

NHC Affordable Housing Policy Review

VOLUME 2 • ISSUE 2

NATIONAL HOUSING CONFERENCE

FEBRUARY 2002

Strengthening Neighborhoods by Creating Long-Term Multifamily Assets



The United Voice for Housing

NHC Affordable Housing Policy Review

NHC Affordable Housing Policy Review seeks to offer a balanced nonpartisan view of complex housing policy issues. This publication encourages discussion and commentary from all who choose to engage in a responsible dialogue on the housing needs of this nation. Published on an occasional basis, *NHC Affordable Housing Policy Review* provides insight into NHC's positions on key housing concerns and also includes other housing industry policy perspectives.

This issue of *NHC Affordable Housing Policy Review* was produced in conjunction with the Neighborhood Reinvestment Corporation's NeighborWorks® Multifamily Initiative's April 18, 2001 symposium entitled "Strengthening Neighborhoods by Creating Long-Term Multifamily Assets."

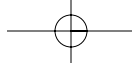
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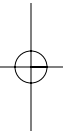
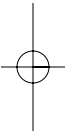
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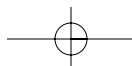
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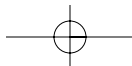
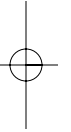
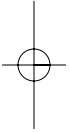
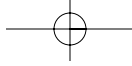
FEBRUARY 2002

Strengthening Neighborhoods by Creating Long-Term Multifamily Assets



The United Voice for Housing





FROM THE EXECUTIVE DIRECTOR:

This nation faces unprecedented affordable housing challenges. Some would contend that current conditions rival those faced by this nation's leaders over 50 years ago when the landmark 1949 Housing Act was enacted.

In its recently released report *Paycheck to Paycheck: Working Families and the Cost of Housing in America*, NHC's research affiliate the Center for Housing Policy found that in 1999, more than 13 million families had a critical housing need — either spending more than 50 percent of their incomes on housing or living in seriously substandard housing. This clearly illustrates the overwhelming need for the production and preservation of affordable housing in this country.

In April 2001, the Neighborhood Reinvestment Corporation's NeighborWorks® Multifamily Initiative presented a day-long symposium entitled "Strengthening Neighborhoods by Creating Long-Term Multifamily Assets." The symposium brought together some of the brightest minds involved in financing, developing and managing affordable multifamily housing to discuss how multifamily housing can be acquired, developed, redeveloped and operated so that it yields positive results for the owners, managers, residents and the surrounding community over the long term.

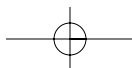
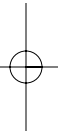
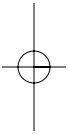
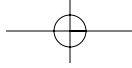
NHC was pleased to have taken part in the planning of this very valuable symposium and is proud to highlight it in this issue of *NHC Affordable Housing Policy Review*. Included in this issue are five papers written by the five lead presenters at the symposium, all of whom are NHC members. These papers were distributed in advance to symposium participants to provide a framework for each panel discussion. Also included, is a summary of the key themes raised at the symposium, along with the comments of three NHC members who examine the issues addressed at the symposium.

This material is intended to enlighten readers about the many difficult challenges faced by those in the business of developing and preserving America's dwindling inventory of affordable multifamily housing. Additionally, the ideas presented clearly demonstrate the talent, entrepreneurial skill and dedication of the participants to improve the nation's housing stock for the long-term benefit of residents and the surrounding community.

It is NHC's hope that this material will help generate further discussion around new approaches for housing America's families with critical housing needs.



Robert J. Reid



Acknowledgments

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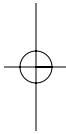
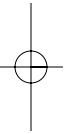
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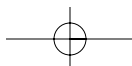
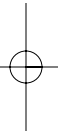
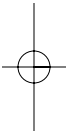
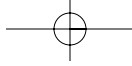
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Strengthening Neighborhoods by Creating Long-Term Multifamily Assets

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Introduction

*By Frances Ferguson
Neighborhood Reinvestment Corporation
NeighborWorks® Multifamily Initiative*

In this issue of *NHC Affordable Housing Policy Review*, the National Housing Conference and the Neighborhood Reinvestment Corporation examine, through the experiences of some of the best minds in the business, what it takes to generate affordable multifamily housing as a desirable long-term community asset, that performs successfully economically, physically and socially.

On April 18, 2001, a symposium called “Strengthening Neighborhoods by Creating Long-Term Multifamily Assets,” was held in Chicago. The symposium was sponsored by Neighborhood Reinvestment’s NeighborWorks® Multifamily Initiative, and was carried out with the generous support of the Fannie Mae Corporation, as well as with a great deal of help on the part of the National Housing Conference, which was instrumental in planning the symposium.

As the title of the symposium implies, affordable multifamily housing can be a cornerstone in the economic and social foundation of a neighborhood. Why so often that is not the case and what can be done to make it the norm was the impetus for this meeting. Those who took part—nonprofit and for profit providers of assisted multifamily housing, underwriters, funders, allocators and investors—all shared their ideas about how to create sustainable affordable multifamily housing that strengthens communities. Neighborhood Reinvestment commissioned papers on key topics to help frame the discussions.

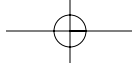
One thing this symposium was not about was assessing the critical shortage of affordable multifamily housing. Simply stated, this is a national problem which continues to grow. Instead, this event focused on the characteristics of excellence in affordable multifamily housing; how to create it and how to sustain it long-term. Some of the important topics discussed were:

Funding

Added development costs as well as recurring operational expenses that are a result of complex multi-layered funding deals; current lack of subsidy or equity sources to create adequate cash flow in properties for resident services, as well as capital and operating reserves.

Organizational Capacity

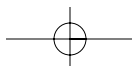
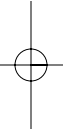
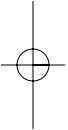
The advantages of achieving technical proficiency and attaining economies of scale in property management functions; the risk-management and leveraging advantages of large portfolios; which functions to outsource versus which capacities to build within your organization; and the need to honor “ownership” as the critical function in long-term property performance, recognizing asset management fees throughout our funding environment as a legitimate operating expense.



Resident Services

Maintaining the long-term health of affordable multifamily housing also requires attention to residents' social and economic well-being. How services improve the health of properties, add value to the property, improve the character of the community, and what available strategies can be used to fund services.

The symposium was remarkable for the candor among such a wide assortment of partners, as well as a consensus that the desired outcomes should be based on more than just property cash flows and return on investments. There seemed to be a common understanding that housing providers, need to begin to underwrite and fund properties with a clear knowledge and understanding of what it takes—organizationally and financially—for these properties to be well-run and well-maintained, while at the same time contributing to the positive social environment of the neighborhood. The bottom-line is to create properties that are likely to increase in value, creating self-refinancing opportunities, that will strengthen and reward owners over time for their strong performance in maintaining both quality and affordability.



Excellence in Affordable Multifamily Housing Properties

*By Charles Wilkins.
The Compass Group, LLC*

We have learned a lot over the years about what makes a property desirable for the residents, the neighborhood and the owner over the long term. So why aren't these properties the norm?...

...[A]ffordable housing is more successful today than thirty years ago:

Professionalism — today, we have a large and diverse group of affordable housing specialists: accountants, architects, attorneys, developers, property managers, regulators and syndicators, to name a few. Most of these professionals have 10 plus years of experience in affordable housing. Education and training opportunities are diverse, readily available, and responsive to professionals' needs.

Allocation of Funds — the tax credit, volume-cap tax exempt bond, HOME and CDBG programs feature localized allocation processes, with local ability to set priorities within broad federal guidelines. This in turn leads to useful experimentation and vigorous competition.

Reliable Funding — tax credits, volume-cap bonds, HOME and CDBG provide a stable base of funding. In turn, this allows a larger number of organizations to specialize in affordable housing, thereby enhancing competition, improving quality and driving down costs.

Lessons Learned — we now have structures in place to prevent the recurrence of some of the major problems of the past. It's unlikely we will ever again combine above market rents, project based assistance, and government guaranteed mortgage debt. We seem to have resolved not to concentrate the poorest of the poor in isolated communities.

Long Term Capital Needs — we know how to determine the ongoing major repair and replacement needs of properties. In a few cutting edge programs, such as Mark to Market, we are actually using capital needs assessments to set adequate reserve deposits.

Non Housing Services — although much remains to be learned and done, we are well on the way to understanding when non housing services should be offered at or through an affordable housing property, and how to do so.

Project Based vs. Tenant Based is now regarded as a false choice. We now understand that we need both approaches. A few of us are even inventing hybrid approaches.

Curb Appeal is now regarded as an important part of affordable housing. For the most part, we now recognize that it's a bad idea to develop affordable housing that looks 'cheap'.

However, our funding programs are flawed. Vigorous competition has sometimes allowed rose colored glasses to substitute for sound underwriting. Many lessons from the past are evident but are not yet incorporated into affordable housing practice. Some of our experimentation with non housing services and mixed income communities is

fundamentally unsound. Our unavoidably schizophrenic identity — pursuing an anti-poverty mission through a businesslike real estate system — often means that we act like bankers when we should act like social workers, and vice versa.

...[A] look at the best affordable multifamily housing [shows that] sustainably excellent affordable multifamily housing:

1. *Is owned and managed by professional affordable housing organizations that are competent, committed to affordable housing, and have access to adequate capital.* These organizations have the ability to survive market fluctuations, to survive in the absence of development opportunities, and to survive the departure of key staff. They monitor their properties closely, heading off most problems before they occur. I believe that the for-profit or not-for-profit status of the owner is largely irrelevant, by comparison to the characteristics noted above.
2. *Is truly affordable for its actual residents. Excellent affordable housing is developed:*
 - For a particular target market, with a thorough understanding of customers' household sizes, incomes and housing needs. Not "build it and they will come."
 - With rents that are affordable based on the actual incomes of the target households, taking into account other demands on their incomes, and when there are a sufficient number of target households. Large numbers of tax credit properties failed because there were too few households with incomes low enough to be eligible but high enough to afford the rents.
 - With rents that are materially below prevailing market rent levels in the neighborhood. Otherwise, don't ask me to justify the governmental cost to develop the housing.

Is efficient. High development costs, high operating costs, slowness, sloppiness, and lack of professionalism are our own worst enemies. If we don't defeat these enemies, the people who pay our bills will take their money somewhere else. Shame on us if that happens.

Is located in a viable neighborhood. The neighborhood mix of homeownership to rental, and residential to nonresidential uses, is appropriate and reasonable. The neighborhood's housing, transportation, jobs, schools, public safety, shopping, recreation, and public spaces form a smoothly functioning network that supports residents and community.

Fits into the neighborhood. Its architecture echoes that of nearby residential buildings. The number of dwelling units is neither too few nor too many, in comparison with other nearby rental properties.

Has an attractive, low maintenance design. A 'zero maintenance' exterior adds a lot of value. Simple construction is better than complicated construction. Simple mechanical systems are better than complicated mechanical systems. Slab-on-grade construction is better than crawl space. Pitched roofs are better than flat roofs. Individual unit entries are better than common hallways.

Is a community. Residents value the opportunity to live here. All members of the

community expect to be treated fairly and courteously, and this mutual expectation creates an informal but powerful force for community cohesion.

Is subject to an appropriate, long-term, use agreement. The availability of the property for long term affordable housing use is assured through a binding covenant running with the land. The long-term affordability of the property is not dependent on the identity or motivations of the sponsor, and is assured even if the property fails financially and undergoes a workout or a foreclosure. The length of the use agreement term and the level of affordability it requires are appropriate for the property, its target resident population, and the subsidies with which it is financed.

Is physically sound over the long term. The operating budget contains sufficient funds to operate and maintain the property to high standards, not just in the early years but over time. From the beginning, the property makes reserve deposits that are sufficient to fully fund expected major repairs and replacements.

Does not rely on appreciation in value. The mortgage financing is fixed rate and self amortizing, so that the property is not exposed to interest rate risk or refinancing risk. The property's debt burden (from all loans, not just the first mortgage) declines over time, at a rapid enough rate to avoid the risk of over-leverage. The property's long term physical and financial viability can be supported by the projected stabilized cash flow, even if this cash flow does not grow over time. This gives the property the potential to improve its affordability over time, but the flexibility to increase rents as needed to respond to unanticipated problems.

Is financed appropriately. By comparison with market-rate apartments, affordable housing requires lower rents and may require higher operating expenses. Moreover, affordable housing requires a reserve deposit that is adequate to fund 100% of reasonably expected major repairs and replacements. As a result, an affordable housing property generates a much smaller net operating income than an otherwise similar market rate apartment property, and can support only a very limited amount of mortgage debt. The remaining development costs must be financed with grants.

Has an adequate operating margin. This is not merely a matter of debt service coverage in an underwriting spreadsheet. The projected rents must be achievable, with room to spare. The vacancy and collection loss allowances must be reasonable and must recognize that real estate markets fluctuate. Projected operating expenses must be at or above the level that good management will need in order to operate the property successfully, not just in the early years when nothing breaks, but over the long term. There must be adequate debt service coverage, without regard to the amount of cash flow the owner is allowed to distribute. Basically, the property must be able to withstand the sorts of income, expense, and capital needs shocks that frequently impact affordable apartment properties.

Is financed through grant programs that combine flexibility, adequate funding, accountability and competition. Each grant program recognizes the full array of development costs that are reasonably required to produce the desired affordable housing. Where appropriate, multiple grantors will collaborate to create 'one stop shopping' grants for the development of unusual properties (e.g., mixed income / mixed use / service enriched) that would otherwise have to assemble multiple funding sources. Each grant program is capable of funding the entire gap between supportable debt and total development cost. Failure to comply with program requirements produces adverse

results that are predictable and that occur rapidly. A successful grant program attracts a reasonable (but not excessive) number of highly acceptable proposals.

Increases rents in line with property needs. Initial rents are adequate. Subsequently, rents are increased modestly each year, in line with inflation in operating costs. Operating costs are well controlled but are not squeezed.

Is crime resistant. The property's design incorporates 'defensible space' approaches. All common areas are easily observed from several different residents' homes. Lighting is adequate. The management plan, and the budget, include initiatives to create, maintain and enhance residents' social ties to each other.

Is in compliance with reasonable regulatory requirements. Wherever possible, regulatory requirements utilize market mechanisms such as incentives and disincentives. If the property utilizes more than one subsidy or financing program, program requirements are coordinated to eliminate conflicts and redundancies. Compliance is monitored through regular and standardized reviews, performed by qualified third parties who are trusted by owners, residents and regulators but who are independent.

Incorporates appropriate non-housing services. A successful affordable housing property provides opportunities to deliver no-cost and low-cost services that are needed by large numbers of residents and can be delivered effectively at or through the property. For example, properties for low income families may provide before-school and after-school activities for children, job search or job skill development for adults, or may simply provide space in which third party providers can deliver such programs. To the extent that the property itself should provide the services, the cost to do so is built into the property's operating budget.

Generates cash flow for its owner. An affordable housing property doesn't need to be wildly profitable, but it does need to generate at least enough positive cash flow to cover the owner's asset management costs and to fund needed reserves. An affordable housing portfolio needs to generate enough additional cash so that the successful properties can support properties that are temporarily struggling.

So Why Aren't These Properties The Norm?

It seems to me that...

It's difficult to produce housing this good, even in the best of circumstances.

Existing financing and subsidy programs aren't designed to produce housing this good.

We don't yet have good benchmarks or good performance measurement systems.

Much of the conventional wisdom about affordable housing is not only unwise but backwards.

And, worst of all, as an industry we don't set our sights high enough.

Excellence in Affordable Housing Ownership

*By David Smith
Recapitalization Advisors, Inc.*

Once upon a time, an affordable housing sponsor could prosper without being a great owner — insulated by a guaranteed income stream, residents that lacked practical choices, and quiescent regulators, the owner had few worries after initial rent-up. Today, affordable housing is harder to own and sustain than conventional:

- It is developed in more marginal neighborhoods and serves an economically vulnerable tenancy.
- It tends to be older and to operate with lower cash surplus margins.
- It faces a schizophrenic double mission, both financial and social, and is vulnerable to social mission creep.

And affordable housing ownership is getting harder. As mark-to-market works its slow-motion avalanche of changes, income is not guaranteed and, residents have many more choices. Meanwhile, with resources scarce, regulators are much more frugal when awarding funds and (properly) much more demanding once they have done so. As a community, owners — whether for or nonprofit, whether new buyers or long-standing holders — need to get better, and get better quickly.

Surprisingly, we have devoted very little effort to studying:

- What constitutes excellence in affordable housing ownership.
- What barriers to excellence we have built in to our programs and policies.
- What we can do to create a climate where ineptitude is punished, mediocrity languishes, and excellence thrives. This paper opens these topics for discussion.

How do we recognize capability in affordable housing ownership?

1. Results

Ownership capability is more than just being able to show pretty pictures and tell a good story; it is shown only over the long term as demonstrated by results at the property. There are six dimensions of affordable housing viability

- Physical* — The property provides a safe, clean, habitable, defensible physical environment. It must be well cared for and it must look well cared for.
- Community* — The property represents its own healthy little community of people.
- Operations* — The property's ongoing income sources exceed its recurring operating costs.

- D. *Financing* — The property has enough working capital to cope with the normal ebb and flow of receivables and payables.
- E. *Compliance* — The property's compliance rules are equitable, creditable, observed, and enforced.
- F. *Downstream responsiveness* — Both rules and operators must have escape hatches or change procedures that can cope with on-the-fly redesign.

The property's success across these six dimensions is seen in three ways:

- Sustainability over time. The property is viable as above over a 10-year or longer horizon.
- Resident satisfaction. Residents like living in the property and seek to remain.
- Allocator satisfaction. Resource providers believe they are getting value for money.

2. Owner Behaviors

In our experience, some owner behaviors are almost always leading indicators of excellence:

- A. *No bad surprises* — They seldom bring bad news surprises because they know their properties and markets well. If bad news arrives, the owner brings it, usually with a thoughtful exposition of both the causes and the potential solutions.
- B. *Property improvement over time* — They improve their properties over time. Old ones look just as good as new ones.
- C. *Advocates for the property* — They create equal levels of discomfort in all stakeholders: residents, regulators, the community, partners. Ideally they create equal levels of (modest but persistent) discomfort in all other stakeholder groups. Being an owner is not a popularity contest; it consists of diligently, consistently, and wisely doing a series of unpopular visible things (raising rents, evicting lease-violating residents, challenging regulators on operating budgets, reinvesting rather than distributing cash flow) because they are the right thing to do.
- D. *Tight financial control and accurate reporting* — They know where every dollar comes from and goes to and can report that information in many ways on very quick turnaround.
- E. *Commitment to learning and innovation* — They constantly seek new ideas.
- F. *Unsatisfied* — They are seldom smug, usually unsatisfied.
- G. *High ethical standards* — There are many easier ways to earn a living. Those who succeed in this field do so out of a sense of personal and corporate satisfaction that goes hand-in-glove with a strong ethical sense.

3. Skills or Attributes That Seem Inescapably Necessary

In our experience the following skills or attributes are inevitable byproducts of the path to expertise in ownership:

- A. *Mission heart* — Wanting affordable housing to succeed as affordable and for benefit of the residents.

B. *Business head* — Rigorous, indeed confrontational, approach to the myriad business decisions a property demands....These two attributes are neither independent of one another nor are they in conflict. Rather they are both necessary; absence of either dooms the owner to mediocrity or worse:

- *Mission heart* with no business head generates good feelings early on but spends far too much money and the property either deteriorates or needs chronic income supplements.
- *Business head* with no mission heart makes a profit but creates no sense of community and destroys its goodwill with residents and regulators.

Why is Outstanding Ownership So Scarce?

Some possible culprits:

1. *Development is complicated and earns the big fees; ownership does not.* Cash flows are constrained by regulation or stripped out to pay soft debt. Ongoing ownership earns modest fees (and asset management is not universally recognized as a legitimate cost item), so ownership skills are not developed with the same zeal.

2. *Until recently, we thought ownership was easy* so allocators seldom emphasized ownership capacity (as distinct from development).

3. *Rent-setting mechanisms tend to starve a property of resources*, especially if the original development was capital-squeezed.

4. *Markets and property needs change much faster than owner capacity.*

5. *Allocated awards go to fence-swingers not contact bitters* — When only one in four properties is funded, to win award, an applicant often feels compelled to use the most optimistic projections, not the most realistic ones. Allocators thus risk funding properties based on nonsustainable rosy scenarios.

6. *Ownership changes hands very slowly.* Many owners who would like to cannot do so because either (a) no one can afford to pay their economic equity, or (b) there is little if any equity and the investors will not leave unless they have their federal contingent exit taxes paid.

7. *The mission and business camps fear one another* so the normal cross-pollination that should occur is resisted. And few of their advisors treat it in the other camp.

8. *Mission and business sponsors seldom partner* because they see themselves as competing for scarce resources or they fight over the talisman of “control.”

9. *Proven capability is seldom rewarded.* Indeed, diversity-oriented allocation plans can have the unintended consequence of penalizing capable owners in favor of “giving someone else a chance.”

10. *Winner-take-all allocation systems* encourage over-subsidy and gold-plating on the front end rather than economizing and emphasizing streamlined operations.

11. *Absent cash motivations for good performance, we devolve to process-oriented regulation* and thus train owners to follow the rules rather than achieve outstanding results.

12. *Few people can distinguish ownership (asset management) from property management.* As a result, property management often serves as a caretaker surrogate for property ownership capacity.

Where should we be trying to head?

Ideally, we should have properties owned by entities that have all these attributes:

1. *Centralized decision-making* rather than dividing it among multiple stakeholders and groups who often have competing if not downright contradictory objectives. Innovation is a key to remaining competitive and efficient, and fractured decision authority destroys innovation.

2. *Private investment for inherent checks and balances.* At the same time, unchecked decision-making invites abuse. Instead the private-investment model, where private capital is channeled via tax-motivated investment, has provided ongoing oversight and compliance monitoring without government involvement. There thus is an ongoing tension between the value of centralized decision-making and the benefits of an internal check and balance provided by the investors' involvement.

3. *Holders not converters.* Owners who want to keep the property affordable under a viable economic configuration so that they are not looking for upside predicated on a market conversion. (It has taken almost 30 years for this view to evolve. The original programs contemplated a finite term of affordability — 15 or 20 years — and explicitly made residual value after conversion a critical ongoing owner's incentive. When the term ran out, inevitably a political and policy struggle arose as owners sought to realize on their contractual rights and unprepared government sought to prevent conversion. A better model provides permanent affordability but makes that ongoing affordability economically viable so that conversion is no longer an essential action.)

4. *Viable ongoing economics* so that holder-owners are properly compensated for holding.

5. *No amateurs need apply.* Only owners who are capable across all the major disciplines.

6. *Efficient use of resources,* whether scarce or freely available.

How might we get there?

The following ideas are offered as brainstorm. They are in no particular order, they are not necessarily feasible, they are not necessarily all internally compatible, and they are not necessarily my personal views. But they are logical possibilities and thus worth exploring:

1. *Differentially allocate resources* in workout, preservation, and sale, not by arbitrary monikers like for-profit or nonprofit but by ownership capacity.

2. *Overhaul financing* to emphasize lower debt and better cash flow.

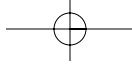
3. *Incentivize reinvestment* so that a healthy chunk of available cash flow is redeployed into replacements and new improvements that could not have been anticipated originally.

4. *Create certification/ ranking systems* that make transparent who is doing a better job and who is doing a worse one.

5. *Build in participant transferability* so that partners who want out can sell their position to those who want in, and those who are not doing the job can be and are rapidly removed before their failure damages the property or takes its operations hostage.

6. *Publicize results* across geographies and program types.

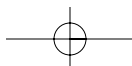
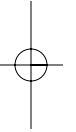
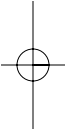
7. *Offer contingent-tax one-time amnesty.* Offer a contingent-tax-relief amnesty window for transfers from unsuitable owners (some of whom are hanging on just to defer



taxes) to preserving entities (who commit to long-term affordability and economic viability).

8. *Stop differentiating for-profit from nonprofit.* An owner is an owner, and it either does a good job now or it does not.

*Further discussion of these topics can be found at our Web site, www.recapadvisors.com, in the articles *Renewed Affordability: A Paradigm for Existing Affordable Housing* and *The New Breed of Affordable Housing Owner*.*



Production Finance: Key Concerns Regarding the Long-Term Sustainability of Affordable Housing

*By Wendell Johns and Phyllis Klein
Fannie Mae*

The financing of affordable housing has evolved tremendously over the last twenty years from the old HUD financing programs to today's low income housing tax credit transactions. Transactions have increasingly become more complex due to the sophistication of the market combined with the dwindling resources in the industry...

As an industry, we all need to focus on some key issues to ensure the continuity and sustainability of this market.

The Ten Commandments of Creating Long-Term, Sustainable Affordable Housing

1. At the end of the day, affordable housing is real estate.
2. It is possible to overbuild affordable housing in certain markets
3. Pay attention to cash flow; "value" may be misleading.
4. People operate apartments and repay debt, not the properties.
5. Prepare for the unexpected; interest rates will not stay static.
6. Subsidy is not the same thing as equity.
7. Bailing out yesterday's properties is bad for everyone.
8. Remember the lessons of the past.
9. Plan for the "back-end" at the beginning.
10. Don't take CRA for granted....

1. Affordable Housing is Real Estate

Above all, affordable housing is real estate — as lenders and equity providers we need to put real estate back into the equation. Yes, affordable housing can provide necessary below-market units to the market but fundamentally; affordable housing is multi-family real estate subject to all of the vagaries and competitiveness of the market. As a lender and investor, we need to be concerned about future competition, market employment trends, project amenities, availability of excess land etc. Market studies may be valuable but we need to provide standards for these documents to assure quality. We need to be concerned about penetration rates in certain markets — what are the "right" levels of demand to ensure feasibility. Building new tax credit projects to compete with older tax credit projects does not make sense. Too often, the philosophy of "if you build it, they will come" transcends the affordable housing market. We have seen that many early projects that were targeted to tenants at 60 percent of AMI have failed especially in softer real estate markets where 60 percent AMI rents are truly market rents or above. Both investors and lenders have become comfortable with affordable housing rents that are a minimum

of 10 percent below market. However, real estate markets certainly can shift and 10 percent below market can erode quickly.

2. Overbuilding Affordable Housing

It is possible to overbuild affordable housing. Investors and lenders hungry for deals haven't been concerned about overbuilding tax credit units. However, with the increase in the tax credit and the bond cap, we may begin to see tax credit projects compete for tenant base. Amenities may become a more crucial factor in the competitiveness of affordable housing projects in certain markets. The project needs to provide the appropriate services for the population in order to compete in the general market should market rents fall.

Real estate development typically assumes some level of appreciation. Not only is a stable net operating income (NOI) important, but an increasing NOI as well. Some sponsors, due to mission driven concerns, may choose not to increase rents despite increases in the market and median incomes. This may further unfeasibility and reality may force these projects to increase rental rates. We need to evaluate markets where median incomes have not risen in proportion to the rest of the country. In those markets, expecting increasing rents may not be feasible. Demand factors also come into play — rents cannot be increased in a market where there is not sufficient demand to support those rents. Subsidies are not infinite. Thus, increasing market rents is a source for future rehabilitation, for increases in expenses and for unexpected issues that arise, such as the rising energy costs faced in California.

3. Focus on Cash Flow; Value may be Misleading

Financial stability is key — with affordable housing it is important to recognize that the stream of rental income coming to the project may not substantially increase, but certainly expenses can accelerate. Therefore, great consideration must be given to debt coverage especially in any market. A cushion on NOI of 10 to 15 percent can whittle down to nothing very quickly. The reality of projects with a predominance of three and four bedroom units is big operating expenses. NOI must be structured to reflect the wear and tear on projects created by a large population of children. Security is also a drain on cash flow. The need for security at a project reflects more on the need to insulate the project from outside forces. Neighborhood renewal is not overnight, as such; many projects may require an extra watchful eye. Utility costs may also become an increasing drain on project resources. Low-income tenants will not be able to absorb huge utility bills. Replacement reserves are crucial — certainly one cannot rely on the cash flow to generate sufficient monies to fund major repairs unless they are budgeted.

The real estate property tax exemption remains a crucial unknown in the industry. In many states, the exemption is a "given" — however, lawmakers could eliminate this favorable treatment to ensure the stability of NOI. Both lenders and investors must undertake careful analysis of the likelihood of this type of event. As an industry, we must be careful not to abuse this privilege — the abatement of taxes is a crucial financial resource but has great impact on the tax base.

Lenders have a tremendous responsibility for their overall portfolio performance. In many ways, the affordable housing market segment has had a lot of lenders chasing a limited number of deals. Lenders need to be diligent about underwriting to prevent

project failures. Loan to value truly has very little meaning for affordable housing. Low-income housing tax credit projects do not trade in the general market — therefore, a cap rate analysis is also of very little value. The value of favorable financing on a tax-exempt bond transaction has also very little proven value in a sale. Adequate debt coverage becomes critical.

4. People Repay Debt not Projects

Project sponsorship is another key to long-term sustainability. Strong project sponsors understand their marketplace, focus on asset management, screen tenants appropriately and are committed to the long-term success of their project. Unfortunately, due to the equity and capitalization structure of affordable housing projects, there are barriers to entry into the business. As such, tenure and track record in the business is key. Overall, strong sponsorship cannot be categorized into non-profit versus for-profit developers. There are strong and weak non-profit sponsors as well as strong and weak for-profit sponsors. The quality of the development entity is reflected by the staff, the board of directors, their experience and their financial health.

5. Prepare for the Unexpected; Interest Rates will not Remain Static

The secondary market's role is to provide guidance, standardization and ready liquidity for lenders to encourage the production of affordable housing and to mitigate its perceived risk. The discipline of underwriting guidelines encourages long-term sustainability by attempting to size debt effectively without over-leveraging and therefore, burdening the housing. For instance, Fannie Mae's interest rate reset is set at an 18 year term versus an industry that has now accepted 10 year interest rate resets. Many projects will be impacted by interest rate resets during the tax credit compliance period. What will occur in year 10 if a project is faced with 100 to 200 basis point increases in rates? Who will cover the shortfall? We are not currently in a rising interest rate environment, however, this could well occur. Rising interest rates will greatly impact investor returns as investors may be forced to cover debt shortfalls or make reductions in principal to protect their investment. Lenders may be forced to restructure loans to prevent foreclosures.

6. Subsidy is not the same thing as Equity

The public sector also provides a significant role that can help to ensure long-term sustainability. The allocation process for tax credits and bonds should be based upon criteria that ensure quality housing. Subsidy money serves a most crucial role by filling underwriting gaps that cannot be met by other sources. Subsidy funds are increasingly important in a rising real estate market, as projects cannot reach lower income levels without gap funds. The public/private partnership in affordable housing is invaluable — debt and equity providers have significant economic hurdles to achieve that are not required by public subsidy. Subsidy funds greatly ensure the economic success of affordable housing by providing the gap money necessary to lower the costs of the project or by increasing the NOI with operating subsidies. For example, it is absolutely infeasible to build housing for mentally ill at 30 percent of area median income (AMI) with merely low income housing tax credit equity and debt financing. A project with rents at that level should be structured to be debt free to encourage project cash flow to provide necessary services for the tenants. Subsidy for these projects is a necessity to ensure

feasibility. The public sector can also be the conscience — the monitoring and oversight by public agencies serves as a watchdog over the industry.

Equity in tax credit projects is like conventional real estate equity even though return on equity is not typically in the form of cash returns but rather tax benefits. These tax benefits, tax credits mostly, must still provide a sufficient economic incentive to the investor — a return that is comparably better than alternative investments. Sponsors of tax credit properties structure their investments in a variety of creative ways to derive market returns. Fannie Mae, as the largest equity investor and debt provider of housing that qualifies for the low-income housing tax credit, views large losses, even on paper, as a negative reflecting a weak financial structure of the project. Although its equity investment horizon is only 15 years, Fannie Mae seeks investments with the long-term viability and a sponsor's intention of permanent affordability.

There are disconnects between the equity and the debt side. For example, 10-year rate resets may make sense for lenders, but at the 10-year mark, the investor would suffer tremendous recapture and penalties should a foreclosure occur. If the project could not support the rate increase, many lenders presume that the investor will solve the financing gap. However, some equity investors feel strongly that they are not appropriately paid for assuming the balloon risk on these projects and will not invest in such deals.

7. Using Current Allocations to Bail out Past Problems — Bad for Everyone

Allocation processes vary across the nation. Although most of the tax-exempt bond and tax credit programs are competitive, states have chosen a variety of ways to allocate the resource. States need to provide more “one-stop shopping” for housing resources and link subsidy and compliance programs together to lessen the burden on sponsors and development costs. States may need to begin to look closely at the resource provided by bonds and credits and evaluate how to address restructures and refinancings of existing projects, particularly those that may not be performing. Today's funding resources are limited, while demand for affordable housing remains high. What will happen to the production of new affordable housing units, if the tax credit and bond caps are utilized to restructure problem projects? Many tax-exempt bond projects are merely a refinance or purchase of a project with lower financing costs and no developer equity. In exchange, the market receives a “light rehab” of an existing project and rents that are restricted. In some markets, 60 percent of median income rents may be equal to market rents, therefore, limited public benefit is provided by the use of the bond. Allocations to these projects may not be the best public policy in light of the housing shortage of today.

8. Remember the Lessons of the Past

What has been the cause of troubled projects? They are the same reasons for the failure of any market rate multi-family project — poor underwriting including misjudging expense factors such as security and repairs, market issues from increased competition to employment losses, rents that didn't increase combined with increasing expenses, underestimating rehabilitation needs for long term sustainability etc. As such, it is incumbent upon lenders (and investors) to “just say no” — oftentimes, realism needs to be injected into the equation. Lenders need to monitor critical signs of project deterioration — deferred maintenance, tenant turnover, vacancies, new market competition, rising expenses, decreasing net operating income, etc. Lenders need to take a hard look at the

“light rehabs or spruce-ups” which are occurring. It is crucial to ensure that the useful life of a project be extended through the financing period at a minimum. Lenders cannot ignore warning signs even if the debt service is being met. It may be prudent to restructure the financing early to avoid future problems.

9. Plan for the Back-End NOW

As an industry, we are faced with many issues of the long and short term that impact long-term sustainability. The first issue is what will happen to low income housing tax credit projects when the tax credit investor has no more financial incentive in the deal. The rental restrictions for most projects will not end for another 15 to 40 years beyond the initial 15-year period when investors receive their benefits. So-called “back-end” structures are numerous ranging from giving the project to the sponsor to structures that include the payoff of debt plus appreciation to the investor. As an industry, many projects may need new allocations of tax credits or tax-exempt bonds to be financially viable. Using the tax credit program to restructure older projects will greatly impact the future production of new affordable housing. The concept of preservation will be greatly expanded.

At the end of the fifteen-year tax credit benefit period, the reality for most projects will be:

- Very little of the long-term debt associated with the project will have been repaid;
- No ability to increase rents given minimal increases in HUD median incomes;
- No significant real estate appreciation given flat rents;
- Increasing expenses due to project wear and tear;
- Minor rehabilitation may be needed using replacement reserves, if available; and
- Interest rates may have risen.

What should the exit strategy be for affordable housing projects? The lesson of the HUD 236 program has not been learned — many of the resources available to subsidize affordable housing are being utilized to preserve the units created under these old HUD programs. We may learn that although we would like to encourage long-term affordability, it may not be possible without an increasing level of resources. Absent more subsidies, converting projects to market rate developments may be the only viable alternative.

10. Don't take CRA for-granted

What will occur if project sponsors do not produce quality housing? Workouts, restructures, foreclosures, etc. As a result, banks will begin to shy away from providing new financing for projects. Although the Community Reinvestment Act (CRA) is a reality for financial institutions, compliance with CRA can be met with other products such as small business loans, credit cards, home loans etc. There has been a decrease in the impact of CRA on banks over the last couple of years with the reduction of merger activity. If this trend continues, there's a risk that the increased credit and bond caps may go unused.

Conclusion

In summary, to ensure long term sustainable affordable housing, lenders and investors must focus on providing some discipline to the marketplace to prevent the failure of projects. Focusing on underwriting, real estate market factors and sponsorship will create

successful projects that can be sustained in the future. This discipline involves the sizing of debt and equity to provide appropriate returns and ensure realistic cash flow.

The challenges we face in creating long-term sustainable affordable housing are great, but worthy of solving. We need to come together to address these issues head-on.

- Is long-term affordability congruent with long-term sustainability? Is it possible?
- Subsidies are crucial to long-term sustainability, but unfortunately they have a finite life. To create incentives for longer-term subsidies, should appreciation become the “return” for the risk taken by the subsidy provider? If so, how do we ensure both a return and an incentive to the sponsor to operate these projects?
- How do we prepare and underwrite for unexpected events such as earthquakes, rising utility costs, changes in legislation?
- Is mixed income housing the answer to provide units targeted to renters with incomes below 30 percent of AMI? Does that mix of tenant incomes work?
- How do we deal with or change the inherent conflicts between the tax credit rules and affordability and project economics?

Can we merge some programs together to encourage efficiencies, compliance monitoring and reduce complexities?

At-Risk Capital and the Creation and Sustenance of Excellent Preservation Entities

*By Michael Bodaken
National Housing Trust*

“In the end, a vision without the ability to execute is probably a hallucination”
(Steve Case, quoted in *The Mind of the CEO*, Basic Books, 2001)

Over the past few years, much has been written about the vexing dilemma of housing poor renters in a time of prosperity. Many of us have taken the time to describe the real estate “Catch 22” that occurs when rents outpace inflation. The nation’s affordable housing need actually deepens in a time of prosperity. That profound crisis, together with the impending expiration of Section 8 contracts covering well over 1 million apartments has rightfully turned our attention toward “preservation” of all types of affordable housing.

Unfortunately, not nearly so much has been written about the capacity of purchasers to preserve and improve thousands of units of affordable housing. This paper focuses on that issue, with particular attention paid to how excellent nonprofit housing providers are created and, once created, sustained. I essentially argue below that the type of “at risk” capital deployed to create a sustainable entity is different than that type of capital required to sustain an “excellent” not-for-profit real estate company.

Finally, a word about “sustainability and the role of government.” I very much believe that government has a unique role to play in both providing financing for properties and helping to create sustainable capacity, especially in the not for profit sector. It is not my thesis, however, that the government guarantees sustainability. Both the properties and the owners must be “long term sustainable” without reliance on government funding. Otherwise, what’s the point?

I. The Case For Building Sustainable Preservation Organizations

The case for creating capacity is an easy one. During the next five years tens of thousands of apartments will be placed on the market by owners of governmentally assisted and/or insured housing, in particular housing now assisted by HUD or Rural Housing Services, and/or properties with expiring low income tax credits. Moreover, portfolios of unsubsidized, but affordable, properties are coming on the market in an increasing number. According to the Joint Center for Housing Studies at Harvard, over the past four years we have lost over 1 million unsubsidized affordable apartments to market forces or deterioration

As current owners look for an exit from their affordable multifamily investments, the demand for capable, mission driven, owners of multifamily housing — particularly housing that shelters very low-income households and seniors — is embarrassingly apparent. A core national policy objective should be the assembly of a new group of interested, vigorous owners willing to invest new resources into this housing. How do

we create and sustain such entities? What institutions will invest in these new owners?

We start with this premise: Strong, business minded/socially motivated, preservation entities (either nonprofit or for-profit) are essential to the preservation and improvement of affordable housing. Indeed, any business model for sustainability requires the presence of such entities. Put another way, we can't save affordable housing unless there are capable stewards willing to take on this important responsibility.

Unfortunately, it is precisely this — a large, diverse community of capable purchasers dedicated to a mission of affordability — that is lacking in today's market. We desperately need a dramatic infusion of venture capital to create new preservation organizations and expand existing preservation entities. For that, we need capital. What types of capital can be deployed for the formation of such entities? For their growth and expansion?

The political economic environment in which we operate

Like all things, capital is much affected by the political-economic environment in which it operates. The situation in which we find ourselves is fascinating. One would have to search hard to find a more uncertain environment. Exogenous risks include, but are not limited to,

- interest rate risk,
- the risk attendant to working with government agencies that are inherently political and often unpredictable;
- credit risk; and
- All the long term risks of late-life property acquisition....new property competition; potential of new environmental risk materials; market obsolescence, neighborhoods that generally are not ones in which properties are rising rapidly, etc.

Perhaps the most complicated of these is the risk that the government, once considered to be certain, if somewhat bureaucratic and plodding, partner, has become a most uncertain partner. Again, I am not asking HUD to bail organizations out of incompetence. Every time HUD changes hands, the bureaucracy recalibrates and reshapes itself at the upper end. While all of this goes on, the middle and lower echelons ossify. Ideology, rather than common sense, often dictates the substance of legislation and/or regulations affecting this housing. What market player in its right mind would want to be associated with such an effort?

At the same time, the business and social opportunity is simply unprecedented. I believe a rational argument can be made that, apart from health care for all of our citizens, our inability to resolve how to house poor renters is the most crucial policy issue of our day. The fact that poor people don't vote, particularly poor renters, doesn't make it any less crucial. Moreover, the issue is easy to write large.

- Literally hundreds of thousands of apartments, many of them in your hometown, can be found on the Internet.
- And all of them have some type of contract or subsidy expiring in the next five years. Most of them happen to house poor senior and families.
- Billions of dollars in tax credit equity, debt and other financing awaits he/she who resolves this issue.

Hence, the siren call to "grow our own."

II. Seeding The Creation and Operations of a Preservation Business Entity

Any business must have both “start up” funds and initial operating capital to fund its initial operations. At its most basic level, the creation of these organizations, like any business, must have a rational business plan. This plan must, at the very least, demonstrate to “seed investors” of that operating capital a reasonable rate of return and return of their capital within five years.

Assuming such a plan exists, and the new entity intends to conserve the housing as affordable over the long haul, promised returns won’t be dramatic. If drawn up honestly, without any start up grants, the business plan, with appropriate hiring, administrative expenses and real estate due diligence costs associated with the start up acquisition effort, will forecast a loss of revenue over the first two-three years. Organizations like NHT/Enterprise and others forecast potential losses of nearly \$1 million over the first three years of their existence. Thereafter, returns should not be greater than 10 to 20 percent per annum plus repayment of original principal. That translates into a return rate of anywhere from 1-7 percent and return of investment over the first five years of existence.

Available venture capital typically requires profitability sooner, and high double-digit returns after three years. This type of return is, I submit, antithetical to the provision of long term affordable housing. What is required is non-speculative, “steady Eddie capital.” Further, venture capital is far less venturesome when asked to take on operational, as distinct from real estate, risk. Finally, there is a legal issue: Venture capital, by its nature, typically asks for an “equity stake” in the newly capitalized organization. Nonprofit organizations cannot typically provide equity stakes to for profit partners. Hence, traditional venture capital is ill suited for the “start up” or creation of preservation entities. Even a for-profit corporation dedicated to this mission won’t be able to provide returns commensurate to the risk demanded by venture capital.

However, a number of sources are well worth exploring. Indeed, alternative finance sources are how our nation typically creates socially minded entities.

1. The NCDI Model

The prudent matching of government and foundation awards could help stimulate the growth of preservation oriented businesses. Here, history serves as an excellent teacher. When our nation couldn’t find “a magic pill” for urban decline, we decided to foster the creation and sustenance of local, community development corporations (CDCs). These organizations promised success where federal, top down solutions had failed. In 1990, a dozen national foundations joined the federal government in creating the National Community Development Initiative (NCDI). Over the past decade, approximately \$25 million annually in low interest loans and grants have been pumped through Enterprise and LISC into CDCs in 23 cities.¹

There is no theoretical reason why this model of “risk capital” couldn’t be replicated to build and sustain preservation entities. Of course, we would have to determine what types of preservation entities should be promoted. For example, I’m not sure that a CDC

¹For a description of NCDI, turn to *Comeback Cities*, Paul S. Grogan and Tony Proscio (Westview Press, 2000).

approach to this issue is necessarily the only means to achieve success. While there are many strong, capable CDCs in the nation who should be encouraged to preserve affordable housing, there is not necessarily a one to one match between where housing stock needs to be preserved and where a capable, local CDC is located or has preservation as part of its mission. That means we need both CDCs and national and regional organizations willing to take on this responsibility. Nevertheless, a preservation initiative between the federal government and major foundations could well be the type of financing that jump-starts this industry.²

2. The Federal Grant Model

To the extent we are discussing the preservation of HUD assisted or insured or Rural Housing Service- financed housing, the federal government has a significant financial and, arguably, moral responsibility. It was, after all, the federal government that financed and assisted in the creation of these 3 million plus apartments. And it was the government which put in place the perverse incentives of increasing Section 8 subsidies beyond market to pay for bloated budgets, while at the same time starving owners from increases needed for the rehabilitation of the stock itself.

No one seriously disputes the government's role. Indeed, the federal government has determined, as a matter of policy, that many of these apartments should be saved. Over the past two years, HUD has developed a number of tools making it simpler for nonprofit owners in particular to save these properties. However, capable, sophisticated entities must be created and sustained to use these new tools and to make this preservation policy more than a dead letter.

In 1999 and 2000, the 106th Congress considered wide ranging elderly and preservation legislation dubbed "HR202." Among its many other provisions, HR202 provided that \$10 million would be set aside for a national competition for preservation oriented nonprofit entities.³ HUD would have administered this program and any nonprofit, from a local nonprofit to a major intermediary or nonprofit owner, could apply for the funds. This grant could be used for operating support for nonprofit preservation entities. As the new Administration determines its budget and as Congress debates the HUD/VA Appropriations measure for Fiscal Year 2002, we should demonstrate the need for significant grant support for capable preservation businesses, particularly nonprofit organizations.

I am not urging that government pour free money, year after year, into organizations that can't compete. However, government does have the responsibility to at least contribute the resources needed to create sustainable preservation entities.

² I have deliberately not tread on the issue of what intermediaries, if any should be used in the Preservation Initiative. It seems best to me for that question to follow the discussion of whether an NCDI type initiative should be undertaken.

³ NHDC, a national preservation entity based in Southern California, has been able to secure up to \$2 million in operating funds and \$10 million in other funds in the set asides provided in the VA-HUD, Appropriations Bill. That type of funding is obviously helpful to individual organizations and should be pursued. This paper concerns more generic forms of capital that can be used for the creation and sustenance of all types of preservation organizations.

3. The Internal Seed Model

After determining the need for a 'niche' housing preservation organization to purchase larger properties and portfolios where there was no local interest or capacity, the National Housing Trust and Enterprise Foundation made five year internal "program related investments" to launch NHT/Enterprise Preservation Corporation. These organizations' willingness to do so attracted others, including the MacArthur Foundation, willing to support internal operations over the first five years of its existence. Similarly, the National Capital Corporation has been "seeded" with \$2 million in grant funds from its parent organization, the Neighborhood Reinvestment Corporation. NCC is set up to act as a "private" intermediary, providing technical assistance and predevelopment loans to a number of larger, competent multifamily producers in the NeighborWorks® Network.

III. Sustaining The Preservation Entity

After the entity is established, an entirely different picture emerges. In marked contrast to the need for "special" alternative financing or grants to create or sustain the operations of a new start up, once the entity has a proven track record, there are any number of ways to justify its continued success. In particular, to the extent the entity relies on cash flow to support its internal growth, the successful purchase and operation of affordable housing will sustain its operations.

As we all know, in any particular real estate transaction there is a simple relationship between the expense of available capital and the risk to which it is being exposed. One pays a much higher premium for capital that takes a much higher perceived risk. Here, unlike the start up operation, the growth and expansion of the preserving entity is much easier to finance. Based on perceived real estate risk, capital is willing to engage in a much more open and fruitful discussion.

Whenever a deal is on the table, the conversation turns to internal risk adjusted returns. Real estate professionals who would no more invest in a start up business than fly to the nearest galaxy are ready, willing and able to make a market rate loan on a multifamily asset. The difference, apart from the obvious, is that the capital markets with which we typically deal are much more interested in real estate than in internal operations.

It is the real estate transactions, and their related development fees and cash flows that support and sustain operating preservation organizations. Consider the following illustrative examples, all of which help deals get closed and enhance the bottom line for the preservation entity:

- *Bridge Finance:* National Housing Trust/ Enterprise and other nonprofits often want to tie down properties through a credit facility. The concept is to take down the asset with a Revolving Fund, then take out the fund within three years. Take-outs will be facilitated with either 501(c)(3) bond financing or through a combination of private activity bonds and 4 percent tax credits. Financial services firms who can manage interest-rate risk and who realize the synergies of both bridge and permanent financing will invest in such funds.
- *Permanent Financing:* Lenders with investment banking capacity can provide 501(c)(3) take out financing for the bridge loan. If the bridge product for the property has been underwritten by the same financial services institution, the

investment banker and original underwriter should be able to better manage interest-rate risk, and bring lower cost financing to the ultimate consumer — in this case, the nonprofit purchaser. To the extent these efficiencies are realized in the marketplace, lower-cost financing should translate into a more affordable multifamily housing product in the form of lower rents.

- *Letters of Credit:* Some lenders provide standby letters of credit to help enhance the credit rating of 501(c)(3) bonds. This is essential when used with so-called “Lower Floater” type bonds where the interest rate of the bonds varies. To mitigate risk, the purchaser needs to buy a cap on the rate.
- *Direct Purchase of 501(c)(3) Bonds:* Some financial institutions will privately purchase the 501(c)(3) bonds for their own portfolios, lowering transaction costs. For example, Fannie Mae and others directly purchase 501(c)(3) bonds.
- *Purchase of Tax Credits:* Low Income Housing Tax Credits are increasingly being used to help purchase and renovate existing multifamily housing. The same firm that provides the bridge and the take out financing can purchase the property’s tax credits. A financial institution could purchase the tax credits and extend the loans in these situations.

Conclusion

In the life of any affordable, multifamily property, capital infusion and fresh, invigorated ownership is required. Available real estate capital and competent stewardship are necessary for that to take place. We focus most of our attention on the “deal capital.” Let’s not lose sight of the need to build preservation entities. Otherwise, our vision may turn out to be nothing more than a lofty, unrealizable dream.

Sustaining Human Development Through Housing Development

*By Patrick Costigan
The Community Builders, Inc.*

Those of us in the nonprofit housing development business are in it because we generally believe that a decent, affordable home is the platform for helping low- and moderate-income people move into the mainstream of American life.

After a few decades of practice, we seem to know how to build the platform. But while providing affordable housing is a noble thing by itself, many of us have taken on the challenge of adding services to promote family self-sufficiency. So what about this human development part of our housing development vision? How does the home actually lead to the mainstream? What should be the focus for this part of our work? And how do we pay for it?...

Focus

Human development activities are generally thought to include everything — from prenatal programs to soccer leagues to science clubs to drug-abuse prevention to job readiness to home-ownership counseling to site-based health care for seniors — and anything else that a public or private funder is or can be persuaded to believe will remotely help the poor.

Yet the everything-and-anything approach doesn't necessarily lead to the promised mainstream. More often than not, it perpetuates a patchwork of well-meaning but disjointed programs, which too often add up to little for the intended beneficiaries. It also fails to prioritize a set of activities with realistic outcomes that can be cost-estimated, budgeted and assessed for success.

If this scope of activity doesn't get the results we want, what does? In our work with public and assisted-housing residents we believe three things are critical: (1) offering case management to families in our housing; (2) focusing the case management on employment and income; and (3) helping families build financial assets for the future.

Our case management uses the methods of social work to achieve narrow, concrete, economically focused goals for families. It involves engaging well-trained professionals — as an augment to and not necessarily a part of property management — to help residents of our housing mediate the maze of human services out there and advance their family plans. And these plans should be principally focused on jobs, jobs, jobs. We believe what William Julius Wilson has shown in his research to be right: Employment provides coherence, structure and purpose for those not in the labor market. It is really the only way for them to achieve a family-supporting income that can pay the rent, build a cushion for contingencies, cobble together a down payment on a house or realize other dreams.

Beyond the jobs themselves, there is the need to facilitate access to a range of supports that make work pay — from making sure that residents take advantage of the Earned Income Tax Credit each year to getting their children in the state child health insurance program, to tapping available subsidies for child care and transportation.

The glue that holds all this together is a case management approach embedded with

a solid workforce-employment development methodology. One of the most proven approaches we have found was developed here in Chicago by an organization called Project Match, which has a 15-year plus track record in helping public housing residents succeed in the job market. My organization is fortunate to have a working partnership with Project Match. LISC is also beginning to work with Project Match in Chicago.

Finally, there should be a focus on building tangible financial assets that afford families meaningful choices about jobs, housing, schools, and supporting their children. There are lots of ways to do that, from mobilizing our friends in the financial services industry and foundation community to help capitalize savings or individual development accounts; to supporting children in the kind of academic performance, financial planning, and “resume building” that leads to two-or four-year college; to preparing residents for homeownership or small business ownership; to increasing financial literacy and access to mainstream banking services.

From our perspective, these are the basics. Other human services should be aligned to them. Day care slots, transportation assistance and even substance abuse treatment should be attached to workforce-employment development programming. Family development should always have a goal of building a sustainable income for a family. Educational enhancements ought to be primarily targeted to building the skills of adult job seekers and out-of-school youth. Where a minimum wage employment base is the norm on a property, education enhancements can focus clearly on the academic success, financial planning, and “resume building” that leads children into post-secondary education and thus the kinds of careers that change the financial strength of an entire family. All should help create what former HHS Assistant Secretary Peter Edelman has called “a pathway to work.”

Doing all of this is within our reach and certainly in our interest. We have a direct working relationship with families who live in our housing. We supply or facilitate their use of a basic economic benefit — a housing subsidy. This subsidy can be leveraged to influence behavior, generate additional subsidies and create opportunities for our residents. And even more in our interest, if undertaken at an appropriate cost to the property, these services prove cost effective to both the owner and the public subsidy sources. The return on investment includes improvement in both the short term annual performance as well as long term physical, social, and economic viability of our properties, especially those properties deeply skewed to serve families under 50 percent of area median income.

Welfare Reform: Pushing Housing Providers In New Directions

In the wake of welfare reform, assisting residents to succeed in employment and build assets is now an essential part of the work of creating sustainable housing and strengthening neighborhoods. Resident success in employment is critical if we are to meet steadily rising operating costs from rent increases rather than federal subsidies, to continue to provide excellent quality housing over time, and to maintain housing assets that contribute to the economic and social strength of the neighborhood over the long term. But consider three recent realities:

Welfare Reform and the Work-Based Safety Net. For better or worse, the nation has adopted a new social policy under which able-bodied adults are expected to work, and must do so to qualify for transitional assistance during periods of unemployment. As the first

wave of five-year welfare time limits draws near this year, we must work to mitigate major social and economic disruptions at our properties. As housers, we will face a convergence of TANF benefits termination, a depressed job market, and shrinking family-support resources from State TANF programs as the economic slowdown crimps state budgets.

Transitional Assistance. Along with tying work to assistance, welfare reform replaces permanent income support with transitional, time-limited assistance. The expectation that families will take control of their financial future demands that we do everything we can through case management to make work pay and build the assets through IDAs, savings vehicles, financial literacy, technological literacy, etc., in the short run.

Performance. It is no longer acceptable to most funders for human service providers merely to address human development problems; they must be resolved in a cost-effective manner, often according to terms of a contract. The new contracting environment increasingly forces providers to specify quantifiable, measurable outcomes, to meet industry standards of performance and to deliver outcomes at a competitive price. A critical challenge for housers is to determine what works, document both the real outcomes and the true costs of the work, and build these costs into project budgets, funding plans and the like.

Paying for It

If case management, workforce development and asset-building are critical strategies in helping the residents of our housing move successfully into a more demanding mainstream, protecting property performance over time, and ensuring that our developments are positive social forces in the neighborhood, how do we pay for it? And how do we pay for it not just once or on a scatter-shot basis, but over the life of our projects? Some places to look include:

Direct Funding: Don't overlook HUD and other public sources. Although HUD channels most of its budget into brick and mortar and transaction costs, it does offer some support for human development activities through programs such as Resident Services Coordinators in elderly and multifamily developments, Drug Elimination Grants, Youth Build and HOPE VI Community and Supportive Services. But act fast. New HUD Secretary Mel Martinez has signaled his interest in transferring these types of programs to HHS.

More and more of HUD, DOL, TANF and other federal funds have been "devolved" for state and local administration. Many can be linked to housing projects. In New Haven, as a part of our agreement to redevelop a troubled housing project in the central business district, the city pledged Empowerment Zone and Workforce Investment Board funds to the deal.

Development/Operating Budgets: Leverage the deal. On the capital side, a tax credit project can include a resident services reserve to fund core staff or services at the site level. Funding sources may agree to further subsidy levels in a development deal if one of the uses of funds is to help support residents to succeed in their tenancy. Operating budgets, at least those supported by project-based rent subsidies or public housing operating subsidies, can include a resident services coordinator in a base budget under a HUD ACC or HAP contract. Operating budgets in LIHTC projects can sometimes include incentive management fees that can be used to enhance site services.

When acquiring HUD-owned, Mark-to-Market or other troubled properties there is often an opportunity to leverage operating commitments from owners and financial sources. In more than a few of our deals, we've been able to secure \$30,000 to \$250,000 per year from these sources. At Plumley Village, for instance, a 450-unit HUD-owned development Community Builders acquired in Worcester, we negotiated \$250,000 annually for resident services, taken from net operating income prior to servicing the HUD debt.

Fees: Think like a for-profit developer. Substantial fees can also be earned in structuring and managing capital pools that channel tax-driven investor capital into LIHTC projects or commercial development under the New Market Initiative. LISC's National Equity Fund and the Enterprise Social Investment Corporation have earned considerable fees from equity syndications for a while, but many large-scale developers can also do this. Fees can be earned from syndicating not only LIHTC but also Historic Credits, New Markets Tax Credits, and Work Opportunity Tax Credits.

Developers can earn loan origination fees and interest rate spreads on internal financing such as equity bridge loans, project predevelopment loans, construction loans, mini-perms, and permanent loans. And why not think about structuring fees as incentives for successfully performing both physical and human development work? Perhaps a fee structure could be proposed to financing sources where a developer earns, over time, 8 to 10 percent on development and 5 to 8 percent on service activities.

Financial Structuring: Think like a banker. Program Related Investments (PRIs) from foundations or CDFI-subsidized bank loans can provide developers with low-cost capital that we can lend to our projects at market rates, and earn interest income on the spread between our cost-of-capital and the market rate. With enough deal volume, the interest income earned could support ongoing resident services costs (delivered in-house or through outside providers).

Real Estate Land Banking: Think like a speculator. Land in revitalizing communities appreciates in value. That value is most commonly captured by existing property owners and real estate speculators. For housers, more aggressive efforts to capture the increase in property values that results from a comprehensive neighborhood revitalization, through land banking and speculative acquisitions, could generate additional resources for future redevelopment and service activity.

Observations Regarding Sustainable Excellence in Affordable Multifamily Housing

By the National Housing Conference

The NeighborWorks® Multifamily Initiative’s symposium “Strengthening Neighborhoods by Creating Long-Term Multifamily Assets,” examined the production, financing and operation of multifamily housing through the lens of sustainable excellence. Indicators of sustainable excellence in affordable multifamily housing were defined as long-term affordability, long-term economic viability, long-term sound physical condition and long-term contribution to the social strength of a neighborhood.

Participants at the symposium all agreed that successful affordable multifamily properties often are cornerstones of healthy neighborhoods and of neighborhood revitalization efforts. Program participants discussed how to make properties such as these the norm and what changes with respect to the way multifamily housing is funded, underwritten, owned, operated and managed will be necessary for housing such as this to become a reality in more communities.

Throughout all sessions, moderators engaged both the panels and the participants in this discussion. The following key points were raised:

Financing Programs and Allocation Methods

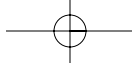
One theme that emerged addressed current financing programs — programs, participants alleged, that are largely aimed at building affordable multifamily housing, but with subsidies too thin and regulations so numerous that owner-operators had little chance to achieve a sustainable level of excellence with respect to the long-term operations of their affordable multifamily properties.

Ownership Strength

Another theme that surfaced was the error made by the affordable multifamily sector which tried to accomplish too much with small owners. This prompted a call for sizeable ownership entities that could bring institutional strengths such as quality personnel and financial depth. Participants felt that qualities such as these were absolutely essential for long-term operational success.

Social Role

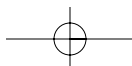
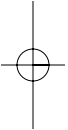
A third theme was the need to broaden the definition of success beyond a single-minded desire to equate “success” in terms of financial return to the owner. Participants advocated that equally important to cash flow projections was dedication to providing quality affordable housing and a layer of services for residents. The discussion pointed out the fact that in the current environment, property owners are often faced with a choice with respect to the need to maintain cash flow; reserves and capital improvements versus the need to fund necessary services.



Realistic Expectations

Finally, there were the strong voices of the finance community. Their argument called on us to recognize that in many non-appreciating, modest income markets (e.g. rural or small towns), affordable housing simply will not yield enough cash flow or build enough equity to either self-fund reserves or enable refinancing needed for capital replacements to occur. Some injection of subsidy capital should be expected every 15 years or so, according to program participants.

During the last session of the symposium commentators and moderators presented their observations on the day and focused on the direction that funding, policy and practices would need to take in the future in order to achieve excellence and sustainability with respect to our nation's affordable housing stock and our nation's affordable housing owners.



Affordable Housing: The Road to Success

*By Gary Eisenman
Related Capital Company*

The design and theme of the NeighborWorks® Multifamily Initiative Symposium on Strengthening Neighborhoods by Creating Long-Term Multifamily Assets were extremely well conceived and presented. Promoting and sustaining the excellence of the affordable housing stock is a highly challenging task when one considers its complexity, dynamic nature and the significance of what is at stake. The constructive presentation of this message in some respects is as challenging as the task itself. However, the designers and presenters achieved this objective.

The consistent theme in most of the program presentations, which was important to communicate to those in attendance, was that in today's affordable housing industry and marketplace the lines between nonprofit and for-profit operators are blurring in the eyes of the financial community. Regardless of the nature of an entity's formation, the objective of creating and sustaining an excellent affordable housing development can only be realized by an operator of high grade and quality. Success in this regard knows no distinction between nonprofit or for-profit organizations; however, it does know effective and professional real estate decisions.

There was an important point that linked the Symposium panel presentations on excellence and financing tools. As nonprofit organizations play an increasing role in the production and creation of affordable multifamily housing, the resources which make this possible will continue to be provided only if both the capital markets and government are confident in the industry's performance. Capital is drawn to certain attributes in an investment, such as low or no risk, consistency, reliability and return. The skills of sound underwriting, due diligence and management (as discussed by members of the panel on excellence) are all necessary to the attainment of those attributes, on a case-by-case basis, and if performed consistently within a sector at large, may lead to the availability of the financial products and resources sought by the members of the Symposium panel on financing.

There was a time in the affordable housing industry that transactions could be completed with significant room for error or unforeseen circumstance. This was at a time when economic loss was a tax benefit and government's willingness to provide programs and resources which allowed for this were present. But those days are gone, and the resources now made available by both government and private sources for these ends must be used in a well-designed and carefully thought through manner. First, because the resources are limited in relation to the condition to be addressed, and second and most significantly, the availability of these resources and the potential to receive them will be dependent on the outcome of their utilization.

Government has recognized the importance of the role which nonprofit organizations play in affordable housing today. Programs such as Section 501(c)(3) financing authority, nonprofit preference for tax credit or bond allocations and other similar incentives provided to nonprofit organizations, create opportunities for them to play an important role in the affordable housing marketplace. However, like any opportunity, these

advantages need to be maximized by the success of their use. To accomplish this, a nonprofit organization's mission must be balanced by intelligent business decisions.

Both Charles Wilkins and David Smith made this point during the Symposium. Mr. Smith said that the "skills or attributes that seem inescapably necessary" for success in the current affordable housing environment requires both a "mission heart and a business head." Regardless of whether an operator in this industry is a nonprofit or for-profit entity, it must combine those attributes in order to truly be successful. The business side of this equation is represented in his assessment by calling for "no bad surprises," and always maintaining "tight financial control and accurate reporting." The point he made is well taken; there is no shortcut to the professional approach a developer or owner of affordable housing must take to be excellent. This point being emphasized in his suggestion is that "no amateurs need apply."

This theme also is pursued by Charles Wilkins, whose "first law of apartments" is "good properties are properties that generate positive cash flow." His point is not to say that this is all that matters because he believes that "good intentions and thoughtful mission statements are good things," but to say "they're not enough." These intentions need to be combined with good business discipline and decisions to provide for appropriate financing, adequate operating margins and generation of adequate cash flow. This is not to suggest, and Mr. Wilkins did not, that this is an elemental task. To the contrary, he suggested that "it's difficult to produce housing this good, even in the best of circumstances. As an industry, we don't set our sights high enough." The clear implication to be taken from this is that he believes there are operators who are not performing to these high standards, and they should be. The result of failing to perform at this level he says is that "the people who give us money . . . will have to [keep bailing us out] and sooner or later, they'll stop . . ."

Is there a difference between how the nonprofit industry and for-profit entities approach tax credit funded affordable housing development? The United States General Accounting Office (GAO) seemed to believe there was. The GAO stated in a report issued in March 1999 that "the average cost of units built by nonprofit developers was about \$18,000 higher than the average cost of for-profit developer units." In fairness, it should be made clear that the cost difference referenced was the result of work which the GAO had done in 1997 and was asked to follow up on to ascertain the substantive cause of the discrepancy. This study attempted to isolate through regression analysis statistically significant differences. The significant differences cited by the GAO were: the locations where nonprofit organizations developed the housing (relative to high incidences of poverty, low unemployment and the availability of additional credits), larger unit size and a disproportionate number of developments in the Northeast and the Pacific. This report does conclude that the cost differences were lower than originally thought and that ultimately from a statistical standpoint, insignificant. It is inappropriate to draw absolute conclusions from the GAO report about what causes these differences or just how significant they actually are. Clearly, a more comprehensive review would be needed to sort this out and draw definitive conclusions. However, it is fair to say, based upon the report's conclusions, that the differences detected by both studies likely are related to mission driven considerations.

The true cause or magnitude of these differences is debatable. However, what could be the final point in any such debate was made by Wendell Johns of Fannie Mae when he said, "tenure and track record are the business key. Overall, strong project sponsorship

cannot be categorized into nonprofit versus for-profit developers. There are strong and weak nonprofit sponsors as well as strong and weak for-profit sponsors." If there are mission driven differences in the way nonprofits approach a particular transaction, which sometime increase cost, they would be viewed as a positive if the project is a success, and could be viewed as a negative if the project fails.

Michael Bodaken stated during his comments on the establishment of a "Preservation Entity," that with respect to such an entity "the capital markets with which we typically deal are much more interested in real estate than in internal operations. It is real estate transactions . . . and cash flows that support and sustain . . . organizations." Mr. Bodaken then went on to list several financial products which are needed in the affordable housing marketplace or are available, but more broadly needed, such as bridge finance, permanent financing, letters of credit, private placement of 501(c)(3) notes and tax credit equity. Part of his point was that the availability of these resources is and will be dependent on the nature and quality of the returns produced by their utilization. It is interesting to note in this regard, that in the Spring 2000, Mr. Bodaken wrote an article entitled "Saving America's Affordable Rental Housing, the Crisis, and the Appropriate Financial Service Role" for an issue of Community Developments. In this article, he advocated for the availability of the very same products to which he referred at the Symposium. The fact that he continues to advocate for these same sources of capital and financial products underscores the fact that the need is still there and the job is not done. Could it be that the failure of the marketplace to respond to this demand relates in some significant way to the fundamental issues discussed above? An August 2000 article written by Moody's Investors Service suggests that the answer may be yes:

" . . . Moody's review of a property does not, generally, allow the tax credits to offset a weaker property's financial condition. The benefits of tax credits, such as equity and additional oversight should be weighed against the potential costs such as additional compliance complexity and risks of noncompliance. The focus of Moody's analysis continues to be the property's debt service coverage, loan to value ratio, historical and projected financial performance, physical condition, market demand, ownership and management. However, due to the additional complexity within the LIHTC program, Moody's places particular emphasis on the owner and management teams; demonstrated experience in successfully operating tax credit properties."

The investor community along with the providers of affordable housing can, together, begin to take steps to promote the kind of activities and requirements which will bring about shifts in the marketplace, many of which were discussed or alluded to by various presenters at the Symposium. Wendell Johns concluded his presentation by saying that to "ensure long-term sustainable affordable housing, lenders and investors must focus on providing some discipline to the marketplace to prevent the failure of projects." This discipline stems from making the right decisions about the real estate and its operations and flows as a consequence of asking the right questions and performing the proper analysis of a particular transaction. He says, "as a lender and investor, we need to be concerned about future competition, employment trends . . . We need to be concerned

about penetration rates in certain markets,” in providing insight into what he regards as the right “discipline.”

What does this mean in a practical sense? For example, the point could be made that when performing an underwriting, it is not sufficient to look simply at historical operating expenses to estimate future performance. An appropriate number of external data sources need to be reviewed to provide a source of comparison and analysis. In reviewing this, a developer’s team should include a person with management experience who can assess these items properly. Wendell Johns correctly calls for market study standards so that assessment and evaluation of the results of these works can be compared on an apples to apples basis. Standardization in this area might include requirements relative to the local and regional economy, analysis of major local and regional employers, and analysis of demographic trends including the socioeconomic characteristics of the subject neighborhood, population trends and unemployment rates. Analysis of the rental market should include a structured review of the supply of similar units in the area (along with their respective occupancy rates), availability of vacant land for future development, as well as absorption rate. To prevent over building and competition with other similar affordable properties, Mr. Johns suggested a penetration or capture review. This point is well taken in this context, if you build a new project and don’t know approximately how many income qualified people live in the market area of the subject development and what percentage of them need to be drawn to the new development for it to be successful, the project may not be.

The larger point to be made is that the performance of a disciplined transaction execution has a far greater impact than producing a single successful housing development. Inconsistent underwriting and transactional requirements and a lack of uniform management standards coupled with a few failures stifles a truly widespread and competitive capital market from developing. Confidence is incremental and established over time and takes not very much to inhibit.

The ultimate success or failure of this industry in accomplishing its goals will be determined by the availability of large amounts of capital to carry it out. The capital markets and their investors are driven purely by business considerations of whether an investment is good or bad, strong or weak. The affordable housing industry is constantly striving to rationalize this dissonance between mission and business objectives by providing shelter for lower income families while providing investors with appropriate returns that are not at risk. The Symposium presentations on excellence pointed out what the affordable housing industry must do over time to convince the capital markets that this has been widely obtained. Until disciplined transaction execution and greater standardization are the norm, our industry probably will not see the infusion of capital that is truly necessary to address the needs of the 15.9 million households in America with significant housing problems. Like a society, an industry is only as good as all the members who make it up and what they produce.

Sustaining Long-term, Affordable Rental Housing

*By Katherine Hadley and Bob Odman
Minnesota Housing Finance Agency*

The NeighborWorks® Multifamily Initiative Symposium on Strengthening Neighborhoods by Creating Long-Term Multifamily Assets focused on the fundamentals. Speakers and participants touched on the issues that have been among the Minnesota Housing Finance Agency's (MHFA) biggest challenges over the years. The following are four of our most important lessons learned.

Getting Funding Agencies on the Same Page

Our first experience of working partnerships with other funding agencies was on the asset management side of the business. Started in 1995, the Interagency Stabilization Group (ISG) was pulled together to deal in a comprehensive way with troubled properties owned by nonprofit owners in Minneapolis and St. Paul. Since then, staff from MHFA, the U.S. Department of Housing and Urban Development (HUD), the Family Housing Fund, the Local Initiatives Support Corporation, National Equity Fund, and the two cities have met bi-weekly; staff from the Des Moines Federal Home Loan Bank join once a quarter.

The ISG developed a universal approach to evaluating the performance of the owners and the stabilized properties that satisfied all the funding agencies. MHFA staff monitors the portfolio of properties even if we have no funding in the project. The rural Minnesota counterpart of the ISG was started over two years ago with a focus on preservation. MHFA, HUD, the U.S. Department of Agriculture's Office of Rural Development, the Minnesota Department of Trade and Economic Development and the Greater Minnesota Housing Fund participate.

We expanded our collaboration with other funding agencies working on the development side of the business by establishing a semi-annual consolidated funding process (the Super RFP) for all development resources. Applicants for tax credits, first mortgages and gap financing from a variety of public and philanthropic organizations now submit a single application. In the last two rounds, project-based Section 8 vouchers were available from two of the four largest public housing authorities in the Minneapolis-St. Paul metropolitan area. The funding agencies all participate in selecting projects and matching proposals with the different programs available.

The ISG and the Super RFP partnerships have brought great benefits. Most important has been the shared learning about the real costs and challenges of successful ownership and operation of affordable rental housing. These lessons inform both our underwriting and property management operations. Both efforts have reduced administrative wear and tear on developers and owners. Both have resulted in greater consistency with respect to public policy goals among various funding agencies. We have the trust and solid working relationships necessary to move toward the important tasks identified at the NeighborWorks® Multifamily Initiative Symposium of increasing standardization and developing common definitions, documents and approaches to underwriting and asset management.

The Reality of Recapitalization

This is the “Never Say Never” lesson. When the MFHA Board considers a workout request and asks us, as they always do and should, whether they will see this development again, we answer differently than we did ten years ago. Even with the best of underwriting, unforeseen changes in neighborhoods, economic disruptions and population changes can result in the need for additional funding for some multifamily developments in the future. We need to have realistic expectations about long-term sustainability and be appropriately responsive to the funding needs of existing affordable rental housing.

For purposes of strategic planning, we recently undertook a comprehensive physical needs assessment of our first mortgage portfolio using a five-year projection of capital needs, rental income, and repair and replacement reserve balances. We sought to determine, by rigorous analysis rather than educated guess, which developments had sufficient reserves, which did not and the extent of the shortfall. We were particularly interested in the last sixty Section 8 developments, which did not have as strong of a cash flow as the previous generation of projects, thus resulting in a slower accumulation of reserves.

The results confirmed that our educated guess was sound. We have incorporated the physical needs assessment into the ongoing responsibilities of our housing management staff. We update the five-year projection for each development every year. We update annually the cost schedule for major improvements that is used by staff in their analyses. The results enable us annually to confirm the adequacy of a portfolio reserve for future capital improvements that cannot be funded out of project reserves.

The physical needs assessment process was a valuable learning opportunity for the MHFA board members and staff. It deepened the knowledge and understanding among staff about the needs of their assigned properties and it sharpened their analytical skills. The physical needs assessment process represents our understanding that even the best underwriting will not always be enough to sustain affordable rental housing over the long-term.

Truth in Underwriting

Our experience in the early and mid-1990s was that we required higher maintenance and operating numbers than any developer proposed. Criticism of the MHFA for being too conservative in its underwriting was common. While some developers may have proposed numbers too low because they felt the real numbers were politically unworkable (the underwriting fib), others were simply inexperienced. Our commitment to real numbers came from hard lessons learned in the post-Section 8/pre-Low Income Housing Tax Credit era when we provided rehabilitation financing for small and mid-sized projects in poor neighborhoods.

Less tension exists now between developers and the MHFA over real underwriting numbers, for three reasons. The first is increased trust; we have demonstrated over the years that we, and other funding agencies, will fill in the development gap created by truth in underwriting. The second is experience; the lessons learned in the ISG process about what real numbers look like have helped inform the whole affordable housing community. The third is evidence; our database of operating expenses of our first mortgage portfolio provides valuable information about how comparable projects have fared over time. Underwriters and management staff work together in the underwriting process and rely on this data. Lately, we have been surprised by the proposed

maintenance costs and operating figures for supportive housing developments and certain preservation projects, a change from ten years ago; but a review of our database has confirmed their reasonableness.

The For Profit Versus Nonprofit Debate

We have always been in the “A Good Owner is a Good Owner” school. While some argue that the lesson of the current preservation crisis is nonprofit ownership, our experience with workouts of badly deteriorated developments involving single-asset nonprofit owners reminds us that there is more than one way to lose federally assisted housing. There is no substitute for a responsible owner with as much commitment to the management and oversight of a property as for getting the deal done. Regardless of the profit motive, it is crucial to do business with people and organizations that will be responsible stewards of the housing we finance and who share our goals of long-term affordability and quality service for the residents.

However, it is clear that expanding the numbers of high quality nonprofit owners and strengthening capacity, particularly in the area of long-term property management, is critical for the many projects where, for reasons of the type of housing, social service goals, the targeted tenant population or location, nonprofit ownership is either the best or sole alternative.

Our two challenges are scale and money. With regard to scale, while not true for every state, in Minnesota we must face the issues of the cost efficiencies, the availability of management systems, and the sound experience that come with developing more projects and managing larger portfolios. Interestingly, in the last ten years, a few regional nonprofit organizations in rural Minnesota, because they are the only game in several counties, have developed more sophistication and had wider experience than many neighborhood-based nonprofit organizations in Minneapolis and St. Paul.

With regard to money, we cannot significantly expand the size or the capacity of the nonprofit housing sector without a serious increase of funding for organizational support and pre-development capital. Whether funding is awarded directly to groups or structured into development budgets is a question of effectiveness. Our agency has committed to distributing all the Community Housing Development Organization (CHDO) operating support funds we are allotted and we recently restructured a state-appropriated nonprofit capacity building program in order to make multi-year commitments of operating support funds; however, these are very small scale efforts and not likely to make much of an impact.

Increased funding will only come from the public or philanthropic sectors; and board members and staff of foundations have proven no more eager than members of Congress, state legislatures, county boards or city councils to fund the operations of nonprofit housing organizations. While interesting ideas are being floated about new funding for supporting preservation organizations, our concern is “if not, then what?”

In the final analysis, it is important that funding agencies have sufficient financial and organizational resources to support the preservation of existing affordable housing while adding to the supply in areas of growth and need. We need a wide array of competent, sustainable ownership and property management organizations to share in the stewardship of this most critical part of our economic and social infrastructure — sustainable, affordable rental housing for low and extremely low-income residents of our communities.

Strengthening Neighborhoods by Creating Long-Term Multifamily Assets: A Lender's Perspective

By David Watson

JPMorgan Chase Community Development Group

It would be difficult to imagine a greater concentration of multifamily housing vision and expertise than that found at this one-day symposium held in Chicago on April 18, 2001. Leaders from the private, government and the nonprofit sectors attended and participated in interesting discussions about how best to address the affordability, financial infeasibility and social threat that many of our multifamily developments across the nation have become. The primary goal of the symposium was to lay a framework for answering the question: If we agree that affordable multifamily housing is a valuable asset in every community, how best do we fund, underwrite, own, operate and oversee our multifamily housing stock? This is no small issue given that the housing stock must be economically, physically and socially viable over the course of 50 years or more. The presenters and panelists put forth much commentary and many suggestions on how to best accomplish this goal. Unfortunately, less than 10 percent of the 150 or so participants were from the lending community. I strongly encourage my colleagues in the lending industry to more actively participate in forums such as the Chicago symposium in order to gain a broader understanding of the issues, challenges and solutions.

The lending community in general is often criticized as being overly transaction-oriented and not focused enough on the long-term issues associated with multifamily developments. What struck me most about Charles Wilkins' paper "Characteristics of Excellence in Affordable Multifamily Housing," was his recital of how far the industry has come in the last thirty years in the areas of professionalism, reliable funding and allocation of funds. However, success in these areas has contributed in part to the blurring of the lines between Community Reinvestment Act responsibilities and prudent lending. Too often, and this is especially true with the financing of tax credit projects, lenders fall back on the premise that equity investors will "do anything" to avoid an adverse consequence such as default and foreclosure. While there certainly exists a strong incentive for equity investors to ensure that a property remains in compliance with IRS regulations with cash flow adequate to service debt and fund reserves, it should not diminish the responsibilities of the lender with respect to such things as market and rent analysis, professional property management, cash flow analysis and an assessment of the quality and availability of resident services. In other words, underwriting. Price competition among lenders is generally a good thing for projects, except where lenders are willing to sacrifice safety and soundness as well to win a deal. Charles Wilkins noted in his paper and at the symposium that "amateur ownership and amateur management are bad ideas, no matter how virtuous the amateurs happen to be." I would add "amateur lending" to that statement. As lenders, we must help to ensure that projects are appropriately underwritten and financed.

The themes of scarce resources, lower margins and long-term viability in general were continued by David Smith in his remarks at the symposium and in his paper “Excellence in Affordable Housing Ownership.” He also stated, correctly, that we need to stop differentiating for profit organizations from nonprofit. The necessary skills and experience can be possessed by both types of organizations, however, neither type of organization can reasonably expect to jump into a large multifamily housing project without having developed an appropriate level of capacity, financial strength and discipline. His insightful analysis detailed some of the reasons why outstanding ownership is so scarce:

- Short-term (development) performance is rewarded with large fees, while long-term ownership typically generates modest fees and cash flow.
- Market and property needs typically change much faster than owner capacity and many owners passively apply “canned” solutions rather than explore creative solutions.
- Allocated awards are often made to undercapitalized projects based on unrealistic projections, almost guaranteeing that the developer fee and future cash flow will be at risk.

Smith offered several possibilities for realizing the goals of viable ongoing economics, centralized decision-making, professional management and efficient use of resources. One of the key ideas in his paper is the creation of a certification or ranking system for owners and publicize the results across geographies and program types. While numerous states rank projects, I know of no system designed to evaluate the capacity and historical performance of owners. Care would obviously have to be taken to minimize the politics involved in the development of any such system.

Another option put forth was an overhaul of financing plans to emphasize lower and better cash flow. While there is a continuing shortage of quality affordable housing across the nation, might our society in general be better off if slightly fewer units were built with the same subsidy dollars? The additional cash flow could be used to help sponsors cope with the short-term versus long-term incentive challenge discussed earlier, as well as fund needed replacement reserves and social service needs. Mr. Smith noted during his remarks that holders should be rewarded for proven performance and proactive management of properties for the long term.

It is critical that services (otherwise known as human development) be available if affordable housing is to be truly successful. This theme was raised by Patrick Costigan of The Community Builders, Inc. during his panel session at the symposium. From a lending perspective, I believe we all agree that the availability of services such as case management, employment, day care, transportation assistance and other social services are necessary. If good programs are expensive, how do these services get funded?

In his paper “Sustaining Human Development Through Housing Development,” Mr. Costigan discussed what he calls the “basic” human services:

- Case management services to families;
- Workforce development: focus of case management should be on employment and income; and
- Asset-Building: help families build financial assets for the future.

Mr. Costigan advocates the consideration of “structured” development fees, with a portion of the fee paid on development activities and a portion paid on service activities. This would help organizations focus on longer-term goals and actively reward them for doing so. He noted that the services discussed must be provided over the life of the project rather than on a scatter-shot basis. In developing budgets for proposed projects, organizations must clearly identify the level and amount of dollars targeted for services. This may sometimes include incentive management fees to pay for services on low income housing tax credit projects or a resident services coordinator in a base budget under a HUD ACC or HAP contract.

Balancing the interests of investors, developers, lenders, owners, residents and the neighborhood is a complex assignment. By recognizing and continuing to discuss the challenges and opportunities of multifamily housing development, our industry must continuously improve the way it does business. As lenders, we must constantly balance safety and soundness issues with our responsibility to actively participate and add value to the development process.

The discussion of long-term sustainability was continued by Wendell Johns of Fannie Mae during his remarks at the symposium. In his paper “Production Finance: Key Concerns Regarding the Long-Term Sustainability of Affordable Housing,” Mr. Johns noted that from both a public policy perspective and market competitiveness, the quality of an affordable housing unit should be no less than a conventional market rate product.

Given the increase in the tax credit and the bond cap, Mr. Johns cautioned that it is possible to overbuild affordable housing. He echoed many comments from others regarding market competitiveness, viability and general underwriting and suggests that a careful evaluation of markets be undertaken where median incomes have not risen in proportion with the rest of the country. He also presented his thoughts on the impact of the Community Reinvestment Act and questions whether long-term affordability is congruent with long-term sustainability.

In summary, some of the major themes of the day were as follows:

- The concept of “sustained excellence” emphasizing affordability, stability and viability, with appropriate rewards for success.
- The need for project participants to continually think “outside the box.”
- The system must bring more pressure to bear on property managers to plan for, and be prepared to react to, a myriad of long-term issues.
- Necessary human services can, and must, be provided for as part of the overall project development plan.
- The need to continue to develop the capacity for residents to play leadership roles in projects.
- For lenders, the need to underwrite not just debt service coverage and loan-to-value on spreadsheets but also to focus on longer-term issues such as resident services, adequacy of replacement reserves and structure.

Closing Session

“Strengthening Neighborhoods by Creating Long-Term Multifamily Assets”

Commentators: James Logue, Michigan State Housing Development Authority
Nicolas Retsinas, Joint Center for Housing Studies

Moderators: Helen Dunlap, Shorebank Advisory Services
Georgia Murray
Shekar Narasimhan, Prudential Mortgage Capital Company
Chuck Wehrwein, Mercy Housing
William Frey, The Enterprise Foundation

FRANCES FERGUSON: ...I'm really pleased that Nick Retsinas is moderating our last panel, and Jim Logue from Michigan State Housing Development Authority — a real leader in the HFA community — has agreed to provide a commentary and be our lead presenter for our wrap-up session.

NICHOLAS RETSINAS: Thank you, Francie. Good afternoon, everyone....Let me give you some sense of the format we're going to follow....In a moment,...Jim Logue will give his comments... [from] the perspective of the resource allocator, the funder, the person and the entity that many of you said you don't really understand....Then we'll have each of the moderators...I'm going to give them a head start now by laying out two questions....

Now that we've listened to this wonderful series of presentations, so what. And, my two questions:...Given what [you've] heard,...given [your] own experiences, what counsel would [you] give to those in the affordable housing business who are looking out upon a portfolio of some projects?... And, as we consider additional activities, additional projects, additional developments, what are some of the things we might think about?

...Jim Logue is an old and dear friend. He has many, many pasts....Among those pasts, he was once the executive director of the New Jersey Housing and Mortgage Finance Agency,...he served a stint in the United States Department of Housing and Urban Development as the Deputy Assistant Secretary for Multi-Family Housing, spent a time with the National Council of State Housing Finance Agencies, and, for the last several years, has been with the Michigan State Housing Development Authority, which is more than just a housing finance agency, but also is a key urban advisor to the governor of Michigan.

He's had a chance to listen in and be a part of many of the panels here today, and he's going to share some of his reactions and thoughts. Jim.

JAMES LOGUE: Thanks, Nick...I feel a little bit like NASA after they sent out a deep space probe and had fifteen years of information they've got to digest and it's literally going to take them fifty years to analyze it....I'm not sure that any of us is in a position, at this

moment, to know what we should do with all this stuff, because there's so much and there needs to be some greater communication, dialogue, and understanding of what it is we're trying to achieve, because there are so many different things that folks are trying to achieve.

One of the things I wanted to talk about, because it has come up in most of the sessions that I have attended,...is the tension between resource allocators, which I represent, [being from] a state housing finance agency that allocates the tax credit, mortgage revenue bonds, non-entitlement home, and CDBG, [that] manages a huge portfolio of Section 8 vouchers as well as a variety of McKinney Homeless Funding and a variety of other funding that we at the state level allocate, and the resource users, whom I think most of you represent....

...Let me suggest the tension between resource allocators and resource users is not surprising. It is not unhealthy. In fact, I think it is very healthy. And, if the relationship between the users and the allocators is good, constructive, open, and honest, I think it can generally lead to very good success in developing programs that meet the needs of the community or the state, the region that you're all doing housing work in....

Let me ask this question: How many of you have attended every qualified allocation plan here in every state where you are applying for tax credits? Raise your hand....Okay, there's one, there's two....If you think qualified allocation plans and public hearings are pro forma...that may be true in some states...it's not true in Michigan. I know it's not true in a majority of the states that I am familiar with....In most places...it is an open process. And, if it isn't, there are things you can do about it...but the reality is if you are not participating in the process that allocates the majority of funding for your projects...you're missing the boat....

...It's important that you participate in that process and, make your case on issues that relate to your state, and your locality, and your particular type of program....

...And, that goes for home and CDBG on the state level, even the local level. There are plans that have to be publicly debated, public input is expected to be received on. That, I would say, is your first avenue of work and effort.

There may be a national agenda to be developed out of this debate. I can tell you from...having worked...with Congress on reauthorization and expansion of the tax credit and a mortgage revenue bond program, those are difficult tasks. There was some talk in at least a couple of the sessions today about a new housing program that maybe removes all the complexity...there was some moaning and gnashing of teeth about how difficult it is to put all of this stuff together, and that's true. Unfortunately, that isn't going to get you a new housing program. Just because it's difficult and complex and hard to do, isn't compelling [enough] for Congress to say, "Oh, well, I guess we'd better develop a new program that meets your needs."

If that were the case, the tax code wouldn't be what it is. It's a simple fact.

My suggestion...is this: We have...a workable delivery system for affordable housing in this country, with a combination of the low income housing tax credit...I think, two thirds or more of Congress co-sponsored the increase in the tax credit program....To me, that is a wonderful base upon which to work.

We have other wonderful programs that are doing the job. They're just not funded to levels that are necessary. HOME is...a great program for enhancing affordable rental housing in combination with the tax credit and for a variety of other uses. It's flexible,

it's usable, it meets the needs of local communities and, in combination with the tax credit and other resources, it can produce very affordable, very good rental housing.

CDBG works. We've got mortgage revenue bonds which, on a smaller scale,...has a role to play in providing affordable rental housing....

Certainly, in other areas, there are challenges that haven't been met. But, let me suggest that we have the elements of a good workable, affordable housing delivery system in the country, and I would suggest to you that making it simpler is not, in my mind, the first priority. Increasing the resources should be the first priority. We'll make it simpler if we've got the resources, but maybe we do need additional rental production program. Maybe there is room for a new program that would, in conjunction with these other resources, help in increasing the level of affordable rental housing.

...What can we propose to augment the current system, because, the current system has, frankly, a lot of political support. Tax credit is a very well understood program by Congress...and I maintain it is as good a program as any that's been developed or could be developed....

I'll end by saying the keys to me are enhancing communication, improving the quality and the transparency of the data we have, and working very hard to achieve a good understanding of our perspective roles of allocators and users of resources.

NIC RETSINAS: Thank you, Jim. As I said, we want to ask each of the panelists to answer a couple of questions. Again, the "so what" question. Now that we have taken in this good advice, we have learned lessons, or at least alleged that we have learned lessons. What do we do about it?

Georgia, your panel talked about the characteristics in projects. You had an excellent presentation by Charlie on some of those sort of characteristics. Thinking of all that, what practical lessons did you garner from that discussion that you might want to share with us today?

GEORGIA MURRAY: Well, I think the first and foremost was...when you think about the underwriting and you think about all the issues with the underwriting...we really do need to rely on the real data. As...we think about all the issues that we talked about, a lot of it comes down to that initial underwriting, both going in to the allocation and getting all the financing in place. And, if we're doing it with numbers that are stretched...on the rents we can achieve, or stretched on the occupancy we achieve, and stretched on the fact that nothing will go wrong and it will be the perfect staff and the perfect property. And, we come down to a level that is then not sustainable, that's when we get ourselves into trouble. So,...one of the things...is that we've got to get some transparency to the data, we've got to be able to kind of unite behind getting the data really right, and support the efforts to do that. And, I think if we did that, then it...might really help with the preservation and the sustainability down the line.

NIC RETSINAS: Georgia, let me follow-up, if I may...and, again, I'm asking everybody here, aren't...little white lies are okay because you really want to get the project done?...David [Smith] talked about the offering segments where you have to list the risk factors. And, if any investor ever read those, they would never invest in anything....

GEORGIA MURRAY: I always used to say during workouts...“Just pretend...that everybody who is affected by this work out is in the room.And, would you still take the same position?”...Think, your mother’s in the room...would you still say it?

NIC RETSINAS: Helen [Dunlap], your panel talked about ownership entities and characteristics of ownership entities, but the discussion turned into the creative tensions of mission and market and sort of cultures and perspectives. From that discussion, what advice can you share with all of us?

HELEN DUNLAP: I’m tempted to answer the last question...I would pick on something that I heard Lillian say. And that is the issue of images and language....don’t define as lies...it’s really important that we are clear about which set of beliefs we’re triggering in people — positive, negative, or otherwise. And, I don’t think...that means we should undercut the criticality of issues that you were just mentioning....

Second,...if we are responsible for taking something forward, this group is simply too small...If our interest is in building more resources, and not just finding new ways to define programs, then we have to tackle, in my perspective, two additions to the group. One is the folks that aren’t here. And, that represents...everybody from...the homebuilders — that would bring an end to any nonprofit set-asides in a heartbeat — to users, neighbors, residents...the critical stakeholder, and yet they’re not here.

...And, one of the things our panel suggested early on, but we passed right over, was the importance of human capital. And, it’s good that we’re part of a training institute...because we simply need to grow a larger cadre of ourselves....

I would hope that, in our attempt to figure out what we’ve done wrong, we also figure out what we’ve done right. And, I thought David did some of that well this morning. I would hope that we keep that in mind. I think that we, as an industry, because we are constantly reacting to somebody else’s opinion, are constantly trying to change and fix something, and yet there are a number of things that we do well....

NIC RETSINAS: Helen,...any thoughts of the kinds of language and imagery we might use that would resonate beyond the usual suspects?...

HELEN DUNLAP: ...We need to look at outcomes....We tend to value the deal making, the structure, the financing, the resolution of all those issues. That’s not what taxpayers and communities and residents have any interest in....So, we need to be about the business of healthy neighborhoods....

The Minnesota Family Housing Fund and Minnesota Housing Now...did that study that shows that children do better in school if they live in a stable home environment...which we all go “duh,” but the reality is that they took that image and they produced significant increases in resources in Minnesota for housing. So, those are the images, and there are lots of them....

NIC RETSINAS: Okay. Shekar [Narasimhan], your panel talked about financing sustainability. And, one of the issues was...we ought to try to ring out inefficiencies and try to have more standardization...more transparency.

On the other hand, you talked about a trend toward “commoditization” that can argue against undertaking some of the developments that we’re thinking about. Could you think about that issue as you give your advice?

SHEKAR NARASIMHAN: Sure....I think we started the conversation about financing because there seemed to be mutual agreement, pretty much across the board, that using the rates of financing sources, using all kinds of gap mechanisms, six, twelve, thirteen different capital sources on a given transaction, has got to be inefficient. And, in addition to costing time, which is obviously money, also cost long-term burdens for the regulatory reporting requirements, complex, and sometimes, unfortunately, conflicting things that have to happen within a transaction and within the project that doesn’t necessarily make economic sense. And, those were costs that were burdensome and were being borne by affordable housing. And...I ended by saying, “Be careful what you wish for,” which would be too much efficiency. Because...everybody who’s working in neighborhoods and local communities knows, their deal is really truly different and it does require all those different pieces to get weaved together. But it is going to be very difficult to deliver efficiency using the prism of the private market efficiency system. What we ought to be striving for is, instead, a free flowing capital market....

...This whole issue of transparency and common definitions. There’s no question that we should be able to write common definitions...we ought to have large databases....Can we have three thousand tax credit deals that are monitored on a routine basis? Can we actually know in 2003 what happened in 2002 when the [1982] deals came due that expired at the end of fifteen years? Or will it all be anecdotal and we’ll be sitting in cocktails saying, you know, one went down and the other went south and the third went private and market? Is there going to be a way to manage this so that we can legitimately answer the questions to the policy makers and then the people ultimately that we need money from?

We did strongly, I think,...refute this notion that came up...which was we should not be trying every ten or fifteen years to appropriate money to fix deals that we had done earlier, which is obviously the forty year FHA with the twenty-year Section 8 kind of example....Personally, and I think Larry Dale and certainly others felt, look, this is low-income and affordable housing. There is not adequate cash flow built in here to be able to provide for major capital improvements. And, they don’t have the built-in equity increases to do refinancing. So, we’re going to need capital grants, soft loans or something ten, fifteen, twenty years into these deals to do it. So, instead of, figuring out a way to build in five hundred dollar or a thousand dollar reserves that just simply won’t underwrite a deal, let’s just admit that this is affordable housing. We’re going to rejuvenate it and, every ten years, we’re going to have to go to the Congress and get a capital grant to do it....

But, the point was there was a strong sense that we should be prepared to stand up for what it is we really do. And, we can’t make it something it is not, absolutely.

So, let me just finish by commenting on tax credits....In the short term, there really is a little bit of an issue, and it’s a combination of many factors which are somewhat unrelated. One is that there has been a diminution in the demand for them...and that’s primarily because the industrial companies that were buying them don’t need them anymore because they’re not making any money. The “dot coms” never bought them and they never needed them. But, in addition to that, you also had another group that had

been in the business — utilities — that not only are not buying them, but are actually selling them. So, if you had a three billion dollar demand-supply, this year, you could have as much as about three quarters of a billion to a billion [dollars] in additional supply....

In fact, prices are going down. This is the first time [it] has happened in the fourteen-odd years of this program.... We do have a supply-demand imbalance. At the same time, we have... the IRS timed rulings... which have some palling effect if you're a tax credit investor....

So, when you have uncertainty about... the credits themselves going forward, you have a supply demand imbalance, and you have the Congress raising the effective supply in the future, starting in 2002, you should expect that people are now looking much more closely at yield and return.... So, there should be some development work done, fairly quickly, on yield and return, and on building a much better secondary market. And, fast. Because, if you're being offered seventy-five cents [on the dollar] today,... I would say three months from now, you will be offered less, not more... [and] you [will] need that ninth financing source to fill that new gap that's going to be created.

NIC RETSINAS: Shekar,... does the lack of transparency have a benefit? And, if we make everything transparent, might it undermine support from the variety of funding sources that many of affordable housing projects need?

SHEKAR NARASIMHAN: We did have that conversation also. What does it cost to build an affordable housing unit? I've seen some of the cost data, and it's sixty-five to two hundred thousand a unit. And, does it cost more to build it because it's affordable and has these tax or other subsidies versus conventional. I've seen studies on that, as well. And, if we really knew all those answers, would we like the answer? Would we want it published in the Wall Street Journal?...

But my response is that we need transparency and data for today to understand performance, [not] so much to try and figure out what the loan-per-unit should be... but to understand performance history and then to develop some indexes to benchmark risk and return in different kinds of affordable contexts. If it ultimately led to a major improvement in the capital markets, efficiency of [what] credits trade for, or where bonds can be sold, or, for that matter, if you could sell the tax losses separately,... perhaps... that would create more dollars for affordable housing. But, at this point in time, I think we need to be very careful that we don't undermine the relatively small constituency that supports us on the public-policy side at the federal level....

NIC RETSINAS: Chuck, your panel talked about risk capital for preservation acquisition.... Talk a little bit about that discussion, and, again, your advice to everyone about financing for preservation.

CHUCK WEHRWEIN: Yeah, thanks, Nick. I think I'd like to sort of break it up into... immediate recommendations and then some broader ones. On the immediate side,... it seems compelling to suggest that, if one is considering taking on a preservation asset or a group of them, that one would be very wise to not lie to yourself. Because, if you miss on these things, they're big, they're complicated, and the train wreck could be much worse than with a twenty unit or thirty unit tax credit deal. So, be true to yourself, if not to anyone else....

I think the first thing we need to do is focus on building stronger organizations, both from a financial capacity standpoint, and a human capacity standpoint. There wasn't as much negative reaction to the threat of different kinds of organizations coming into this environment. The need is so significant and so great. I think the only worries about threats were about the financial resources that might be available to do this and who would get them first. But, in general, I think folks felt that it is a large impending problem that really called for the need for more organizations...and for the organizations that do exist...to build financial and human capacity.

I think the other advice that could come out of this would be to make yourself stronger. Be ready for some of the challenges that are coming. And, be ready for some opportunities that might be showing up in down-market economies. There may actually be positive opportunities to create and sustain affordable housing in those market places going forward....

Look at cooperating more. When we're going to be focusing on portfolios of assets that have a very broad geographic context, they're not going to fit so well into the organizational geographies that we've created. And, so it's going to be critical that we think about working together more and with other organizations, and whether or not some organizations might want to work together more permanently.

And, finally, I was struck by something Jim [Logue] said: "Show up at the hearings." We need to do a much better job, as Helen said, [of] speaking with one voice, once we decide what the problem is and what the solutions might be....

MR. RETSINAS: Thank you, Chuck. Bill, your panel talked about funding for services...Sometimes people need...more than the walls and the roof, but need services...Talk a little bit about what you learned from the discussion, and again your advice and counsel to your colleagues here.

WILLIAM FREY: We initially started out recognizing that there is a significant...lack of affordable housing for very low-income people around the country...Some of the things I heard were, in terms of responsibly underwriting housing,...looking at building in significant reserves and looking at building in a significant amount of capital replacement. And, then, we look at services. As part of that, if you're looking at long-term basis as far as the asset management and operations of these particular projects.

There's always going to be this tension. Is it housing or is it going into services?...And there was some recognition that in some of the HUD programs that have been very successful...there has been a benefit to having a large enough scale that there has been some resources from the housing that's been able to go into the services. That's not always going to be the case and it's probably more the exception than the rule.

But, it's not just the people that benefit from the services, it is also the housing that benefits from it...And, in smaller kinds of developments, we heard from some people in terms of...collaborating with communities...really working with the community residents and finding out what is the right thing in terms of services.

And, finally,...the case work model: Whether it's a permanent casework person,...the critical way in which they work is that they're more entrepreneurial in really connecting the people and the buildings to other kinds of resources within the community....

NIC RETSINAS: Thank you, Bill. Let's open it up for a few minutes for questions....

UNIDENTIFIED PARTICIPANT: Yes. It's a little bit of a question and a little bit of a response....The single scariest and perhaps most profound statement that I've heard today...tax credit prices, which have done nothing but go up in cents per dollar for fourteen years, have, in the last four to six months, dropped ten percent. They've gone from about eighty-two cents on the dollar to seventy-five cents on the dollar....

And, related to that, there was something Janet Falk said at the preservation panel. She said, affordable housing does really well in good times. It's hard to buy in good times, but easy to do in bad times. I have news. It's hard to do in bad times, because poor people are among the first people to lose their jobs or have their earnings impaired. So, we may suddenly find that we're differentiating property quality and owner quality a lot sooner than you think. So, I'm going to echo what Shekar said about be careful what you wish for or you may get it.

NIC RETSINAS: Let me ask a last question of the panel.... We talked a lot today,...[and one] implication...is [that] it costs more [to develop low-income, affordable, subsidized multifamily housing] than we are now getting. Help me answer the obvious sort of trade-off question. That is, more resources for one unit means not enough resources with another unit. Help me with your sort of take on that, Bill.

WILLIAM FREY: I think that's the, the tension that we're all dealing with...I think that we all make those decisions when it gets to a certain bottom line, and we have to say no to certain things. And, I think that, for a long period of time, people are afraid to say no, especially the nonprofit industry, because we're afraid that nothing else will follow. And, I think that there has to be much more of an advocacy attempt to try to influence the decision makers....If you...have ten people lining up for affordable housing, the question is do you spend more to build all this in, or do you build more housing.... I think we need to come to some sort of compromise....

CHUCK WEHRWEIN: Nick, I think, first of all, the question presumes that there are no additional resources available to fill that gap. I think that's a presumption we ought not to make, although, we clearly understand how difficult those additional resources might be to come by. What strikes me is there's a couple of things that will happen....As long as allocators are requiring certain levels to achieve a successful deal allocation, everybody's going to keep telling them what they want to know,...because the one honest group is going to not see a deal next year. And, it's not like they're taking a pass on, you know, some levels of fees just to make the deal stronger. They're just not going to see the deal, and they're too weak to sustain too much of that.

SHEKAR NARASIMHAN: I think there clearly are costs to be wrung out of the system;...just look at the total cost of a single affordable housing transaction...estimates run from nine to eleven percent. There's too many consultants [and] too many lawyers in our business.... There's got to be a way to wring some of that cost out of the system....

GEORGIA MURRAY: I don't know what the answer is. But,...the money is there. We

spend it differently;...if we could somehow...figure out how to get those resources realigned so that they're there at the beginning.They're there and you can point to them and you can get them so that we don't have to go through the pain of having a workout....

HELEN DUNLAP: Assuming that our resources are limited and that we have rung the efficiencies out of the system, we then have to choose what we're trying to achieve.And, I'll use an example which everybody can relate to and will inflame.Why are we building more elderly 202 units in this country?...There are plenty of apartments, basic elderly apartments, in this country. But, because we are trying to serve poor people who are elderly and need a subsidy....

NIC RETSINAS: Thank you. Let me just spend a couple of minutes and give you my own take on the day. Beside being a fascinating and at times entertaining day, parts of it were disheartening....There was almost, pardon the expression, a masochistic quality to the day, as we all were sort of thinking about the mistakes we have made over the years, and certainly, we have made some.

In some ways...we could have been describing the "dot com" phenomenon...where there are no profits [and] we celebrate when we don't lose as much as we lost last year. We are consistently trying to lure investors or subsidizers to make them think we're smarter than we think we are, and most of our time is spent doing that, and lastly, we have no exit strategy, we just sort of go on and on.

...The last time I spoke before the Neighborhood Reinvestment Corporation...I used the line...by Sam, the piano player in Casablanca,...which is, "the fundamental things apply, as time goes by." And, much of what we talked about today are the fundamental things that apply. Producing and sustaining affordable housing is really, really important. You all know that. In another month, [the Joint Center for Housing Studies is] going to be releasing our annual report on the state of the nation's housing. While we will continue to marvel at the overall prosperity of the housing market in the United States, some of the statistics we will be talking about, particularly relating to the rental market, will be harrowing. Let me give you a preview of some of them. We've lost about five and a half a million units on the private market stock that were affordable back in 1993, up until 1999. Two thirds, seven point five million, of low-income, extremely low-income families, pay over fifty percent of their income for housing, and what's most interesting about that number, that's up by a million and a half during the longest period of prosperity this nation has ever enjoyed....

Overall, we estimate that there are about four and a half million unsubsidized renter households in the United States who are low income, and we see the private rental stock having about one point two million units that are affordable. So, there's a supply/demand imbalance of about three million units, just looking at raw numbers.

This issue is exacerbated particularly because most of the rental stock in this country is aging. The average age of multifamily units in the United States is 34 years. And, in some places, it is much older. For example, here, in Chicago, 80 percent of all the multi-family stock generally was built before 1979. In Boston, my hometown, 82 percent. In New York, it's 92 percent. The improvement of that rental stock will be a major agenda item.

As I listened to the lessons learned and the admonitions, I've summarized them with

six E's. I don't have time to go over all of them in detail, but let me kind of walk through them, because I want to spend my last thirty seconds just on the last one. The first one is economics. This is sort of the truth in development, the truth in management. We heard words like cash flow and market. Basic economics have to be understood, have to dictate how we do our work.

We talked about excellence. Much of the day was about excellence. How do we build and oversee developments that can be sustainable over time?

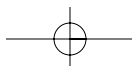
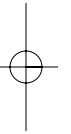
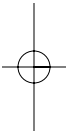
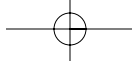
We talked about enterprise. We talked about this as a business for professionals. For profit, nonprofit, whatever it is....

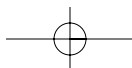
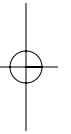
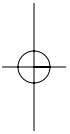
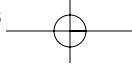
We talked about environment in terms of the community, the larger community of which these developments, by their very nature, are only a small part of. They don't define the community. They are affected by and affect that community.

We talked about energy. This is hard work. It's hard work in the good times, it's hard work in the bad times. And, it needs a sense of energy.

But, the last E I want you to leave with is equity. And, I don't mean...the word that isn't debt. I mean, real equity. Equity in terms of social justice. Equity in terms of a promise where people have a decent place to live. This is hard work. We've done a lot of good things, we've done a lot of not so good things. But we have to continue. The need is great. We have to pay homage to the definition of this workshop: "Strengthening neighborhoods by creating long-term multi-family assets." It's...all about how do we make affordable housing an asset building strategy...for the individuals that live in that affordable housing, and for the communities that are defined in part and are affected by that affordable housing? There is no more important task before us than the task of asset building, for individuals, and for communities.

The session today, I think, brings us one step closer towards that strategy. Thank you all very much.







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