Strengthening Los Angeles Permanent Supportive Housing Developers

LA Family Housing's New Campus

Nonprofit Finance Fund®

California COMMUNITY Foundation

Nonprofit Finance Fund®

Strengthening Los Angeles Permanent Supportive Housing Developers

NFF AUTHORS
Claire Knowlton, Martin Lenarz-Geisen
September 2019

Nonprofit Finance Fund® (NFF®) advances missions and social progress in underserved communities through financing, consulting, partnerships, and knowledge-sharing.

This report was made possible with generous support from the California Community Foundation.

PHOTO CREDIT
Dana Stranz

ABOUT NFF

For more than 35 years, NFF has been working to connect money to mission, providing nonprofits with strategic financial management consulting services, access to capital, and thought leadership and advocacy. NFF has provided customized consulting to thousands of organizations throughout the country. In 2016, NFF provided one-on-one support to more than 225 organizations, with the goal of helping to build their capacity and sustainability to enable a more just and vibrant society.

NFF has always asserted that creating a strong, well-capitalized, and durable nonprofit sector is crucial to delivering mission-driven programs and services. Organizations using clear, accurate, and relevant financial data in decision-making can better understand their ability to handle risk and pursue opportunities; therefore, they are better able to create sustainable and successful business models that deliver effectively and meaningfully on mission. NFF's methodology centers on ensuring that nonprofits not only have financial data that accurately reflects their true operating performance, but also have the tools and understanding to use this information.

Contents

Introduction

Overview

Permanent Supportive Housing (PSH) developers in Los Angeles County are facing market challenges and opportunities to grow their pipelines. An ever-worsening housing and homelessness crisis in the region demands more housing. Local and State initiatives are providing an influx of capital intended to build more PSH, faster.

Nonprofit Finance Fund (NFF) is a national Community Development Financial Institution (CDFI) and financial consulting practice for nonprofit organizations. Since 2016, NFF has engaged with 12 nonprofit PSH developers in Los Angeles with the support of the California Community Foundation (CCF) and other local funders. The length, depth, and focus of each engagement varied according to organizational need and was designed to:

- Provide an understanding of supportive housing developers' financial dynamics and challenges;
- Provide tools and customized financial management support for data-informed decision-making and scaling considerations; and
- Strengthen the ability of leaders to tell the financial story of the organization to support the long-term stability of the organization.

NFF is currently in the process of due diligence and underwriting for $7 million in loans to three PSH developers in Los Angeles and designing a fund with California Community Foundation and other potential funding partners to address developers' most critical capital needs (see Appendix A).

Through these bodies of work, we have gained insights into the business models and capital needs of nonprofit PSH developers, including the dynamics challenging them as they seek to expand their development pipelines. This report is intended to share our learnings and provide our initial recommendations on how to help PSH developers scale to meet the housing crisis in Los Angeles County.

Summary of Findings

- Nonprofit PSH developers have unmet capital needs that limit their ability to scale.
- The capital most difficult to secure is for concept and pre-development activities and enterprise-level needs.
- Unmet capital needs can be addressed with grant funding and/or loans.
- Additional capital is only one factor constraining growth.
- Other factors constraining growth are staff capacity, land available for purchase at reasonable prices, and government subsidy for constructing and operating the buildings.

Findings

Operating as a Nonprofit Permanent Supportive Housing Developer

PSH developers have business models that are somewhat unique in the nonprofit world. This can make it difficult for developers to effectively communicate their financial story externally and make it difficult for philanthropic foundations to interpret their financial health and needs.

How are PSH Developers Different from Other NPOs?

	Human Services NPO	PSH Developer NPO
Business Cycle	Usually annual, occasionally bi-annual. Financial statements reflect the business cycle.	Based on life cycle of projects, often 5-6 years. Financial statements do not reflect business cycle.
Competition	Little or no competition from for-profits.	Stiff competition with for-profits for land, financing, staff, and construction.
Achieving Scale	No discernible cost savings or economies of scale achieved with growth.	Scaling reduces risk of individual projects and creates economies of scale.
Use of Debt	Debt averse, able to operate with little or no debt.	Sophisticated use and management of debt as a necessary tool of business.

THE DEVELOPMENT PROCESS AND ITS IMPACT ON BUSINESS MODEL

The business model of a nonprofit PSH developer is inextricably tied to the lengthy (5-6 year) process of developing housing. Developers work on multiple development projects simultaneously with staggered start and completion dates. Each stage in the development of PSH carries its own set of risks, revenue dynamics (discussed in the next section, see page 7), and expense dynamics that must be understood before the business model and capital needs of a given developer can be assessed. Each organization we worked with conceived of and named the phases of development slightly differently. Below, we offer a framework of development phases that our clients found useful for identifying discrete financial risks they encounter. This framework is not meant to replace the frameworks organizations use for managing the development process.

PHASES

1 CONCEPT FEASIBILITY

Activities during the concept phase assess whether a development project should be pursued. It involves research and analysis on a specific site to determine if the site is suitable for development. Research is performed using a combination of staff time and outside expertise. This phase often includes: environmental analysis such as soil testing; identifying the market and resident needs that will be met; projecting the economics of the project given the price of land and other preliminary cost estimates; and assessing the community dynamics that may offer support or opposition to the project.

A project in the concept phase often costs an organization $15,000-$20,000 in out-of-pocket expenses. Organizations estimated that one-third of the projects in concept phase do not proceed, meaning the project does not get developed and the costs incurred are never recovered through developer fees on the project (developer fees discussed in the next section, see page 8). Developers had difficulty estimating the amount of staff time spent in the concept phase during our engagements. The concept phase is funded through organizational reserves or flexible, non-project-specific financing, which is rare and difficult to secure. EQ2[1] is the most commonly referenced example of this type of flexible financing in the market.

2a EARLY PRE-DEVEL.

Feasibility assessment of a project often continues into the early pre-development phase. Developers are obtaining preliminary design information; refining estimates for development and operating costs; creating a plan for financing over the course of the project; and beginning to form the project development team.

This early stage is also the time when pre-development financing or a line of credit will be secured, but developers may have a waiting period before funds are transferred from the financial institution. This period may be 1-2 weeks and developers still need to make cash outlays to keep the project moving forward. Developers bridge funds by drawing down reserves that will be replenished once pre-development funds are transferred. The amount is dependent on the project with some developers estimating about $100,000 in outlays during this period.

2b LATER PRE-DEVEL.

Later pre-development activities become more costly and involved. Therefore, developers ideally have control over the site at this stage. Developers are typically completing due diligence on land or property including environmental reviews and assessment of risks; negotiating terms of purchase,

1 "The EQ2 product is a long-term deeply subordinated loan with features that make it function like equity. These features must be present under current bank regulatory restrictions… Like permanent capital, the equity equivalent investment enhances the non-profit's lending flexibility and increases the organization's debt capacity by protecting senior lenders from losses. Unlike permanent capital, investments must eventually be repaid and they require interest payments be made during their terms, although at rates that are usually below market." Lipson, B. (n.d.) *Equity Equivalent Investments (EQ2)*, Federal Reserve Bank of San Francisco. Retrieved from https://www.frbsf.org/community-development/initiatives/community-development-finance/investment-vehicles/equity-equivalent-investments.

executing a purchase contract, and managing entitlements; working with architects to complete drawings and plans; and bidding out construction work. Developers are also working to complete final budget estimates in order to secure financing for construction and permanent financing (not necessarily in that order). Nation-wide, total pre-development costs[2] run between 5-20% of total development costs for the project. The total outlays for pre-development (phases I, II and III) typically fell between $1-2MM per project for the developers we engaged.

The activities in this phase are typically financed through pre-development loans or lines of credit that are restricted to the specific project and cannot be used to finance other projects. If developers need to acquire the land, this is done with an acquisition loan. Some developers shared that use of debt is preferred to use of their own reserves for pre-development costs. In other words, use of debt for pre-development is appropriate in their view and normal to the course of business. Other developers have secured, or hope to secure, reserves that they can quickly and flexibly access for pre-development costs, thereby reducing the time, complexity, and uncertainty of securing multiple loans for pre-development costs.

The financial risk of a project failing to move forward at this stage is significant and increases as pre-development spending increases. If the project does not move to the construction phase because of entitlements issues, community resistance, etc., the developer will not be able to recoup their costs from developer fees and will likely take a loss for the hundreds of thousands of dollars they have paid out for the project to date. Therefore, some developers have set internal limits to how much they will spend on a project in pre-development (e.g., $500,000). In addition to careful management practices, the financial risks in this stage are mitigated by thorough, quality due diligence in phases I and II.

Other essential activities during this phase include securing construction financing and structuring appropriate partnerships for property management and supportive services. If the PSH developer does not provide property management and supportive services themselves, securing partnerships for these services before construction begins ensures services will be in place immediately when construction is complete.

3 CONSTRUCTION

During this phase the focus is both on monitoring the construction schedule and progress while simultaneously ensuring that qualified residents are identified for lease up, a property management plan is in place, and permanent financing documentation is finalized in preparation for conversion.

In the Los Angeles market, construction loans are generally available through commercial banks and easier for developers to secure than pre-development loans. In other markets where NFF has engaged, construction loans are sometimes much more difficult to secure. Developers typically receive a portion of their developer fee once construction starts and the fees received are used to repay pre-development loans. Remaining developer fees are received during different milestones throughout construction and final phases. It is important to note that the timing of revenue recognition and cash receipt of developer fees are often different.

Developers face the risks of construction delays and cost overruns that exceed the construction contingency budget. If construction is delayed, revenue from developer fees may be delayed. Revenue delays may impact the developer’s annual operating budget and require the developer to

2 Seltzer, C. (2019) ‘Affordable Housing 101’ [PowerPoint slides], February 22, 2019, presentation.

borrow or use their reserves to sustain operations. If there are significant construction cost overruns, they are typically paid for out of developer fees. This effectively reduces the capital developers are able to add to their balance sheet, which can negatively impact future projects, financing deals, and investment in organizational capacity. Developers mitigate these risks through conservative construction budgeting practices that include a contingency line item (typically 10% or more of the construction budget).

4 CONVERSION

At the completion of construction, the construction loan is converted to a permanent mortgage. Any other outstanding project-specific loans are repaid. The developer begins servicing the mortgage immediately.

Developers need to move from conversion to lease up as quickly as possible (typically one month) so that the property is "placed in service" and begins collecting rent revenue. Otherwise, the mortgage is repaid with developer fees. The primary risk in this phase is that the property is delayed in being "placed in service" due to either not passing inspections from government agencies, or, increasingly, the lack of capacity from agencies to perform their required inspections when the project is ready.

5 LEASE UP & OPERATIONS

During lease-up, tenants occupy the property and rents are collected. Rents are used to repay the mortgage, though developer fees may still be used while the property has vacant units. Property managers perform income verification and tax credit reporting. An asset manager may be brought on for maintenance and repairs. Delivery of supportive services begins, either by the developer or a partner organization.

The primary risk in this phase is inability to fully lease the property quickly.

DEVELOPER FEES AS PRIMARY REVENUE SOURCE FOR PERMANENT SUPPORTIVE HOUSING DEVELOPMENT

Investment in the development of affordable housing in the US is primarily driven by a federal Low Income Housing Tax Credit ("LIHTC") program. This program was enacted by Congress in 1986 to incentivize the private market to invest equity in affordable housing by providing an indirect federal tax credit. Operationally, the Internal Revenue Service allocates federal tax credits to state housing finance agencies based on the population of each state. The state then makes available to qualified affordable housing projects one of two types of LIHTC allocations based on the priorities for the state: a 9% credit allocation that produces more equity but is very competitive in most states, or a 4% credit allocation that produces less equity but is awarded on a non-competitive basis with tax exempt bond financing. The project sponsors apply for one of the two types of LIHTC allocations and, if awarded, then use the tax credits awarded to raise equity from private investors. Private investors benefit by using the tax credits and real estate losses to lower their federal tax liabilities, while the equity raised for the project reduces the debt burden on the property, making it feasible to provide housing at lower rents.

As part of this program, developers are incentivized to develop affordable housing properties through the promise of a developer fee. This fee is built into the project budget and, with LIHTC projects, states restrict the amount of the fee as a percentage of the project development costs or as a capped dollar figure. Unlike market rate developments where the developer receives the excess cash distributions after debt and equity is repaid, PSH projects typically do not have much by way of excess cash for distribution. The developer fee is meant to compensate nonprofit developers for the risk and resources they put into each project as a pre-defined percentage of the project development costs. Once a developer fee is established for a project, it is not changed. If costs are incurred beyond the budget, whether due to delays or overruns, the developer fee is used to cover these costs.

Typical payment times for developer fees are at the start of construction, at construction completion, and at conversion/lease up. Developers are therefore waiting upwards of two years to receive compensation for the activities and resource outlays that occur from concept and pre-development phases. The delayed compensation inherent in PSH development is important to consider when evaluating financing and capital needs to operate.

Example Developer Fee Schedule:

Milestone	Date	Percentage of Developer Fee
Phase 3: Construction start	February 2019	25%
Phase 3: Construction completion	June 2020	25%
Phase 4: Conversion to permanent	July 2020	40%
Tax Filing	August 2020	10%

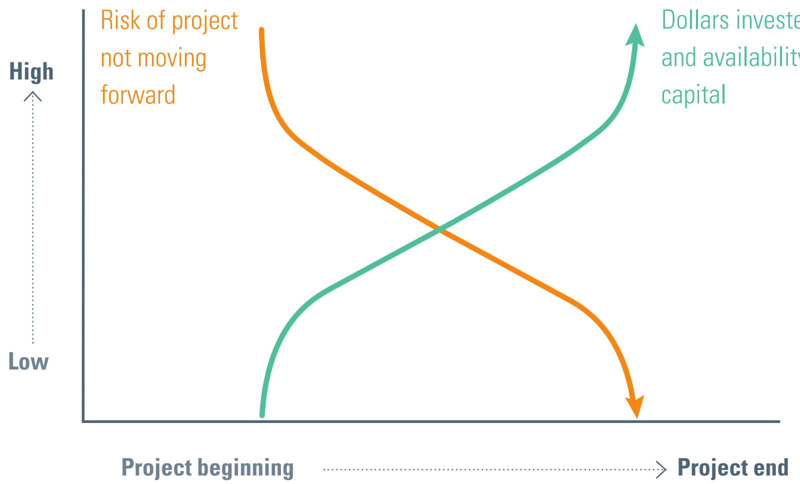
This is only an example as each project is different. The percentage payout may be different at each milestone, there may be different milestones, and there may be more milestones. In addition, developer fees may need to be allocated across multiple organizations when projects are co-developed with other nonprofit or for-profit developers.

Quantifying Financial Risks and Incentives

OBSERVATIONS OF EARLY PHASE RISKS

The risk of a project not moving forward and the availability of capital or financing are inversely related. In earlier phases of project development, developers face a high risk of the project not moving forward and lower dollars invested. At the concept phase, developers must invest time and money in thorough investigation to prevent high cost consequences of losing the project in later phases. Yet due diligence activities will be unfunded if the project does not move forward and result in developer fees. This suggests developers have a financial incentive to limit due diligence work to only the most promising projects. Does this reality limit the number of projects a developer is willing (or financially able) to investigate, and therefore stifle the pipeline of development? Does this also limit the type of project that a developer is incentivized to explore?

Relationship of capital and risk



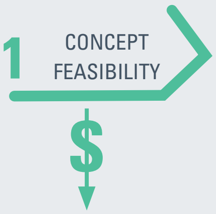
Because the risk of financial loss declines as projects move through the pipeline, and because the construction phase allows for financial risk mitigation through the construction contingency budget, NFF's work with developers focused on addressing risks in the earlier phases of development.

DEFINING DISCRETE CAPITAL NEEDS TO MITIGATE FINANCIAL RISK

NFF's engagement with developers found that experienced developers could often cite the dollar amount of their unmet capital needs, but not articulate the specific reasons that amount was needed. The lack of specificity made it difficult for these leaders to gain internal alignment around capitalization goals and made it difficult to externally advocate and fundraise for their enterprise needs. NFF's partnership with select developers illuminated and quantified the specific organizational risks that need to be mitigated, and where in the development process these risks occur. Based on real exercises with clients, but adapted to represent a fictitious organization, below is an example quantification of met and unmet capital needs.

CASE STUDY: RESERVE FUND TARGETS

This case study organization generally has a pipeline of four-six active projects in pre-development or construction. They plan to expand that pipeline to have seven-nine active projects. They currently have $2 million in cash and investments on hand, $900,000 of which is needed to comply with loan covenants and the remainder to meet operating working capital needs. This is an established and experienced developer.



$80,000 - Highly likely to access

$80,000 would cover the costs of early due diligence on four projects that do not advance through the pipeline and, therefore, do not result in developer fees to recover the costs. A project may not move beyond the concept phase due to:

- Site owner decides not to sell/selling price too high
- Major environmental finding(s)
- Market competition for site control
- Not competitive for tax credit allocation

Given plans to expand its development pipeline, it is reasonable to assume that a higher percentage of projects will not advance beyond this phase and therefore will need cost coverage. The size of this organization's development pipeline and margins achieved through the organization's other development projects would allow for this reserve to be replenished through surpluses every two-three years.

$200,000 - Highly likely to access

For up to two projects, $200,000 would bridge pre-development costs incurred before pre-development financing is secured. The likelihood that the organization would access this reserve is very high but is going to vary by project depending on the availability of early pre-development money in the market at the time. Funds are intended to be accessed and repaid on a regular basis with each new project. The availability of such funds allows the organization to continue with early pre-development activities while waiting for pre-development financing to be made available.

$300,000 - Somewhat likely to access

$525,000 - Rarely accessed

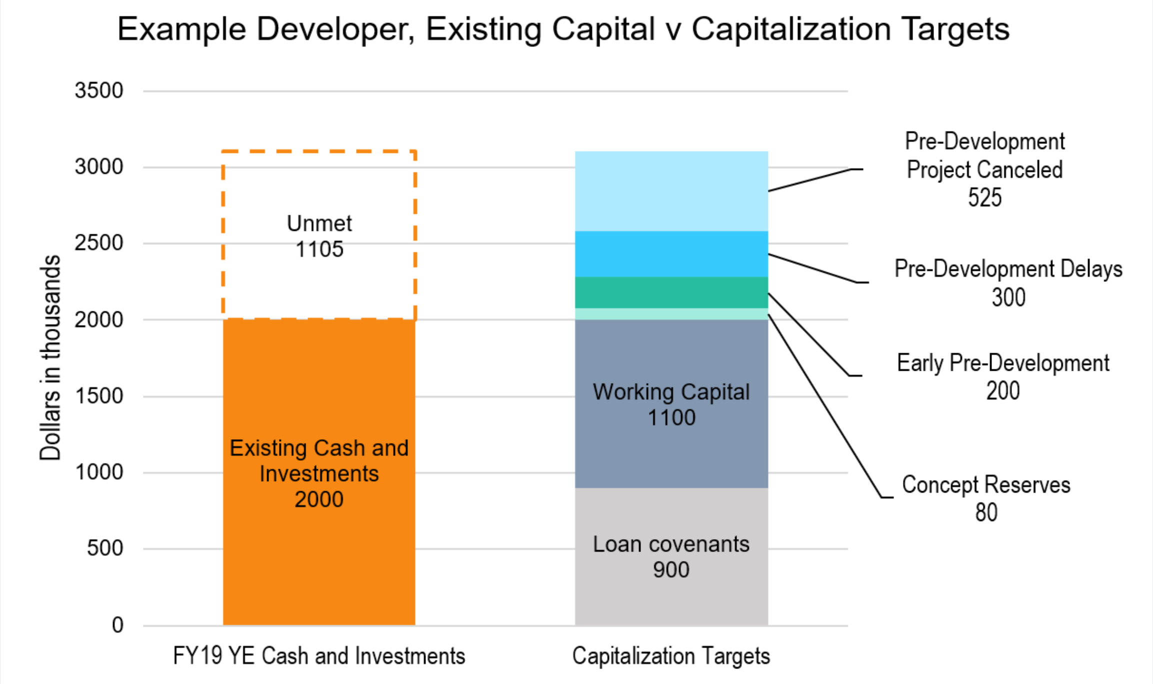
If projects are delayed moving into construction, the developer must be able to cover additional interest expenses on acquisition and/or pre-development loans and potentially other hard costs for activities that need to be duplicated or extended in order to move into construction. A $300,000 reserve would cover primarily the additional interest on loans for two projects for up to an additional 18 months beyond the projected timeline. This reserve is expected to be eventually replenished with developer fees.

Another, less likely risk, that this organization faces during pre-development phases is project cancellation.

A project may be canceled because:

- Site sale falls through
- City or other budget-dependent funding changes/not awarded
- Lawsuits or significant community resistance arise

A $525,000 reserve would allow the organization to recover from a project that does not advance to construction without jeopardizing other projects in the development pipeline. Use of this reserve represents a loss for the organization which would not be recovered through developer fees.



ADJUSTING CALCULATIONS FOR MARKET CONDITIONS AND GROWTH

As with other nonprofit organizations, developer capitalization needs are not meant to be a one-time calculation. Rather, they should be revisited as market conditions and organizational goals change. Land is becoming more and more expensive. In response, some useable land owned by municipalities and religious organizations is being offered to developers for use, but not for purchase. Without land as collateral, developers are struggling to secure needed financing. If this is the direction the market is heading, how might developers need to change the composition of their balance sheets to make it work?

As nonprofit PSH developers are being asked to expand their pipeline, they will need to perform due diligence on more projects, simultaneously. We hypothesize that an increasing percentage of projects will not move beyond phases I or II as pipelines increase. This is because organizations are currently performing due diligence on those projects most likely to succeed. As the pipeline expands, it necessitates performing due diligence on projects slightly less likely to succeed. For each that does not move forward, the organization will have to absorb a financial loss.

Preliminary Recommendations for Philanthropy

USE ALL THE TOOLS IN YOUR TOOLBOX

Deploy large, flexible funds to meet the most pressing needs

Whether in the form of grants or loans, flexible dollars that are not tied to specific projects or project milestones are the most useful for organizations, the most efficient to manage, and the hardest to secure.

These funds can be used for enterprise working capital, project specific needs, acquisition, or capacity building. Long term funding is better.

Developers with small pipelines may benefit more from grants than loans

For developers that have smaller pipelines, each project has outsized financial risk as it represents a relatively higher portion of the organization's portfolio. The ability to absorb unrecoverable losses in the development process depends on the developer fee margins realized in the developer's portfolio as a whole. As such, developers with smaller pipelines and operating at a smaller scale have business reasons to be more conservative in their development work and choices, and therefore may be better suited for grant funding instead of financing until they reach economies of scale. When discussing needs, small developers were generally hopeful to secure more grant funding.

Developers with large pipelines may benefit more from PRIs and other loan products

With a large development pipeline, any one project represents a smaller share of risk within the portfolio. Therefore, larger developers can comfortably take on more debt. When discussing need, larger developers were more interested in seeking loans than grants. Unrestricted grants are also an effective tool for meeting large developer capitalization needs in situations where adequate philanthropic capital exists in the market.

Grants for growth and capacity building

Developers found recent philanthropic capacity building grants[3] of $275,000 over three years to be incredibly valuable for addressing staff capacity limitations. Because it often takes five years for a project to move from concept to completion, the revenue benefit from this type of staff expense outlay can be slow to be realized. Recognizing this dynamic, many of the capacity building grants were extended to four years as of June 2019. Plans are now being considered that would extend the grants for another two years (six years total) in order to fully span the typical development cycle and ensure that compensation for new staff is secure until final developer fees are received.

Leveraging philanthropic capital for more capital

As developers deliver against multiple projects with dozens of loans on the books, they may find their assets fully leveraged, thereby making it difficult to secure financing for the new projects entering the pipeline. This is a moment when philanthropy, after vetting developer projections and plans, can offer top-loss or loan guarantees that will allow a CDFI or commercial lender to make a loan that they otherwise could not make.

California Community Foundation (CCF) is one example of a funder who has shifted its focus from providing project-specific acquisition or pre-development capital to investing in top loss positions on loan funds with CDFIs. Over the course of multiple years, CCF made four separate project-specific loans totaling $2.6 million to help a developer create 322 units of affordable and supportive housing. After shifting strategy, CCF helped the same developer in 2019 by combining $1 million in CCF lending with $4 million from other sources (Weingart Foundation and NFF). The $5 million loan is supporting the creation of 662 units over the next five years.

3 Philanthropic capacity building grants were provided through a pooled fund from California Community Foundation, Conrad N. Hilton Foundation, Weingart Foundation, The Kresge Foundation, and The Carl & Roberta Deutsch Foundation in partnership with United Way of Greater Los Angeles' Home For Good Funders Collaborative.

WHAT IS THE POTENTIAL IMPACT OF OUR RECOMMENDATIONS ON THE SECTOR?

Will providing greater access to flexible capital cause developers to be less rigorous in their decision-making about which projects to pursue, leading them to take unnecessary risks?

We are highly doubtful that developers would engage in such behavior. While our sample size is limited, we found an exceptionally conservative culture pervades developers, owing to the high-risk, low-reward nature of the sector. We would not expect this to change in the short-term. We also assume the philanthropic capital that can be made available would be meaningful but modest, and certainly would not flood the system with excess cash.

Would the provision of additional or more flexible capital go unused because of land and staff constraints?

As of now, we have no reason to believe that available capital outpaces available land or available staff resources. All three are constrained, and likely not in equal measure across different organizations. Those few developers who have recently secured new flexible capital seem to be expanding their pipelines successfully, indicating that the capital infusion is working. Funders should of course perform due diligence to ensure that the capital they deploy can be used as intended. There is the potential that placing flexible capital inside a developer allows them to address other constraints as well, giving them the ability to act quickly if a qualified candidate becomes available, for example.

We believe expanded access to flexible capital will allow PSH developers to expand their pipelines, putting one more piece of the puzzle into place in our collective efforts to end homelessness in Los Angeles.

Appendices

Appendix A: Details Regarding NFF's Work with Developers

Advisory Services Activity

Developer	One-on-one engagements with developers	Participated in LA Homeless Service Providers convenings
A Community of Friends	2018-2019	2018
Affordable Living for the Aging	2017-2018	2018
Clifford Beers Housing	2018-2019	2018
Coalition for Responsible Community Development	2017-2018	
LA Family Housing	2017-2019	2018
LINC Housing	2018-2019	2018
Little Tokyo Service Center		2018
PATH Ventures	2018-2019	
Skid Row Housing Trust	2017-2018	2018
SRO Housing		2018
Step Up on Second	2016	
Venice Community Housing	2018-2019	2018

Financial Services Market Activity

Accelerating Permanent Supportive Housing Fund (APSH Fund)

NFF is raising capital for a $10 million lending pilot to provide working capital loans to established nonprofit housing developers in Los Angeles County with the goal of accelerating the creation of affordable and supportive housing units. It will allow developers to increase and better manage their development pipelines with capital that can be invested in projects on an as-needed basis. This enterprise-level financing, which is largely unsecured and flexible, is not readily available in the market. NFF expects to offer two loan products:

- Loans at the enterprise level, which may be partially secured by unencumbered real estate or an assignment of developer fees. Loan term up to five years.
- Predevelopment loans at the project level, to the extent there is excess demand in the market for this type of loan product. Loan term up to three years.

Loan amounts are expected to be in the range of $500,000 - $3 million.

Capital Raise

- NFF has received a $3 million Program Related Investment (PRI) from California Community Foundation.
- UniHealth Foundation is underwriting a $750,000 PRI request from NFF.

- Weingart Foundation is underwriting a $1 million PRI request from NFF.

Loans to Developers

- NFF is currently underwriting loans to three developers.
- Loans are between $2-3 million each
- NFF is in early conversations with two additional developers interested in accessing loans at similar sizes.

Appendix B: Assessing Financial Health for Developers

Indicators of Financial Health for PSH Developers Vs. Other NPOs

	Human Services NPO	PSH Developer NPO
Business Model Health	Consistent annual operating surpluses.	Average operating surpluses across multiple years.
Capital Structure Health	Positive net asset position.	Positive net asset position with consideration given to "soft" or forgivable debt and availability of assets on balance sheet as well as assets that might not be captured on a non-consolidated statement.
Liquidity and availability	Months of cash; months of available net assets	Cash-on-hand with consideration given to loan covenants and cash needs for existing and planned development pipeline.

Financial Information to Assess Developer Financial Health

- Five-six years of audited financial statements
- Enterprise budget projections covering two-three years, including all planned and current developments
- Enterprise cash flow projection covering two-three years, including all planned and current developments
    - This should show the expected timing of developer fee receipts for each project
- Overview of loan covenants that must be met to remain in good standing with lenders. Loan covenants are typically financial metrics set by lenders, such as:
    - Minimum ratio of cash and equivalents to current liabilities
    - Maximum ratio of total debt to net assets
    - Cash flow from operations equal to at least a set percentage of unrestricted revenue, on average for the past three years
    - Minimum days cash on hand
    - Unrestricted net assets equal to at least a *set percentage* of total unsecured debt
    - Unrestricted net assets equal to at least a *set percentage* based on a set percentage of last audit

Project-Level Versus Enterprise-Level View

We have found that many in the PSH space, particularly lenders, have taken a project-level view to assess risk and understand need. The benefit of this view is that one project is more easily quantified and understood.

One downside of limiting assessments to only the project-level is it fails to capture costs associated with concept and early pre-development phases, which are too early to secure financing.

A second downside of project-level view is it fails to capture organizational capacity. This may cause staffing, systems, and enterprise-level capital needs to go unconsidered.

Presence of Other Programs

The aforementioned dynamics, needs, and recommendations focus on PSH development activities for organizations that are often also providing property management, supportive services, or other programs. Although we isolated the development activities, risks, and capital needs in this report, it cannot be ignored that organizations generally leverage their balance sheet, staff capacity, and other resources across programs and activities. Developers that operate programming beyond PSH development expressed the mission-delivery tension that exists in allocating developer fee surpluses, and available capital generally, between the expansion of their pipeline versus funding needs like working capital for managing cash flow in government service contracts. We assume and expect that developers who offer supportive services, property management, and other programming beyond PSH development need to allocate developer fee surpluses to a greater number of uses beyond expanding their development pipelines, thereby potentially increasing the grant or loan capital needed to manage risk and grow.

We also observed that organizations with multiple lines of business had leadership teams with uneven knowledge of the development process and business model. This resulted in varying levels of comfort with the debt needed and risk inherent to the development process. Simultaneously, we heard from organizations that were engaged in multiple lines of business, or exploring doing so, about the mission benefit of organizational continuity between the development process, property management work, and provision of supportive services as it relates to successful PSH outcomes.

Appendix C: Staff Capacity Constraints

This report has primarily focused on the financing needs of nonprofit PSH developers. In our work, we also noted that a central constraint to expanding development is adequate staffing. Nonprofit developers are competing directly with for-profit developers for experienced project managers.

Project managers are critical to a functioning business model for developers. They are tasked with ensuring that a project is moving through the development process in an efficient and closely managed manner. Experienced project managers often have access to important market intelligence and external stakeholders; they ensure proper due diligence is executed; and they manage tight timelines, making sure the right processes are being followed in a time-appropriate and often sequenced manner, among other responsibilities.

Recruiting and retaining experienced project managers for nonprofit developers is challenging for several reasons. First, there is a lack of market supply. Developers have expressed the extensive training and time required in order to get hires to a point of being able to effectively manage the complex project development process. Second, at for-profit developers, project managers are often tasked with ownership of specific portions of the development process. Conversely, at nonprofit developers, project managers are required to take on a more complex and often heavier workload managing a broad set of activities throughout the entirety of the development process. Lastly, and perhaps most obvious, nonprofit developers are not able to compete with the salary packages that for-profit developers are able to offer experienced project managers.

A select number of developers in this cohort are actively exploring the increase in staff salaries needed in order to begin to address this issue. Our work with organizations in creating dynamic projections models will help leaders explore potential scenarios over time and begin to quantify the investment needed in order to be able to better retain and recruit project managers to manage an expanded project development pipeline.

Developers cited the importance of multi-year grant funding from foundations to expand their staff.

Nonprofit Finance Fund®

Join the Conversation!

Visit **nff.org** to learn more and sign up **here** to join NFF's mailing list for the latest news.