

AN INVESTMENT LETTER FOR MINNESOTA PHILANTHROPISTS

Thursday, January 15, 2004

This issue begins a new series of the “Investment Letter for Minnesota Philanthropists” which will focus on the issue of “affordable workforce housing”. In contrast to the returns derived from our analysis of workforce development organizations, the investor in affordable workforce housing must have a somewhat longer investment time horizon. Mortgage lending institutions recognize this when loans are made over a twenty-five to thirty year time frame.

The purpose of “An Investment Letter for Minnesota Philanthropists” is to demonstrate how return on investment calculations can be applied to the private and public investment we make in our non-profit organizations. Opinions will vary widely on assumptions and methodology. We know intuitively that society and the economy benefit from well thought out social investment. However, accounting systems have yet to be developed that make the financial returns transparent.

“The Third Way Network” mobilizes church based and other neighborhood groups to locate and produce affordable rental units by refurbishing under utilized space that exists in private homes. The philanthropic investors in “Third Way Network” can achieve attractive financial returns for our communities with a relatively modest investment plus add a new unit of housing to the neighborhood..

WHAT’S THE PROBLEM?

- The lack of affordable workforce housing impacts the desired growth of our Twin Cities labor force (some estimate by as much as \$ 1 billion annually in lost consumer purchasing power and lost income to business) and creates a drag on the economy from concentrations of poverty that makes neighborhood revitalization difficult
- Approximately 17% of Metropolitan Area residents (171,000) lack affordable housing which both the private and public sector define as a family having to spend more than 30% of its income on housing.
- The 2003 study by the Minnesota Housing Finance Agency, Greater Minnesota Housing Fund and Family Housing Fund projects an additional 22,000 families will be without affordable housing by the year 2010 if current trends continue.
- According to the 2000 census the Twin Cities seven counties fell in the top 1% of all U.S. counties for lowest vacancy rates.
- In the fall of 2001 two private sector real estate research firms (Maxfield Research, Inc. and GVA Marquette Advisors) projected that 31,700 new affordable units would have to be built over the next five years to satisfy the regions workforce housing needs.

HOW DOES “THIRD WAY NETWORK” HELP?

- The excess space in a single family home is used to create a two bedroom 1,200 square foot affordable apartment that can rent for \$500/month or less.
- Construction costs can be limited to approximately \$40,000 per unit since much of the work is comparable to remodeling a basement plus the requirements to bring the space up to code. Volunteer assistance also helps reduce costs.
- Neighborhood volunteers are trained and assist with project or site identification, family support, local group organizing and training and program management expense.
- The more conservative estimates project a total of 5,000 metropolitan units that could be converted to this type of low cost highly affordable rental housing.
- Quality workmanship is assured by the two to three year time frame from project identification to completion.. Continuity is provided to the project and the new family by the local sponsoring group which is often church based in the immediate neighborhood.
- The property owner, in most cases lower income families, benefit from the \$500 per month rental income. \$6,000 per year is a significant addition to the average household budget in the cities. It is the equivalent of a \$2.50/hour raise.
- The “Third Way Network ” derives its name from not relying upon large governmental sponsored housing programs or more expensive subsidized market rate programs. The “Third Way” counts on neighborhood volunteerism and private sector contributions.
- Performance to date is encouraging. One church group involved 120 volunteers organized into four work groups and has already completed two projects with a goal of completing eight more. Another has adopted the program as the statewide strategy for the entire denomination!
- “Third Way Network is training an entirely new cadre of urban and suburban neighbors who bring neighborhood sponsorship and know how to affordable workforce housing in a manner that overcomes traditional fears associated with the NIMBY (not in my backyard) syndrome.
- Reductions in government funded social service support come as a result of the large group of volunteers engaged in the program plus the fact that rents are affordable at \$500/month removing stress from the balance of the family’s budget.

WHO BENEFITS?

- The Minnesota Economy benefits as healthy families can afford the type of housing that promotes greater stability at home, in the neighborhoods, in our schools and at the workplace.
- Minnesota taxpayers benefit from programs that produce income for the family renting out newly designed space and reductions in social service system expenses as families become more self sustaining from rents that are affordable.
- Expanding Minnesota businesses gain workers who can afford to live here and consume the products and services produced and sold throughout the state.

WHAT'S THE RETURN ON INVESTMENT?

In these calculations we have assumed a growing economy with each new housing unit adding about \$14,000 in spending as consumers and \$16,000 as producers for business to the economy each year. Wages are assumed at \$10.00/hour. Business profit margins are assumed at 5% and corporate taxes have not been calculated and are included as part of the return generated by business. We assume 20% of new spending is subject to sales tax and that 70% of the gain in home value from new construction pays real estate tax at 1%. The reduction in social service support and other economic costs (housing/shelter assistance, health care, school performance, day care availability, work performance and criminal justice system) are estimated to be \$3,000/year. Rents at or below \$500/month permit the family budget to meet basic needs and thus avoid significant social service support costs. We have not added the assessed value of the enhanced property in the return on investment calculations nor have we considered the charitable deduction taken by taxable contributors in the calculations. Total philanthropic contributions average \$25,000 per unit.

Using these assumptions a philanthropic investment in “Third Way Network” achieves breakeven in five years and generates a 68% return to the system by year ten (or 6.8% average annual rate) and a 235% return by year thirty (or 7.8% average annual rate). The after tax return generated by the individual philanthropic investor would approach 9 to 10% annually over these time periods.

It is clear that a host of conditions improve for the family when housing needs are stabilized. The cost of emergency housing for example is very high totaling as much as \$2,400 per month. The returns for the “Third Way Network” investor rise dramatically when a family living in an emergency shelter is placed in their new home.

CALCULATING THE RETURN ON INVESTMENT

Assumptions:

Individual type = Individual or individual with family

Family Income = Range from \$16,000 to \$30,000

Maxfield Research/GVA Marquette Advisors = Report of September 2001 used as basis for economic contribution to the economy for the consumption and production contributions of each new family household.

Third Way Network= Report of August 2003 used as a basis for construction costs and dollar contributions required from foundations and individual contributors.

Social Service Cost Reductions = Government studies and community experience.

Star Tribune= Editorial of May 2002 basis for monthly cost estimate of homeless shelter.

Present Values: (5% discount rate)	<u>30 years</u>	<u>15years</u>	<u>10years</u>	<u>5years</u>	<u>1year</u>
Gain in consumer spending & business income per unit built	\$460,000	\$310,000	\$230,000	\$130,000	\$30,000
Gain in corporate profits (from consumer spending & business income per unit built)*	24,000	17,000	13,500	9,000	4,600
Gain from sales tax	6,100	4,200	3,000	1,750	400
Gain from real estate tax	4,600	3,100	2,300	1,300	300
Gain from reduced social service costs	<u>46,000</u>	<u>31,000</u>	<u>23,000</u>	<u>13,000</u>	<u>3,000</u>
<u>Total Benefit</u>	<u>\$84,000</u>	<u>\$55,000</u>	<u>\$42,000</u>	<u>\$25,000</u>	<u>\$8,300</u>

*includes impact of year one construction spending

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