

# Diversification of Capital Creates Fresh Focus

By Heather Hood, Enterprise Community Partners

reating new money is a lot like making stone soup. Just like in the famous children's tale, diverse players must come together to leverage and pool resources to create something more substantial than they could alone. Financial 'chefs' can cook this base of combined public and private resources, and use it as a catalyst to secure other key components in the affordable housing process.

Unfortunately, on their own the private markets do not create sufficient affordable housing or many other community serving needs, like health clinics or community centers. It does not appear that in our country's foreseeable future, public subsidies will ever be enough to meet such needs. To do so will take the willingness and ingenuity of interested entities from all sectors. This article

will highlight a few promising and innovative ways to create resources for community-serving needs, combining components from public policy, public investments, and private development.

#### **Public Policy**

Public funds and public investments are as essential as broth in soup. Public policy sets the parameters for the creation of affordable homes in many ways. Inclusionary zoning (IZ), for example, is a policy tool that either requires developers to offer lower-priced units in otherwise market-rate developments, or encourages their inclusion through incentives such as density bonuses. In some cases, IZ is the most financially efficient mode for municipalities to achieve their affordable housing goals. Independent

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consultant reports are mounting all across California advising clients, usually cities, about the sensitivity of private developers to IZ policies. The common thread of the logic in these varied reports, whether they are written for urban or suburban settings, is that in the hottest markets with relatively predictable entitlement processes, an IZ policy is viable.

IZ policies have had a rough run in the past five years. For example, the 2009 Palmer v. Los Angeles court decision limited the ability of California cities to apply inclusionary requirements to rental properties and, since the market downturn when ownership units were stalled, this remains a barrier for many California cities. Nonetheless, in San Francisco, even as the market is recovering from the recession, the housing market is so strong that the IZ policy is not dissuading private developers. Since 2009, San Francisco's policy has resulted in the entitlement of 1,001 affordable homes, roughly half of which are built or under construction thus far. In November 2012, San Franciscans passed local ballot Measure C, which reduced the city's on-site affordability requirement from 15 to 12 percent in most areas of the city. The reduction was designed to be sensitive to current market conditions and was part of a package that created a citywide Housing Trust Fund with ongoing, annual allotments of at least \$20 million from the city's General Fund. The reduction in the affordability requirement was also designed to encourage greater on- site production on the heels of the city's transition to a fee-based requirement. This innovation pursues three things all at once: it ensures that communities are mixed-income, works around the Palmer ruling, and creates a new source for affordable housing production.

There are many other examples of ways that public investments catalyze other investors to take action. The Low Income Housing Tax Credit (LIHTC) is a primary example. The LIHTC Program, which was enacted by Congress in 1986, provides the private market with an incentive to invest in affordable rental housing. Federal housing tax credits are awarded to developers of qualified projects. Developers then sell these credits to investors to raise capital (or equity) for their projects, which reduces the debt that the developer would otherwise have to borrow. Because the debt is lower, a tax credit property can in turn offer lower, more affordable rents. Provided the property

maintains compliance with the program requirements, investors receive a dollar-for-dollar credit against their federal tax liability each year over a period of 10 years. The amount of the annual credit is based on the amount invested in the affordable housing.

As noted in a recent article in the *Community Development Investment Review* titled 'Pay for Sucess: Building on 25 Years of Experience with the Low Income Housing Tax Credit,' Terri Ludwig, President and CEO of Enterprise Community Partners, said "After over \$100 billion in private capital in 25 years, our industry truly has gained many insights from the Low Income Housing tax Credit (LIHTC). The industry continues to sharpen the LIHTC tool and is ready to share the wisdom as we create inspiring new tools such as Social Impact Bonds.<sup>2</sup>

Social Impact Bonds are a newer tool that serve as a contract with the public sector in which a commitment is made to a non government entity to pay upfront for programs and projects that result in improved social outcomes. The outcomes are designed to result in public sector savings. These performance-based investments encourage innovation and tackle challenging social issues such as health care delivery and education. New and innovative programs have potential for success, but often have trouble securing government funding because it can be hard to rigorously prove their effectiveness. Social innovation financing allows the government to partner with pioneering service providers and, if necessary, private foundations or other investors willing to cover the upfront costs and assume performance risk to expand promising programs, while assuring that taxpayers will not pay for the programs unless they demonstrate success in achieving the desired outcomes.

In both the LIHTC and Social Impact Bonds, in essence, a government entity pays only after the private market has proven that the model for investing in buildings or programs works.

#### **Leveraging Government Investment**

One common way for the government to invest in affordable homes is in the form of direct subsidies to specific projects that bridge financing gaps. In municipalities in California dealing with the loss of redevelopment-based tax increment financing last year, however, as well as in many cities across the country that are cash-strapped, these types of subsidies are drastically dwindling. A fresh approach to building additional resources is to use government funds to leverage capital from philanthropic, community development financial institution, and private sources. Three recent examples in California demonstrate how this can work.

Launched in 2012, the \$93 million Golden State Acquisition Fund (GSAF) finances affordable housing with

loans from a consortium of four entities: Enterprise Community Loan Fund, Low Income Investment Fund, Century Housing, and Rural Communities Assistance Corporation. The consortium serves as a revolving loan fund with access to the state funding available to the consortium's community development financial institutions (CDFIs) on a first come, first served basis. California's Department of Housing and Community Development awarded a \$23.25 million low cost loan as seed capital for the consortium to leverage by 3:1 with an additional \$69.5 million provided by the originating lenders. The Golden State Acquisition Fund has begun to make loans to housing developers to acquire real property for the development and preservation of affordable housing. Loans from the GSAF are made at favorable terms including longer terms, below-market interest rates and higher loan-to-value ratios, providing access to much-needed acquisition capital for affordable housing developers. The project loans are available statewide, and will serve urban and rural communities. Loans will lead to the development of both rental housing and homeownership opportunities for low- income California households.

A second example, the \$50 million Bay Area Transit-Oriented Affordable Housing (TOAH) Fund, launched in 2011, provides financing for equitable transit-oriented development (TOD) across the nine-county Bay Area by catalyzing the development of affordable housing, community services, fresh foods markets and other neighborhood assets. Through the TOAH Fund, developers can access flexible, affordable capital to purchase or improve available property near transit lines for the development of affordable housing, retail space and other critical services, such as child care centers and health clinics. The TOAH Fund was made possible through a \$10 million investment from the Metropolitan Transportation Commission (MTC), a Bay Area regional transportation and planning body. The Low Income Investment Fund is the Fund Manager and an originating lender, along with four other leading CDFIs (Corporation for Supportive Housing, Enterprise Community Loan Fund, LISC, and the Northern California Community Loan Fund). Private capital for the TOAH Fund was provided by Citi Community Capital and Morgan Stanley, while program related investments were provided by philanthropies, including the Ford Foundation, Living Cities, and The San Francisco Foundation. The Silicon Valley Community Foundation also covered startup expenses.

The participation of MTC – which might be considered a non-traditional partner in the affordable housing arena – has been key to the success of the fund. MTC recognized that development enabled by the TOAH fund would encourage ridership on public transportation and improve environmental outcomes by diminishing auto transport,

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and as such would support the agency's broader goals. The program has proved to be such a valuable investment that just two years later, MTC made an additional \$10 million grant to help expand the fund. Enterprise is exploring recreating such funds in other regions, including in Sacramento and Los Angeles counties partnering with LIIF, and in the Seattle-Puget Sound region partnering with Impact Capital.

A final example demonstrates how public investment can be used in a long-term, scattered site public housing project that engages multiple sectors. HOPE SF is the nation's first large-scale public housing revitalization project to prioritize current residents while also investing in high-quality, sustainable new housing and broad-scale community development. In existing public housing sites across San Francisco, HOPE SF is creating mixed-income communities that provide residents healthy, safe homes and the support and services they need to succeed, including better education and workforce development programs, new local businesses and onsite residents by just providing shelter.

In the case of HOPE SF, Federal US Department of Housing and Urban Development funds that flow through the San Francisco Housing Authority seed the capital it takes to rebuild these homes. These federal funds are never enough to rebuild properties, but they can serve to leverage other funds. In HOPE SF the federal investment was able to leverage LIHTCs and now myriad other investors are in play. Of the communities being rebuilt thus far, a private developer, the John Stewart Company, is building one, while a nonprofit developer, Mercy Housing, is developing the other.

When it is complete, the initiative will transform obsolete housing projects into vibrant neighborhoods with over 6,000 new public, affordable and market-rate homes—more than doubling the original number of homes. HOPE SF housing communities are in areas of the city struggling with persistent crime problems, property decay, and a lack of grocery stores or laundromats within walking distance. HOPE SF will invest several hundred million dollars in these neighborhoods over time to preserve their strengths and bolster their communities. At a time when

federal money for public housing revitalization has decreased, San Francisco launched an innovative campaign to fund these improvements with a combination of public and private dollars.

Critical to the success of HOPE SF is the Campaign for HOPE SF, a unique public-private partnership with a bold goal to raise \$25 million in capital by 2016. The Campaign for HOPE SF is a collaborative of foundations, nonprofit organizations, government agencies, and community members, which brings in private resources in the form of funding and other support to strengthen the revitalization of HOPE SF communities. It will leverage support and invest dollars in a range of areas – specifically workforce development, education and community health to ensure the best outcomes for HOPE SF residents and neighborhoods. This means better coordinating and colocating services as well as raising funds and developing programs that are better integrated into current community needs. The Campaign was created in 2010 through a public-nonprofit partnership between the City of San Francisco, Enterprise Community Partners and The San Francisco Foundation, and is now a partnership with public, mission-based, and private sector partners including Bank of America, JP Morgan Chase and the Walter and Elise Haas Sr. Fund. HOPE SF not only demonstrates another example of how land and other public resources can leverage revitalization, it also exemplifies how tightly knit leadership and coordination amongst all sectors is key to success.

#### **Leveraging Private Investment**

One example in the Bay Area shows the benefit of the private sector joining the effort to address the need for affordable housing. This initiative is a pilot between Waypoint Homes and Enterprise to purchase, renovate, and lease 100 single-family homes that have been foreclosed upon in distressed neighborhoods in Oakland, California.

"Enterprise has seen a lot of attention focused on the new 'asset class' of single-family rental homes, but many neighborhoods hardest hit by the foreclosure crisis are not benefiting from this increased investment activity," said Rob Grossinger, Vice President of Community Revitalization at Enterprise. "Our goal with this pioneering partnership is to bring private equity investment into neighborhoods that desperately need stabilization."

Enterprise and Waypoint will contribute an initial investment totaling \$1.6 million in equity, and Citi Commu-

nity Development will provide a \$150,000 grant to fund the first phase of 20 homes. Enterprise and Waypoint are working together to raise the remaining debt and equity to reach the \$20 million program cost. Waypoint serves as the general operating partner and will utilize its successful REO-to-rental model to assess acquisition targets, complete the property rehabilitation, and manage the properties using its sophisticated customer service platform. Enterprise will coordinate tenant financial education and the workforce development component at the construction sites. Enterprise also will serve as liaison with the local nonprofit groups in the neighborhoods and with local government representatives. Additionally, debt counseling and training in budgeting skills for the residents will be offered by a trusted local community development corporation, East Bay Asian Local Development Corporation. The program is designed to ensure that low- and moderate-income renters are able to sustain rent payments while building assets for future homeownership or other financial goals.

Colin Wiel, co-founder and managing director of Waypoint Homes, said, "Scattered site single-family rental is a key national issue and government, nonprofit, and for profit organizations are trying to solve the operational challenges of developing these homes as affordable rental housing." If the model works in Oakland, Waypoint and Enterprise can scale the model to other places throughout the country.

#### **Looking Ahead**

In the current context of diminishing government funding, we need to be ambitious and creative in leveraging the resources we do have. In order to create affordable homes and other community needs, the community development finance field needs to continue to push our new boundaries and stretch our models to create partnerships and pool resources. Public and private interests need one another to succeed. Silos between the transportation, health, and housing sectors are being removed, partially out of necessity and partially out of a conceptual shift in which diverse partners realize we seek similar outcomes. The promise of creative diversification of funds for a public-minded mission, evident in the examples described above, can inspire similar efforts using this model to build and support stable communities through pooled resources and strong coalitions. CI

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## Improving Financial Stability by Building the Capacity of the Local Community

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