STATE OF THE CITY:

5 TRENDS IMPACTING AMERICA'S CITIES

LIVING CITIES

INNOVATE ▸ INVEST ▸ LEAD

Introduction

BACKGROUND

Globalization, changing demographics, and advances in technology, have fundamentally transformed the world we live in, but the ways in which we address social problems have not kept pace.

In the decades following World War II, the challenges the urban poor have faced in the U.S. have primarily been blamed on geographic isolation in blighted neighborhoods. Conventional wisdom had it that if leaders improved such neighborhoods — by upgrading buildings, attracting employers, and delivering programs to strengthen the social fabric — residents' opportunities and incomes would improve as well. This spurred an increased level of investment in place-based approaches to the symptoms of urban poverty, and community development as a field was born. Over the remainder of the 20th century, philanthropy, the federal government, states and cities targeted limited redevelopment dollars towards neighborhood-level programs with the hope that this would eventually have spillover effects and improve the city as a whole.

For years, this strategy seemed to produce the intended results. Public dollars towards revitalizing urban communities were leveraged with billions in private investment, millions of families have been supported through affordable housing, and the community development industry itself has grown with local, regional, and national nonprofit organizations leading the charge. However, the world has drastically changed over the past few decades.

Jobs that once flourished in downtown factories and offices have moved beyond city limits to the suburbs and abroad; technology has changed how people interact and what defines community; and poverty is no longer concentrated solely in the urban core, with failing schools, foreclosed homes, and high unemployment rates plaguing all communities.

Despite this reality, the community development sector has failed to keep up with these enormous changes. Our systems for supporting national prosperity and individual economic opportunity were built for different times on outdated assumptions. Place-based efforts, while beneficial to some, are not sufficient to reaching the scale necessary to fix these broken systems. We cannot simply manage decline in cities – we must be on the cutting edge of these economic and social shifts and change how cities operate.

OUR CHARGE

Over the last several years, Living Cities has been dedicated to fundamentally adapting how we work in an effort to keep pace with the changing world. Through new partnerships and initiatives, we're actively learning what drives our cities and what creates enduring systems change. In order to help us better anticipate changes in the social and economic climate, we embarked on an environmental scan of likely trends that will particularly impact low-income people in U.S. cities over the next few years.

Our charge was twofold:

- Identify the dominant trends that will impact cities and their low-income residents over the next four to five years; and
- Identify new ways Living Cities, in collaboration with private, public and philanthropic organizations, can lead and shape systemic changes, and accelerate innovation in light of these trends.

With the help of McKinsey & Company, we conducted a comprehensive review of documents offered by think tanks, non-profits, philanthropy, academia and cities. In addition, we conducted interviews with city government staff, civic leaders, non-profits and think tanks, private sector companies, and key federal agencies. After analyzing the results of this scan, it was evident that continued municipal fiscal strain, inadequate infrastructure, poor educational outcomes, a skills/job mismatch, and a struggling housing market are issues that will be particularly challenging for low-income people and communities in the years ahead. We also identified some emerging responses to these changes to inform how we can begin to think through addressing these challenges.

A VISION FORWARD

Identifying solutions to these complex problems will require us to let go of the old ways of working, in favor of more adaptive strategies. First, while each trend has particular challenges to consider, we must understand the interdependent nature of these trends, and address these challenges in more comprehensive ways. Second, we must recognize that no institution or sector alone can reverse the direction of these trends, and we can no longer afford to work on these challenges through parallel efforts. Lastly, we must take advantage of innovations in financing and harness the power of technology to accelerate and scale our work. This report is meant to serve as a high-level analysis of the trends impacting low-income city residents, and offers our thoughts on how to address these challenges more strategically. For more information on these trends, you can access the full results of the research on our website here.

TREND 1

Municipal Fiscal Strain

Fiscal strain is causing city governments to reduce services and scale back capital investment.

Historically, the public has counted on local government for leadership, direction, and solutions to our most pressing problems.

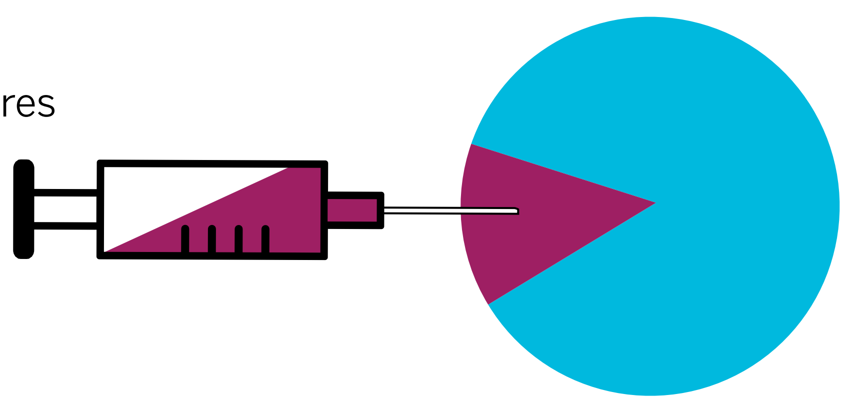
During the 1960s, this leadership was critical in institutionalizing many of the programs that serve low-income communities today. However, in recent years, the public has lost its faith in government and has looked to the private and nonprofit sectors to lead the search for solutions to our problems. As a result, organizations have worked to fill gaps and create programs as workarounds to broken government systems.

Yet, since the Great Recession, the public's views and expectations have shifted once again, and as our problems become more complex, the government is suddenly expected to do more with less. As the country continues to recover from the economic crisis, people are looking towards local government for more support than ever before, yet decreasing budgets are inhibiting cities from even meeting their most basic responsibilities. We can expect this trend to continue in the years ahead.

Rising healthcare costs are the most common driver of increased municipal expenditures and constitute roughly

14%

of the average city budget.



1. American Society of Civil Engineers; Brookings; National League of Cities; Massachusetts Department of Revenue

First, cities will continue to face declining revenues. With a shrinking property tax base and a sharp decrease in sales taxes, city budgets will continue to decline. Further, cities are facing reduced federal and state funding as governments are tightening budgets at all levels.[1]

While resources are declining, cities will continue to face increasing costs.
Rising healthcare costs are the most common driver of increased municipal expenditures, representing roughly 14% of the average city budget.[2] Further, pension obligations, once the hallmark of the government workforce, are ballooning and have become the second most common driver of increased city costs.[3] It is projected that the total unfunded pension liability could rise to $1.2 trillion this year. Lastly, the average city's aging infrastructure– including transportation, water, electric, and sewage systems – continues to drive up expenditures.

And yet, city governments are being forced to take on additional responsibilities.
Many state and federal governments are backing away from programs they have traditionally been responsible for including police and safety, education, health, transportation, and infrastructure. In addition, there is a simultaneous increase in the number of citizens who are dependent on city resources due to high unemployment rates and an aging population. Such budget pressures are leading cities to reduce service levels and personnel, delay capital projects, and increase fees. These changes will disproportionately affect low-income residents. When facing tradeoffs, cities may adapt services for the aging (mostly white) population, potentially at the expense of the needs of the younger (largely minority) working poor population.

Some cities are taking extreme measures to combat fiscal strain.
One trend that has gotten national attention is the increase in municipalities filing for bankruptcy. While the occurrence is relatively rare, there has been a noticeable increase from years past. California is the one state that has experienced a noticeable spike in municipal bankruptcies, with four since 2008. However, this is partly due to the fact that the state has relatively few barriers to filing Chapter 9 compared to other states. Most municipalities, even the ones struggling most, want to avoid the negative consequences that accompany bankruptcy, such as a poor credit rating.[4] In some cases, most notably the City of Detroit, municipalities seek a receivership to get the city's finances in order and avoid bankruptcy.[5]

Emerging Responses

As local governments struggle to reconcile their diminished resources with the public's increased expectations, some key responses are beginning to emerge:

First, municipalities are looking for innovative ways to increase revenue streams, including:

- Differential service-level pricing, such as trash collection fees based on volume or frequency;
- Demand management pricing, such as congestion pricing or variable parking meter rates based on current occupancy;
- Cost-based pricing, or pricing public transit based on actual costs; and

2. American League of Cities "City Budget Shortfalls: 2010-2012 Projections"; Center on Budget and Policy Priorities; team analysis
3. Cited by 84% of respondents in the National League of Cities 2011 Fiscal Survey
4. Maciag, Mike. How Rare Are Municipal Bankruptcies? Governing. January 24, 2013. http://www.governing.com/blogs/by-the-numbers/municipal-bankruptcy-rate-and-state-law-limitations.html
5. http://www.freep.com/article/20130212/NEWS15/302120066/Michigan-Gov-Rick-Snyder-talking-to-Detroit-emergency-manager-candidates

- Selling and leasing assets, which many cities already do with advertising in public spaces, such as bus stops, or selling branding or naming rights for stadiums.

Second, municipalities are looking to increase efficiency through innovative operations procedures, such as:

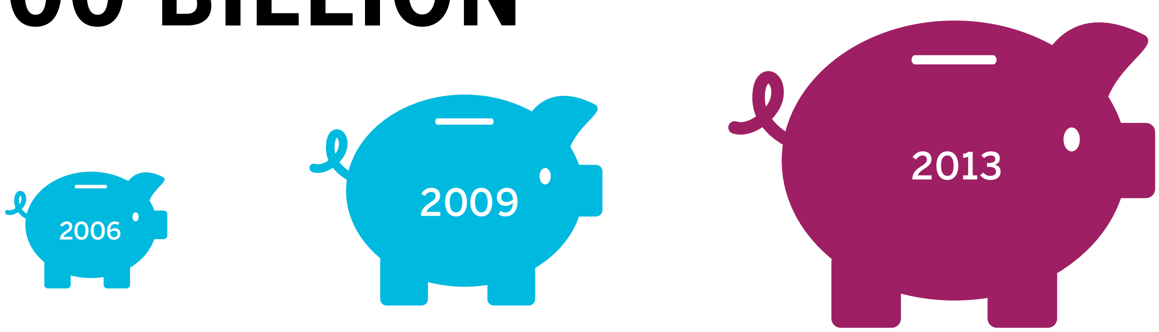
- **Incentivize productivity improvements.** Some cities, such as New York and Chicago, have turned to crowdsourcing – or posing questions to employees for feedback – to improve how city agencies operate.
- **Increase efficiency of procurement and capital projects.** Savings is achievable in the public sector, through demand reduction, process improvement, and negotiations.
- **Utilize data and technology to improve services and lower costs.** Some cities are looking to leverage technology (internet, apps, etc.) and data that is already being collected to improve operations while reducing costs. For example, the City of Boston created smart phone applications to help cities track and report problems (such as potholes) throughout the city, making citizens part of the solution.

Lastly, municipalities are trying to identify innovative financing mechanisms.

Over the past 18 months, the potential of new approaches to help governments finance the upfront costs of interventions that are proven to reduce costs over the long-term has generated significant interest. Building on models in the UK, governments at the federal, state and local level have begun to explore social impact bonds and other pay for success mechanisms. Social Impact Bonds are a tool investors (financial institutions, philanthropy, etc.) use to pay for the upfront costs of programs that have a social impact in exchange for a modest return from the city, should the program succeed. If the program fails, the investors, not the tax payers, lose their money.[6] New York City, Bloomberg Philanthropies and Goldman Sachs have closed a transaction in the area of juvenile justice, and similar mechanisms are being considered in fields ranging from early childhood education to supportive housing for seniors.

The total unfunded pension liability doubled from 2006-2009 to

$700 BILLION and could **rise to $1.2 trillion by 2013**



6. Getting Back More Than a Warm Feeling: http://www.nytimes.com/2012/11/09/giving/investors-profit-by-giving-through-social-impact-bonds.html?pagewanted=all&_r=0

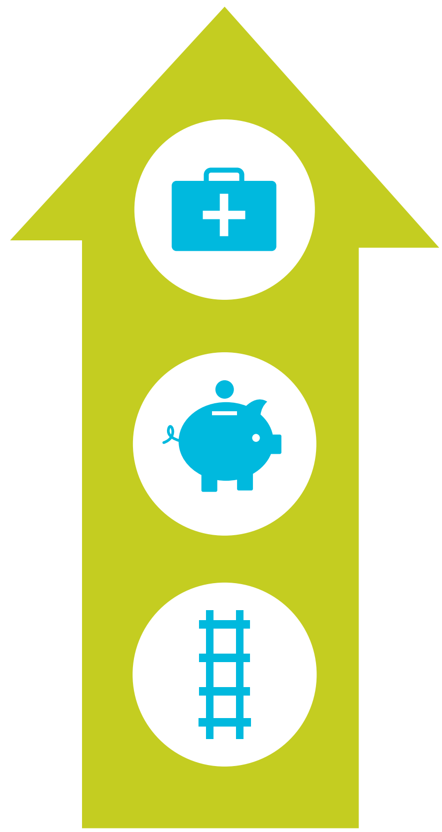
TREND 2

Inadequate Infrastructure

Failing infrastructure is inhibiting economic growth, sustainability and overall mobility of goods, people, and information.

During the 19th century, the industrialization of the U.S. economy and the expansion of railroads led to increased urbanization across the country. As cities began to grow, and people faced difficult and often unsanitary living conditions, local governments responded by digging sewers, creating water systems, paving roads, and providing public transportation. The development of a comprehensive infrastructure system made it easier for people to live in densely populated places, and allowed cities to expand and the country to prosper. During the 1950s, there was another spike in the country's infrastructure with the construction of the interstate highway system, this time enabling people to move beyond the urban core. While the highway system was viewed as great progress, this investment ushered in an era of infrastructure policy heavily focused on expanding and maintaining these highways, regardless of the country's actual infrastructure needs.

Today, as gas prices continue to rise, and our water, electric, and transportation systems continue to age, we must adopt a modern view of urban infrastructure that considers the real needs of city residents.



Rising infrastructure costs have rivaled increased costs in healthcare and pension.

Cities are facing multiple infrastructure problems with limited resources.
While some cities are considering their various infrastructure needs, they are often doing so in silos. It makes no sense to dig up streets to lay fiber and then do it again to expand the area of permeable pavements. This might be called the "dig once" principle. There is real benefit to be achieved by breaking silos of funding and planning and integrating transportation, broadband and water investments.

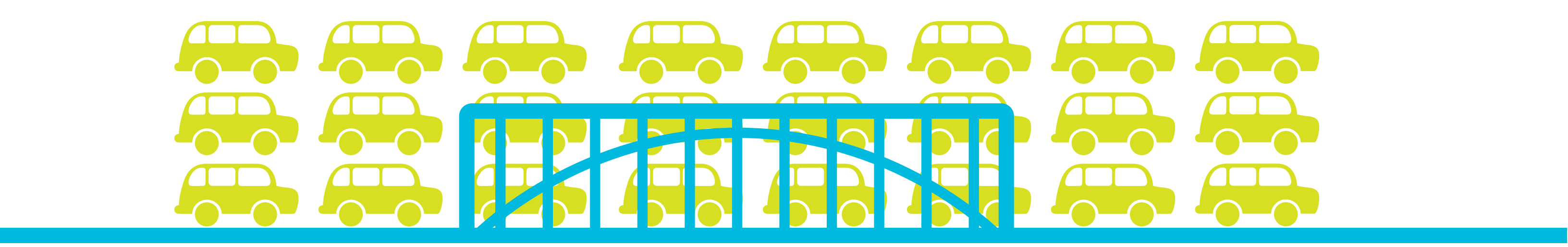
Cities are facing fiscal pressure and aging assets.
According to a survey conducted by the National League of Cities, rising infrastructure costs – including water, electric, sewer, and transportation - are the fourth most common driver of increased costs for cities. In the same survey, over half of cities questioned say they report more than 50 burst water mains annually.[7] In addition, in many cities, bus and rail assets are under maintained, contributing to the fiscal pressure cities will face in the years ahead. While rail and bus have similar capacity to carry passengers across US cities, many cities focus on maintaining and expanding rail, despite the fact that it is five times more costly than buses.[8]

Strains in the transportation system will continue to have a disproportionate impact on low-income people, who depend on public transportation for basic mobility.
First, low-income transit riders tend to live further from the urban core, resulting in less access to transportation. As a result, low-income people have even higher transit wait times as they are generally unable to substitute public transit with more convenient options. Further, there is an underinvestment in transportation in low-income areas, resulting in poorer quality transportation. This impacts employment prospects, access to services, and inhibits social mobility. Low-income shift workers are disproportionately affected by these longer wait times as irregular schedules can impact their work schedules and livelihood.

Emerging Responses

As the nation's infrastructure continues to age, some cities are considering innovative new ways to introduce a more modern infrastructure:

Urban areas have **~26% of road miles** and **~25% bridges**, but receive **66%** of total vehicle traffic



7. National League of Cities 2011 Fiscal Survey

8. US DOT; McKinsey analysis

Some places are considering innovation financing mechanisms to support their infrastructure needs. The West Coast Infrastructure Exchange, for example, holds promise for becoming a center of expertise that crosses silos and jurisdictional lines to improve the environment for infrastructure investment. The partnership is being launched to develop innovative methods to finance and facilitate the development of the infrastructure needed to improve the region's economic competitiveness, support jobs and families, and enhance quality of life. This would be an alternative to traditional infrastructure banks. Those are devoted to a single area of infrastructure (e.g. energy or transportation) and have not been able to attract private financing to leverage public money.

Some cities are partnering with the private sector to expand broadband. For example, Gig.U is an initiative that seeks to accelerate the deployment of high-speed internet to leading universities and their surrounding communities. The university serves as the hub for the service, but the surrounding community benefits. The initiative has already garnered over $200 million in private investment. Similarly, The Google Fiber initiative is bringing service to residential consumers in places, such as Kansas City, attracting new businesses in the process.

As the transportation system continues to struggle, some cities are beginning to address these challenges through creative pricing, while managing current income disparities. For example, some cities are managing cost disparities through measures such as transit subsidies based on income, travel vouchers, and reimbursement schemes.

Many cities are also looking to provide public transportation more strategically by encouraging transit-oriented development (TOD), a land use and transportation strategy that emphasizes place-based solutions to connecting people to housing, transit, and other key services. Encouraging density growth in transit-oriented areas (rather than car-dependent areas) helps reduce congestion, improve the environment (reduced air pollution), and increase overall livability.

In Boston, black bus riders experience

162 minute

excess commute time compared to white auto commuters

TREND 3

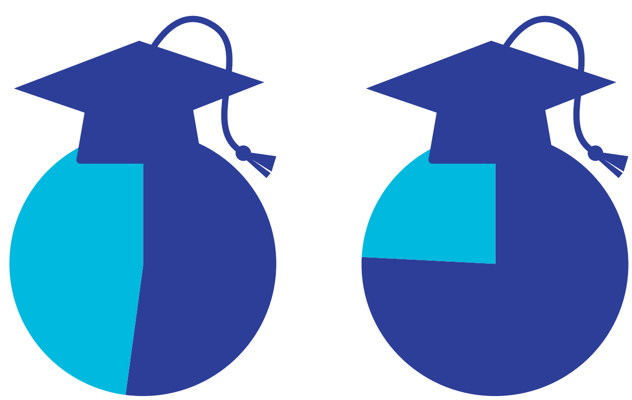
Poor Educational Outcomes

Stagnant educational outcomes have implications for talent production, attraction and matching to jobs.

America's long commitment to universal education for all citizens has been viewed as the great equalizer and the cornerstone of our democracy. As a result, our educational system has come to mirror the development of the country. The nine-month school year reflects past needs to accommodate summer harvests in America's agricultural economy. A focus on reducing educational inequality – as seen through Brown v. the Board of Education and the creation of Pell Grants – reflected the tides of change in our country. And today, calls for school vouchers and the spread of charter schools reflect the public's dissatisfaction with a failing school system, and our country's declining ability to compete globally. The American public school system is broken, yet many of the attempts to address these challenges are steeped in what worked in the past or focused on point interventions (e.g. a third grade reading program) rather than true systems transformation. What we need is a new vision and approach for our educational system, as we can expect current challenges to continue into the future.

First, growing fiscal pressure on cities and states is reversing the educational investment trend as cities are forced to cut costs. Pressure on education budgets is leading to layoffs, furlough days, and reduced investment. In some cases, the practice of laying-off teachers based on seniority rather than effectiveness may compromise student outcomes. **Still, spending does not guarantee better student outcomes.** Increased investment is not leading to a meaningful improvement in outcomes despite a four times increase in investment over the last 50 years. In just 2011, 48% of public schools were deemed "failing"

Only **52%** of African American students graduate high school on time, compared to roughly **76%** of white students.



– up 20% in one year.[9] Further, US high school graduation rates lag nearly all OECD countries.

Outcomes will continue to be particularly poor for low-income and racial minority students, who are less likely to complete high school and college. While the racial achievement gap is narrowing, it remains significant, with African American and Latino students approximately one to two years behind their white peers. Further, racial and income gaps in high school graduation rates are leading to poor college participation and completion. Only 52% of African American students graduate high school on time, compared to roughly 76% of white students. In addition, very few low-income students graduate from a four-year college – 41% of low-income students start college, but only 9% graduate.[10]

Not only is student performance low, the educational system is not preparing students for a changing job market. Currently, a mismatch exists between the national demand for jobs and the expected output by the educational systems. By 2020, approximately 1.5 million additional college graduates will be needed to meet employment demand and roughly six million high school dropouts will not have jobs.11 In order to link more people to opportunity, we need to think about the educational-employment system from cradle to career.

Emerging Responses

As student test scores remain stagnant, cities are looking for key levers to shift the tide, including:

- **Focusing on the cradle-to-career pipeline–** Building off of the success of the Strive Partnership in Cincinnati, The Strive Network is becoming a leader in the national cradle-to-career movement, demonstrating how cross-sector teams in cities can use shared goals and common metrics to develop an educational pipeline that prepares children for career opportunities as adults. By building a cross-sector table of stakeholders and holding them accountable through data, Strive is breaking down silos and addressing every aspect of the educational system.
- **Increasing teacher effectiveness–**By adopting incentive-based teacher and principal performance contracts and evaluation systems, which incorporate measures of student attainment and growth.
- **Innovative school models–**Technology offers the potential for innovative school models, such as virtual classrooms, and personalized learning. A "blended delivery" model of instruction is emerging and sparking some convergence in traditional, charter, and virtual schools, combining face-to-face and online delivery of instruction. One model, the "flipped classroom", devotes class time to more interactive and collaborative instruction, and reserves passive instruction (i.e. lectures) for homework, where students can watch taped lectures at their own pace. One resource growing in popularity is the Khan Academy, which offers more than 2800 educational videos covering a variety of subjects. And, Massive Open Online Courses (MOOCs) take the best professors at the best universities and make their courses available online around the world.
- **Diverse school operators –**Permitted in 40 states and DC, charter schools tend to serve a higher percentage of low-income, minority, and urban students. In the last 10 years, charter school enrollment has increased approximately four times.

9. National Assessment of Educational Progress (NAEP); Current Population Survey 2010; Center on Education Policy; "The Economic Impact of the Achievement Gap in America's Schools", McKinsey analysis

10. National Assessment of Educational Progress (NAEP) 2009 reading assessments; US Census Bureau; Current Population Survey, 2010; Bill and Melinda Gates Foundation

11. McKinsey analysis

TREND 4

Skills/Job Mismatch

The changing economic landscape is creating unemployment and shifting centers of job creation.

Over the past few decades, jobs that once flourished in the urban core have moved outward to the suburbs and increasingly abroad, effectively disrupting the American workforce. Gone are the days when workers could depend on local businesses or factories where they live for employment, reducing the role neighborhoods have on the economic well-being of their residents. Not only have the jobs moved, they have also changed. We find ourselves in an increasingly global trading system where the U.S. is but a single player, and the skills we're teaching people are not necessarily the skills the global workforce demands. This skills/job mismatch trend, therefore, must be considered an extension of the education trend. We can no longer rely on the outdated education and worker training systems that no longer consistently lead to employment opportunities. We need more middle-skilled workers prepared to fill the jobs we're creating. Despite this reality, evidence shows the skills/job mismatch will persist, decreasing our ability to compete on the global stage or to create opportunity for cities and their low-income residents.

First, there is a shifting demand for labor.

Demand for labor in cities is being shaped by forces including macroeconomic trends, globalization, and growing business complexity. Over the last 10 years, there has been an overall decline in job growth with job opportunities shifting from manufacturing to services and towards management and professional occupations. However, job growth in service industries is projected to continue, with greatest potential in high-skill sectors, such as healthcare and business.[12]

Despite job growth in certain sectors, there are inadequate levels of educational attainment in the US workforce that will continue to grow.

Workers with limited education will continue to face high unemployment levels compared to those with higher education degrees – a trend that his been growing since 2007. In fact, it is projected that more than six million low-skilled workers will be in need of work by 2020.[13] In addition, workers lack key content knowledge. Employees are failing to acquire comprehensive skill sets, including soft skills (punctuality, professional dress, customer service skills, etc.) and specific job-related skills. Programs working to close the work gap are generally focused on improving the curricula or delivery of instruction in educational institutions. Still, employers at all levels are finding it difficult to fill positions with qualified applicants – particularly in management and science/engineering.

12. CPS; BLS; McKinsey Global Institute

13. McKinsey Analysis

Compounding the need for greater skills is the fact that people are experiencing decreased labor mobility. Labor mobility in the US is at its lowest point in 50 years, preventing the efficient reallocation of labor across geographies. This is partly driven by the housing crisis as individuals tied to mortgages cannot move.[14]

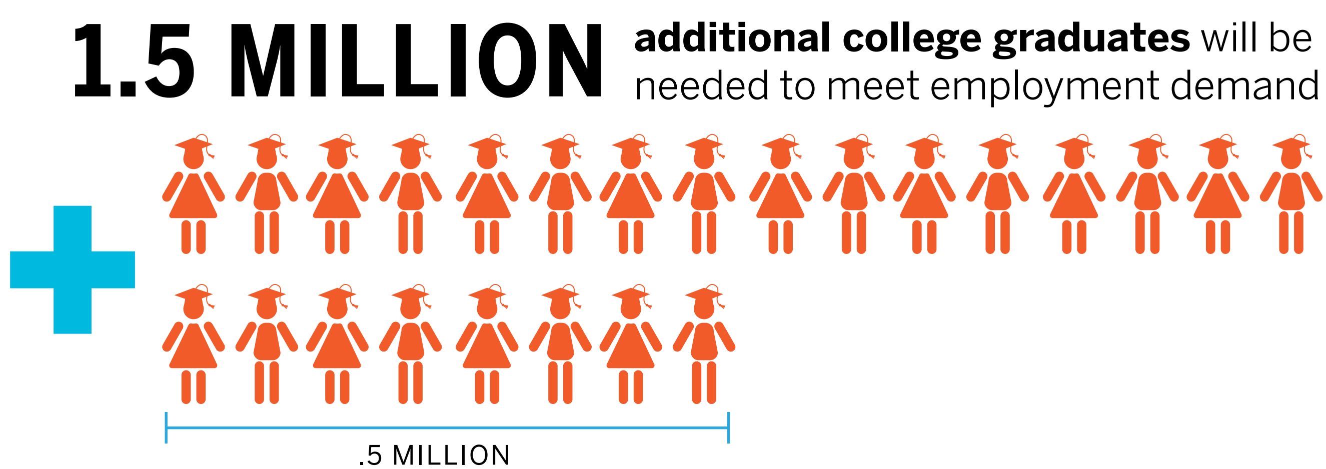
A growing number of American companies are "reshoring," or bringing manufacturing back to the United States. A survey of American manufacturing companies by the Boston Consulting Group (BCG) revealed that 37% of those with annual sales above $1 billion were planning or actively considering moving production facilities from China to the U.S., and 48% of the biggest firms were looking at reshoring. One motivation for the shift is that, according to some estimates, as early as 2015 it could cost about the same to manufacture goods (including labor, transport costs, etc.) for the American market in certain parts of the country as in China for many industries, including computers and electronics. With increasing job opportunities on the line, Americans workers will have to be prepared for this trend.

Lastly, the aging workforce will likely exacerbate the skills shortage. The workforce is aging rapidly, as 25 million people are projected to leave the workforce between 2010 and 2025 – that's roughly one-third of the entire workforce. This has the potential to increase the talent gap as retiring workers have slightly higher educational attainment than the overall workforce, leaving the overall workforce less skilled as employers demand workers with higher education and management skills.[15]

Emerging Responses

As student test scores remain stagnant, cities are looking for key levers to shift the tide, including:

Many places are working with employers to identify what skills workers need. The National Fund for Workforce Solutions emerged in 2007 and continues to be a pioneering initiative of national and local funders using a model of substantial employer engagement to advance the careers of low-wage workers. This dual-customer effort



14. US Bureau of Labor Statistics; McKinsey Global Institute analysis

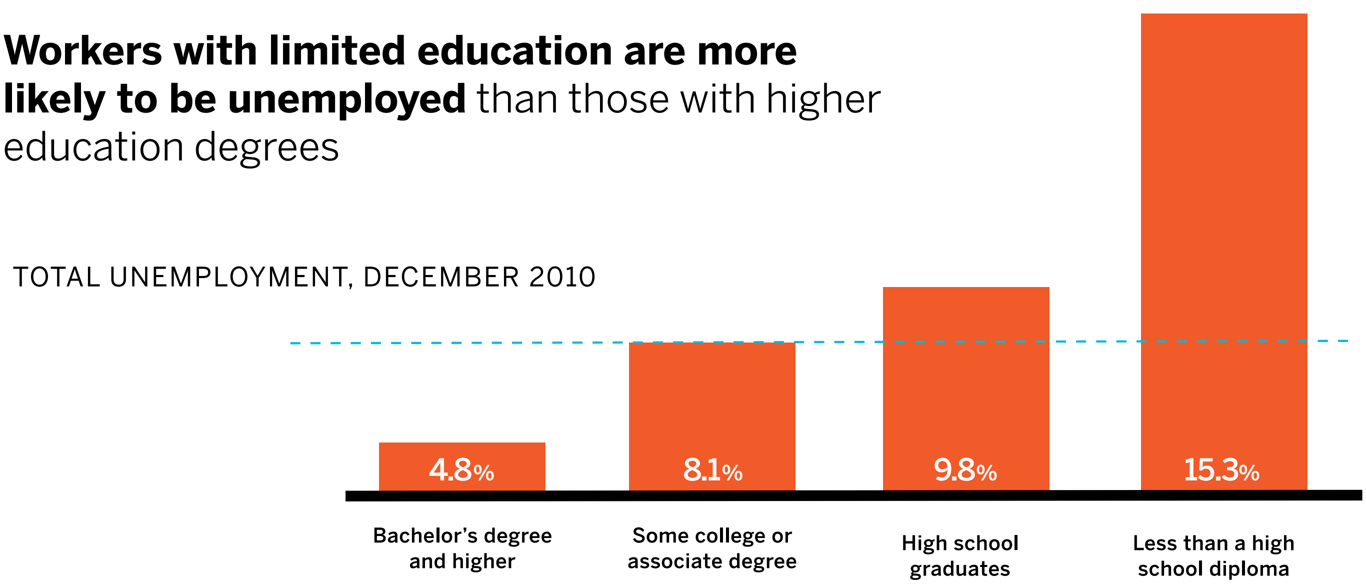
15. US Census; Bureau of Labor Statistics; McKinsey analysis

has invested in organizing employers, creating workforce partnerships, and advocating for public policies and private practices that make businesses more competitive and workers more likely to earn family-sustaining wages. The unique value of the National Fund rests on its support for local communities to organize and sustain regional funding collaboratives that invest in worker skills and their key regional industries.[16]

Over the last 3 years, 65% of US businesses have made operational improvements, which involved reducing labor.[17] As businesses are learning how to make do with fewer employees, many of these jobs will not return. As a result, cities are focusing on strategies to spur job creation, such as:

- **Fostering innovation, new business creation and new industries.** Some cities are working to distinguish or brand themselves as innovation centers to spur job creation and attract investment by outside companies.
- **Some cities are working to remove impediments to business investment.** Friendliness to start-ups and small businesses varies across the US based on ease of starting a business, hiring costs, regulations, labor and hiring, tax code, licensing, etc. In response, cities are looking at using lean management techniques to fast track regulatory approvals and create one-stop shops for business permitting.
- **The Brookings Institution's Global Cities Initiative is helping cities understand their trading partners and where they can grow from existing strengths.** The Initiative is a $10 million, five-year project of Brookings and JPMorgan Chase aimed at helping the leaders of metropolitan America strengthen their regional economies through research, data analysis, and convenings to become more competitive in the global marketplace.
- **Other leaders focus on "Economic Gardening"** or really understanding the businesses that you already have that can and want to grow. The idea is to foster entrepreneurship as a primary lever for greater economic development.

Workers with limited education are more likely to be unemployed than those with higher education degrees



16. National Fund for Workforce Solutions www.nfwsolutions.org/about-us

17. McKinsey Global Institute US Jobs Survey, 2011

TREND 5

Struggling Housing Market

The collapse of the housing market and the tightening of the rental market are creating material pressure on household economics and the health of communities.

Nothing has been a greater sign of achieving the "American Dream" than owning a home. Being a property owner was once the measure of true citizenship, and home ownership became the goal of generations of Americans. Even our government has traditionally held the belief that people do better when they own their own homes. As a result of these engrained beliefs, much of our modern housing policy has worked towards spreading home ownership, and overcoming discriminatory practices of the past that prevented many minority and low-income families from owning their own homes. However, such policies often created perverse incentives for lenders and consumers alike. According to a New York Times article "lenders who peddled easy credit, consumers who took on mortgages they could not afford and Wall Street chieftains who loaded up on mortgage-backed securities without regard to the risk," were all to blame for the recent mortgage crisis.[18]

The bursting of the housing bubble has destroyed much of the wealth households built, and has challenged our devotion to home ownership. Today, we are faced with a struggling housing market and strained rental market that will continue to make recovery slow.

First, there is a low demand for homeownership due to high unemployment, stagnating wages, and damaged credit scores. As owners are forced to sell because of negative equity or move to rental homes, there is an oversupply of single-family homes, which has led to a decline in home values. Despite these declines, a majority of younger Americans still prefer to own their homes. However, the housing recovery is expected to be unbalanced as negative equity remains severe in some states. **There is also a tightening rental market** as renters are experiencing price pressure on rental stock, and there is an increased demand as people move away from home ownership. This is compounded by the undersupply of rental homes, especially for low-income city residents as multifamily home production is at its lowest in 17 years.[19]

Further, decreased home values have reduced the use of housing equity for investment.

Real net household wealth plunged $12.4 trillion from 2006 to 2010, and decline in home equity accounted for 61% of the drop.[20] As a result, individuals in negative equity are tied to their mortgages, exacerbating the spatial mismatch of jobs and employment as stated earlier. Reduced home values are contributing to the decline of entire neighborhoods, which struggle to attract business and investment.

18. Jo Becker, Sheryl Gay Stolberg, and Stephen Labaton, "Bush Drive for home ownership fueled housing bubble," New York Times, December 21, 2008, http://www.nytimes.com/2008/12/21/business/worldbusiness/21iht- admin.4.18853088.html

19. Expert interviews; McKinsey analysis

20. Expert interviews; McKinsey analysis

Low-income people have been placed at a greater disadvantage because of the crisis. Low-income residents faced the highest foreclosure rates, and are less likely to be able to refinance their mortgages because of poor credit scores. **Still, housing affordability problems are creeping up the income scale.** Households earning between $45,000 and $60,000 saw the biggest increase in their share of income spent on housing, paying more than 30% of their income, up from 7.9 percentage points since 2001. 17.1% of American households – an unprecedented 19.4 million – spent more than half of their incomes on housing.[21]

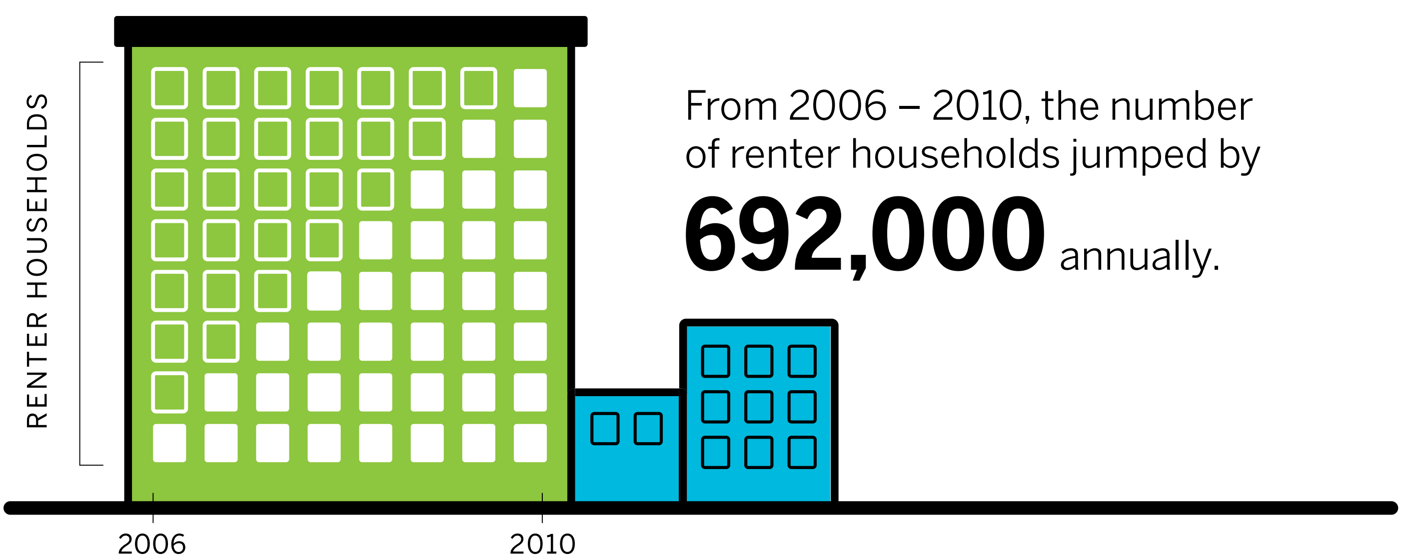
Emerging Responses

The changing housing market is serving as an opportunity to rethink our approach to rebuilding communities.

Policymakers are recognizing the interconnected nature of all these trends, and are no longer relying on housing as a panacea for poverty. For example, HUD's Choice Neighborhoods grants that work to transform distressed neighborhoods into viable and sustainable mixed-income communities. As HUD Secretary Shaun Donovan explained, "we're emphasizing a comprehensive approach to revitalizing neighborhoods by considering the totality of a community with regard to health, safety, education, jobs and quality housing in mixed-income neighborhoods."[22] Choice neighborhoods also considers the critical role that quality public transportation serves in creating access to these key services and opportunities. Further, local governments are recognizing that they must work with businesses and developers in order to advance place-making strategies as well as market driven approaches to affordable housing.

In addition, distressed and abandoned housing lots have given communities an opportunity to rethink land use policy in creative ways.

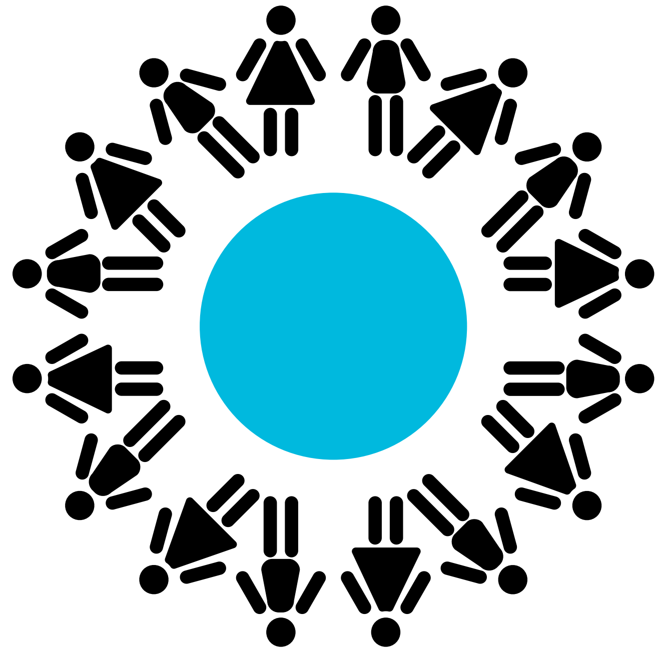
The urban agriculture movement in cities like Detroit, as well as innovative open space designs and green storm water proposals seen in Cleveland are among the many ways cities are rethinking their planning efforts.



21. JCHS tabulations of US Census Bureau, 2001; 2009 American Community Surveys

22. HUD http://portal.hud.gov/hudportal/HUD?src=/states/ohio/news/HUDRegionV12-104

A Vision Forward



The complex nature of these trends underscores our belief that no one organization or sector can solve these problems alone. Fortunately, we are at a unique time when leaders across sectors are beginning to recognize the importance of U.S. cities. Many books and organizations have emerged touting the key role of cities in building tolerance among people, spurring economic growth nationally, and accelerating new ideas that improve how we live. The level of attention being paid towards American cities is long overdue, but noticeably absent from these conversations is the fact that low-income people face tremendous hurdles to accessing the opportunities that cities create. At Living Cities, we're working hard to harness this momentum and ensure that our leaders recognize the need to reengineer our urban systems for the benefit of all people.

We believe that in order for cities to adapt to this changing world, our leaders must find new ways of working together. It is imperative that we build a new civic infrastructure that supports collaboration; that we develop a high performing public sector that provides leadership and resources more strategically; and that we spearhead capital innovation to ensure the sustainability of our efforts. These strategies can help us address the anticipated trends and work towards achieving population-level results, ensuring all city residents can access the unique opportunities cities provide.

COLLABORATIVE CHANGE:

Isolated approaches to fixing our most intractable problems have not worked. There needs to be new, local, 'civic infrastructure' built around one table where cross-sector decision-makers come together to set ambitious goals, use data to transform systems and achieve better outcomes. Living Cities has successfully been supporting this type of civic infrastructure in cities across the nation. As mentioned above, Strive has used this approach to move the needle in education in just six years—including a 13% increase in school readiness, a 16% increase in 4th grade reading levels, and a 7% increase in college enrollment. With Living Cities support, the Strive Network has helped spread this innovative framework to 80 more sites.

We've adapted the Strive cross-sector leadership model to stimulate systems changes in workforce (Baltimore), economic development (Cleveland), urban revitalization (Detroit), equitable transit-oriented development (Twin Cities), and education and health (Newark) through our

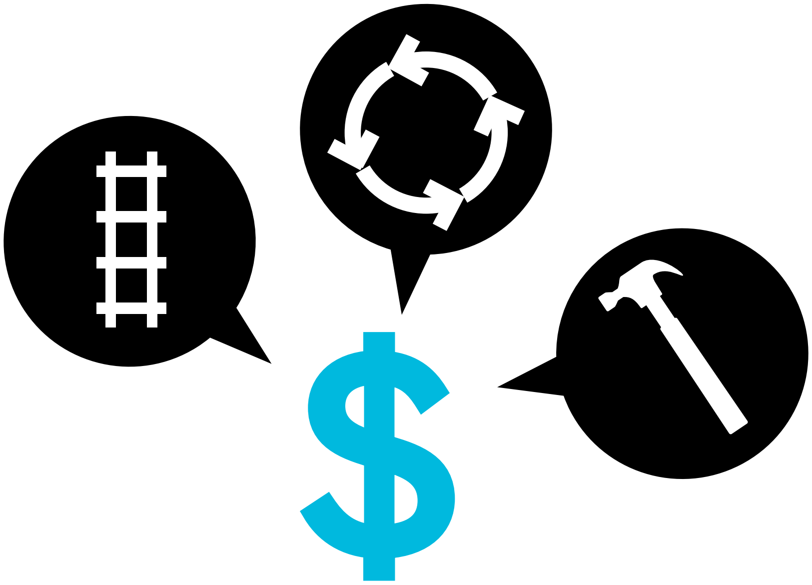
signature effort, The Integration Initiative (TII). After just two years, we have gleaned important lessons on realigning institutions across issues, sectors and disciplines. We also have seen significant evidence pointing to enduring change. In the Twin Cities, for example, five local and state funding streams have been permanently redirected to support the build out of a light rail transit system that will increase low-income residents' mobility. There has also been increased integration across discipline areas and stakeholder groups in all sites, with one of the biggest changes being increased relationships with the private sector. In both Baltimore and Detroit, CDFI capacity has been strengthened by the introduction of The Reinvestment Fund (TRF) and NCB Capital Impact respectively as lenders to the initiatives.

PUBLIC SECTOR INNOVATION:

Our chances of achieving transformative change dramatically improve when local government is nimble, collaborative, data-driven, and focused on leveraging public resources to transform systems. As discussed earlier, cities such as Boston are exploring innovative ways to leverage public data and technology to improve city operations and are alleviating their strained budgets in the process. The public sector is uniquely positioned to make these innovations part of everyday life as the public sector has the authority to set policy, invest resources, and institutionalize and run programs. For these reasons, we have to strengthen government as a partner, rather than trying to work around public sector efforts.

Living Cities' Project on Municipal Innovation (PMI), a partnership with Harvard's Kennedy School of Government, has become a trusted platform for local government leaders to work together to do just that. Through PMI, mayoral chiefs of staff from 35 cities and counties, representing 40 million Americans, meet semi-annually to learn from each other and co-create new strategies to common challenges. Issues range from harnessing Big Data to addressing much needed infrastructure needs and escalating pension costs. PMI allows Living Cities, federal partners, and thought leaders a strategic and ongoing platform to work directly with some of the country's largest and most creative cities.

In 2012, Living Cities launched a corollary network with the Brookings Institution and 12 state economic development agencies. We are working with them to facilitate similar cross-fertilization of ideas and innovation at the



state level. Our leadership in municipal innovation was recognized by Bloomberg Philanthropies in 2012 with a seat on the 12 person selection committee for its nationwide Mayors Challenge competition. Bloomberg also awarded Living Cities a $16.5 million grant to incubate The Cities for Financial Empowerment Fund which is now replicating New York City's Centers for Financial Empowerment in Denver, Lansing, Nashville, Philadelphia, and San Antonio.

CAPITAL INNOVATION:

We recognize that grants alone cannot support solutions to overcoming the challenges cities and low-income people face, making private sector investment critical to achieving population level impact. Living Cities is acting as a platform for rethinking community investment to better meet the needs of American cities and their residents in the 21st Century. This includes the sort of innovations discussed earlier that the West Coast Exchange is exploring in order to become a channel for infrastructure projects to get private funding. Much of the present system is rooted in the neighborhood and focused primarily on the debt financing of real estate. It is divorced from the need to create economic opportunity, invest in human capital, and unable to respond to challenges that go beyond the traditional boundaries of community development, such as funding of infrastructure. There is a palpable hunger in the field for new solutions and an evolution in thinking. Fortunately, there are investors who care about the future of cities and want to invest in revitalizing these communities. However, they often lack the staff or skills to source, underwrite and monitor social investments. In addition, many cities do not have the mechanisms to attract and deploy capital in place. As a result, strategies are needed to enable institutional and individual investors to use available capital to improve America's cities.

Our capital absorption agenda – focused on how the actors in cities are organized to accept and deploy investment in order to create an environment that puts dollars to work on behalf of low-income people – is gaining national interest from practitioners and more than a dozen cities across the country. As part of this effort, we developed a diagnostic tool for cities to assess their capital absorption capacity and have begun working closely with cities on conducting studies to identify how they can best fill their gaps.

Conclusion

The five trends highlighted in this report have the potential to greatly impact cities in the years ahead. While each trend has particular challenges to consider, these areas are inextricably tied.

For this reason, no one institution or sector can reverse the direction of these trends. Improving the state of cities and increasing opportunity for low-income people will require unprecedented collaboration—problem-solving networks of public, private, and philanthropic actors working together in new ways. We hope that outlining these trends, and highlighting how we are approaching this work with our partners, will help leaders across sectors to better understand their role, and how they can most effectively work with others, to ensure that cities are truly places of opportunity.

ABOUT LIVING CITIES

America's cities are the engine for national prosperity and individual economic opportunity. Indeed, for generations, low income people from around the country and the world viewed our cities as the best path to a better life. But in recent decades, that has been less true. Living Cities harnesses the collective power of 22 of the world's largest foundations and financial institutions to change that course by scaling new approaches for creating opportunities for low income people and improving the cities where they live. These institutions are not simply our funders; they serve as our Board of Directors and contribute the time of over 100 of their expert staff.

We view this working paper as the basis for continuing dialogue and invite your questions, reactions, and comments

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