Partnering To Develop Affordable Housing

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Over the last couple of decades, nonprofits have been playing a rapidly expanding role in the production and operation of affordable housing and the delivery of services to low- and moderate-income families. They have taken over many service delivery functions formerly conducted by government, and they are increasingly active in the physical development of low-income neighborhoods and revitalizing areas.

Nonprofits should be primary providers of affordable housing. They are organized specifically to undertake activities that benefit low- and moderate-income persons, and often involve low- and moderate-income persons directly through board, committee and membership structures. They attract dedicated staff to serving the low- and moderate-income population, and restrict their profits to charitable purposes. They have flexibility of structure and procedures that is not often available to public agencies. And their mission commits them to preserving affordable housing in the long run.

At the same time, many nonprofit organizations are short on the funds and skills needed to develop affordable housing in a timely and efficient manner. They have to seek operating support regularly, and this may divert attention or delay their ability to implement projects on a timely basis. Few have the capital to take on predevelopment costs and meet equity requirements. Community-based boards and staff might lack some of the key skills needed for cost-effective implementation of projects and programs.

For some affordable housing projects, the complex demands of project financing, development and ongoing operation may be met best by a joint venture of a for-profit and nonprofit entity. Each brings a different but complementary set of strengths. For-profit developers bring project management skills, equity and access for private capital and loans. Nonprofits may have better to community support and approvals, grant funding, marketing and outreach, and an interest in the long-term affordability of the project. Together, these two organizations may bring a better set of skills and resources that ensure long-term success – if a stable partnership or joint venture can be created.

Such partnerships are essential to enhancing the capacity of the nonprofit industry to deliver an expanded range of affordable housing opportunities. In HUD's Building Public-Private Partnerships to Develop Affordable Housing, the benefits of partnerships were found to include increases in affordable housing production and "dramatic improvement" in the leverage of other funds.

1.1 Why Should a Nonprofit Consider a Joint Venture

There are three major reasons why nonprofits consider partnering with other nonprofit or for-profit entities in the development of affordable housing:

1. Raise equity pr resources – When nonprofits need equity partners, such as in Tax Credit projects, partners often are necessary. Sometimes, however, it is not

equity that is needed, but access to other capital, such as construction or conventional loans.

2. "Acquire" skills – When a nonprofit has limited skills pertaining to a type of development, partners can provide the needed skills and train the nonprofit staff while implementing the project.
3. Leverage your capacity – Sometimes a nonprofit has the required skills, but the staff capacity is devoted to other projects and is unavailable. Assigning staff to work on this development project would prevent them from doing other projects or activities (this is known as "opportunity cost.")

Sometimes the decision is whether to take on a partner, or just hire a consultant to do the work. If the issue is a capacity one, and you just need certain technical development skills or temporary capacity to perform the required developer tasks, then a consultant may be in order.

However, if you need equity, access to other financial resources, risk sharing, and/or post-development participation, then a partner should be considered as one or more of these are unlikely to be provided by a consultant.

1.2 Types of Partnerships

Under most affordable housing circumstances, there are three potential types of partnerships:

- Development partnerships – Two development entities share the responsibilities, risks and rewards during throughout the development process. (One or both parties remain in during the period of occupancy.)
- Turnkey partnerships – One party takes responsibility for the development process and turnkeys the completed project over to the other party, with the first party having no ongoing responsibilities or obligations after the handoff.
- Limited partnerships – Unique to Tax Credit projects and other projects involving tax advantages, one or more general partners manage the development and occupancy of the property, while one or more limited partners participate in a passive manner only for purposes of the tax credits.

1.3 Essence of a Balanced Joint Venture

The success of a joint venture depends upon a business relationship that is balanced. A balanced joint venture is not necessarily an equal partnership, but each partner has clear roles and responsibilities, and the risks and the rewards are commensurate with the role. In other words, each partner should earn fees in relation to the share of developers taken on, should contribute equity in relationship to their ownership and decision-making interest, and should not be put at risk beyond its ability to enjoy the rewards of development.

Successful partnerships balance the four R's:

- **Rule** (control) – how decision-making is shared with respect to the key development decisions – project scope, budgets and financing, design, implementation, marketing, occupancy management, and disposition;
- **Risk –** how the parties split the liabilities, including equity, loan guarantees (and recourse liabilities), performance guarantees, and other contingent liabilities;
- **Responsibilities –** how the parties split the responsibilities or tasks of the developer; and
- **Rewards –** how the fees, cash flow, tax benefits and residuals are split between the parties.

A successful partnership achieves a balance across the 4 categories in two major relationships:

- **Equity = ownership interest = control**
- **Rewards = Responsibilities**

1.4 Looking for a Partner

What do you look for in a partner?

- **Developer skills –** Do they have project management skills that you don't have, or don't have in sufficient quantity to manage all of your current projects?
- **Technical skills –** Do they possess knowledge of specific project type or funding sources that will be needed for your project? For example, if you haven't done a Tax Credit project, working with an experienced partner who has placed Tax Credit deals and has contact with syndicators is important.
- **Unique access to property/resources –** Do they own the property you are interested in developing, or do they have access to the construction lenders or permanent conventional lenders that will facilitate your project?
- **Experience working with nonprofits partners** – Do they have prior successful experience in working with nonprofit partners? Do they understand what is unique about, and important to, nonprofits? Can they live with the way nonprofits operate?
- **Trustworthy –** Can you count on them to meet their obligations, disclose any issues that affect you or your project, hold confidences that relate to you or your project, and take action to defend you or the project?

How do you find a partner? You have to rely on referrals and reputation searches to identify good potential partners. Ask funders, lenders and public agencies who they have worked with and found to be successful partners with nonprofits. Ask your nonprofit peers and nonprofit trade associations.

Once you have identified potential partners, interview them and check references with past partners. Explore the total experience of partnering with the entity. Were they reasonable and respectful of the nonprofit? Did they meet their obligations? Were they responsive? Would you partner with them again?

Private developers can bring important assets to the table:

- Equity & capital advance liquidity
- Bank relationships & access to construction and conventional permanent loans
- Ability to provide personal guarantees to construction and other loans
- Development experience
- Complex project and construction management expertise

Private developers cannot rely on other funding sources for operating support. They need to earn development fees to survive. So what do they need from a nonprofit partner?

- Sensitivity to the schedule and the need to complete the project to earn fees
- Timely decision-making, including delegation of reasonable authority to project managers, and willingness of boards to meet when needed to approve
- Completion of assigned tasks in timely manner
- Willingness to negotiate on matters that affect the schedule and earning of fees

What might you bring to the table?

- Site control?
- Neighborhood support?
- Local government support?
- Access to seed money and predevelopment funds?
- Access to technical assistance in housing development and management?
- Government & foundation funding?
- Experience with local process?
- Access to/experience with customer base?
- Willingness to manage the project long-term?

What are our shared interests?   A nonprofit developer's long-term success and survival is determined by quality projects completed in a timely manner on budget.   Both of us can't survive if we don't earn fees.

1.5 Negotiating a Joint Venture

As you prepare for negotiation of the joint venture with your partner, consider the following advice:

> **Negotiating Tip 1: Prepare by analyzing the differences and the shared interests.**   How are we different? What can we each bring to table?   What are our shared interests?
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> **Negotiating Tip 2: Identify/disclose the "non-negotiables."**   What are deal-killers for you? For example, do you absolutely need to serve certain income levels?   Do you need to control the occupancy of the units?   Do you require community participation?   Are there certain financial issues (risks and rewards) that are essential for you to agree to participate?   On the other hand, what are deal-killers for your partner?
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> **Negotiating Tip 3: Seek the win-win, or the 3rd alternative.**   You can't have a successful partnership with an unhappy partner, but you can't be unrealistic in your expectations either.   Both sides have to give to get.   Can we achieve a partnership deal that achieves both of our needs?
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> **Negotiating Tip 4: Balance risk and rewards for all partners.**   As discussed earlier, a successful partnership has to be a balanced partnership.   What is the balance between control and the risks/liabilities assumed by each partner?   What is the balance between responsibilities and the fees and other rewards allocated to each partner?
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> **Negotiating Tip 5: Put the business deal in writing**.   Trust your partner, but document the agreement!   Document the business deal in a joint venture memorandum of understanding before turning it over to the lawyers for them to turn it into the legal deal. Don't sign till you understand!

1.6 Elements of a Joint Venture Agreement

A joint venture agreement is a combination of the "business deal" as well as the legal provisions and protections that each partner needs to enter into the joint venture relationship.

The business deal has to come first.   A joint venture is constructed around a mutual agreement on the following points of the business deal:

1. **Scope of project –** A clear delineation of the project scope, including:
   - Number/mix of affordable units (& other uses)
   - Targeted households
   - Term of project
   - Low income affordability/use restrictions
   - Changes to scope:
   - Non-negotiable v. desirable
   - What changes of scope can be made & how changes will be decided?
2. **Ownership entity and interest –** The type of ownership entity, the split of ownership interest between the partners, and how this will be determined. Also, how change or sale of ownership interest occurs: how partners acquire interest from other partners, rights of 1st refusal by other partners, and succession in event of death/demise of partner.
3. **Decision-making –** How the partners will make decisions (voting, consensus, etc.) Voting rights are usually based on ownership interest, but some key decisions that must be made jointly or by consensus, such as incurring debt or financial obligations and significant changes in project scope. Also, what decisions individual partners can make in fulfilling developer obligations.
4. **Equity contributions and capital advances –** How and under what terms there will be calls to the partners for equity contributions or capital advances, and how the failure of a partner to make required contributions in a timely manner will be handled. How and when capital advances will be repaid How return on equity will be paid
5. **Division of responsibilities –** How the responsibilities of the developer will be split among the partners: management of the joint venture, acquisition, financing, design, local approvals, construction, marketing and occupancy. What rights to complete exist if a partner fails to fulfill its responsibilities.
6. **Split of developer fees –** How the developer fees will be split among the partners, presumably in proportion to the developer responsibilities; often this is established by a schedule of values for each responsibility.
7. **Guarantees –** Which partners are responsible for guarantees to lenders and limited partners, and the compensation associated with those guarantees.
8. **Dispute resolution –** How the parties will resolve situations when there is disagreement (mediation, arbitration, etc.)
9. **Termination –** How the partnership can be terminated, either before the project is completed or after all work has been completed. If a “handoff” from one partner to another is contemplated on completion, how that will occur.
10. **Buyout –** If applicable, the terms for one partner buying out the interests of another, either planned or as a result of an unresolved dispute. Elements of the nonprofit’s strategy to buy out the other partner(s) may include:

- Right of first refusal
- Favorable formula for buyout "price"
- Management fees, incentive payments & distributions
- Maximized residual interest of nonprofit
- Public financing structured to minimize residual value to partners but assumable by nonprofit
- Grants/subsidies converted to nonprofit loans to projects (& accruing interest)
- Ground leases/land trusts to control land value
- Escrow portion of developer fees dedicated to buyout (sinking fund)

In some cases, a project involves a handoff of a completed project rather than a buyout. For example, a for-profit partner wants out after developing the project, or a service nonprofit takes over ownership and management of a special needs project after it is completed. In such cases, the joint venture agreement needs to specify:

- Standards for completion and acceptance of the project
- Warranty by the developer (including possible fee retention or guarantee)
- The process for the handoff, including lender/funder approvals

After you have negotiated the business deal as outlined above, create a joint venture memorandum between the partners to document the business deal. Then it can be turned over to the lawyers to create the full joint venture agreement with the appropriate set of legal protections. Some of the legal protections that your attorney will add to the joint venture agreement include the following:

- Joint approval in writing of major decisions
- Regular partner meetings
- The right to examine the books and records of the joint venture
- Receipt of monthly/annual reports from the managing partner
- Disclosure requirements
- Dual signatures on checks & documents
- Bonding
- Prohibition against self-dealing
- Arbitration/mediation

Together, the terms of the business deal and the legal protections constitute the full legal agreement of the joint venture. Make sure that your agreement contains both.

1.7 Some Final Thoughts to Remember

- If you need specific task/skill, hire a consultant; if you need resources, risk sharing &/or management, get a partner.
- Skills and resources aren't enough to justify selection of a partner. Seek a compatible partner(s) that you can trust.
- If you want to have control, you have to be able to put up equity or capital advances. Equity = ownership interest = control.
- Successful partnerships balance control, liability & rewards. Make sure that the developer fee split reflects the work and responsibilities of the parties. Split the developer's fee by tasks, then among partners.
- Plan for the end(s) of the venture. Make provisions for the buyout or the handoff.
- Negotiate in good faith (with full disclosure of any non-negotiables) and seek win-win arrangements.
- Document the business deal first in a joint venture memorandum; then let the lawyers turn it into a legal agreement with the appropriate legal protections.