The MTO Fund:
Harnessing the Market to Promote Opportunity and Inclusion

Hans Buder, The Moving To Opportunity Fund

Despite decades of persistent effort, the challenges confronting community development practitioners in the housing space are perhaps greater than ever. There are 4.25 million low-income children growing up in neighborhoods of concentrated poverty; the country is in the grip of a crushing affordability crisis, with families in the bottom income quintile spending over half of their income on rent;[1] and social mobility, which rose steadily throughout the postwar period, has been declining for almost 40 years.[2] The federal government currently spends almost $50 billion a year on housing-related programs for low-income families,[3] but with ballooning federal deficits and a notable lack of broad-based political will, the prospects for significant spending increases are limited. Given these realities, we are left with two operative questions. First, how can we increase the impact of existing expenditures by using those dollars more effectively—in other words, how can we do more with what we already have? And second, how can we bring additional resources to bear by harnessing market mechanisms and leveraging private capital? This essay describes one particular strategy for achieving these goals, outlining an "opportunity acquisition model" that has been consciously designed to attract capital from mainstream institutional investors by fusing frameworks drawn from real estate private equity with best practices from mixed-income development, and exciting new research detailing the life-changing benefits that exposure to high-opportunity neighborhoods can have for low-income children. Still in its infancy, the mission of our organization, The Moving to Opportunity Fund (MTO Fund), is to pioneer a scalable impact-investing model capable of putting low-income children born into concentrated poverty on the path to college, by providing access to service-enriched, mixed-

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[1] Jeff Larrimore and Jenny Schuetz, "Assessing the Severity of Rent Burden on Low-Income Families," Board of Governors of the Federal Reserve System: *FEDS Notes* (December 22, 2017), https://www.federalreserve.gov/econres/notes/feds-notes/assessing-the-severity-of-rent-burden-on-low-income-families-20171222.htm.

[2] Jonathan Davis and Bhashkar Mazumder, "The Decline in Intergenerational Mobility After 1980," working paper 17-21, Opportunity & Inclusive Growth Institute, Federal Reserve Bank of Minneapolis, MN (2017), https://www.minneapolisfed.org/institute/working-papers/17-21.pdf.

[3] In 2018, federal spending on housing-related programs for low-income families included: $22 billion for the Housing Choice Voucher program, $11.5 billion for Project-Based Section 8, $7.3 billion for Public Housing, and $8.1 billion (in foregone tax revenue) for the Low-Income Housing Tax Credit program. This equates to roughly 8 percent of all non-defense discretionary spending, which totaled $610 billion in 2017. See: "Housing," Center on Budget and Policy Priorities, accessed May 22, 2019, https://www.cbpp.org/topics/housing; Corianne Payton Scally et al., *The Low-Income Housing Tax Credit,* Washington, DC: Urban Institute (September 2018), https://www.urban.org/sites/default/files/publication/98761/lihtc_past_achievements_future_challenges_finalized_0.pdf.

income housing in high-opportunity communities with top-ranked public schools—and to so do while delivering market-rate returns for investors.[4] What follows is a brief overview of our approach and its underpinnings. A preliminary section outlines the growing disconnect between research findings, and the manner in which traditional affordable housing strategies are being implemented. The second section explains the rationale for a private-sector solution, underscoring the magnitude of the potential impact. The third section represents the heart of the essay, outlining our vision for the MTO Fund in greater detail and providing an overview of key components of the model: our approach to family recruitment, the mobility counseling and supportive services that we intend to offer, and our investment strategy. A fourth section identifies the constraints imposed by our double-bottom-line approach and walks through how we designed our model to satisfy those constraints and maximize our potential impact. The essay concludes with an examination of the operational challenges that we anticipate, with a final section proposing implications for action.

Traditional Place-Based Affordable Housing: A Disconnect Between Research and Practice

These days it is virtually impossible for an informed American to get through the week without encountering a commentary lamenting rising social inequality and declining social mobility. Perhaps even more alarming, however, is the rise of residential segregation by income, which has been increasing for nearly four decades.[5] Put simply, upper- and lower-income Americans are less and less likely to live near one another, to be friends with one another, to coach Little League together, or to send their kids to the same schools. And while the ramifications are troubling across the board, the consequences of this growing segregation are particularly disturbing at the bottom of the income distribution, as evidenced by the fact that the number of low-income Americans living in neighborhoods of concentrated poverty *more than doubled* between 2000 and 2014.[6] A robust body of social science evidence demonstrates that growing up in this kind of concentrated poverty is extremely damaging for low-income children—resulting in higher dropout rates, negative health outcomes, and diminished economic mobility.[7]

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[4] "Overview," The MTO Fund, accessed May 22, 2019, https://www.mtofund.org/.
[5] Richard Fry and Paul Taylor, "The Rise of Residential Segregation by Income," Washington, DC: Pew Social & Demographic Trends (August 2012), https://www.pewresearch.org/wp-content/uploads/sites/3/2012/08/Rise-of-Residential-Income-Segregation-2012.2.pdf; Gregory Acs et al., "The Cost of Segregation: National Trends and the Case of Chicago, 1990-2010," Washington, DC: Urban Institute (March 2017), https://www.urban.org/research/publication/cost-segregation/view/full_report.
[6] Elizabeth Kneebone and Natalie Holmes, "*U.S. Concentrated Poverty in the Wake of the Great Recession,*" Washington, DC: Brookings Institution (March 2016), https://www.brookings.edu/research/u-s-concentrated-poverty-in-the-wake-of-the-great-recession/.
[7] George C. Galster, "The Mechanism(s) of Neighbourhood Effects: Theory, Evidence, and Policy Implications," in *Neighbourhood Effects Research: New Perspectives,* eds., Maarten van Ham, David Manley, Ludi Simpson, and

And yet, rather than combating the problem, federal housing programs have instead substantially exacerbated it. Indeed, despite the research findings, traditional place-based affordable housing models such as the Low-Income Housing Tax Credit program (LIHTC), public housing, and Project-Based Section 8 continue to provide financing for housing that is almost exclusively low-income, rather than mixed-income, and that is overwhelmingly concentrated in higher-poverty neighborhoods, trapping kids in failing schools and perpetuating the cycle of poverty. The numbers are striking. For all of the buzz in community development circles about mixed-income development, 95 percent of units in LIHTC-financed properties are low-income units,[8] and most public housing projects are essentially 100 percent low-income. The school quality findings are equally dismal. The average LIHTC development feeds into a public school ranked in the 31st percentile, in which 67 percent of students qualify for free or reduced-price lunch, and the average public housing and Project-Based Section 8 sites feed into schools that rank in just the 19th and 28th percentiles, respectively (See Figure 1).[9] Perhaps unsurprisingly, given this bleak portrait, traditional place-based affordable housing models do not meaningfully enhance economic mobility for low-income children: they neither raise lifetime earnings for kids nor narrow the achievement gap in education.[10]

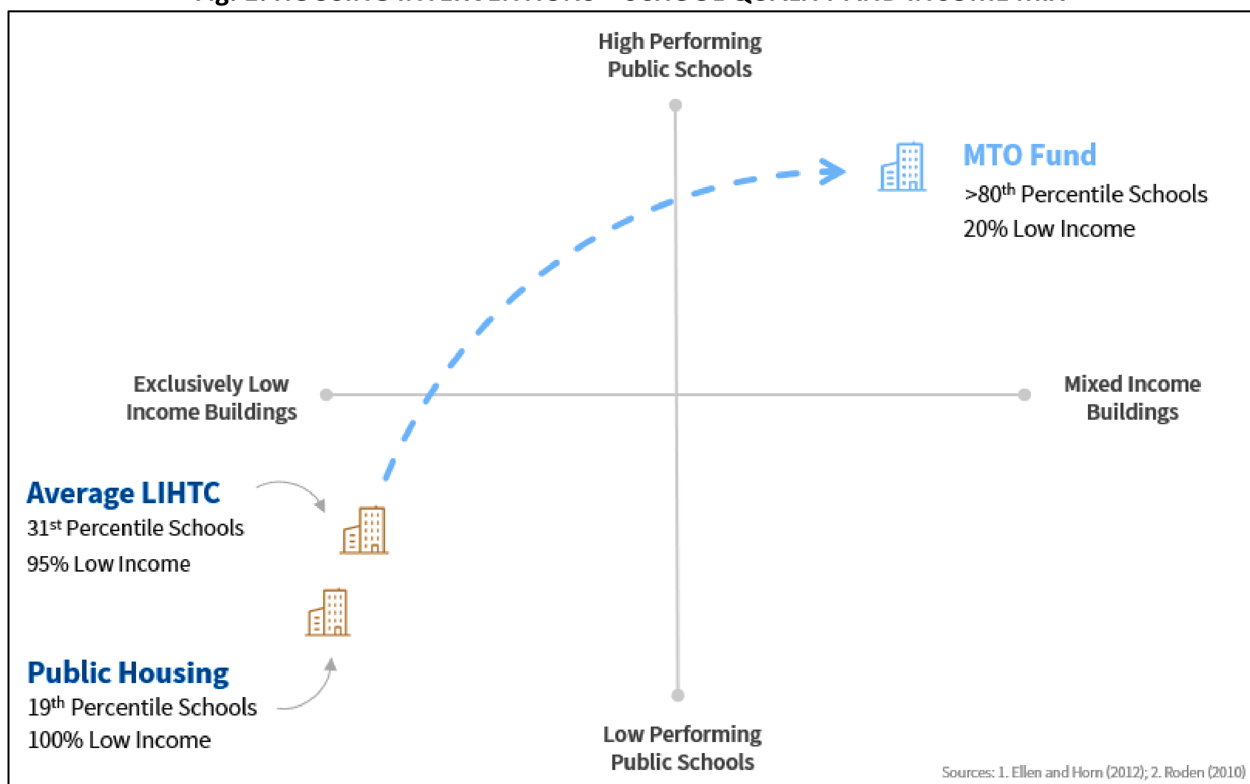
Duncan Maclennan, London, UK: Springer, Dordrecht (2012): 23-56, https://link.springer.com/content/pdf/10.1007%2F978-94-007-2309-2.pdf.

[8] Amy Roden, "Building a Better Low-Income Housing Tax Credit," *Tax Notes* (April 2010): 210, http://www.aei.org/wp-content/uploads/2011/10/TaxNotesRodenApril2010.pdf.

[9] Ingrid Gould Ellen and Keren Mertens Horn, "Do Federally Assisted Households Have Access to High Performing Public Schools?" Washington, DC: Poverty & Race Research Action Council (November 2012), http://furmancenter.org/files/publications/PRRACHousingLocationSchools.pdf.

[10] Robert Collinson, Ingrid Gould Ellen, and Jens Ludwig, "Low-Income Housing Policy," NBER Working Paper Series, Working Paper 21071, National Bureau of Economic Research, Cambridge, MA (April 2015), https://www.nber.org/papers/w21071.pdf.

Fig. 1: HOUSING INTERVENTIONS – SCHOOL QUALITY AND INCOME MIX



Fortunately, recent research demonstrates that housing interventions that provide low-income children with access to high-opportunity neighborhoods have the potential to be incredibly effective in combating inter-generational poverty and promoting social mobility—findings that have important implications for place-based approaches. In the most high-profile of these studies, a 2015 re-analysis of outcomes for children in the Moving to Opportunity experiment, Harvard economist Raj Chetty and his colleagues found that low-income children randomly assigned to move out of public housing and into private rental housing in lower-poverty neighborhoods before the age of 13 had 31 percent higher incomes in early adulthood and were 32 percent more likely to attend college, with girls being three times more likely to be married and 26 percent less likely to be single mothers.[11] These headline statistics are all the more remarkable in light of the fact that MTO was a fairly weak treatment: three-fifths of families moved to neighborhoods that were still quite segregated (80 percent minority), there was no budget for mobility counseling or supportive services, and kids in the treatment group attended schools ranked in just the 19th percentile (versus 15th percentile schools for children in

[11] Raj Chetty, Nathaniel Hendren, and Lawrence F. Katz, "The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment," *American Economic Review* 106, no. 4 (2016): 880, https://www.aeaweb.org/articles?id=10.1257/aer.20150572.

the control group).[12] Additional research has drawn a more explicit link between opportunity-oriented strategies and educational achievement. In one notable study analyzing low-income children randomly assigned to scattered-site public housing units located in market-rate properties in Montgomery County, Maryland, Heather Schwartz of the RAND Corporation showed that children assigned to housing in neighborhoods feeding into low-poverty schools cut the math achievement gap in half over five to seven years in elementary school.[13] And, thanks to the recent publication of a new on-line mapping tool by Raj Chetty and his colleagues, these findings on the linkages between neighborhoods and economic mobility are now remarkably actionable for practitioners. This tool, The Opportunity Atlas, employs data on 20 million Americans born between 1978 and 1983 to show us the current income of American adults who grew up in a particular census tract, controlling for factors such as income, race, and gender.[14] In other words, we can now look at metro areas across the country and pinpoint on an extraordinarily granular level the precise neighborhoods that have historically generated the greatest economic mobility for particular demographic groups: for example, children of low-income parents.

The Case for a Private-Sector Solution

All of this begs the question: How can we build on this research to create a pathway out of poverty for children in low-income families? Policy change would seem to be a natural starting point, but unfortunately, from a political standpoint, residential mobility and opportunity-oriented strategies historically have been a cause without a constituency, either on the right or the left.[15] Nor is substantial support likely to be forthcoming from the philanthropic sphere, as major foundations such as MacArthur and Ford are ending their active involvement as champions for housing strategies. And even if this were not the case, the endowments of even the largest foundations pale in comparison to the resources required—it would be like trying to boil the ocean with a space heater. By process of elimination, what remains is private capital—a massive untapped resource in the affordable housing space. Simply put, this is where the money is. Investing activity in real estate investment trusts (REITs) and closed-end real estate vehicles

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[12] Lisa Sanbonmatsu et al., "Neighborhoods and Academic Achievement: Results from the Moving to Opportunity Experiment," Working Paper no. 11909, The National Bureau of Economic Research, Cambridge, MA (2006), https://www.nber.org/papers/w11909.pdf.

[13] Heather Schwartz, "Housing Policy is School Policy: Economically Integrative Housing Promotes Academic Success in Montgomery County, Maryland," Washington, DC: The Century Foundation (2010), https://tcf.org/assets/downloads/tcf-Schwartz.pdf.

[14] "The Opportunity Atlas," The Opportunity Atlas, accessed May 22, 2019, https://www.opportunityatlas.org/.

[15] This may be beginning to change, as evidenced by recent bipartisan Congressional support for a limited mobility pilot demonstration, but the politics of the issue remain fraught.

alone tops $200 billion a year[16], dwarfing both government expenditures on place-based affordable housing programs, and the $408 million[17] a year in housing-related grantmaking by foundations. Indeed, a single pension fund, the California Public Employees Retirement System, has significantly more assets under management—$340 billion—than the top 50 U.S foundations combined.[18] And, while major investors are increasingly paying lip service to so-called ESG (environmental, social, and governance) considerations, this capital is overwhelmingly returns-driven and largely impact-agnostic. The challenge, then, is as follows: to design an investment product that can compete for meaningful allocations of mainstream institutional capital, virtually none of which is currently being leveraged in a purposeful way to improve outcomes for low-income kids.

The Vision: The MTO Fund

Informed by research described above, our vision is to raise a social impact real estate fund to provide low-income families across the country with access to service-enriched, mixed-income housing in high-opportunity communities with high-performing public schools, leveraging Housing Choice Vouchers and forgoing a portion of our investment management fees to cover program costs and deliver a market-rate financial return. The MTO Fund will specifically target neighborhoods that feed into top-ranked schools and that have historically provided low-income children with significant economic mobility, pursuing an opportunity acquisition strategy to circumvent "NIMBY" ("not-in-my-backyard") barriers by acquiring existing market-rate apartment buildings with private financing. Properties will be held for the long term, with 20 percent of the units voluntarily reserved for voucher families with young children. We are initially targeting foundations (for either program-related or mission-related investments), Community Reinvestment Act-motivated banks, and high-net-worth investors, but our ultimate goal is to create a scalable impact investing model with broader appeal—one that can compete head-to-head with mainstream investment managers for major allocations of institutional capital.

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[16] Preqin, Preqin Quarterly Update: Real estate Q1 2018, accessed June 5, 2019, https://docs.preqin.com/quarterly/re/Preqin-Quarterly-Real-Estate-Update-Q1-2018.pdf; "Historical Offerings of Securities", Nareit, accessed June 5, 2019, https://www.reit.com/sites/default/files/IndustryData/HistOff1812.pdf

[17] Based on 2015 grants data, the most recent year for which full data were available, in the Foundation Center database as of May 12th, 2019. The figure includes 13,666 grants classified by the Foundation Center as being in support of "Housing Development" with a U.S.-based recipient organization, where the funder was a community foundation, independent foundation, or company-sponsored foundation. While the Foundation Center database is not comprehensive, it contains 2015 grants-level data on 63,724 foundations, including the largest and most active funders.

[18] "CalPERS Investment Fund Values," CalPERS, accessed May 22, 2019, https://www.calpers.ca.gov/page/investments/asset-classes/trust-level-portfolio-management/investment-fund-values; "The Foundation Center," The Foundation Center, accessed May 22, 2019, https://foundationcenter.org/.

The MTO Fund will have a "core-plus" profile, acquiring substantially stabilized, class A properties in the top 20 metro areas in the United States and employing typical core-plus leverage (approximately 50 percent loan-to-value). We will hold properties for the long term, adopting an open-end fund structure to provide investors with ongoing liquidity while maintaining housing stability for families in the program. The Fund will target risk-adjusted market-rate returns for core-plus multifamily real estate: an 8 to 11 percent internal rate of return, net of fees. In order to achieve these returns, we will proactively manage the properties in the portfolio, upgrading common areas and gradually renovating unit interiors every five to 10 years on a staggered schedule. And, unlike other models, which couple an opportunity acquisition approach with a naturally occurring affordable housing (NOAH) strategy aimed at artificially holding down rent increases, we will manage our market-rate units like a traditional operator, aggressively pushing rents to grow net operating income and increase net asset value.

In order to fill our inclusionary units, we will engage in targeted outreach to identify families that fit our selection criteria: extremely low-income families with young children that have household incomes of 30 percent of Area Median Income (AMI) or below, have qualified for a Housing Choice Voucher, and are currently living in census tracts of concentrated poverty (30 percent poverty rate or higher). Wherever possible, we will conduct this outreach by working in conjunction with established local partners, whether that be a mobility program (as in Dallas, where we are partnering with the Inclusive Communities Project), a non-profit service provider, or a local housing authority. Families that express interest after this initial outreach will attend small-group information sessions in which they will receive a detailed description of the program. Subsequently, families will participate in one-on-one mobility counseling sessions, in which counselors will perform a life resource assessment, analyzing transportation needs, childcare arrangements, family stability, and financial health, and helping families to think through the implications of an opportunity move. At the end of the recruitment process, families will enter a lottery and be placed on a waitlist.

Families that ultimately enter the program will participate in a high-touch supportive services program organized around four pillars. The first pillar is a mobility counseling program, which will feature both pre-move and post-move counseling. In the pre-move phase, the counselor will help families prepare for the move: cataloguing strengths and assets that the family can draw upon for their transition; mapping out alternative resources and arrangements that can substitute for existing support systems; facilitating introductions to school staff, service providers, and other families in the new community; and supporting families as they iron out details such as transferring their voucher between housing authority jurisdictions and enrolling school-age children in the school system. Post-move, the counselor will help families navigate the transition by tracking children's academic progress, conducting home visits, and providing customized support for parents organized around regular goal setting and goal monitoring. The second pillar of the services program is service connection. In order to keep costs to a

manageable level, instead of recreating complex direct services programs our approach will be to refer families to established local service providers with particular areas of specialization, such as mental health, substance abuse, etc. The third pillar of the program focuses on community building, with the goal of helping families establish strong social networks and systems of social support in their new community. This will be a multi-pronged effort: families in the program will be paired with a similarly situated "buddy" family, small group dinners will be organized with individuals from the broader community, and the property management team will work to foster as sense of community at the building level by organizing events and other programming. Finally, the fourth pillar is crisis intervention. Building on findings from the housing mobility literature, which showed that manageable crises such as job loss and health problems can quickly spiral, a key responsibility for our counselors will be to proactively intervene to address potential threats to housing stability.

We believe this model has the potential to be incredibly impactful. A favorite "gotcha" question that wealth managers like to ask social entrepreneurs in the impact investing space goes something like this: "This is interesting, but could you put $100 million to work behind this strategy?" For most the answer is no, and the implication is clear: "You're a rounding error—we would be wasting our time with this." In our case, however, the answer is a resounding "yes"—many, many hundreds of times over. There are 1.8 million low-income kids in families with Housing Choice Vouchers, and on average they attend bottom-quartile schools.[19] And there are *1.94 million units* in large multifamily properties located in school districts ranked in the 80th percentile or higher, based on state test scores.[20] For those of us accustomed to seeing a program officer blanch at a $2 million program-related investment request it can be easy to lower one's sights, but we need to remember that the market has the potential to aggregate capital on a massive scale—provided we play by its rules. Indeed, a *single* core-plus real estate fund, launched by private equity giant Blackstone in 2014, now has $32 billion in assets under management, with plans to reach $60 billion within two years.

The Constraints Imposed by Our Double-Bottom-Line Approach

As noted above, the MTO Fund has a double-bottom-line mission: to put low-income kids born into concentrated poverty on the path to college by providing them with access to service-enriched mixed-income housing in communities with top-ranked public schools, while delivering market-rate returns for mainstream institutional investors. Both facets of that mission

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[19] Barbara Sard and Douglas Rice, "Realizing the Housing Voucher Program's Potential to Enable Families to Move to Better Neighborhoods," Washington, DC: Center on Budget and Policy Priorities (January 2016), https://www.cbpp.org/sites/default/files/atoms/files/11-9-15hous.pdf; Gould Ellen and Mertens Horn, "Do Federally Assisted Households Have Access to High Performing Public Schools?"

[20] MTO Fund analysis of U.S. Department of Education and U.S. Census Bureau datasets.

imposed key constraints as we were designing our model. In this section we highlight four of those constraints and describe how they influenced several foundational design decisions.

The Strategy Must Address the Challenge Posed by NIMBY Political Opposition in High-Opportunity Neighborhoods.

To state the obvious, efforts to create affordable housing in high-opportunity neighborhoods typically encounter significant NIMBY opposition from residents. And, since ground-up development requires discretionary public approvals, NIMBYs effectively have veto power over new construction projects. Given that we are targeting affluent communities with top-ranked public schools, this was a particularly relevant consideration for us, and one that factored heavily into the design of our model. Our approach was to eschew development and focus exclusively on the acquisition of existing properties. An opportunity acquisition strategy of this kind effectively circumvents formalized NIMBY opposition because, unlike ground-up development, acquiring an existing property is a purely private transaction involving no public approval process of any kind.

The Property Must Be Held for an Extended Period of Time in Order for Low-Income Families to Benefit.

The second major constraint in our model is the need to hold properties for an extended period of time so that low-income children have access to a high-opportunity neighborhood and its amenities throughout their childhood. Because our model contemplates renting to families with Housing Choice Vouchers in situations in which the maximum voucher subsidy does not fully cover the market rent, we cannot sell the property in the near term because a buyer would re-tenant the property with higher-paying households. (Even if the voucher *does* fully cover the rent, this would remain a concern in most markets because source-of-income discrimination against voucher families is legal in 37 out of 50 states.[21]) Nor could we add a deed restriction tying the hands of a future buyer, since this would significantly lower the resale value of the property, resulting in a below-market return for investors.

If we cannot sell the property in the short term, and we cannot add a deed restriction, we need a structure that will allow us to remain in control of the property while providing investors with liquidity (i.e., the ability to withdraw their capital). On our initial investments, we are building in a planned re-capitalization after five to seven years, with fresh investors buying out our initial investors at a mutually agreed-upon valuation (and with the Fund retaining its role as

[21] "Expanding Choice: Practical Strategies for Building a Successful Housing Mobility Program; Appendix B: State, Local, and Federal Laws Barring Source-of-Income Discrimination," Poverty & Race Research Action Council, last modified January 30, 2019, https://www.prrac.org/pdf/AppendixB.pdf.

the investment manager).[22] Longer-term, however, our solution is to create an open-end fund structure. In this structure, properties are appraised on a quarterly basis, at which point investors have the opportunity to make withdrawals based on the current fair market value of the properties held by the fund. Managers of open-end funds are perpetually fundraising, with new investors joining an entrance queue. Withdrawal requests are then satisfied by back-filling with new investors from the queue. Thus, an open-end structure of this kind will allow us to provide our investors with ongoing liquidity while holding the property for the long term and maintaining fidelity to our social impact mission.

To the Greatest Extent Possible, the Offering Should Resemble an Investment Product That Already Exists, to Facilitate Widespread Acceptance within the Industry.

The asset-management industry is highly standardized, and the gatekeepers for the largest pools of capital have established a defined taxonomy for particular types of investments—replete with elaborate return benchmarks, industry standard fee guidelines, and expectations about what kinds of structures are "market" or "out of market." Whether we like it or not, any investment product cooked up in the lab that strays too far from these boxes is destined to be dead on arrival. In the world of institutional real estate investing, there are essentially four such boxes, corresponding to different points on a continuum of risk and return: core, core-plus, value-add, and opportunistic strategies. Value-add and opportunistic strategies are an imperfect fit for our model, because we would never be able to consistently deliver the high returns that they target without adopting their buy it, fix it, sell it approach—an approach precluded by our social impact mission, as detailed above. On the opposite end of the risk spectrum, core funds, which use an open-end fund structure and which make conservative, long-term investments rather than three- to five-year flips, represent a better model to emulate; however, their focus on brand-new properties stresses the economics in our model and limits the percentage of units that can be reserved for low-income families. A better fit for our approach is a slightly modified version of a core strategy, known as core-plus. Core-plus funds share many of the characteristics that make a core strategy an interesting fit for what we are trying to do—a focus on current income, a bias toward longer-term hold periods, and an open-end structure—but while they target high-quality, class A properties, those properties are slightly older than true core product, which will allow us to reserve 20 percent of the units for low-income families.

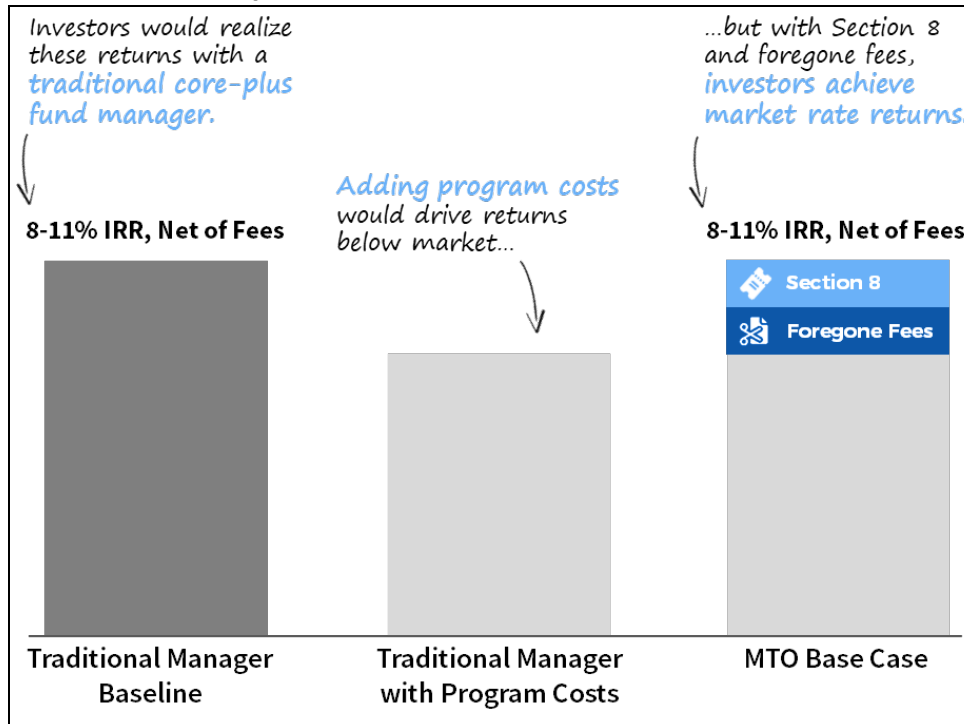
[22] Initial investments will be structured as single-asset LLCs, with the goal of contributing those properties into an eventual open-end fund at fair market value.

In Order to Achieve Meaningful Scale, the Investment Product Must Provide Investors with a Market-Rate Financial Return.

Unfortunately, while there is an effectively infinite supply of return-driven private capital, the universe of investors willing to accept a concessionary return is vanishingly small,[23] which means that in order for an impact investing model to achieve meaningful scale it needs to deliver a market-rate return. This poses a challenge in our case, because there are two significant costs associated with our model: (1) foregone revenue on the low-income units (to the extent the Housing Choice Voucher does not fully cover the market rent), and (2) the cost of the mobility counseling and supportive services that we intend to provide. In theory, several parties could potentially cover these costs, including investors, philanthropists, the government, and the investment manager. Shifting these costs onto the investor is out, for the reasons we have just discussed. And, while we will likely need some start-up funding for our services program, in order for the approach to be scalable and self-sustaining, we made the conscious decision to design a model that covers these costs without ongoing philanthropic support. Of the parties remaining, we have the government picking up most of the tab, although—to return to the first of the two questions that framed this essay—we accomplish this not by seeking new subsidy but by making more effective use of a program already in place, the Housing Choice Voucher Program. Since we are targeting class A properties in high-opportunity areas, the maximum voucher subsidy will usually only cover 70-85 percent of the market rent, but for families that can only contribute $350-500 a month in rent this represents a massive subsidy and puts us within striking distance.[24] We have identified a number of return-enhancing mechanisms that can help to cover the remaining costs—from property tax abatements to tax benefits for taxable investors—but the most straightforward option, and the one we use in our base case modeling, is simply to run the Fund as a social enterprise and charge slightly lower investment management fees to investors, thereby shifting the residual cost onto the investment manager. From a returns perspective, net operating income will be lower due to the added costs, but we make up for that with savings on fees, with the math penciling to the exact same net-of-fee return that an investor could expect from investing in the identical property with a traditional impact-agnostic manager.

[23] In fact, pension funds, which represent the largest bucket of institutional capital, are expressly forbidden from making concessionary investments by U.S. Department of Labor guidelines.
[24] In markets with local payment standards or ZIP Code-based payment standards (so-called Small Area Fair Market Rents), the voucher will often fully cover the rent, even on newer Class A properties in high-opportunity areas.

Fig. 2: THE MTO FUND'S FINANCIAL MODEL



Operational Challenges to Overcome

What is the Highest Proportion of Low-Income Households that Can Be Included without Meaningfully Increasing Turnover Costs or Depressing Rents on the Market-Rate Units?

The single greatest operational challenge in our model will be integrating households from two distinct ends of the economic spectrum: class A renters and families with Housing Choice Vouchers (whose incomes average just 23 percent of the area median).[25] Complicating the task is the fact that market-rate renters in the affluent, high-opportunity areas that we are targeting are predominantly white, while the majority of our voucher families will be racial and ethnic minorities.[26] To put it simply, one of the key questions at the heart of our approach is: Will higher-income residents be tolerant of living alongside lower-income minority families with young children, or will they demand a discount for doing so? It is critical that we take steps to ensure that the new income and racial mix does not impair the marketability and financial performance of the property, but our goal is to do so in a manner that avoids the kind of "incorporated exclusion" that has led to alienation among low-income households in other

[25] "Assisted Housing: National and Local (2017 data)," U.S Department of Housing and Urban Development, accessed May 22, 2019, https://www.huduser.gov/portal/datasets/assthsg.html.
[26] Editor's note: All references in this essay to black/African-American, white, or Asian populations refer to non-Hispanic/Latinx individuals unless otherwise noted.

mixed-income models.[27] On our initial investments we are planning a multi-pronged approach, which includes starting out with smaller buildings, partnering with a boutique property management firm known for its high-touch approach, and leveraging the relationships that we establish through our services program. Longer term, our goal is to take property management in-house in order to develop a dedicated training program for front-line staff and to have greater touch down to the property level.

How Can We Combat Social Isolation and Help to Build Community?

From a community-building standpoint there are two important tasks before us. First, how can we combat social isolation among the low-income families in the program as they seek to navigate the unfamiliar cultural milieu of a high-opportunity neighborhood? (Although, truth be told, research has shown that this may be less of a concern than one might expect.[28]) Second, more aspirationally, how can we help to foster relationships between voucher families and individuals from the broader community, without making those interactions feel forced or awkward? While the specifics undoubtedly will evolve over time, at the core of our approach will be proactive and sustained attention to community building, with the goal being to help families establish strong social networks and systems of social support in their new building and community. Families will be paired with a similarly situated "buddy" family in the program; small group dinners with members of the broader community will be organized to create space for mutually beneficial relationships that bridge lines of class and race; and the property management team will work to create community at the building level by organizing events and other programming.

How Can We Help Low-Income Families Adapt to the Loss of the Support Systems that They Relied on in Their Old Neighborhood?

Moving can be a disruptive experience for any family, and for a low-income family an opportunity move can be especially so, because low-income families are more heavily reliant on informal arrangements for basic needs such as transportation and childcare. Admittedly, dealing with this challenge will be a continual learning process for us over the next several years, but in an attempt to set ourselves up for success our model incorporates an extremely extensive post-move mobility counseling program, with a far higher-touch staffing model than even the most successful housing mobility programs and with ongoing support for families throughout their tenure in the program.

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[27] Robert J. Chaskin and Mark L. Joseph, *Integrating the Inner City: The Promise and Perils of Mixed-Income Public Housing Transformation,* Chicago, IL: University of Chicago Press (2015): 159.
[28] Xavier de Souza Briggs, Susan J. Popkin, and Jon Goering, *Moving to Opportunity: The Story of an American Experiment to Fight Ghetto Poverty,* New York, NY: Oxford University Press (2010): 254.

Implications for Action

Implications for Policy.

- Research consistently demonstrates that providing low-income families with access to housing in high-opportunity neighborhoods generates substantial savings for governments at all levels, in the form of higher tax revenue, lower healthcare costs, and reduced expenditures on everything from prisons to social services.[29] To encourage impact investors and developers to provide affordable housing options in these areas, states and local governments should consider implementing a pay-for-success approach, providing a small monetary reward for each year that a low-income child is housed in a high-opportunity neighborhood. Pay-for-success contracts have often been criticized for their bespoke nature and high transaction costs, but this situation presents an opportunity for a state or municipality to craft a far more streamlined and scalable model—one that is open to all property owners within the jurisdiction and is predicated on a pre-defined payment structure based on the magnitude of the savings identified by researchers. The end result would be a win-win for all involved: investors would receive a modest degree of financial compensation for providing affordable housing in hard-to-access opportunity areas[30]; low-income children in the families touched by the program would enjoy dramatically enhanced economic mobility; and, because the savings generated would be greater than the cost of the pay-for-success payments, the program would have no net cost associated with it and, in fact, would save the government money.
- Existing policy incentives in the affordable housing space are geared almost exclusively toward the LIHTC and Project-Based Section 8 programs, and should be expanded to support the efforts of social entrepreneurs seeking to leverage mainstream private capital through acquisition-based strategies. For example, eligibility for real estate tax abatement programs and low-cost affordable housing-oriented debt products typically requires onerous 30- to 50-year deed restrictions, which are unworkable when acquiring a market rate property. However, with some additional flexibility these programs could easily be modified to accommodate a more

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[29] Dan Rinzler et al., "Leveraging the Power of Place: Using Pay for Success to Support Housing Mobility, working paper 2015-04," San Francisco: Federal Reserve Bank of San Francisco (2015), https://www.prrac.org/pdf/LeveragingThePowerOfPlace2015.pdf; Chetty, Hendren, and Katz, "The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment."

[30] The magnitude of the financial incentive here would not need to be large. Even if the pay-for-success payments enhanced the internal rate of return by 50 basis points (0.50 percent), it would substantially increase the universe of financially feasible projects, allow for deeper affordability targets, and alter the behavior and site selection of impact-agnostic investors and developers.

market-driven approach, while still maintaining reasonable protections to safeguard their underlying social objectives.

- While the availability of Housing Choice Vouchers provides a key boost to the feasibility of our model, the voucher program has several significant and well-known flaws. Reforms aimed at addressing some of these shortcomings—for example, more widespread adoption of Small Area Fair Market Rents and the passage of source-of-income protection laws—could attract other groups to help take the model to scale, and could do as much to advance the goals of income and racial integration and equality of opportunity as any proposal outlined in this volume.
- Given the overall demographic make-up of the voucher population in our target markets, an extremely high proportion of the children in our program are likely to be racial minorities[31]; and as such, they are likely to encounter subtle forms of subconscious racial bias (and potentially incidents of overt racism) that could blunt the positive impact of the move or even impel their parents to leave the neighborhood altogether. Social science indicates that these biases can be manifested in a variety of forms: on the part of teachers, who tend to have lower expectations for minority students, which become a self-fulfilling prophecy[32]; on the part of school administrators, who tend to give black/African-American children more severe discipline than their peers for similar infractions[33]; and on the part of local law enforcement and community members at large, with research showing that minority children report feeling less safe in white neighborhoods due to the increased scrutiny that they often receive.[34] Therefore, housing-focused policies are necessary but not sufficient. Unless we take steps to address these subconscious biases, the opportunity and economic mobility that the children in our program enjoy will remain, at least in some measure, constrained.

Implications for Research and Evaluation.

- Through a research partnership with the Urban Institute and the National Initiative on Mixed-Income Communities, the MTO Fund's pilot investments will represent the

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[31] As an example, in Dallas, one of our initial target markets, 94 percent of individuals in households with Housing Choice Vouchers are racial or ethnic minorities. The corresponding figure at the national level is 69 percent. "Assisted Housing: National and Local (2018 data)," U.S Department of Housing and Urban Development, accessed May 22, 2019, https://www.huduser.gov/portal/datasets/assthsg.html.

[32] Seth Gershenson and Nicholas Papageorge, "The Power of Teacher Expectations," *Education Next* 18, no. 1 (2018): 66.

[33] Nathan Barrett et al., "Discipline Disparities and Discrimination in Schools," *Brown Center Chalkboard (blog), Brookings Institution* (November 20, 2017), https://www.brookings.edu/blog/brown-center-chalkboard/2017/11/20/discipline-disparities-and-discrimination-in-schools/.

[34] Sandra E. Garcia, "Black Boys Feel Less Safe in White Neighborhoods, Study Shows," *New York Times* (August 18, 2018) www.nytimes.com/2018/08/14/us/black-boys-white-neighborhoods-fear.html.

first dedicated effort to measure the effect of a mixed-income or inclusionary housing model on rents and turnover among market rate renters. Refining our understanding of those impacts will be critical for assessing the financial viability of various place-based mixed-income models.

- Unlike inclusionary zoning models, which reserve affordable units for families at higher levels of area median income (only 2 percent of such programs target households below 50 percent of AMI[35]), the MTO Fund will seek to integrate extremely low-income families with Housing Choice Vouchers into otherwise market-rate, class A properties. This research will help to inform practitioners and policymakers about the social and financial implications associated with incorporating deep affordability targets into market rate properties—be it through acquisition, tax credit financed mixed-income development, or more ambitious forms of inclusionary zoning.

Implications for Development and Investment.

- This model represents a call to action to impact investors to set a higher bar for target neighborhood selection, income mix, and attention to a more comprehensive array of supports.
- Given that the acquisition of an existing property circumvents the discretionary public approval process (and the attendant NIMBY veto) associated with new construction, opportunity acquisition models of this kind represent an important alternative for impact investors seeking to equalize access to high-opportunity neighborhoods.
- Asset managers frequently lament the lack of impact-oriented investment opportunities capable of absorbing significant allocations of capital. An opportunity acquisition strategy along the lines described here has the potential to help fill this gap in the market. Indeed, as noted above, there are 1.8 million children in families with Housing Choice Vouchers, and 1.94 million *units* in large multifamily properties located in top-quintile public school districts, so the opportunity to achieve impact at scale and to put significant capital to work is substantial.[36] However, the very quality that makes real estate such a compelling opportunity in this regard—its inherent capital intensiveness—also makes it challenging to finance pilot-stage efforts aimed at developing promising new concepts into investable opportunities. Unfortunately, in the nascent impact investing ecosystem there is currently a dearth of mission-driven institutional investors with the capacity and motivation to invest in early-stage efforts

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[35] Brian Stromberg and Lisa Sturtevant, "What Makes Inclusionary Zoning Happen?" (2016), http://landuselaw.wustl.edu/Articles/Inclusionary%20Zoning%20Rept%202016.pdf.

[36] Barbara Sard and Douglas Rice, *Realizing the Housing Voucher Program's Potential to Enable Families to Move to Better Neighborhoods.*

to test novel supply-side housing strategies. Foundations, which often devote grant dollars to "field-building" efforts in the impact investing space, should consider that charge more broadly when it comes to housing. As noted above, it is not that foundations need—or have the financial capacity—to *directly* address the nation's housing challenges through their housing investments; rather, they should focus on seeding promising new strategies that have the potential to yield substantial downstream impact, but that would otherwise struggle to attract pilot funding.

Implications for Residents and Community Members.

- Research clearly shows that providing low-income children with access to mixed-income housing in high-opportunity neighborhoods has life-changing benefits. In making these moves, however, low-income families in the program will often be stepping significantly outside of their comfort zone. Maximizing the benefits of the program will require support, advocacy, and self-reflection on the part of neighbors in the building and the broader community to ensure that lower-income residents feel welcomed and included as full and valued participants in the life of the community. For their part, the low-income households will need to draw upon resilience and open-mindedness, and demonstrate some willingness to adapt to the norms and expectations of the building and community.

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