Steve Minn

Inclusionary zoning ordinance in Minneapolis is 'unfunded mandate' for developers

A Minnesota Affordable Housing Policy Interview

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Lupe Development's Steve Minn discusses his concerns about the permanent inclusionary zoning ordinance currently being considered by the Minneapolis City Council. He also stresses the importance of maintaining naturally occurring affordable housing (NOAH) as one solution to the issue of providing affordable housing.

Present

Tom Abeles, John Adams, Janis Clay (executive director), Pat Davies, Paul Gilje, Steve Minn, Lee Munnich, Paul Ostrow (chair), Dana Schroeder (associate director), Walt Seibert, Clarence Shallbetter, T Williams. By phone: Randy Johnson.

Summary

Lupe Development Partners Vice President and Chief Financial Manager Steve Minn believes the permanent inclusionary zoning ordinance now under consideration by the Minneapolis City Council will have several negative impacts on the supply of both affordable housing and market-rate housing in the city. He also says the city has not been willing to listen to the voices of housing developers in its deliberations.

Inclusionary zoning policies are mandatory or voluntary programs at the state and municipal level that require or incentivize the development of affordable housing alongside market-

rate units. The policy Minneapolis is considering would be mandatory. The city passed an interim inclusionary zoning ordinance a year ago and is now considering making the ordinance permanent. Proponents of inclusionary zoning say it will ensure that affordable housing is included in new residential or mixed-use developments.

Minn is critical of the City Council's approach and says negative impacts of the proposed permanent inclusionary zoning policy include: (1) investors who choose to stay in this market will reduce building new housing units and, instead, start to acquire vintage existing affordable housing and turn it into market-rate housing; (2) the regulations will eliminate the supply stream; and (3) developers will decide to build under the threshold that triggers the requirement for inclusionary housing.

Minn believes the best way to provide affordable housing is to preserve the naturally occurring affordable housing (NOAH) that we already have. He discusses how NOAH units are disappearing as investors buy up the units, renovate them and raise the rents to market-rate levels.

He discusses the impact of a shortage of construction workers on the rising cost of housing and believes we must recruit high school students-particularly those in inner-city schools-to train in the construction trades.

Biography

Steve Minn is vice president and chief financial manager of Lupe Development Partners, a for-profit, Minneapolis-based firm founded in 1989 that plans, designs and manages residential and mixed-use real estate development projects in the Twin Cities urban core. He directs the planning, acquisition, budgeting, finance and other aspects of the business. Since 2002, Minn has managed the development and construction of more than 1,500 units of housing and more than 2.5 million square feet of mixed-use, commercial and industrial property.

Minn has more than 35 years of real-estate development experience and a varied career in state and municipal government and has an expertise in affordable housing. He served on the Minneapolis City Council from 1994 to 1999, when he joined the Governor Jesse Ventura administration as Minnesota Commissioner of Public Service. He then served as Minnesota Commissioner of Commerce from 2000 to 2001 and served as a Minneapolis Public Housing Authority commissioner.

Minn has served on several civic boards, including the Minnesota Environmental Quality Board and commissions or committees at the University of Minnesota, the Minneapolis

Community Development Agency and the Mississippi River Critical Area. He was a founding director of Bloomington-based Bridgewater Bank. He is currently a member of the Aeon Construction and Summit Academy advisory boards.

He and Lucy Brown Minn, president and CEO of Lupe Development, focus their support on organizations that provide hands-on training, crisis intervention and job-readiness skills in the construction trade, among other training opportunities, including WomenVenture, Youthlink, Aeon, the Northside Achievement Zone, Summit Academy and MicroGrants.

Minn earned a bachelor's degree in management from Syracuse University and a master's degree in business administration in urban development/finance from the JL Kellogg Graduate School of Management at Northwestern University.

Background

The Civic Caucus has been focusing on the topic of affordable housing in its interviews since late October 2018. All of those interviews are available on the Civic Caucus website. The Caucus interviewed Steve Minn to learn about the operation of Lupe Development, a for-profit market-rate and affordable housing developer, and to get his perspective on issues surrounding housing for people with low incomes, including inclusionary zoning.

About Inclusionary Zoning. Since a significant part of Steve Minn's interview was devoted to a discussion of inclusionary zoning-also known as inclusionary housing-the following paragraphs offer some background on the topic.

According to a National League of Cities March 2019 report, *Local Tools to Address Housing Affordability: A State-by-State Analysis,* inclusionary zoning policies are "programs at the state and municipal level that require or incentivize the development of affordable housing alongside market-rate units. These policies can either be voluntary or mandatory, depending on the state or city. Mandatory inclusionary housing programs require developers to include affordable units in their building plans in order to obtain development rights for market-rate housing. In voluntary programs, developers earn incentives like tax breaks and density bonuses, in exchange for including units in their developments for sale or rent below market-rate."

A short National League of Cities blog post about the report notes that cities in 20 states, plus the District of Columbia, are permitted to create mandatory or voluntary inclusionary zoning policies. In 10 of those states, at least one city has implemented a mandatory inclusionary housing policy.

According to the post, 22 states-including Minnesota-impose either limitations on city inclusionary housing policies or legal barriers to implementing inclusionary housing policies, especially mandatory programs. In Minnesota, the state prohibits cities from enacting rent control, but allows cities to establish sales prices or rents for low- and moderate-income affordable housing. The state also allows equity sharing to maintain the long-term affordability of the affordable units. These provisions, the report says, make it possible to implement inclusionary housing policy, but it's limited to development projects receiving public subsidy or a zoning change.

The post says that eight states expressly prohibit cities from enacting local inclusionary zoning measures, although some states permit cities to establish voluntary policies through which developers can be incentivized to create more affordable housing. The report offered the example of the city of Austin, Texas, which offers developers waivers, density bonuses, tax breaks and development agreements if they set aside affordable housing units for low- and moderate-income households.

Discussion

1. Lupe Development Partners.

Lupe Development Partners has produced 1,200 affordable housing units in the Twin Cities metro area. Lupe Development Vice President Steve Minn mentioned several examples of Lupe's housing projects, among them: Stone Arch Apartments and Broadway Flats, both in Minneapolis, and Eastside Apartments in Saint Paul. Lupe employs five people in its office and 30 to 40 people at its properties. Minn said his company's production capacity is 100 housing units a year.

He said Lupe is trying to develop housing along transit corridors with bus rapid transit or light-rail transit (LRT) in an effort to get out of building parking, which he said is very expensive.

Lupe develops workforce affordable housing. Minn said most of Lupe's affordable housing is developed using federal low-income housing tax credits (LIHTC). The program gives four percent or nine percent tax credits for 10 years to investors in affordable housing projects. Developers using LIHTC must guarantee that the housing remains affordable for 30 years. (For more information on LIHTC, see notes from the June 21, 2019, Civic Caucus interview with Dominium Housing's Owen Metz and Paula Prahl.)

Minn said the tax credits really depend on the developer generating enough income at the property level "to pay most of the freight." Workforce affordable housing residents are people who are at 60 percent or less of the average median income (AMI) in the nine-county metro area, he said, explaining that the AMI is almost $100,000 for a family of four. But, he said, in Hennepin and Ramsey Counties, which contain the two core cities, the income level is not that high. There the AMI, he said, is probably closer to about $59,000 to $62,000.

But as far as the federal government is concerned, Minn said, the $100,000 AMI holds for all nine metro counties. "The expectation is that we'll be able to generate more revenue in the core-city counties; the reality is we don't," he said.

He said workforce housing means a good share of his projects are aimed at the 60 percent of AMI target, as opposed to a 50-percent target or a 30-percent target. For a couple, the 60 percent works out to an income of $35,000 a year to qualify.

He said the 60-percent units rent for about $900 to $1,200 a month for a two-bedroom apartment. The one-bedroom units rent for about $800 to $925 a month. That includes electricity and heat.

Lupe applies to the Minnesota Housing Finance Agency (MHFA) and other state /regional/local sources for each of its housing projects. Minn said Lupe has won MHFA financing for two projects of the 10 for which it has applied over the last 10 years. He said last year the MHFA only provided financing for 28 housing projects statewide-two of them in Minneapolis and one in Saint Paul. "The need is great and the resources scarce," he said.

A healthy market is where both affordable and market-rate housing are being built. Minn made that statement and said building market-rate housing will help increase the housing supply; building affordable housing will help target the problem of housing for low-income people.

2. Existing tools in Minneapolis for developing affordable housing.

The City of Minneapolis has one of the best tool boxes in the country for increasing the supply of affordable housing. Minn made that statement and said, "The city has done all that it could and more. The city's been forward-thinking on the finance side and the staff has been on the cutting edge on the finance side. The tools available in Minneapolis are more flexible than in any other city in the state or even the region. The problem is that the concentration of the need is overcoming the ability to fund in any reasonable environment."

Minn said Minneapolis has had an Affordable Housing Trust Fund for nearly a decade. The sources of the fund's money are (1) Community Development Block Grant (CDBG) money, which is federal direct-to-city money; (2) HOME money, which is the HUD allocation for housing; and (3) city levy funds. The total is around $10 million a year, he said. The $40 million Mayor Jacob Frey budgeted for affordable housing this year is a one-time lump sum.

The City of Minneapolis is generally fair in its fees and costs for developers, Minn said. Lupe spends about $1 million in fees for a 100-unit affordable housing project, he said. "I pay the city plenty just to get in the hole."

3. Inclusionary zoning in Minneapolis.

The Minneapolis City Council is considering making its interim inclusionary zoning ordinance-passed in 2018-permanent. Minn said the inclusionary zoning initiative is being led by City Council President Lisa Bender, aided by Council members Cam Gordon and Jeremy Schroeder. The City Council is scheduled to vote on the permanent ordinance on December 13, 2019. Proponents of inclusionary zoning say it will ensure that affordable housing is included in new residential or mixed-use development.

"The City Council is trying to compete with Portland, Seattle and San Francisco," Minn said. "They aren't us."

He said the Council hired an inclusionary-zoning advocate, Grounded Solutions Network of Portland, as its consultant on the zoning ordinance. He said the firm has done inclusionary zoning consulting in 30 cities around the country. In each one, he said, they have recommended inclusionary zoning.

Under mandatory inclusionary zoning, he said, developers must include income-restricted housing in order to get approval to build an otherwise market-rate development. (See "About Inclusionary Zoning" section above, prior to the Discussion section.)

Inclusionary zoning imparts a burden of income-restricted housing on top of market-rate housing in order to get market-rate housing approved. Minn made that statement and said, "With inclusionary zoning, the burden is being shifted to private developers rather than government," he said. "It's an unfunded mandate, unless there's aid that comes with it." He said some communities around the country have attached subsidies for developers adding inclusionary housing units.

Minn said Minneapolis-at least in its interim ordinance-chose to say that developers will have to bear the cost of the first 10 percent of units at 60 percent of AMI that they will be required to provide. If a developer chooses to include 20 percent of units at 50 percent of AMI, the city will provide some tax-increment financing (TIF) for the development. "Unfortunately," Minn said, "that doesn't work. Neither works."

He said developers have been trying to tell the City Council that the complexities of urban development finance are well prescribed in market function. "The Council is trying to legislate against market function," he said. "Markets tend to not react favorably to legislation that defies market function." People will go elsewhere, he said.

Minn said 90 percent of housing in Minneapolis-market-rate or affordable-is produced with outside investors' money, largely from pension funds, insurance funds and real-estate trusts. "They all are chasing yield," he said. "If yield is reduced, they'll look for markets where yield is better. Right now, Minneapolis is a very robust marketplace and yield has been very strong. So we've had an influx for the last decade of investor money into this market for both market-rate and affordable housing. But if yield is compressed and other markets look more attractive, those investors will go elsewhere."

The inclusionary zoning legislation, Minn said, will have three major negative impacts:

- If investors choose to stay in this market, they'll start to acquire vintage existing housing and turn it into market-rate housing. Minn said, "We're already seeing that. The precipitous decline of existing naturally occurring affordable housing (NOAH) will accelerate." He said investors will buy up these older apartment buildings from the 1960s, 1970s and 1980s-that have evolved into NOAH, remodel them and turn them into market-rate housing.

- The regulations will eliminate the supply stream. "The more supply there is, the price will go down," Minn said. "The more housing is cannibalized-while, at the same time, we're producing less new housing-the higher rents will be.

- Developers will decide to build under the threshold that triggers the requirement for inclusionary zoning.

The current Minneapolis City Council has it in for developers in a way that isn't productive. Minn made that statement and said the City Council does not want public hearings. "They have refused to have a public hearing where the development community can actually present our proposals," he said. "The adoption of the interim ordinance did have a public hearing in 2018. Speakers were limited to three minutes after the consultant had an hour to present. The development industry was not allowed to offer a counter-proposal, nor a formal industry alternate presentation."

Minn clarified that there was no public hearing on the interim ordinance in front of the whole City Council. Instead, the public hearing was held in front of the city's Planning Commission, which, he said, meets the statutory requirement for a public hearing. "But the Planning Commission has no power," he said. "There's only one Council member on the Planning Commission."

He said the permanent ordinance adoption will have a public hearing before the Planning Commission and then be reviewed in two City Council committees without public hearing, followed by a full Council vote.

"The purpose of having the public hearing at the Planning Commission is so the public record doesn't show what developers have told the City Council," he said. "They're using the Planning Commission as a shield. They don't want to confront us."

Minn said the Council has refused to have public hearings to challenge the consultant's report and to hear from large and small nonprofit and for-profit housing developers, who have formed an organization called Building Minneapolis Together.

Why does the Minneapolis City Council think the 2040 Plan is a good idea? An interviewer asked that question and Minn replied that it's a philosophical or ideological divide. "There's nobody on the Council with any business experience," he said. "They don't understand the financing of housing. There's a fundamental ideological divide as to whether anyone should make money from housing. But they don't price risk and the risk is all on my side."

An interviewer commented that there are lots of people in Minneapolis who have a steep learning curve in front of them. "We must find common ground," the interviewer said. "We need someone who can step in and do some peacemaking. If we want a public hearing to take place at the City Council, not at the Planning Commission, we can do that."

"I disagree that people are just learning," Minn responded. "There's a large amount of hubris on this City Council. They're all newbies and they don't know much. They should say, 'Tell me more,' not 'This is how it should be done.'"

There's no build-by-right process in Minneapolis. Minn said all development requires land-use approval. Typically, he said, a developer needs a conditional-use permit, variances and land-use approvals for each project.

Lupe is building a housing development at Garfield Avenue S. and W. Lake Street, he said. The development's Phase 1 is already under construction. He said it includes 111 housing units, which are all totally affordable. Ten units are set aside for homeless veterans. Minn said Lupe wants to do the same thing in Phase 2 and build market-rate housing in Phase 3.

"Inclusionary zoning caught me in Phases 2 and 3," he said. "The city staff told me I could go ahead with Phase 2 as planned, but I'd have to do 10 percent affordable housing units in the Phase 3 market-rate development. I have 222 affordable units right next door. Why doesn't phasing meet the requirement for affordable housing?" The staff told him the inclusionary zoning policy didn't allow it.

"So, what are my choices?" Minn asked. "I can build under the threshold under which the inclusionary zoning requirement is triggered. So, instead of building 111 units of affordable housing in Phase 2 and 93 units of market-rate housing in Phase 3, I could do 52 units of market-rate housing in Phase 2 and 48 units of market-rate housing in Phase 3. So, we get half the development and no affordability."

"Why is that in the public interest?" he asked. "That will be the outcome of inclusionary zoning. We'll build under the threshold."

Operating costs vary for market-rate housing versus affordable housing. Minn said for market-rate housing, operating costs make up 35 percent of the revenue. For affordable housing, he said, operating costs make up 40 to 50 percent of revenue.

He said the nonprofit affordable housing developers take less profit and thus can serve lower-income residents-concentrated at 50 percent or 30 percent of AMI. Under new rules put in place by the Trump administration, Minn said, developers using LIHTC can now do income-averaging for affordable housing. He said that means they can average units built for people with incomes at, say, 30 percent of AMI with units built for people at, say, 80 percent of AMI, to make the development qualify as affordable to people at, say, 60 percent of AMI.

4. Naturally occurring affordable housing (NOAH).

The cheapest, most effective way to get affordable housing is to preserve what we already have. Minn made that comment and said that as drafted now, the inclusionary zoning policy wouldn't change existing housing in any regulatory sense. But, he said, it would make existing affordable housing dramatically more attractive to investors to purchase, renovate and take to market at higher rents.

He said today it costs $250,000 to $300,000 to build a one-and-a-half to two-bedroom market-rate housing unit, he said. But it would cost only $100,000 to $125,000 to buy an existing naturally occurring affordable housing (NOAH) unit, he said, plus about $25,000 to renovate it and bring it to market-rate rents.

And, he said, under the inclusionary zoning policy, a developer building new market-rate housing will have to take 10 percent of the profits and invest them into affordable units that won't be profitable. "Existing affordable housing units are going to get cannibalized," Minn said. "And we're not going to get new housing built to offset that loss.

In terms of solving the affordable housing problem, Minn said, "There's not enough money to pay for new public housing for people with the lowest of incomes. There isn't going to be enough money ever to build our way out through new production. We have to focus on preservation if we're going to solve the problem. In the metro area, we've lost 5,000 units of NOAH in the last three years. That is going to accelerate."

The nonprofit housing develop Aeon is one of the leading purchasers of NOAH in the metro area. Under a partnership, Minn said, Aeon and the Greater Minnesota Housing Fund formed the NOAH Fund. "They are actively participating in the normal market function of buying properties at market prices," he said. "The fund comprises investors who will take less yield."

(See notes of the September 20, 2019, Civic Caucus interview with Alan Arthur, CEO and president of Aeon.)

The development community suggested to the Minneapolis City Council that the public sector could also buy NOAH units . Minn said the developers proposed that instead of the city requiring 10 percent affordable housing units in new developments, they could invest that same 10 percent into the city's Affordable Housing Trust Fund, a public fund that could buy existing affordable housing units and preserve them. He said if developers did that, they should, as investors, get some of the benefits of the LIHTC program and of depreciation. "It's like talking to a wall, though," he said.

5. Construction labor shortage

Construction costs are going up because there is a dearth of labor coming into the industry to fill the trade spots. Minn made that statement and said he supports organizations like Summit Academy, which has a construction training program. He said Lupe has funded a total of 50 Summit graduates over the last three years. The company continues to support Summit's recruiting and training of construction trainees. It encourages placement of Summit graduates on Lupe construction sites. A total of 12 such graduates have worked on recent Lupe projects, Minn said.

He said there's a shortage of people going into the trades and the unions aren't very good about recruiting in the inner-city high schools. "I'm telling Summit Academy to get into the high schools and tell these kids-before they find drugs as their career-that they can make $50,000 or $60,000 a year as a second-year carpenter," Minn said. "And a lot of master carpenters are making $100,000 a year."

He said kids need to know they don't have to go to college and that trade school is honorable and leads to good living. "We're not doing enough of that," he said. "It's a real problem."

6. Conclusion.

"Everybody wants to solve the problem of affordable housing," Minn said. "There is an ideological divide as to whether developers are entitled to make a profit doing it."