This is the first in a series of case studies documenting the experience of housing development organizations in amassing, attracting and managing capital at the enterprise level.

Our goal is to better understand the general organizational underpinnings that support enterprise finance and to highlight the specific practical lessons that these organizations have learned. Our first task was to clarify the definition of enterprise finance in this context as:

The strategic pursuit of business activities and discretionary use of new capital and / or an organization’s existing assets - either directly or through leverage - to fund:
- business activities (working capital),
- growth (investment capital)
- reserves to mitigate risk (permanent capital).

Our working definition distinguishes itself from some other uses of the term. Often times the phrase enterprise finance is simply used to indicate a specific type of loan product made to a parent organization and that does not take real estate as collateral. For instance, one might say, “They got an enterprise finance loan from the bank which they used for pre-development costs on any project they wanted”. Occasionally, the term is used to distinguish the United Kingdom and other similar systems from that of the United States. In the UK, housing associations often hold real estate portfolios directly (rather than in special purpose entities). These associations have received stock transfers (10,000s of units) from the government, have access to operating subsidies and raise capital from the cash flow off of their portfolio.

Our use of the term is intended to encompass the entire practice of managing an organization’s many sources of capital in order to better serve its mission; a deliberate
attention to the health and effectiveness of the organization and a switch from a project-driven to an organization-driven decision framework. It implies a clear intention to serve mission, the presence of systems and ongoing discipline; all of which must exist for the organization to amass its own capital, access capital from others and manage all of its capital prudently for stability, nimbleness and growth.

The presence of these strengths, systems and discipline can create more opportunity for capital access and growth, which then allows organizations to further reinforce their strengths, systems and practice their discipline, but also create their own opportunities to grow and serve their mission. Ideally, this is a mutually re-enforcing upward dynamic.

We believe that practicing an enterprise finance approach can help housing organizations grow in times of opportunity, weather market downturns and continue to be productive in times of dwindling resources – all while asserting their commitment to mission. We thank the organizations that have agreed to share their experience in these case studies as a way to reflect on their own enterprise finance practice but also to help others learn from their experience.

Acknowledgements
Deidre Lal Schmidt prepared this case study with the assistance of Sara Joy Proppe, both of One Roof Global Consulting, LLC. The author and Strength Matters gratefully acknowledge the time and effort of Nancy Rase and Chris Cherry of Homes for America that contributed significantly to this work. Mary White Vasys and Frances Ferguson, on behalf of Strength Matters, were instrumental in framing the case and the analysis of the financial condition of Homes for America.

This document was prepared in December of 2012 with information available at the time. All financial analysis was done with information provided by HFA and was not subject to external audit. The contents of this case are intended for general informational purposes only.
The Organization

Homes for America (HFA) is active in the development and preservation of housing – with enhanced services – for low- and moderate-income households and special needs populations. Founded in 1994, HFA has developed 68 rental communities with over 5,200 dwelling units in the mid-Atlantic states of Maryland, Pennsylvania, Virginia and Delaware. HFA’s central office (in Annapolis, Maryland) houses 12 of their 16 staff. HFA’s portfolio is comprised of 55% new construction and 45% preservation projects that serve a diverse population. Ninety-two percent (92%) of their residents earn at or below 60% of area median income. Among non-elderly families, this climbs to over 98%. HFA’s families have an average annual income under $17,000 and over 55% receive rental assistance. Six developments serve extremely low-income families, with incomes under $10,000 a year. Seniors constitute 58% of HFA households and are largely single-person (90%), female households (72%). Average annual income for HFA seniors is just over $18,000 and 44% receive rental assistance. Less than 1% of HFA senior residents earn over $50,000 annually. HFA provides 114 units (2% of their total resident population) for the formerly homeless. HFA has set aside units in every community for low income persons with disabilities and 17% of all residents are households including a person with a disability. Minority populations are represented in over 73% of all HFA households.

Homes for America began with a commitment to be a self-supporting business. From the outset, Nancy Rase and Trudy McFall founded HFA as a sustainable business with a mission orientation. Why did they choose to incorporate as a non-profit rather than forming a for-profit with a mission orientation? Among the most influential considerations were; their long careers in the public sector, a desire to build on those relationships and reputations, limited start-up funds, a lack of desire to fundraise and acknowledgment of funding preferences to non-profits.

The availability of an enterprise-level financial tool was a significant catalyst for autonomy and financial strength. In 2004, HFA joined four other organizations in accessing a brand new financial product offered by the MacArthur Foundation. Now called Window of Opportunity, these funds were a source of low-cost and long-term capital, provided at the enterprise level, to support preservation activities. HFA secured $1.75 million, which required quarterly payments of 3% interest-only, over a maximum 10-year term. This allowed HFA the space to think strategically and take advantage of some unique business opportunities, including stepping into another developer’s troubled project. These original funds have now been repaid and HFA has amassed about $2.5 m in their own flexible capital.

Most significantly, the original MacArthur capital enabled their transition to the role of sole or lead developer / owner rather than having to joint venture with a “partner of substance”. These resources
Case Study 1: Homes for America
Strength Matters In Becoming the Partner of Substance

empowered them to do projects that align with their mission and it is linked to their completion of a
dozen preservation projects in the lead developer position.

The shifting focus of the organization’s development activities reflects the influence of the MacArthur
preservation funds. Pre-2004, HFA’s development focused on new construction with only 24% of
units in preservation. Post-2004, preservation dominated HFA’s development activity, with 66% of all
units brought on line. In total, 74% of the units ever preserved by HFA were done post-MacArthur,

A clear focus on their strengths and the maintenance of a lean organization marks HFA’s
efficient operation and financial health. HFA has resisted becoming a large staff organization and
has deliberately limited their core business lines through honest assessment of costs and benefits (in
both financial and mission terms) of their major areas of activity.

• Rental Housing Development – A key business line is the development of affordable rental
housing opportunities, including new construction, and acquisition / rehabilitation of existing
rental housing in a multi-state region. HFA is a credible sole owner / general partner allowing
them autonomy to select geographies that are hospitable, structure projects as they see fit and
access fees and cash flow to a greater extent. HFA continues, however, to partner with other
non-profits, particularly when the opportunity opens up new markets.

• Asset Management – HFA takes pride in its rigorous standards for the physical and financial
health of their portfolio. They have controlling interest of 57 of their 68 developments, and
these projects receive the most aggressive Asset Management (AM). AM staff track projects’
operating expenses, reserve levels, cash on hand, accounts payable, occupancy and other key
indicators of project health while also looking at contingent liabilities of the parent. Their
concerted effort to understand and manage their portfolio has proven to be worth the
investment. The portfolio currently generates sufficient and consistent cash flow to support the
core operations, including nearly all of resident services (HFA does limited fundraising for
special and short-term programming).

• Resident Services – HFA considers this a mission-critical part of their business, thus resident
services are on-site at all their properties. Service programs are planned, monitored and refined
for and with residents to make sure that they meet residents’ specific needs. These programs
are then coordinated with, but not provided by, property management. The work is staffed both
at the central office and regional levels to provide consistency and local familiarity.
Case Study 1: Homes for America

Strength Matters In Becoming the Partner of Substance

- **Property Management** – HFA has made a deliberate decision not to develop their own property management capacities based on their view that development and ownership are their core business lines and that participating in a non-core business line would only make sense if it were quite profitable. Profitability, they concluded, would come from a level of concentration that was not found in their portfolio. They assessed that this was not an area of competence and building capacity would require more staff, limit profitability and potentially destabilize the organization. Furthermore, HFA has been able to get good results from third-party property management providers by being proactive asset managers, which includes playing roles in decisions that impact quality of management, like approval of site managers for each property. HFA is considering a joint venture with an existing non-profit management company to create a hybrid organization that will combine property management and service provision. While HFA would not serve as property manager, it would be in a stronger position to influence quality, pricing, etc.

- **Consulting** - Consulting, though part of their startup strategy, is no longer a core business line, as profitability and ability to advance the mission are limited in consulting in comparison to preservation, new development and service provision. HFA does consulting on a limited pro-bono basis, often as a means to identify and build capacity with potential joint venture partners, who are other nonprofits.

- **Single-family development** - HFA no longer develops single-family homes. This work, originally seen as a sign of commitment to their hometown priorities, was deemed too demanding in cash and staff time, compared to mission impact. It was a “one-staff-person-activity, which supported itself and created a lot of good will”. The tax credit lease-purchase model has replaced this activity, which works well for prospective buyers who need a longer runway to be ready for homeownership.

A number of practices have enabled HFA to access third-party enterprise-level capital, amass their own flexible capital and manage those resources prudently. The organization has a tradition of disciplined and consistent systems, growth and production that convinced a major funder that they could handle the responsibility of taking in new, flexible capital and producing results. Additionally, HFA has further evolved their procedures to manage the capital they’ve amassed. A few are highlighted here:

**Property-level strategies / practices**

- **Choose new projects carefully.** HFA is active in multiple market areas and has begun to focus their development activities on projects in jurisdictions that allow non-profit developer / owners to have access to cash flow on performing projects. This serves as a financial threshold
and also a philosophical litmus test by indicating to HFA which local partners understand the inherent challenges and effort required to manage and maintain quality housing and services for the long-term. After determining a municipality will support reasonable cash flow distributions, HFA favors structures that will maximize that cash flow. They are now doing more 501c3 bond and TE Bond / 4% credit deals, which have the added benefit of not being competitive sources. This is paying off, as they currently have 28 of 62 deals that are spinning off cash ranging up to $126k annually.

• **Check and balance system at the project level.** Development staff at HFA is encouraged to be aggressive and search for opportunities. The CEO helps determine which deals should proceed; weighing the risks, investment levels required and alignment with the mission. This has become an increasingly formalized process, which now includes written self-assessment by the development staff with reporting to the Board. In anticipation of a planned leadership transition the organization has plans to initiate a Project Review Committee comprised of Directors and one or two “outside” experts to work with staff on final project decisions.

• **Use investment capital to avoid unnecessary joint venture.** As mentioned, access to enterprise-level capital gave HFA the financial wherewithal to act as sole or managing general partner. Since then, HFA has amassed its own investment capital in a development fund of $2.5m. This means that HFA has autonomy to pursue projects within their mission and other parameters. It also enables them to earn more fees and have increased access to cash flow. They continue to joint venture only if it serves their mission and / or makes a project stronger.

• **Aggressive refinancing of properties.** HFA staff monitors when refinance lockouts and prepayment penalties burn off or when it makes sense to pay those fees to lock in a much lower interest rate. Refinancing to better terms when possible facilitates service provision at the property level or upstream cash flow for services or enterprise-level capital accumulation.

**Enterprise-level strategies / practices**

• **Involve / educate the whole organization in enterprise-level financial health.** The entire HFA staff are encouraged to examine the organization’s financial health:

  o Twice a year HFA holds an open conversation with all staff on the financial health of the enterprise and its future prospects. This transparency is generally viewed as empowering, rather than anxiety producing because it is coupled with an opportunity to influence the organization’s actions.

  o Staff members help to identify areas for improvement and create an action plan. For instance, last year a cross-disciplinary working group reviewed a small portfolio acquisition where mistakes resulted in lower-than-expected cash flow. A procedure
and standards for reviewing portfolio acquisitions was developed by the work group and approved by the Board.

- Every 5 years the organization updates their business plan, but more frequently if the market changes. To formulate the plan, staff discussions occur as a whole group, rather than in siloed functional areas.

**Engage a high-capacity Chief Financial Officer.** HFA hired a CFO who is relied upon to review, analyze and guide enterprise finances and consult on project finances. The CFO’s charge is more than just proper accounting and compliance / reporting. Instead he acts as a partner in an iterative process where project structures are fine-tuned to support parent entity financial health. The CFO takes the lead role in recasting 5-year organizational cash flow projections for review by staff and with the board.

**Evaluate and act on what is mission-critical.** HFA has systemized their self-evaluation and turned an attentive ear toward their residents. This is exemplified in their evaluation of resident services. First, managers submit quarterly reports to HFA describing the services, resident participation, and any unmet needs or problems. The HFA Service Manager ranks each community’s performance against HFA’s service standards and rates their relative need for special attention. Last year, four projects received a low ranking, making them a focus of intensive improvement efforts. The Manager of Resident Services presents this report quarterly to HFA top management so that all key staff knows about the status of services at each community. Action steps are agreed to for the next quarter and progress picked up in the future reporting. Periodic planned and unannounced staff visits help keep HFA aware of the physical state of the properties. They have also established a “Talk to Us” email program enabling residents to go directly to HFA staff with issues. Last year 8 projects moved up in ranking from low to middle or middle to high ranking, showing such attention does indeed provide results.

**Professionalize the Board of Directors.** The HFA Board has evolved from a group of trusted friends and colleagues who possessed capacity, interest and commitment based, in some part, on their relationship to the Founders, into a highly professional and more objective Board. The Board is now self-generating, with members not necessarily chosen by the Chairman and CEO.

**Get maximum value from the Board and advisors without bogging down.** HFA strives to give full access and transparency of information to their Board. One strategy was to create an audit and finance subcommittee, resulting in a more rigorous review than previous all-Board discussions and ultimately providing a deeper comprehension on the part of the whole board. Additionally, the audit and finance committee includes non-Board industry experts whose
outsider’s perspective can check for the potential that Board enthusiasm might overshadow clear decision-making.

- **Rely on the Board of Directors to monitor mission.** The HFA Board is tasked with monitoring the balance between mission orientation and financial sustainability. An example is the organization’s choice to end single-family development. HFA had a lot of resources tied up in individual homes where the market risk made them vulnerable. The Board judged that the impact was limited, the risk high and profitability low. Instead, HFA decided to engage in long-term ownership (through LIHTC lease-purchase) in a way that was less risky for the organization. This diligence doesn’t imply that every deal has to be highly lucrative, but no deal should have long-term adverse impact on the organization. For example, even though HFA is capable of solo development, they will still work with small local nonprofits when it serves the mission.

- **Put in place systems that endure beyond leadership transitions.** HFA’s founders are stepping back. One founder has resigned her full-time staff position and is now serving on the Board and working part-time on special projects. The CEO has announced her retirement 4 years in advance. This presents an opportunity, and an obligation, to build systems that bring more staff in contact with the Board, rather than relying on the founders’ commitment to balance mission and sustainability. A manifestation of this is the upcoming creation of a project committee of the Board that will assess individual projects early in their feasibility stage. The format is evolving from an informal conversation with the CEO into a more formal presentation.

- **Diligent portfolio review for project-level intervention and entity-level implications.** The AM team performs project risk ratings monthly and reviews project performance and risk ratings monthly with the CFO and CEO and quarterly with the Board. Projects are evaluated and given risk points if standards are not met, leading to an action plan for addressing projects that are likely to struggle. A comprehensive risk report captures the entire HFA portfolio and is an early warning system at the parent level, particularly for projects where HFA has operating deficit and other guarantees. Risk rating categories include the following:
  - Economic and physical vacancy (risk points if > 5%)
  - Accounts payable (as % of revenue, with risk points at > 15%)
  - Operating reserve (risk points if none funded)
  - Cash on hand (as # of months of revenue, with risk points at < ½ month)
  - Debt service/expense coverage ratios (risk points if < 1.15 or 1.1 DCR for projects with serviceable debt or 1.0 on expense coverage for projects without hard debt)
  - Operating expense ratio (with risk points for variance of >2% actual to budget)
Case Study 1: Homes for America
Strength Matters In Becoming the Partner of Substance

• **Amass its own pool of flexible investment capital.** Access to flexible third-party enterprise level capital provided tremendous opportunity for HFA. But the organization was also committed to building its own pool of flexible investment capital. To this end, HFA created a development fund which accumulates a portion of their developer fees on each new deal. The Board of Directors sets annual goals (approved in conjunction with the annual budget) for the funding level of the Development Fund. The staff can only use this development fund for pursuing more income-producing and asset-building projects and business lines, not operational expenses. The fund has grown from the original $1.75m to $2.6m, net after repaying the $1.75 enterprise level PRI. Last year, the Development Fund funded predevelopment costs for five development projects, and paid third party and lender and closing fees for two portfolio refinancings. Several projects repaid advances made during the year and in previous years. The net impact was an increase to the fund balance by $168,600.

What Do The Numbers Say?

Being the partner of substance has resulted in greater access to developer fees and cash flow. HFA’s evolution can be broken into three stages:

• **Stage I** (inception through 2003) when it was primarily the minority general partner in projects.
• **Stage II** (2004 through 2008) when it transitioned to a partner of strength and leadership.
• **Stage III** (2009 to present) when it has expanded its stakeholders / partners, with HFA always assuming the managing general partner role.

As mentioned previously, the availability of an enterprise-level loan made it possible for HFA to act as a lead developer on new projects starting in 2004 (commencement of Stage II). This was due in part to their ability to offer required guarantees but also to pursue acquisition and bear predevelopment costs (in addition to their organizational development and asset management capacity).

An analysis of their access to both developer fees and cash flow from projects before and after their transition to lead / sole developer supports the assumption that HFA has and will likely continue to benefit financially from this evolution. HFA only earned 29% of developer fees in projects developed in their early years vs. 80% and 50% in later stages (when HFA was acting as sole developer or partnering by choice, not necessity).
Interestingly, HFA has also been better able to collect fees on the projects developed in these later stages. In early projects, where HFA is not the managing general, they have only collected 79% of fees earned, whereas these percentages are 84% and 94% in the later stages. This is likely a reflection of both improved deal structuring and HFA’s close stewardship, and may be surprising to those who assume that projects are “thinner” now than they used to be. It is worth noting that HFA has made a concerted effort not to defer large portions of their developer fee throughout their entire organizational history.

An analysis of cash flow from projects (in years 2009-2011) reveals that HFA’s split of cash–flow in the same stages follows a similar pattern; HFA receives the smallest share of cash flow on early projects. In later stages, HFA is receiving a larger percentage, but some of the projects are not cash flowing as strongly. Each projects’ ability to upstream cash to HFA varies, and they are quick to point out a couple of large “game changing” projects developed in Stage II. Many projects are subject to HUD maximum distributions and all have some level of rent restriction; increases which do not necessarily keep pace with operating costs – thus limiting cash flow. For this reason, HFA is cautious about forward projections on cash flow from projects.

<table>
<thead>
<tr>
<th>Stage</th>
<th>HFA % of Project Cash Flow</th>
<th>Per Unit Cash Flow (average)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage I</td>
<td>11%</td>
<td>$699</td>
<td>Minority partner (26 of 36 projects), no access to enterprise-level loan</td>
</tr>
<tr>
<td>Stage II</td>
<td>48%</td>
<td>$593</td>
<td>Lead (18 of 19 projects) or sole partner (12 of 19 projects), access to enterprise-level loan</td>
</tr>
<tr>
<td>Stage III</td>
<td>29%</td>
<td>$832</td>
<td>Lead (all 13 projects during this phase) or sole partner (4 of 13), access to enterprise-level loan, HFA development fund</td>
</tr>
<tr>
<td>Overall</td>
<td>23%</td>
<td>$683</td>
<td></td>
</tr>
</tbody>
</table>
HFA has become less dependent upon developer fees. As mentioned previously, HFA has worked its way into the enviable position of being able to sustain its basic operations without depending on new developer fees. As all developers know, there is great variation in the ebb and flow of project timelines and funding availability, much of which is outside of the developer’s control. This can make it difficult for those organizations that depend heavily on this potentially unpredictable revenue source. A review of HFA development fees earned and the percentage that they constitute of unrestricted revenue over the last 12 years shows that while HFA has indeed seen dramatic variation in their developer fee income, they have been able to diversify and reduce the contribution that developer fees make to the total revenue of the organization.

HFA Developer Fees as % of Revenues 2000 – 2011

HFA has experienced a general growth trend both at the parent company level and at the consolidated level. A review of total assets in the last 12 years for the parent company and over the last 5 years at the consolidated level show HFA’s growth trend. The parent organization has seen assets nearly triple over that period. The organization did not begin consolidation until 2009, but since that time has increased total assets by 33%.
Baseline refers to the amount of assets existing in the first year shown on the graph in each case.

**Assets of the HFA parent and consolidated 2000 – 2011**

HFA has amassed capital that it can use at its own discretion. While HFA has had access to enterprise-level loans from third parties, the organization has also been able to amass its own flexible resources; allowing them to pursue more opportunities at their discretion. The HFA development fund, which is discussed previously, is only one such resource. A review of HFA history (see chart next page) reflects this in terms of cash and total unrestricted net assets and shows that HFA is growing its pool of flexible capital. HFA’s unrestricted cash on hand today is 13 times what it was in 2000 and their total unrestricted net assets in more than 5 times what it was in that year.
Putting those absolute growth numbers in context, we also compared cash and total unrestricted net assets to total assets in those years, which indicates that HFA also has more flexible capital relative to its size. This increase in the amount of cash that comprises HFA’s unrestricted net assets indicates the increased liquidity, and hence flexibility that they enjoy.
The Primary Challenge Moving Forward - Investing at the Project Level.

As capital subsidy resources become scarcer and more competitive, Homes for America must explore financing and structuring alternatives in order to continue production/development. They anticipate doing more acquisition with minimal rehabilitation or mixed-use/mixed income projects. In order to make such projects feasible it may require HFA to make an equity investment of their own in these transactions.

For example, HFA is currently undertaking a mixed-income project that will utilize project-based vouchers and the preferential terms of a 221(d)(4) FHA-insured loan, as well as some local funds. Even so, the deal will require an equity investment by the organization.

HFA is fortunate (and deserves credit) for having amassed a significant amount of capital at the enterprise level, so that this type of cash equity investment is actually an option. However, it also means that HFA will need to address some important questions that include:

- How much of this type of investment is prudent? The board and staff will have to weigh the value of new development opportunities against the comfort of having funds in reserve.
- What are the strategies for recovering such investment? Cash flow from these properties may or may not be the best option. HFA may have to consider profit upon sale or future deep-subsidy refinance options.
- What is a reasonable return and likely investment timeline? Long-term planning and conservative assumptions will help HFA avoid having cash tied up longer than expected. They will need to set return parameters that acknowledge their risk, project viability and mission.
- How will these types of projects differ in their demand for asset / property management? Balancing project cash flow potential and the need for on-going capital improvements (in light of minimal rehab upon acquisition) will likely require intense oversight that is a real cost to the organization.

Because HFA is in a position of relative financial strength, has well-established internal systems and a demonstrated discipline of analyzing opportunities from both business and mission perspectives, they are well positioned to meet these challenges. This is the essence of enterprise finance.