Organizational Capital:
A New Approach to Lending in Nonprofit Affordable Housing

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Overview of STRENGTH MATTERS™ Initiative

STRENGTH MATTERS™ brings together three national networks of nonprofit owners and developers in the affordable housing field — Housing Partnership Network, NeighborWorks® America and Stewards of Affordable Housing for the Future — to advance the strength, productivity and profitability of their member organizations and to communicate the best practices to the private, public and philanthropic sectors, thereby attracting additional capital. Together the member organizations of these three networks own over 200,000 units of affordable rental housing and represent a broad spectrum of nonprofit community development real estate institutions, from large multistate owners and developers to citywide or regional organizations to community development corporations serving very targeted geographies.

Abstract

In spite of a diminishing supply of public resources, many nonprofit housing developers are expanding their roles and their portfolios to address an increasing need for decent affordable housing. But as nonprofit housing organizations mature, the traditional project-by-project funding system fails to support their broader development goals. This paper stresses the urgent need for equity, or "organizational capital," to help nonprofit housing organizations build their capacity and their impact.

Unlike conventional financing, organizational capital is underwritten against a borrower's balance sheet, or its organizational ability to repay. Whereas project-based loans are tied to one particular project, organizational loans can be a source of liquidity whenever an organization needs it: on the front end of a deal, for general business operations or during periods of organizational expansion.

Despite its many advantages, there is an extremely limited supply of organizational capital in nonprofit affordable housing. This research outlines the practical challenges to organizational investing and uncovers the underlying barriers that have prevented a nonprofit organizational capital market from emerging. These findings lead us to explore nonprofit housing organizations in a "closed system" of standardized reporting and rational decision-making.

The study concludes that while a new nonprofit reporting system would greatly encourage organizational investing in housing, the private markets alone will not bring organizational lending to scale. The final sections of the paper discuss the public policy implications of a closed nonprofit capital system and highlight some innovative approaches taken by lenders to overcome the obstacles of organizational investing and advance a new model of lending in nonprofit affordable housing.

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Methodology

The findings presented in this paper draw on information gathered from interviews, a review of relevant literature and feedback from experts at a policy briefing in Washington, D.C. and a focus group in Chicago.

First and foremost, information provided by participants in the STRENGTH MATTERS™ initiative guided much of this research. STRENGTH MATTERS™ was launched in 2006 to gather lenders and developers in a collaborative discussion around ways to improve the way community development real estate institutions[1] (CDREIs) are funded. STRENGTH MATTERS™ has engaged developers and lenders along with other experts in housing policy and nonprofit accounting to share their practices and expertise and to discuss the possibility of creating industry standards for nonprofit real estate accounting. STRENGTH MATTERS™ is cosponsored by NeighborWorks® America, HPN and the SAHF. With continued support from the John D. and Catherine T. MacArthur Foundation, STRENGTH MATTERS™ is laying the groundwork for a more effective community development finance system.

STRENGTH MATTERS™ comanager, Frances Ferguson, and lead consultant, Mary Vasys, provided written materials and access to an essential network of STRENGTH MATTERS™ participants, the pioneers of organizational lending in affordable housing. The findings contained in this study draw heavily on interviews with STRENGTH MATTERS™ collaborators.

Apart from STRENGTH MATTERS™ internal documents, literature on organizational lending to nonprofits in housing is limited. Recently, foundations have made program-related investments in promising nonprofit ventures, but few have shown interest in affordable housing. Publications from philanthropic organizations were, nevertheless, critical in identifying common and distinct barriers and to finding potentially replicable solutions.

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[1] Internal STRENGTH MATTERS™ documents define community development real estate institutions as "nonprofit organizations that are primarily focused on the initial development and long-term ownership of affordable housing and commercial real estate serving low-income communities or low-income households. They are large and small, national, regional, statewide and local. These organizations are mission focused but also strive to operate their businesses profitably." (STRENGTH MATTERS™ 2006, 1)

Executive Summary

Nonprofit affordable housing developers are expanding their roles and portfolios. Many nonprofit developers have skilled leaders, high levels of annual production and extremely strong balance sheets. They've introduced essential programs and services to rebuild entire communities and position their residents for success. In spite of their strengths, nonprofits remain stifled by the deal-by-deal affordable housing finance system. They face inadequate cash resources, a cumbersome fundraising process, extended periods of delayed funding, and other inefficiencies that undermine their ability to accomplish their mission. The system limits developers' ability to act quickly in markets in which sometimes even short delays result in lost affordable housing opportunities. Moreover, the layers of debt, subsidies, and restrictions built into subsidized housing agreements dampen even the strongest nonprofits' hopes of sustaining organizational growth while preserving their properties' affordability.

To fill the capital gaps of conventional, project-based finance, a small group of mission-driven investors has introduced a new form of lending to affordable housing developers: They are investing "organizational capital" in their best borrowers to help them resolve their equity capital challenges.

Objective

The objective of this study is to summarize the limitations of the existing affordable housing and community development finance system in the United States and to illustrate how a nonprofit version of equity, referred to throughout this paper as "organizational capital," addresses these challenges.

Through interviews and a review of relevant literature, this study hopes to answer the following questions:

- What challenges do nonprofits face within the traditional, project-based affordable housing finance model?
- How does organizational capital address these issues?
- Who offers organizational loan products?
- Is the demand for organizational capital satisfied by a sufficient supply?
- What are the barriers to increasing the supply of organizational capital?
- What can we learn from previous and ongoing efforts to increase the availability of organizational capital to eligible nonprofit real estate borrowers?

What Is Organizational Capital?

- Nonprofit “organizational capital” is comparable to corporate equity or debt. It serves a number of different purposes and can be structured in a variety of ways.
- Organizational capital is underwritten at the entity level. Investments are based primarily on the borrower’s ability to repay rather than on property cash flows.
- Use restrictions and collateral requirements vary. Some forms are eventually secured by real estate (but underwritten before the project is identified or title is obtained) while others are unrestricted, general recourse obligations.
- All products offer some degree of flexibility beyond that provided by traditional project-based loans. Because organizational loan instruments have fewer use restrictions and accept riskier forms of collateral, they are also easier to leverage.
- Working capital pays for both development and nondevelopment costs. It can be used for predevelopment and acquisition so organizations can move quickly and compete in strong real estate markets. Working capital fills funding gaps when certain projects are held up by funding delays. It can also be used for routine operating expenses during periods of organizational illiquidity.
- Growth capital can be used to invest in capacity-building initiatives and to increase the scale and scope of an organization’s businesses. Strategic investments such as professional development, new accounting systems or new lines of business all require growth capital.

Figure 1: Project-to-Organizational Capital Continuum

Project Lending → Organizational Lending

	Devlopment Capital	Predev/ Bridge Capital	Working Predev Capital	Working Capital for Operations	Org Growth Capital
UNDERWRITING	DEAL	DEAL/ORG	ORGANIZATION	ORGANIZATION	ORGANIZATION
RESTRICTIONS	PROJECT RESTRICTED	PROJECT RESTRICTED	PIPELINE SPECIFIC	GENERAL OPERATIONS	UNRESTRICTED
USE	CONVENTIONAL, DEAL-SPECIFIC DEVELOPMENT FINANCING FOR AQUISITION AND CONSTRUCTION	PROJECT SPECIFIC PRE-DEV. ACTIVITIES OR TO FILL GAPS WHEN BILLS DUE BEFORE CONTRACTS, GRANTS, OR FEES RECEIVED	OPERATING RESERVES MADE AVAILABLE FOR FUTURE DEALS BUT SECURED BEFORE THE SPECIFIC DEAL IS IDENTIFIED	FUNDS THAT SUPPORT ROUTINE OPERATIONAL ACTIVITIES. (PAYROLL, UTILITIES, INSURANCE, ETC)	CAPITAL FOR EXPANSION OR STRATEGIC GROWTH (UPGRADING SYSTEMS, TRAINING, NEW LINES OF BUSINESS, ETC.)
TYPES	AQCUISITION OR CONSTRUCTION LOAN	PREDEV LOAN, BRIDGE LOAN CASH FLOW LOAN	ACQUISITION OR PREDEV LINE OF CREDIT	WORKING CAPITAL LOAN OR LINE OF CREDIT	GROWTH CAPITAL LOAN
COLLATERAL	REAL ESTATE	RECEIVABLE/ REAL ESTATE	REAL ESTATE	GENERAL RECOURSE	GENERAL RECOURSE
COLLATERAL RISK	LOW	MODERATE	MOD-HIGH	HIGH	HIGH

Who Supplies It?

- Community development finance institutions, foundations and national umbrella networks or trade associations are beginning to see the value and experiment with organizational investing.
- Some lenders offer revolving lines of credit for predevelopment to their best borrowers.
- General working capital is scarce.
- Growth capital investors rarely invest in housing.

Who Has Access to It?

- Successful borrowers are well established housing developers who demonstrate financial discipline and organizational stability through consistent balance sheet growth, committed management and market adaptability.
- Nonprofits with small, highly localized portfolios and startup organizations are usually not good candidates for organizational capital.

Primary Findings and Concluding Observations

- Without a "closed system" of reporting in place, organizational capital is difficult to underwrite, monitor and manage. It is therefore perceived as being much too risky.
- The elements of a closed system include standardized financial accounting, enforceable disclosure requirements, access to industrywide filing information, and shared or third-party performance rating systems.
- Developing a closed system will require public policy support.
- Lenders have had difficulty affecting policy, but they have moved the organizational lending model along by adopting innovative techniques to help mitigate organizational risk.

I. Context

A. Nonprofit Affordable Housing Enterprises

Over the past 40 years, nonprofits have assumed a critical role in addressing our nation's affordable housing needs. The nonprofit housing movement, which began in the mid-1960s with about 100 local organizations, grew rapidly. By 2005, an estimated 4,600 affordable housing organizations existed in the United States, and about one-third of these were operating at a regional or national scale (National Congress for Community Economic Development 2005, 1–7). The leaders in the nonprofit housing field were producing an annual mean of 124 multifamily units, more than double the amount produced by for-profit affordable housing developers[2] (Bratt 2006, 10).

As nonprofit developers increased their production and expanded their social development goals, many adopted market-based business approaches to carry out their missions. These entrepreneurial leaders created new lines of business, formed partnerships, and began offering the programs and services necessary for their projects — and their tenants — to thrive. Today, many of these nonprofits have the track record, professional qualifications and technical expertise to compete with their for-profit real estate counterparts. What nonprofits do not have, however, is the liquidity needed to sustain such growth.

Many of these organizations are now facing 30- and 40-year subsidy contracts that are about to expire and portfolios of aging properties that need substantial renovations. While nonprofit property owners and developers remain committed to preserving the affordability and the quality of their units, they also recognize the long-term value of investing in the growth of their businesses. To make the necessary improvements to their buildings, to retain their qualified staff and to invest in supplementary lines of business, nonprofit affordable housing owners need access to equity.

B. Financing Nonprofit Affordable Housing

Financing nonprofit affordable housing is a project-by-project matter. While financing is available for projects, the system has several shortcomings. It is widely understood to be time consuming and cumbersome. According to a study commissioned by the U.S. Department of Housing and Urban Develpoment, nonprofit development deals involve, on average, 7.8 different sources of funding (Bratt 2006, 30), including multiple layers of debt, grants and project equity. These typically take over a year to gather due to differing

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[2] Mean annual production of the Housing Partnership Network's developer members. See Appendix B for a list of the top 10 nonprofit affordable housing developers as of May, 2008.

application deadlines and funding schedules, and often funds come with inconsistent requirements.

Another weakness in the existing system is that most loans, grants, subsidies, and tax credits are permanently restricted to one particular project. Moreover, if a subsidized property generates any residual cash flow, the surplus is also restricted; it cannot be used to subsidize other projects or to support other organizational activities. This system of project-restricted funding often leaves nonprofit affordable housing enterprises cash constrained, which limits their ability to act quickly in markets where even short delays can result in lost development opportunities.

Without access to an outside infusion of equity, as subsidy contracts near their maturity dates, many affordable housing owners are facing the difficult decision of whether to convert some of their valuable stock of housing to market-rate rents. While for-profit affordable housing developers often convert and refinance their units to capture the appreciated value of their assets, nonprofits are more likely to maintain below-market rents; thus they are constrained in their ability to build equity in their properties. (Bratt 2006, 16).

II. What Is Organizational Capital?

Unlike conventional project financing, which is typically long term and secured by the real estate, nonprofit "organizational capital" is more comparable to venture capital or to corporate debt or equity. Organizational investments are underwritten against a borrower's *organizational* ability to repay. This capital provides a source of liquidity when an organization needs it: on the front end of a deal, for general business operations or during periods of organizational expansion. This form of investment is efficient and flexible and is a critical ingredient for growth.

The following forms of organizational capital are critical to nonprofit housing organizations if they are to expand their portfolios and maintain their existing stock of affordable housing:

- Working predevelopment capital
- Working capital for general operations
- Growth capital for business and program expansion

Table 1: Organizational Investment Instruments

Organizational Capital Class	Eligible Use(s)	Common Instruments	Collateral	Principal Benefit(s)
Working Predevelopment Capital	Preconstruction activities including feasibility and environmental studies, architectural drawings, acquisition	Loan or line of credit	Subordinate lien, accounts receivable	Enables nonprofits to compete for properties and land in market, reduces resources spent on fundraising, encourages developers to build pipeline, enhances fund balance.
Working Capital for General Operations	General operations (including predevelopment and development activities)	Short-term line of credit, loan, program-related investments (PRIs), unrestricted operating grant	Accounts receivable; general recourse	Serves as a ready source of liquidity, increases flexibility, stabilizes cash flows, provides leverage, enhance fund balance.
Growth Capital	Investments in growth: plant, power, equipment, software upgrading, personnel, new lines of business, tenant services, and other capacity and productivity improvements	PRI, equity-like debt, mezzanine debt	None; "equity" stake	Long-term, builds enhance fund balance capacity, fuels growth/expansion, helps organizations scale up production so that eventually they can become self-sufficient.

III. Existing Sources of Organizational Capital

Despite the extensive need for organizational capital, there is a very limited supply. The seven lenders participating in the STRENGTH MATTERS™ collaborative make up the major sources of private organizational capital available to nonprofits in affordable housing.

They comprise three major categories (For lender profiles and details on their organizational loan products, see Appendix A.):

- Foundations: These institutions can offer low-cost loans called PRIs, "provided that financial gain is not the primary motive of the foundation and that the funds are not used for political lobbying" (Ryan 2001, 19). PRIs are long-term, below-market rate debt instruments that can be used flexibly by borrowing organizations.

- National intermediaries and cooperative networks: Most of the organizational lending activity in affordable housing appears to have been driven by intermediary networks. In the early 2000s, when the demand for housing was high and developers' production levels began to rise, fundraising for every transaction was costing nonprofits potential real estate deals. Intermediary networks helped their strongest members maintain high levels of production by offering flexible lines of credit or creating dedicated growth funds.
- Community development finance institutions (CDFIs): Private-sector lenders that bridge the financial needs of low-income communities with capital from private financial institutions. Today, there are more than 550 CDFIs filtering $6 billion in private institutional investments to financially underserved areas (Andrews 2008, 3).

IV. Findings from the Field

The findings in this section were drawn from interviews with collaborators in the STRENGTH MATTERS™ program. Interviews with loan officers from other community development funds were also conducted, providing important feedback on why most affordable housing lenders do not invest at the entity level.

A. Not every nonprofit organization is a good candidate for organizational debt.

Small-scale CDCs are considered unfit for organizational debt because their size, breadth, and often very-low-income tenants prevent certain efficiencies of scale. Many of these organizations live "hand-to-mouth," from developer fee to developer fee and suffer from constant liquidity problems. If a nonprofit is not able to generate its own working capital, lending against its balance sheet may have harmful effects. Borrowers might be inclined to act with less discipline; perhaps by slackening their funding of reserves or by using funds as a "budget balancing wildcard," to pay back other debt obligations rather than to invest in growth (Stevens 2000, 1).

B. Nonprofits have inconsistent methods of accounting.

Nonprofits have inconsistent methods of recording and presenting their operations, transactions and financial positions. Their internal accounting practices are often established in accordance with the preferences of their major funding sources, thus the information and the format of financial statements can vary significantly from organization to organization. Even certified public accountants have no systematic requirements or format for preparing audited financial reports. Because there are no prescriptive industry standards, nonprofits have different fiscal year-ends, different ways of recognizing developer fees, different methods for valuing real estate assets and receivables, and different ways of presenting historical performance.

C. Financial statements do not show an accurate organizational picture.

In addition to being inconsistent, most lenders find that the information presented in nonprofits' financial statements is ineffective at communicating the overall strength of the organization. The Internal Revenue Service (IRS) Form 990 tax filing is the only federal public disclosure for tax exempt 501(c) 3 corporations. Unfortunately, industry research has shown that Form 990 public disclosures can be inaccurate, out of date, and lack the oversight necessary to be considered reliable (Keating and Frumkin 2000, 6).

D. Underwriting risk and projecting return is extremely complex at the entity level.

CDFI lenders emphasized the intensity of underwriting as one of the greatest barriers to organizational investing. Lenders must identify the sources of repayment, determine which sources of income are reliable, which sources are profitable, and to what extent sources are interdependent. Underwriters must consider the timing of cash flows and whether revenues will coincide with expenses. In order to properly assess cash flow risk, investors must also have a good understanding of real estate cycles and housing policies that might influence a borrower's cash flows.

E. Organizational underwriting is "more of an art than a science."

Organizational investments are new and unproven products, so lenders have very limited information from which to develop strict risk-rating systems or benchmarks. While lenders have some basic quantitative targets for their organizational investments, few lenders have generated enough volume to codify their organizational investment criteria. Lenders claim that the most important ingredient in their organizational investments is trust. They weight the merits of the organization's leadership, reputation and staff most heavily (Miller 2008, 44). In fact, several lenders referred to it as "relationship lending" because of the emphasis placed on communication and trust.

F. Organizational lending is an exclusive field of network lenders and their top-performing members.

Network associations are the most common type of organizational investor, in part because many membership networks have internal rating systems and their members' performance has already been evaluated. In addition to member evaluations, some networks have performance monitoring systems, which relieves the loan fund of this critical responsibility. Finally, network associations offer their members operating support in many different capacities. This provides reassurance to lenders that a borrower is getting the support and training it needs to grow its business, increase its social impact and remain creditworthy in the process.

V. Closing the Organizational Capital Gap: A “Closed System” for Nonprofit Reporting and Investing

As we have seen, there are a number of practical challenges to investing at the organizational level in housing. While many investors are introducing innovative new models to overcome these challenges and advance the nonprofit housing field, a few investors will not fill the nonprofit capital gap on their own. In order to bring organizational lending to scale, underlying nonprofit capital market failures must be addressed. A basic understanding of how for-profit equity capital markets work helps to explain why an equity capital market has failed in nonprofit affordable housing.

In the for-profit world, equity investors make investment decisions based on an informed assessment of a business’s profitability as compared to other potential investment opportunities. Investors determine an organization’s growth and profit potential based on aggregate-level data and third-party reports derived from standardized public filings. In the nonprofit world, however, there are no generally accepted standards of accounting, no systematic way of reporting performance results and no strictly enforced disclosure requirements. According to one study on nonprofit funding, “Nonprofits’ lack of financial disclosure, asymmetric information dissemination among stakeholders, and absence of governance controls could cause inefficient resource allocations. (e.g., donations not going to most productive endeavors)” (Behn, DeVries, and Lin 2007, 3).

Table 2 summarizes the fundamental components of an efficient equity capital market and compares the accountability mechanisms of nonprofits to those in place for publicly traded companies. As the table shows, nonprofit housing developers lack the information, the transparency and the accountability that make the public equity capital market function.

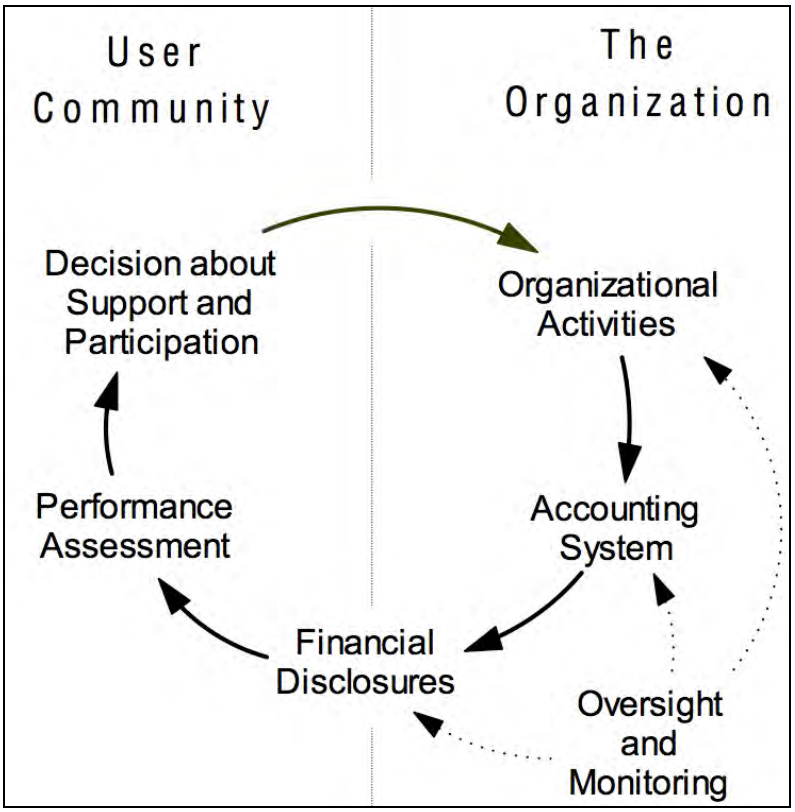
Table 2: Accountability and Investment: Two Capital Markets Compared

Components	Function	Nonprofit Housing Organizations	Publicly Traded Companies
Accounting Systems	Up-to-date record of organization's activities. Used to prepare financial statements.	• Inconsistent practices • Not always sophisticated • Often understaffed (may not have both CFO and controller)	• Uniform standards • Highly professionalized • Large, dedicated accounting departments • Internal auditors hired to test internal controls
Financial Disclosures	Reliable and relevant financial information required by government or equity stakeholder. Helps stakeholders make qualified investment decisions.	• Form 990 IRS public tax filing often inaccurate, out of date and unclear • Audits required by lenders: must comply to generally accepted accounting principles (GAAP) but quality is inconsistent and information is not always meaningful • Other disclosure requirements vary by lender, agency and state	• GAAP compliant audited financial statements: public • Supplementary quarterly and annual 10-K and 10-Q filings required for public companies with > $10 million in assets • Qualified external CPAs • Audit committee
Oversight and Monitoring	Unbiased, third-party assurance of compliance to accounting principles and disclosure requirements.	• IRS and state attorney generals' offices rarely enforce regulations • Lack of qualified external auditors	• Overseen and enforced by the Securities and Exchange Commission (SEC) • Sophisticated, reliable external auditing
Information Channels	Provides visibility into macro-level market data for cross-sector analysis.	• Guidestar — Form 990 • Network associations • Individual nonprofit Web sites	• EDGAR — SEC filings • Securities exchanges • Indices • Bloomberg, Yahoo Finance, Thomson Financial
Performance Assessment	Assessment of organizational strength usually based on quantitative analysis of financial documents.	• CDFIs, foundations, public agencies • Outside consultants • Membership networks/trade associations • Rating agencies (National Charities Information Bureau)	• Financial/industry analysts • Credit rating agencies • Independent consultants • Market research companies

Borrowing a framework developed by Peter Frumkin and Elizabeth Keating, this section explores a "closed system" for financial reporting and investing in the nonprofit affordable housing market.

As seen in Figure 2, in a closed system organizational activities are accounted for systematically, they are subject to financial disclosure requirements and they are overseen and monitored by an accounting regulator. The investor or "user community" can then compare consistent financial statements over time and across peers and eventually develop industry benchmarks. This closed loop of information provides investors with the ability to assess and manage risk and make the most profit-, or impact-, maximizing investments.

Figure 2: A "Closed System" for Financial Reporting and Investing



Source: Keating and Frumkin, 2000: 36.

Adapting this framework to nonprofit housing organizations, the following recommendations address many of the challenges faced by community development lenders, foundations and other organizational investors.

A. Standardized Financial Accounting and Reporting

To compare often drastically different organizations and distinguish the organizationally credit worthy from the rest, accounting conventions must be uniform across competitors and over time. Standardizing the way nonprofits in affordable housing record and present financial information is the first step to building a rational nonprofit capital market. An independent accounting standards board or commission should be established to address accounting inconsistencies and set uniform accounting standards for each nonprofit sector.

Operating support collaboratives (OSCs) or trade networks could perhaps serve as the standard-setting agencies for their respective sectors. These intermediaries could help develop standard accounting and reporting principles and either require or encourage their members to adopt them.

The STRENGTH MATTERS™ initiative is piloting such an effort with a subset of the field's strongest member organizations. With the input of CFOs from eight housing organizations and experienced housing accountants, STRENGTH MATTERS™ has made progress towards creating a set of "best practices" to share across the nonprofit community development real estate industry. They have identified the discrepancies in nonprofit developers' accounting customs and collaborated to codify a single industrywide standard. (For a complete list of STRENGTH MATTERS™ external reporting issues, see Appendix C or www.strengthmatters.net.)

Another option for standardizing and enforcing reporting practice is at the state level. In fact, the foundation of a multistate accounting protocol may already be in place. In 1997, the National Association of State Charities Officials and the National Association of Attorneys General launched what is now the Multi-State Filer Project, Inc. (MFP). They crafted a single nonprofit registration form, the Uniform Registration Statement (URS) so that nonprofits that operate in one or more of the 36 cooperating states or Washington, D.C., only have to file once. While the focus of the project has been standardizing nonprofit registration, many participating states are making audited financial statements a nonprofit disclosure requirement.

B. More Relevant Organizational Disclosures

In closed market systems, lenders need financial information that not only is consistent but also shows clear and meaningful information about an organization's overall strength. Many nonprofit stakeholders, especially those without experience in real estate finance, do not know how to interpret a nonprofit real estate organization's financial statements. It is therefore critical that the industry develop new performance metrics that potential organizational investors can understand and use to make qualified projections. Some of the important factors that should be reflected more clearly on nonprofit developers' financial statements include the following:

- **Financial accountability and discipline:** Does the organization have clear, well-documented financials? Are financial statements consistent over time? Does the organization make financial documents available on its Web site? How does it portray its organizational profitability and social impact?
- **Leadership and staff:** Does leadership demonstrate commitment to financial accountability and sustained affordability? Is the organization too dependent on one manager's expertise? Are staff turnover rates low?
- **Sources of organizational repayment:** What are the sources of debt repayment? Are they diverse, growing and reliable? Which activities make or lose money? How much of the business depends on government subsidy? What are the most profitable lines of business, and is the organization at risk?
- **Demonstrated results:** Does the organization have social impact and core cash return measures? Did the financial and social returns of previous organizational investments exceed the costs of underwriting and adequately compensate for risks?

Finding more meaningful performance measures is one of the main goals of the STRENGTH MATTERS™ initiative. In collaboration with eight national affordable housing lenders, STRENGTH MATTERS™ is exploring which performance measures should be included in CDREIs' audited financial statements. It is hoped that with the help of leading real estate nonprofits, a recognized set of sector-specific performance metrics will eventually be incorporated into nonprofits' financial statements.

STRENGTH MATTERS™ suggests that nonprofits consolidate financial statements and attach relevant disclosures about the parent organization, its other lines of business, and its historical performance. The supplementary notes would also include clear information about an organization's liquidity, the reliability of its income streams, and an asset–liability matching schedule. Lenders also suggest that nonprofits track and disclose their actual revenues and expenses against their budgeted cash flows (STRENGTH MATTERS™ 2007).

The for-profit real estate sector may have performance measures that would be relevant to nonprofits. Real estate investment trusts (REITs) have made great progress in addressing the shortcomings of GAAP for real estate businesses. In 1991, The National Association of Real Estate Investment Trusts, Inc. (NAREIT) introduced a non-GAAP performance measure called "funds from operations" (FFO) to supplement GAAP net income. Today, FFO is the REIT industry standard for measuring net earnings. Through its Best Financial Practice Council, NAREIT has since revised FFO disclosure guidelines and is circulating a series of national policy bulletins to disseminate information and test new non-GAAP real estate disclosures. An excerpt from NAREIT's April 2001 national policy bulletin discussing the original FFO white paper disclosure recommendations is included in Appendix D. FFO and NAREIT's other disclosure recommendations should be examined to see whether they would be relevant and valuable to nonprofit real estate investors.

C. Increased Accountability and Oversight

Especially in rental housing, where rent restrictions, subsidies and market volatility add to an investment's uncertainty, investors need to be confident in an organization's financial accountability and forthrightness. In a closed nonprofit market system, a regulatory agency would oversee and enforce the accounting rules set by the standards board in much the same way the SEC does for publicly traded companies. The accountability regulator would penalize nonprofits that failed to file, missed filing deadlines or misrepresented their financial information (Keating and Frumkin 2000, 15).

Intermediaries and collaboratives like Local Initiatives Support Corporation (LISC), Enterprise and NeighborWorks® have become active proponents of increasing the accountability and financial diligence of their nonprofit members. However, compliance with networks' accounting and disclosure guidelines is typically voluntary for network members. Eventually, for a closed system to function properly, recommended best practice should evolve into an authoritative industry standard.

D. Better Channels of Financial Information

Investors also need channels to access consistent, relevant and reliable financial information. In the public equity capital markets, a company's filings are submitted quarterly and stored permanently on EDGAR, the SEC's searchable public Web site.[3] From aggregate-level company filings, third party data providers compile cross-sector and historical financial data and update it regularly. This data is then sold to market research companies so that it can be analyzed and manipulated for company ratings and industry benchmarks.

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[3] Quarterly and annual 10-Q and 10-K filings are required for public companies with > $10 million in assets.

Guidestar, a project summarizing and making scanned Form 990s available over the Internet has helped to address the issue of data availability and made nonprofits somewhat more transparent. Unfortunately the IRS Form 990 is not conducive to aggregate-level data compilation, so most of the information requires intensive scrubbing. Moreover, because of the weak monitoring system ensuring the accuracy of Form 990 disclosures, most investors would not rely on this financial information exclusively to make their investment decisions.

As it is for publicly listed companies, the more reliable, audited financial statement should be a public filing for tax-exempt organizations over a certain size. A broad Web-based platform like EDGAR should also be created where nonprofits can electronically file their annual reports and supplementary disclosures. Filings would be stored on the Web site and be accessible to the public. This filings database not only would serve as an additional source of oversight but also would foster the creation of third-party resources to help investors in their decision-making.

E. Shared Performance Assessment Techniques and Third-Party Risk Ratings

In an efficient market system, lenders do not assume the full responsibilities and costs of risk rating and underwriting. Instead, risk analysis, underwriting and monitoring responsibilities can be shared or outsourced to independent consultants and third-party service providers.

Shared Organizational Underwriting Methodologies

Today there is too little known about flexible funding to nonprofit affordable housing organizations. Years ago, after the Low Income Housing Tax Credit (LIHTC) program was created, investors faced similar challenges with evaluating and underwriting projects due to the complex legal arrangements involved in tax credit deals. The Affordable Housing Investors Council (AHIC) was established to increase knowledge of the benefits of investing in affordable housing tax credit properties, to educate corporate investors on all aspects of affordable housing and to discuss issues of importance to investors in the industry.

As AHIC does for LIHTC property investors, the few lenders with experience should collaborate to share their insights and to raise awareness about organizational investing. Topics including underwriting criteria, monitoring methodologies and return calculations could be extremely useful to others in the field.

This is one of the projects STRENGTH MATTERS™' lenders have under way. Although specific loan underwriting criteria will remain proprietary, collaborating lenders have agreed to set consistent definitions of performance indicators and discussed the option of creating a common template for assessing organizational performance.

Third-Party Risk Ratings and Outcome Assessment Tools

Many nonprofit funders, especially those without experience investing in real estate, do not have the skills or the resources to undertake organizational investment activities on their own. As the consistency, quality and availability of information on nonprofits increase, and the practice of organizational investing is better understood, third-party investor resources must be made available to potential organizational investors.

Third-party ratings agencies could assume the tasks of gathering up-to-date filings, conducting organizational assessments, establishing organizational performance indicators, analyzing market trends and developing industry benchmarks.

The Opportunity Finance Network recently developed a rating system to streamline lending in the community development finance industry. The CARS™ rating system is a rigorous, comprehensive performance assessment and rating system for CDFIs. While the report is optional and CDFIs that choose to subscribe do not have to make their CARS™ risk rating known, the product is gaining traction among foundations, banks and other CDFI investors. Today, all of the largest CDFIs are CARS™ rated. Public funding agencies and institutional investors have applauded the consistency and transparency that CARS™ provides, and they are beginning to rely more heavily on its ratings.

While there are several variations of investor service providers in the nonprofit world, no ratings agencies have targeted housing nonprofits specifically. A CARS-like product for affordable housing developers would encourage organizational lending and further advance the affordable housing market.

F. Tracking Organizational Investment Returns

Another element in the closed-loop system is a measure that tracks the financial returns, and, in nonprofits, the social impact of an organizational investment. In order for investors to understand the advantages of "building" an organization instead of simply "buying" its social services, they need to see significant, measurable results. This too could be a specialized function outsourced to third-party agencies.

The Nonprofit Finance Fund has developed a new and innovative product that measures financial returns on equity-like investments in nonprofits. The Segue system separates entity-level investments ("build" funds) from program-specific funding ("buy" funds). To date, none of the Nonprofit Finance Fund's clients have been affordable housing nonprofits.

VI. The Role of Public Policy

A closed-loop reporting system would greatly encourage organizational investing in creditworthy nonprofits, but experts assert that private actors alone will not bring organizational real estate lending to scale. Attracting investment in affordable housing at the organizational level will ultimately require federal, state and local government support.

"CDFIs tend to respond more quickly to shifts in policy than to changes in the market." (Ratliff and Moy 2004, 19)

A. Federal Policy Changes

Over the years, federal banking regulations, tax credits and subsidy programs have helped to substantially increase the level of private investment in nonprofit affordable housing projects. But at the same time, government housing policies and nonprofit tax laws contribute to many of the market inefficiencies discussed in the previous section.

Policymakers must reconsider the restrictions and regulations that threaten the long-term sustainability of affordable housing projects and/or undermine nonprofit affordable housing enterprises' ability to expand. In addition to adjusting existing policies, federal agencies should develop new programs that support nonprofit organizations, not just their new developments.

The following policy recommendations should be considered:

1) Allow equity stakeholders in tax-exempt organizations.

The IRS should adjust the way it restricts profit in 501(c)3 organizations so as to heighten the private sector's interest in nonprofits. Allowing nonprofit investors to receive modest cash flow distributions from their nonprofit equity investments would help to attract private investment. This would increase the demand for reliable financial information and, in turn, encourage nonprofits to be more diligent in their financial accounting and their usage of outside funds.

2) Adjust restrictions on residual income to allow for cross subsidization.

HUD should reconsider its guidelines on how nonprofits must treat residual income and reserves in subsidized properties. Strong organizations should be allowed to use the positive cash flows generated from profitable projects to subsidize other properties in their portfolio. They should also, under certain circumstances, be allowed to transfer reserves from one project to another.

Again, to ensure that project cash flows and operating reserves are not used irresponsibly, only eligible nonprofits should be afforded this latitude. The release of restrictions on project surpluses and reserves might be considered on an individual project basis; exemptions would be granted if projects met certain performance criteria.

3) *Adjust long-term rent restrictions on subsidized properties.*

HUD should also adjust its long-term rent restrictions. It should allow rent increases that reflect true operating costs, with consideration for the disparity between market inflation rates and low-income wage inflation rates.

4) *Compensate private investors for what they may have earned in conventional private markets.*

The federal government should offer financial incentives to equity investors that would balance the playing field between nonprofit affordable housing developers and other real estate investment alternatives. In order to raise the low-cost capital necessary to grow and improve their businesses while maintaining their existing properties, large entrepreneurial nonprofits need private institutional investors. Similar to the federal tax credits and grant programs that attract private investment in affordable housing at the project level, public subsidies should be available to compensate investors for what they could have earned in conventional real estate markets.

The federal government could also provide backing for organizational investments through guarantees or insurance policies. The Dutch loan guarantee fund, which secures investments in accredited housing associations, presents a potentially replicable model.

The U.S. government should explore the possibility of prequalifying certain nonprofit housing organizations to be eligible for organizational investments, and create incentives and credit enhancement products that encourage investments in accredited nonprofit enterprises.

5) *Adjust philanthropic foundation giving policies.*

Congress should adjust foundation giving requirements to increase foundations' organizational investment activities. The current federal rule requires that 5% of foundations' annual returns be given to charitable organizations in the form of nonrenewable grants. New rules should require that a certain percentage of foundations' yearly outlays be in the form of program related investments. Many recent studies have emphasized the role of foundation PRIs in the evolution of the nonprofit funding system.

6) *Coordinate Funding Application deadlines, application requirements and allocation schedules.*

Public agencies must better coordinate their funding programs so that their funding programs complement one another rather than conflict. A first priority should be for

HUD and the IRS to coordinate their disclosure requirements and their fiscal year-ends to help eliminate the complications surrounding consolidation. HUD should also coordinate with state housing finance agencies to streamline the fundraising process for borrowers. HUD should support initiatives that are working toward standardizing reporting practices, like STRENGTH MATTERS™ and the Multi-State Filer Project, and it should consider implementing such standards at the federal level.

B. State and Local Adjustments

Some state and local policies and requirements can be cost burdens for nonprofit developers. Some policies that need to be reevaluated locally are as follows:

1) Include state-required supportive housing services as operating cost.

State housing finance agencies sometimes require that nonprofit housing borrowers provide additional social services to their low-income tenants. The costs of running supplementary programs are often not counted as operating costs in initial underwriting. Such requirements are considered positive and should be kept intact, but the costs associated with social service operations should not be borne on developers. Additional social service requirements should be written into the project's financing.

2) Reflect restricted rents in local tax policies.

Municipal tax authorities often impose disproportionate tax levies on affordable property owners. Local property assessors do not factor lower-than-market-rate rents into property values when appraising subsidized properties. Owners are taxed at the "highest and best use value" instead of the lower-than-market subsidized value. Local tax policies should be adjusted so that taxes are proportionate with affordable rents.

VII. Risk-Mitigating Strategies

Nonprofit housing enterprises have had difficulty affecting policy, especially at the federal level. In a study of HPN members, the Urban Institute found that members had "low expectations of their ability to impact policy" and that "Housing Partnerships tend more frequently to find ways to work with and around various policy obstacles than to concentrate on changing policy" (Mayer and Temkin 2006, A-13).

Especially in affordable rental housing, where subsidy programs and market volatility add to investor uncertainty, organizational investors need alternative risk-mitigating strategies to ensure that they "strike a balance between taking risks consistent with our role as charitable lender, and recovering our capital so we can make our funds available to future projects" (LISC 2008, 1).

Organizational lenders have used innovative strategies to share underwriting costs, manage risks and enhance organizational credit. Investors interested in launching their own organizational loan products might consider the following risk-mitigating strategies.

A. Pooled Investment Structures

To share the risk and costs of underwriting, lenders can pool their capital and form a collective organizational loan fund. Many public housing finance entities are experimenting with pooled, place-based funds that offer predevelopment and acquisition capital. Local acquisition funds have been launched in urban areas including New York City and Los Angeles so that multiple lenders can share the costs of underwriting. While these models lend only on a secured basis, they offer important efficiency benefits for high-volume borrowers.

Sometimes these pools are structured as closed-loan funds. As such, borrowers must be prequalified to access funds. The Lower San Antonio Community Development Fund is one example of a place-based closed-loan fund. The fund preselected a group of strong affordable housing developers to borrow funds for predevelopment and acquisition of properties within a defined redevelopment district in Lower San Antonio. By underwriting eligible borrowers in advance, developers can move quickly on opportunities in the area without having to undergo lengthy application and underwriting processes.

The Edna McConnell Clark Foundation's "Growth Capital Aggregation Pilot" is another example of a pooled, closed-end organizational capital fund. With commitments from 19 foundations, corporations and individuals, the $120 million fund will help bring three specific nonprofits to scale (Stannard-Stockton 2008, 1).

B. Financial Controls, Clauses and Covenants

Since they do not always secure real estate as collateral, organizational lenders manage risk by stipulating explicit conditions that must be met by borrowers throughout the life of the loan. Lenders impose both administrative and financial controls to protect themselves from unexpected changes in the borrower's organizational position.

A few common requirements include borrower disclosure and/or lender approval of uses of funds, restrictions on changes in key management, restrictions on additional borrowing and maintenance of financial ratios (days cash on hand, net asset ratio, working capital ratio, etc.). Many loan agreements also include an exit clause permitting lenders to withdraw funds at any time, even if the borrower is in compliance with loan covenants.

Loan requirements vary greatly across lenders and depend on the risk, collateral, and term and size of the loan or line of credit. Some covenants, though they may mitigate risk for the lender, can have negative implications for the borrower. Most social purpose investors try to balance the level of risk they are willing to assume and the level of control they impose on their borrowers. The consensus among STRENGTH MATTERS™ participants was that covenants against changes in management or additional borrowing can do more harm for a borrower than good.

Of the three organizational investor types interviewed, CDFIs are generally the most rigid about their borrowers' financial ratios staying above certain thresholds. Most CDFIs have specific cash covenants, annual return requirements and unrestricted net asset thresholds.

C. Credit Enhancements: Guarantees and Insurance Products

Credit enhancement vehicles, like loan guarantees and insurance products, offer an additional layer of security to entity level investors. Some foundations and network associations are piloting such products to encourage equity-like investments in nonprofits. The MacArthur Foundation, for example, offers a top-loss guarantee product to loan funds that invest in housing preservation at the entity level.

The Housing Partnership Network (HPN) offers credit enhancement products for community development organizations as well. In 2006, with funding support from public and private investors, HPN launched Housing Partnership Securities, a financial guarantee product for affordable rental housing loans. HPN also offers an insurance product to its members. Housing Partnership Insurance provides property and liability insurance for a pool of affordable units.

Public agencies have also created credit assurance facilities to encourage lending in affordable housing (see VI(A), recommendation 4).

VIII. Conclusion

As strong, experienced nonprofit affordable housing developers expand, the deal-by-deal affordable housing finance system fails them in their efforts to build and protect affordable housing and operate their businesses strategically at the same time. They face problems of inadequate cash resources, a cumbersome fundraising process, extended periods of delayed funding and other inefficiencies that undermine their ability to accomplish their mission.

To fill the capital gaps of conventional, project-based finance, a small universe of "organizational lenders" is experimenting with equity-like investments in their top-performing housing borrowers. Unfortunately, the field of organizational investment has not matured as fast as some nonprofit developers have.

The challenges to organizational investing are the result of several underlying failures in the nonprofit accountability and funding system. In a functioning "closed" capital market system, equity investors are able to make rational investment decisions because they have access to standardized, relevant and reliable company data at the aggregate level. They can also take advantage of third-party service providers to reduce or enhance their internal investment analysis. In the nonprofit world, however, there are no generally accepted accounting standards, no systematic way of reporting and no strictly enforced disclosure requirements.

Without a "closed system" of reporting in place, nonprofits are extremely difficult to evaluate. In order to close the organizational capital gap, nonprofits must standardize their accounting practices and report more relevant, user-friendly financial information. Third parties must also step in to oversee the filing process, collect financial data, analyze risk and disseminate nonprofit financial information.

A closed-loop accountability system will unfortunately not address all of the barriers to organizational investing in affordable housing. Increasing the level of organizational investments in affordable housing will require public policy support. Restrictive government policies must be lifted, new investment incentives must be created and new rules must be instated to increase foundations' organizational investment activity. As the systems of public and philanthropic support for nonprofit development evolves, individual lenders will need alternative ways to mitigate the risks associated with organizational investment. While foundations, networks and CDFI lenders have had difficulty affecting policy, they have taken the first groundbreaking steps away from project-based finance toward a new system of lending in nonprofit affordable housing.

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APPENDIX A: An Inventory of Organizational Lenders

- ***The MacArthur Foundation Windows of Opportunity Initiative -*** *The Window of Opportunity Initiative was launched in 2003 to support the preservation of affordable rental housing. MacArthur invites high-performing rental housing developers and lenders to apply for a 5- to 10-year program.*

- ***NeighborWorks® Capital -*** *NeighborWorks® America is a federally sponsored national community development and housing network. Its lending affiliate, NeighborWorks® Capital, has recently launched a pilot organizational investing program. It capitalized a pool of funds and is selected high-performing member organizations to apply for its predevelopment and working capital loans. Loan-fund officers are currently in the process of reviewing applications and underwriting the fund's first round of loans.*

- ***Enterprise Growth Fund Initiative -*** *Enterprise Community Partners is an affordable housing network working with community development corporations (CDCs) across the country to pursue a common mission. In 2004, Enterprise launched a product to help its CDC members build their organizational capacity. They provided $2 million to $3 million loans for 3-year terms to approved CDC borrowers. In 2006, the product was discontinued (Chatman, July 2008).*

- ***The Housing Partnership Fund -*** *The Housing Partnership Network is a membership network of 96 high-performing nonprofit affordable housing developers and lenders. The Housing Partnership Fund provides its most reputable members with subordinate lines of credit of as much as $1.5 million for predevelopment and acquisition. These equity-like facilities are underwritten in advance, based on the strength of the borrower's balance sheet and management. This lending model avoids the onerous loan application and allows borrowers to be competitive and encourages them to keep their pipelines moving.*

- ***The Local Initiatives Support Corporation (LISC) -*** *LISC is one of the largest community development networks. Its local field offices provide technical and financial assistance to CDCs across the country. LISC leverages capital from institutional investors to create local loan pools of funds that offer an array of products to CDC affiliates. Among its offerings, it has 2- to 3-year revolving capital facilities for its top-performing borrowers. These can be used for early-stage development capital, for working capital on multiple projects or for general operating cash. Local offices work directly with borrowing CDCs to determine loan terms and uses and to ensure that borrowers remain creditworthy.*

- ***Calvert Social Investment Fund -*** *The Calvert Foundation pioneered organizational lending in the nonprofit housing field. Through the Calvert Social Investment Fund it has allocated $19.8 million to affordable housing, $10.5 million of which is invested directly in affordable housing developers and owners. Calvert's loans are not restricted, so borrowers can use the funds for predevelopment, for general operations, or for approved business improvements. The Fund's four other mission targets are community development finance institutions (CDFIs), microfinance, social enterprise and fair trade.*

- ***Low Income Investment Fund (LIIF) -*** *LIIF is a nationally accredited nonprofit CDFI committed to community development. Through its revolving loan fund, it finances child care, education and other community-building efforts. It offers flexible working lines of credit for project-related activities and other organizational needs. Nancy Andrews has an active voice in the discussion around financing organizational capacity.*

Lender	Total Fund Size ($ Millions)	Year Established	Organizational Loan Products	Eligible Use of Organizational Funds	Collateral Requirements/ Restrictions	Organizational DebtO/S($ Millions)	Cum. Loss (%)	# Borrowers	Median Loan ($ Millions)	Loan Size ($ Millions)	Interest Rate (%)	Term (years)	Minimum Application Requirements
Housing Partnership Fund www.housingpartnership.net	30	2000	Predev. loan /LOC, "STAL" revolving LOC	Rental predev, acquisition	100% recourse subordinate mortgage	10.89	0.03 5	8	1.35	0.2–2.0	7.72	≤ 2	Network member
LISC www.lisc.org	200		Revolving loan/LOC, recoverable grant	Predev., general operating	> 75% RE					0.5–2.0	7.0–7.2	2–3	Network member
NeighborWorks® Capital www.neighborworkscapital.org	10	2008	Pilot Product	Predev.; acquisition	≤ 30% unsecured/ unrestricted	10	NA	6	1.5	0.5–2.5	4.50	3–5	Network member
Calvert Loan Fund http://www.calvertfoundation.org	137	1996	Term Loan	Growth, predev.	General recourse/ 100% unrestricted	10.5	1.39	20	0.5	0.25–1.0	4.49	3–5	2 years pos income, 3 years financials
Low Income Investment Fund (LIIF) http://www.liifund.org/	200	1993	Line of credit	Working capital LOC	General recourse					≤.75		2–3	
MacArthur Window of Opportunity www.macfound.org	109	2003	PRI	Predev. gap working	General recourse/ 100%	68	NA	28	1.5–3	1–10	1–2	5–10	Invitation only
Enterprise Partners Growth Fund www.enterprisecommunity.org		2004–2006	Line of credit	Working, growth	< 25% unrestricted					2–3	≥ 4	3	Invitation only
Nat'l Housing Trust Community Loan Fund www.nhtinc.org	7	2001	Term loan	Pre-dev, interim	50% unsecured/ 0% unrestricted	7	0	14	NA	NA	NA	2–4	Preservation only
Lower San Antonio Community Development Fund www.aecf.org /MajorInitiatives/MakingConnections.aspx	8	2005	Closed loan fund	Pre-dev, acquisition	100% RE secured/ restricted		0	2		≤ 1.5/proj.; $3/borrower	0.06	≤ 3	Preapproved borrower

APPENDIX B: Top 10 Nonprofit Affordable Housing Developers[4]

Rank	Owner	Units	Region	Detail
1	**Volunteers of America**	17,107	National	Volunteers of America owns 352 affordable housing developments in the United States. Through thousands of human services programs, the organization helps more than 2 million people in more than 400 communities.
2	**National Church Residences (NCR)**	16,320	National	NCR owns more than 250 affordable housing developments. The organization, which focuses on senior housing, manages more than $1 billion in assets.
3	**Mercy Housing**	12,985	National	Mercy Housing provides the full spectrum of affordable housing, from housing for the formerly homeless to senior housing. Mercy has formal partnerships with nine major U.S. healthcare systems.
4	**Bridge Housing**	9,404	California	BRIDGE Housing celebrates its 25th anniversary this year. The nonprofit organization has built a variety of projects, including large mixed-income and mixed-use urban infill developments.
5	**National Community Renaissance**	8,754	National	More than 78 percent of National Community Renaissance's portfolio is low-income households earning less than 60 percent of the area median income. It owns 71 affordable housing developments.
6	**The Community Builders, Inc.**	7,407	Midwest, Northeast, Southeast	The nonprofit organization is involved in the building of large-scale, mixed-income urban developments. It owns more than 100 affordable housing properties.
7	**Mid-Peninsula Housing Coalition**	5,625	California	Mid-Peninsula Housing Coalition is a leading nonprofit affordable housing provider in California. Its portfolio includes family, seniors, special needs and farm worker housing.
8	**KDF Communities, LLC**	5,271	California	KDF owns 43 affordable housing developments. The company's "Village at the Crossing" in Califorina earned a Gold Nugget Award for best senior housing.
9	**The NHP Foundation**	5,072	Midwest, Northeast, South Central, Southeast	Involved in multifamily rental, mixed-income and mixed-use developments. The resident services division, Operation Pathways, concentrates on education and training.
10	**EAH Housing**	4,979	West	EAH Housing develops and manages a full range of primarily 100 percent low-income housing family projects. The group has also developed several large student housing developments.

Source: Affordable Housing Finance Magazine 2008.

[4] Extracted from Affordable Housing Finance Magazine's Top 50 Affordable Housing Developers.

APPENDIX C: STRENGTH MATTERS™ External Reporting Issues

Source: www.strengthmatters.net

1. Determination of parent organization fiscal year-end
2. Presentation — comparative statements vs. noncomparative statements
3. Consolidation issues
    a. Eliminations
    b. Presentation of minority interests/noncontrolling interest
    c. Combining Schedule
4. Developer fee recognition
    a. Developer fee recognition
    b. Consolidation
5. Determination of supplemental schedules
    a. Combining schedules
    b. Schedule of expenditures of federal awards
    c. Statement of functional activities
    d. Schedule of finding and questioned costs
6. Statement of financial position
    a. Current assets
    b. Property
    c. Other assets
    d. Current liabilities
    e. Long-term liabilities
    f. Minority interests
7. Net assets
    a. Permanently restricted/temporarily restricted/unrestricted
    b. Board designated — reimbursed vs. an advance — donor vs. government source
    c. Government contracts considered restricted revenues?
    d. Deferred revenue vs. temporarily restricted assets — government contract/donor directed
8. Statement of functional expenses
    a. Methodologies around and combining allocation methodology
9. Issuance of stand-alone financial statements or parent-only financial statements
10. Impairment allowances for receivables
    a. Proper calculation
    b. Fair value
11. Statement of activities
12. Statement of cash flows
13. Segment reporting
    a. Principles for segmentation
    b. Presentation of supplemental
14. Cash presentation
    a. Restricted vs. nonrestricted
    b. Corporate vs. property (supplemental and footnote presentation)
15. Footnote disclosures
    a. Review the 15–20 standard footnotes
    b. Note 1 — list of organizations
    c. Property value schedule
    d. Notes payable schedule — (hard, org, soft debt)
    e. Contingent liabilities
16. Bad debt writeoffs (policy)
17. Capitalization of fixed assets (policy)

APPENDIX D: Highlights from a NAREIT National Policy Bulletin on FFO White Paper Disclosures

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White Paper Disclosures

A discussion about certain disclosures contained in the funds from operations (FFO) white paper, as originally written in 1995, and unchanged in 1999 during the review of FFO, addresses the following:

1. FFO/generally accepted accounting principles (GAAP) net income reconciliation
2. Capital expenditures — tenant improvements/allowances, leasing commissions, expansions, major renovations, acquisitions, etc.
3. Straight-line rents

The Council recommends that, at a minimum, the disclosures for I, II and III below be presented for the current and prior-year period:

I. <u>FFO/GAAP Net Income Reconciliation</u>

Net income attributable to common shareholders (Note 1) . . . . .x,xxx,xxx

<u>Adjustments:</u>

Depreciation of real estate assets . . . . .x,xxx,xxx
Amortization of tenant improvements and tenant allowances . . . . .xxx,xxx
Amortization of deferred leasing costs . . . . .xxx,xxx
Gains/losses from sales of depreciable real estate . . . . .xxx,xxx
Gains/losses from sales of other real estate and securities (Note 2) .. . . xxx,xxx

<u>Other items:</u>

Discontinued operations . . . . .xxx,xxx
Extraordinary items . . . . .xxx,xxx
Cumulative effect of accounting change .... .xxx,xxx
Impairment losses related to depreciable property . . . . xxx,xxx
Adjustments for minority interests — consolidated affiliates (Note 3) .... .xxx,xxx
Adjustments for unconsolidated affiliates (Note 3) . . . . .xxx,xxx

<u>FFO:</u> $x,xxx,xxx

<u>Weighted average shares and units</u>:
Basic x,xxx,xxx
Diluted x,xxx,xxx

Note 1 — For practical purposes, some companies begin the reconciliation with income from continuing operations. This practice eliminates the need to provide certain adjustments for discontinued operations, extraordinary items, cumulative effect of accounting changes, and minority interests. The above format attempts to display all the potential adjustments that may be necessary in the calculation of basic and diluted FFO.

Note 2 — Section III.E., *Gains and Losses on Property Sales*, of the White Paper provides guidance on gains/losses from sales of other real estate and securities. This section states, in part:

> The prohibition against the inclusion of gains or losses on property sales in FFO was not meant to address this kind of activity, but rather the gain or loss on previously depreciated operating properties.

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The white paper allows companies to choose whether to include such gains or losses from the sale of securities or land in funds from operations (FFO):

> Those real estate investment trusts (REITs) that choose to include such gains or losses on sales of securities or undepreciated land in their FFO should disclose the amount of such gains or losses for each applicable reporting period. Those that do not should address the amount of such gains or losses in their reconciliation of net income to FFO.

Note 3 — "Adjustments for minority interests — consolidated affiliates" includes all adjustments to eliminate the minority interests' share of adjustments to convert net income to FFO. "Adjustments for unconsolidated affiliates" includes all adjustments to convert the company's share of net income from unconsolidated affiliates to FFO.

II. Summary of Capital Expenditures

The FFO white paper describes certain capital expenditures that are known to be of particular interest with respect to certain property types. These include, but are not limited to, tenant improvements; tenant allowances; leasing commissions for office, retail and industrial properties; and floor coverings and appliances for apartment properties. Other capital expenditures may be of particular interest regardless of the property type. These include, but are not limited to, corporate/administrative items, equipment replacement, capital maintenance, expansions, major renovations and acquisitions.

Some capital expenditures of particular interest may be similarly grouped regardless of the property type. For example, the industry utilizes the nomenclature revenue enhancing vs. non-revenue-enhancing capital expenditures, or acquisition vs. recurring capital expenditures.

The following outlines the information to be included in the disclosure:

- Company definitions of terms used to categorize capital expenditures, such as revenue enhancing and non-revenue-enhancing capital expenditures.
- Units of measurement (e.g., rentable square feet, units, rooms, sites, beds, etc.) in period:
  - Total in portfolio
  - New tenants
  - Renewal tenants

The following types of expenditures should be provided in the aggregate ($) and per unit of measurement for both new and renewal tenants.

New tenants:
- Tenant improvements and tenant allowances
- Leasing commissions

Renewal tenants:
- Tenant improvements and tenant allowances
- Leasing commissions

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The following types of expenditures should be provided in the aggregate and/or per unit of measurement (rentable square feet, units, rooms, etc.).

Corporate/administrative items:
- Company office renovations, furniture, fixtures, equipment, computers

Existing properties:
- Equipment
- Capital Maintenance
- Building renovations
- Rentable square feet, units, rooms

Development properties:
- Building expansions
- Rentable square feet, units, rooms
- Building renovations
- Rentable square feet, units, rooms

Acquisitions:
- Investment (total cost)
- Rentable square feet, units, rooms

III. Other Information

For each period presented, the following may be used to develop stabilized cash flow/valuation metrics (i.e., adjusted funds from operations [AFFO], cash available for distribution or funds available for distribution [CAD/FAD]):

- Straight-line rents in excess of (less than) contract rents...................... .... $ xx,xxx
- Amortization of deferred financing costs.. .... $ xx,xxx
- Amortization of stock compensation................................. .... $ xx,xxx
- Deferred taxes... .... $ xx,xxx
- Deferred contingent rents.. .... $ xx,xxx
- Gains/(losses) on sales of securities or property included in FFO .... $ xx,xxx
- Other significant unusual and/or noncash items..................... .... $ xx,xxx

Source: National Association of Real Estate Investment Trusts, Inc. 2001

APPENDIX E: Multi-State Filer Checklist for Initial Registrations© (URS v. 3.20)

	Fee	State Forms	IRS Det. Lttr	Fund. Contrc	Bylaws	Cert/Arts Inc	Form 990	Audit	Notarized
Alabama	√		√		√	√			√
Alaska	√			√			√	√	
Arizona			√				√		√
Arkansas		√	√	√	√	√	√	√	√
California	√	√	√		√	√	√	√	
Connecticut	√						√	√	
D.C.	√	√	√	√	√	√	√		√
Georgia	√	√	√				√	√	√
Hawaii							See Appendix		
Illinois	√		√	√	√	√	√	√	
Kansas	√		√			√	√	√	
Kentucky			√				√		√
Louisiana	√			√	√	√	√		
Maine	√	√	√				√	√	√
Maryland	√		√	√	√	√	√	√	
Massachusetts	√		√		√	√	√	√	
Michigan			√	√	√	√	√	√	
Minnesota	√		√	√		√	√	√	
Mississippi	√	√	√	√	√	√	√	√	√
Missouri	√	See Appendix	√	√		√	√		√
New Hampshire	√	See Appendix	√		√	√	√	√	√
New Jersey	√		√	√	√	√	√	√	
New Mexico			√	√		√	√	√	√
New York	√		√		√	√	√	√	
North Carolina	√	√	√	See Appendix			√		√
North Dakota	√	√	√	√		√	√		√
Ohio	√		√		√	√	√		√
Oregon			√		√	√	√		
Pennsylvania	√		√		√	√	√	√	
Rhode Island	√	See Appendix	√	√		√	√	√	√
South Carolina	√		√				√		
Tennessee	√	√	√	√	√	√	√	√	√
Utah	√	√	√	√	√	√	√		√
Virginia	√		√	√	√	√	√	√	
Washington	√	√	√	√			√	√	
West Virginia	√	√	√	√			√	√	√
Wisconsin	√	√	√		√	√	√	√	√

Source: www.multistatefiling.org 2008