured as a limited partnership between the nonprofit property owner and private investors. Private investors would receive their proportional return on equity and be able to capture the total depreciation value. While this depreciation value is an equity enhancement to them, it would also serve to increase the upfront funding received by the nonprofit property owner.

Figure 6: Depreciation Value Fund Model



Source: Milken Institute.

Next Steps Continued:

- Pool mission-driven investor equity from a coalition of local CDFIs, which can act as a supplement equity enhancement of the first mortgage loans that they provide. This would include the agreement of terms at the outset to simplify the distribution of funds.
- Create a toolkit to support smaller developers as they navigate resources for financing, including resources for QOF equity and first-loss capital. The city's Small Business Center has programming dedicated to helping business owners identify financial resources. If Lab participants raise awareness on how difficult it is for smaller developers to find financing options, this will encourage the center to dedicate resources to the issue.
- Enable nonprofit property owners to monetize property depreciation values by facilitating partnerships with private investors who would receive the tax benefit.

Next Steps:

- Prepare a pipeline of potential Opportunity Zone projects using Qualified Opportunity Funds. This could be done by the governor's office, which designated Opportunity Zones across the state with input from the City of Chicago. The city or other public agency should consider how to integrate these projects with existing sources of gap financing.

De-Risk and Enhance Early Investment by Critical Providers

3.

Currently, affordable housing is built and financed by key stakeholder groups, many of whom actively participated in the Lab. There is room to include a wider range of participants, such as local philanthropists and corporations.

One of the best examples of a regional partnership across business and industry lines is the Silicon Valley Housing Trust in the San Francisco Bay Area. Created in 2000 by a group of corporate and business leaders, this CDFI is one of the first nonprofit housing trusts.³⁷ Initially funded by the private market, the trust is innovative for partnering local public and private players. Attracting investments from local

businesses has helped to de-risk the market and bring in additional stakeholders. With an AA- credit rating from Standard & Poor's, the trust attracts investors and corporations through its TECH Fund, which offers community "impact notes," i.e., short-term loans to developers to cover land acquisition and predevelopment costs. The loans are repaid as developers close construction financing and offer modest returns to investors locked in for five or 10 years.³⁸ For many of the companies located in the Silicon Valley, the structure offers a financial vehicle that is familiar, while providing them the opportunity to make an investment that will positively affect the community in which they operate. Lab participants discussed how a group of corporations headquartered in Chicago could adopt this model.

Another way to engage the corporate sector in housing development is to attract business anchors and corporate tenants to newly revitalized neighborhoods. This type of long-term investment by an established company can de-risk future investment into an area, demonstrating the potential for economic growth and job creation. Communities experiencing decline can benefit from new business tenants opening and creating quality jobs, bringing economic activity and signifying a long-term commitment to enhancing a community.

Local success stories like that of the historic Pullman neighborhood demonstrate how critical it is to identify partners that understand the long-term commitment necessary for building prospering communities. Few partners will have better-aligned timeframes than the city itself and the agencies that provide government services. Participants suggested devising a program with the Chicago Department of Planning and Development to offer nonprofit affordable housing property owners subsidized utilities, such as water, electricity, gas, or telecommunications/ data.

Programs designed to increase resilience and lower operating costs exist. The Illinois Solar for All Program utilizes funding, from the Renewable Energy Resources Fund, to

install rooftop solar panels in low-income and economically disadvantaged communities.³⁹ By subsidizing the higher upfront costs to operational improvements, property owners see increased efficiency in their operational expenditures. These savings in overhead costs could be passed on to tenants via lower rents or higher-quality building maintenance. Reduced operating expenses could increase the residual cash flow available, allowing building owners to provide higher returns to equity investors and opening up critical new sources of financing. Participants at the Lab agreed that additional tools to support the operational side of affordable property management would be helpful, as there is currently a lack of capacity in the market.

The Pullman Neighborhood: Addressing Development for the Community

The historic Pullman neighborhood on the south side is a remarkable success story of a community rebuilt "completely," or holistically. A local CDFI, Chicago Neighborhood Initiatives (CNI), began its revitalization efforts more than a decade ago, first by surveying resident needs. To bring jobs to the community and attract an initial anchor tenant, CNI used Tax Increment Financing (TIF) to secure Walmart and subsequently others. TIF allowed Pullman to entice development in an untested community by earmarking the increased property tax revenue that resulted from the improving local economy. The earmarked capital was used to build out the necessary infrastructure to enable Walmart to be successful.

In addition, CNI leveraged new market tax credits, federal tax credits that encourage private investors to develop high-impact community facilities projects, such as charter schools and health centers, within their developments.⁴⁰ Bringing Walmart and other businesses to the community increased the quality of life by increasing job opportunities and providing better access to health care and food resources. As the local economy grew and thrived, local entrepreneurs opened their own businesses.

CNI has been preserving affordable housing block by block. A built-in advantage to Chicago is its ample supply of existing housing stock available for preservation and rehabilitation. In Pullman, a community that has struggled with disinvestment for decades, there is a surplus of iconic brick row homes that were hit hard by foreclosures during the 2007 financial crisis.

Next Steps:

- Create a citywide marketing strategy within the Mayor's Office to attract new investors and stakeholders, such as local philanthropists and corporations that can contribute to solutions to the affordable housing crisis.
- Encourage corporations operating in Chicago to create partnerships similar to the Silicon Valley Housing Trust that facilitate investment opportunities in the communities in which they operate. To start the conversation, the city should pilot an "employer housing council" that would convene the region's major corporations to discuss local affordable housing challenges and opportunities.
- Utilize the proposed Mayor's Office pilot neighborhood prioritization plan (fashioned after Detroit's lessons learned) to identify the merits of each community and to market its commercial opportunities to potential business anchors and corporate tenants.
- Identify utility improvements that can be subsidized on a citywide basis, similar to the Solar for All Program. By subsidizing the upfront costs to improve utility efficiency, subsequent savings can be passed on to property managers, which in turn can pass them through to tenants or equity investors.

4. Identify Creative Pools of Gap or Takeout Financing

Redeveloping a neighborhood is no small feat; yet, it is important to keep the process as streamlined as possible. Unfilled financing gaps can widen quickly with delays, a challenge for developers struggling to ready their capital stacks. Lab participants explored ideas of matching required payments with existing projects, identifying a short-term loan pool, and involving flexible philanthropic capital in the process.

The Lab's market rate and nonprofit developers discussed mutually beneficial improvements to existing policies. Chicago's ARO, for example, leverages market rate development to build affordable units. Policymakers have modified initial versions of the law, but developers have identified still more room for improvement. Current policy allows developers to build the units or pay an in-lieu fee to a government-managed fund. A suggestion that resonated with Lab participants was to match in-lieu payments to funding gaps in existing affordable housing projects. As noted previously, the ARO requires market-rate developers to build the units themselves, and preservation of existing units does not count toward the requirement. The Small Business Center or some other city entity could organize a database of pre-approved affordable housing projects that can accept the ARO in-lieu fees to fill financing gaps. It is important to facilitate funding for projects already underway or naturally occurring.

Turner Multifamily Impact Fund: Using Private Capital for Public Good

The Turner Multifamily Impact Fund was launched in 2015 with the purpose of "acquiring, preserving, and enriching apartment communities for working individuals and families," that is to say, people who earn too much to qualify for government-subsidized housing yet struggle to keep up with surging rents.⁴¹ This category of housing is often called workforce housing; household income comes up to 80 percent of area median income.⁴² The fund works in urban areas across a handful of states, including Maryland, Illinois, Texas, Georgia, and Nevada, and has acquired 6,000 housing units in locations selected because they are near public transportation and employment.

The fund acquires apartment complexes and then enhances them with additional community services, including supplemental education, health care, and security staffed by residents. By leveraging the expertise of the residents, the fund lowers operating costs and minimizes insurance premiums.⁴³ The fund is offered to investors in a private equity vehicle and targets risk-adjusted returns of 10-12 percent net of fees.⁴⁴ The city should look to the Turner model as an example of utilizing the similar skills of public housing tenants as a way to improve the communities around the properties its agencies manage.

Developer participants commented on the challenge of meeting certain milestone payments. For example, investors may require a payment once construction has been completed. However, at this stage, leases are often not yet signed, and because the building is empty, there is no revenue source.

Attracting sources of capital to fill these kinds of gaps between the most common layers of affordable housing finance would help to deliver completed projects. The Ohio Housing Finance Agency, for example, established its successful Housing Development Loan Program to offer short-term, low-interest loans to developers who have secured housing credits through either the competitive LIHTC or its Bond Gap Financing (BGF) program. The loans provide interim financing for deferred equity. The program holds \$150 million, with a maximum loan size of \$2 million and a requirement of sufficient collateral to ensure repayment.⁴⁵ If Chicago could aggregate a small amount of low-cost capital—such as a portion of Community Development Block Grants or HOME (a federal block grant for the creation of affordable housing)—to serve as a revolving bridge loan program, it could alleviate a burden for developers and allow them to limit pre-development costs that grow the longer a deal takes to complete. Once the initial stages of a deal are completed, the short-term loan can be repaid and recycled into a new deal.

For impact investors, such as those providing foundation or high-net-worth capital, pooling funds to function as a takeout financing vehicle would also facilitate the timely delivery of housing. Development deals that produce positive cash flows would be able to repay the investment as equity, whereas those with slimmer margins could use the equity injection as a grant to meet mission-driven investor goals. Sites and projects that leverage philanthropic investment and are not dependent on public-sector assistance would streamline a solution to the affordable housing emergency.

Next Steps:

- Enable relationships between developers of market rate and affordable housing, and ensure that rehabilitation and preservation of existing housing are encouraged through current programs. Given the city's oversight of the permitting process, the Mayor's Office is in a unique position to lead this effort.
- Establish a revolving short-term bridge financing fund to cover pre-development costs, and allow more proactive land or asset acquisition strategies from mission-driven developers.
- Pool philanthropic investment for developers to leverage as a takeout financing option.

Conclusion

The Financial Innovations Lab was part of an ongoing dialogue to address Chicago's affordable housing needs. The discussion among government agencies, private investors, market rate and nonprofit developers, legal experts, and community groups produced new ideas to help meet the demand. Outlined in this executive summary are the key recommendations from the Lab, including next steps on how to prioritize place-based policies, source innovative equity pools of capital, de-risk early investment, and establish revolving sources of later-stage financing. Follow-up items could include additional working groups and research to develop the recommendations, as well as continued conversations among experts and stakeholders.

Acknowledgments

IN COLLABORATION WITH



This executive summary was prepared by Maressa Brennan.

We are grateful to those who participated in the Financial Innovations Lab for the contributions to the recommendations summarized in this report.

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