Best Practice: Early Stage Capital for Affordable Housing Development

REPORT UPDATED: JUNE 18, 2008

CITY: NEW YORK CITY **POLICY AREAS: AFFORDABLE HOUSING; PUBLIC–PRIVATE PARTNERSHIPS**

BEST PRACTICE

The **New York City Acquisition Fund** (Department of Housing Preservation and Development) is a $233.5 million public-private partnership that provides early stage capital for the acquisition of privately owned land and buildings to create or preserve 30,000 units of affordable housing.

ISSUE

In the 1970s and 80s, thousands of abandoned buildings and vacant lots were taken in tax foreclosure by the City, providing the City and its partners a source of land to develop affordable housing over the next several decades. The successful redevelopment of the foreclosed properties, or *in rem* properties, combined with the City's economic recovery and growing population, has transformed the City's challenge from abundance of abandoned property to affordability. In 2006, Mayor Bloomberg announced the sale of the last lots in the tax foreclosed stock.

Developers of affordable housing now must face the challenges of the private market in order to assemble parcels for development. However, non-profit and smaller developers—the key partners in the City's efforts to revitalize the *in rem* stock—have few resources to pay for property acquisition, appraisals and environmental surveys, and other pre-development costs. Without acquisition and pre-development funding, affordable housing development risks being replaced by luxury housing built by market rate developers with the resources to fund predevelopment themselves.

GOALS AND OBJECTIVES

The goal of this program is to provide both non-profit and for-profit developers of affordable housing with the capital for acquisition and predevelopment costs, so that these developers can successfully compete with large market-rate developers. The fund is also intended to facilitate implementation of Mayor Bloomberg's New Housing Marketplace Plan, which seeks to create or preserve 165,000 units of affordable housing by 2013.

IMPLEMENTATION

The Fund levels the playing field, allowing smaller or nonprofit developers to compete both on equity and speed. It provides low-interest capital at higher advance rates and lower recourse levels than are available from conventional financial institutions, and it can respond far faster than typical government funding cycles. The central innovation behind the Fund is a sophisticated use of structured finance techniques to combine mission-oriented and market-oriented capital in a new way: a consortium of 16 banks made capital commitments of $192.5 million through a revolving credit facility, while New York City blended an investment of $8 million in City funding with $33 million from six foundations to create a guarantee pool for securing loans. The Fund is managed by Forsythe Street Advisors.

By leveraging both mission-oriented and market-oriented capital, the Fund is able to give smaller developers the financial resources they would otherwise not have access to in order to compete in New York's competitive market. This early stage capital is essential to non-profit and smaller developers of affordable housing, who are creating and preserving much-needed affordable housing across the city.

Non-profit borrowers are eligible for a maximum loan-to value of 130%, including capitalized interest; for-profits are eligible for up to 95%. The Fund's loans are interest-only with principal repaid from construction loan proceeds. The maximum loan term is 36 months.

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The Fund's design allows it to provide loans for both small and large new construction and preservation deals. For example, the Fund has created a mechanism for the construction of small supportive housing developments, housing with on-site services for special needs populations. These loans—typically around $1 million—and the short time frame required to process them -- benefit nonprofit developers, who are then able to further accelerate the development process through commitments for construction financing from HPD's Supportive Housing Loan Program.

Cost

In an unprecedented collaboration, sixteen major banks and financial institutions made available over $190 million in financing. This large pool of private financing was leveraged by a small investment of $8 million in City funding, which was blended with $32.6 million in foundation funding to create a "guarantee pool" for securing loans. Nine foundations participated in the Fund, including The Starr Foundation which made the initial $12.5 million challenge grant that helped lead to the Fund's creation. This unique partnership allows each participating foundation, bank, lender and HPD to achieve its own mission while addressing this critical need.

Results and Evaluation

There are three critical measures of the funds success: Scale, speed and sustainability.

<u>Scale</u>
The overall goal is to create or preserve 30,000 affordable housing units over ten years. In its first three years, the fund has financed 559 units. As of June 2008, the Fund's manager reports over $87.4 million of new projects in the pipeline, representing more than 2,100 units of affordable housing.

<u>Speed</u>
The speed at which the loan is processed is especially important in light of the Fund's original intent to equalize the disparity in financial resources between affordable housing and other developers in New York City's strong market environment. In its first year of operation, the Fund has succeeded at quickly providing capital to qualified developers of affordable housing and continues to improve its turnaround time. The Fund's approval process now stands at less than fifteen business days after the submission of a complete set of loan documents from the Originating Lender. For non-conforming loans the Credit Committee then has ten days to perform a Full Review. For conforming loans, the process is even quicker. The Credit Committee has three days to request a Full Review; in the absence of such a request, the loan is automatically approved. Although the fifteen day approval process is typically fast enough to accommodate most loan requests, the Fund has excelled in accelerating its approval process to accommodate loan requests with more compressed schedules, enabling a turnaround time that is comparable to the typical single-step approval process employed by conventional lenders.

<u>Sustainability</u>
The Fund was established as a for-profit corporation with the expectation that profitable operations would create a permanent source of acquisition and predevelopment financing with no further funding from foundations or government. For foundations, this was a key attraction because it promised a truly catalytic model that, if successful, might create a new private sector lending market for the benefit of affordable housing and low-income neighborhoods. For government and its national non-profit partners, profitable operations would create a long-term pipeline of land and buildings for affordable housing without new costs to the taxpayer, but also a model attractive to other jurisdictions facing affordable housing shortages with limited financial resources. With profitable results in the first year of operation, the Fund's manager, Forsyth Street Advisors, predicts that the Fund will build up sufficient reserves to achieve self-sufficiency within five to seven years.

Timeline

1970s and 80s	City of New York acquires thousands of properties through tax foreclosure.

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December 2002	Mayor Bloomberg issues New Housing Marketplace Plan, promising to create or preserve 65,000 units of affordable housing by 2008.
April 2005	New Housing Marketplace Plan expanded to create or preserve 68,000 units of affordable housing by 2008.
August 2005	Mayor Bloomberg announces the sale of last vacant lots in the tax foreclosed stock.
October 2005	Mayor Bloomberg announces creation of the Acquisition Fund to help the City meets its goal in the New Housing Marketplace Plan. City commits $8 million, and the Starr, Ford, Rockefeller, and MacArthur Foundations commit $26.5 million.
October 2005	Mayor Bloomberg announces expansion of the New Housing Marketplace Plan from 68,000 units by 2008 to 165,000 unites by 2013.
December 2006	Fund announces first closing – a loan to Housing Options and Geriatric Association Resources, Inc for acquisition of property.
July 2007	Fund closes first preservation deal – a loan of $23 million to the Fordham Bedford Housing Corporation for acquisition and preservation of 277 affordable units in the Bronx.
December 2007	Fund has initiated seven loans totaling $32.75 million.
July 2008	81,418 affordable housing units have been preserved or created through the New Housing Marketplace Plan.

LESSONS LEARNED

Two important obstacles relate to the broader challenge facing the affordable housing community, which for decades depended on *in rem* properties that could be acquired from the City for a nominal fee. The exhaustion of the *in rem* stock has forced the City and developers of affordable housing to find new strategies for property acquisition. Until it was depleted, the *in rem* stock not only defined the affordable housing landscape, it in many senses *was* the landscape, and as a result, the transition will take many years and there remain a number of obstacles in adapting to the new realities.

First, while the Fund is a helpful tool for developers of affordable housing looking to acquire property at reasonable market prices, the Fund cannot provide adequate funding to acquire very high value properties if government programs cannot ultimately subsidize the gap between market value and affordable rent levels. What's more, the Fund should not be willing to pay the highest price in cases where bidding wars lead to acquisition prices well above market price. In both these cases, the City has determined that the subsidy cost to taxpayers cannot be justified by the affordable housing benefit that would be provided. As a result, with the very strong real estate market in New York City over the last five years, the Fund has been forced to turn down a significant number of transactions. However, as the market has begun to cool in certain neighborhoods in New York City, a number of stakeholders in the Fund believe a larger number of reasonably priced properties may become available in the near future, and the Fund is now well positioned to take advantage of such a change.

Second, to be successful, the Fund is dependent on smaller affordable housing developers being able to identify and successfully bid on privately owned property in New York City. Yet given their historic dependence on the *in rem* stock provided by HPD, many of these developers are only beginning to develop these entrepreneurial skills. The City has been working with Enterprise Community Partners and a number of other partners to build these skills through training, broker services, and other assistance.

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TRANSFERABILITY

The Fund's general architecture is highly replicable. Its features—using government and foundation money to insulate banks from risk, and thereby encourage the banks to extend credit to developers of affordable housing—require, at heart, only a few core elements. There needs to be a government with a financial commitment to affordable housing, foundations willing to assume a fair amount of risk for the sake of affordable housing, a consortium of banks willing to provide credit to developers of affordable housing, and existing community development financial institutions (CDFIs) that can serve as the originating lenders of the fund.

There are two central hurdles to setting up new funds based on the New York City Acquisition Fund's model. The first is educating the stakeholders—i.e., local government, foundations, and banks—about the complexities of the credit enhancement structure. The second is adequately preparing the CDFIs so that they can offer the fund's product to borrowers. Fortunately, many of the parties involved in the New York City Acquisition Fund (NYCAF) are national entities that because of their involvement in the NYCAF, are increasingly comfortable with the basic structure and are ever more willing to set up comparable programs in new cities. Their organizational experience helps the regional CDFI offices become comfortable with the fund's product.

Already, Enterprise and Forsyth Street Advisors, the day-to-day manager of the Fund, are in the advanced stages of setting up a new fund in the City of Los Angeles. The LA Fund is the same size and set-up as the NYCAF, and will likely ramp up to full operations over the course of 2008. Another city potentially ready for a similar fund is New Orleans. In New Orleans, Enterprise runs a small stimulus-loan program that could be enlarged to include other CDFIs in a structure comparable to the NYCAF's. Funds based on the NYCAF are also being explored in Chicago and Atlanta, where the MacArthur Foundation has convened a group of local stakeholders to examine the model and invited Forsyth to consult with them.

The NYCAF can also be translated to larger and smaller scales. A statewide program could be implemented, or a program for cities smaller than New York and Los Angeles. The key to a larger-scale program is cooperation among all levels of government: local and state governments need to be willing to work together to make a statewide or regional fund practicable. On smaller scales, the challenge is raising capital because smaller cities tend to have more limited budgets and there are certain fixed costs in the startup and ongoing operation of a fund like the NYCAF. In smaller cities, amassing sufficient funds to provide credit enhancement to a bank consortium would therefore require a proportionally greater commitment of the government's resources.

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