

## **Testimony of Thomas A. Bledsoe**

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**Before Subcommittee on Housing and Insurance**

**House Financial Services Committee**

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Good morning, Chairman Luetkemeyer and Ranking Member Cleaver, I am Tom Bledsoe, President and CEO of the Housing Partnership Network (HPN), a business collaborative of high-performing nonprofits that develop, own, manage and finance affordable housing and community development. Creating private sector partnerships and enterprises that achieve ambitious social missions, HPN and its member organizations work together to scale innovation and impact, helping more than a million people gain access to affordable homes and thriving communities that offer economic opportunity and an enhanced quality of life. In 2013, HPN received a MacArthur Foundation Award for Creative and Effective Institutions, and a Wells Fargo NEXT Opportunity Award in recognition of its ongoing leadership and innovation in affordable housing and community development. HPN operates businesses that help improve the efficiency and impact of our members, such as property and casualty insurance company that insures their apartments, a group buying business that helps them purchase the supplies and materials they need to build and renovate housing, and a social purpose Real Estate Investment Trust that purchases naturally occurring affordable housing. HPN is a social enterprise – we use private sector business practices to create and preserve stable homes and vibrant communities that offer an improved quality of life for residents.

Housing Partnership Network's search for innovative social enterprise models that can better leverage private sector resources have led us to explore international examples as well as domestic, particularly from the United Kingdom. In April 2003, HPN, with support from the MacArthur Foundation, expanded its peer exchange network by organizing a visit by 15 HPN leaders to social housing organizations in the Netherlands and England. The trip concluded in a day-long forum at the Rowntree Foundation in London attended by housing leaders from the three countries. Discussions ensued over the next three years, chiefly with British colleagues, and culminated with a summit meeting in April 2007 in Washington, DC, that effectively launched the International Housing Partnership (IHP), which HPN coordinates. Since the 2007 summit, IHP has held annual meetings and formed an ongoing partnership among housing leaders in the United States, Great Britain, Canada, and Australia. The top nonprofit housing leaders in each of these countries has replicated the HPN model by building peer-based networks – Housing Partnership UK, Housing Partnership Canada and PowerHousing Australia – that have joined with HPN to constitute the International Housing Partnership. It is through this partnership that we have gained insight into the strengths and challenges facing our peers abroad. These insights are the foundation of HPN's policy proposals, which are premised on the core principle that high-performing, mission-driven actors can be effective developers of affordable housing.

## **Social Enterprise Model**

Safe, decent, affordable housing plays a key role in helping improve lives and communities in the U.S. and around the globe. The ongoing shortage of affordable housing has opened the door to new ideas and thinking here and abroad on ways to manage, preserve, and develop affordable housing that are more sustainable and cost-effective, while also guaranteeing the best possible living situation for residents. The international exchanges have deepened our thinking on how the combination of social mission with private enterprise is the most effective way to develop and manage affordable housing and improve communities. We believe that housing policy in the US would benefit from an emphasis on institutions that combine deep social mission and strong business acumen. This is why after Hurricane Katrina, HPN created the Gulf Coast Housing Partnership to rebuild affordable housing in the region and why we have launched Develop Detroit, a social enterprise that is working to revitalize Detroit.

HPN members and our international colleagues share an approach to developing communities that combines the best features of mission-driven nonprofits with the entrepreneurship of the for-profit sector. The IHP has shown us that housing nonprofits that have a fundamental focus on public purpose and a commitment to reinvesting any financial return into their work but are structured to efficiently raise private capital and create partnerships with the private sector can deliver the best outcomes for people and communities while effectively leveraging limited public resources.

The materials circulated before the hearing include a paper that HPN issued this winter about the lessons that we have learned working with the International Housing Partnership, particularly from the United Kingdom. HPN's 10 years of hosting peer exchanges between domestic and global industry leaders has helped us understand how the growth of social enterprises that develop housing in both countries has strengthened both systems. As the affordable housing systems in both countries change and evolve, we encourage the thoughtful adaptation of British practices that have worked well, while respecting successes of our own system and understanding the need for consistent resources.

## **Large Scale Voluntary Transfers in Great Britain**

Starting in 1988, Britain has had a policy of Large Scale Voluntary Transfer (LSVT) which intended to address the growing capital needs of the aging council housing stock by transferring council housing to nonprofit housing associations. Conversations with our British colleagues about how the British policy of LSVT worked clarified our thinking about how a social enterprise model can improve the delivery of affordable housing. The policy was premised on the idea that the new nonprofit owners of the housing would be able to access private capital and reduce demands on public funds, which would help to recapitalize the housing stock and fund ongoing maintenance and management. A similar challenge has motivated policies like the Rental Assistance Demonstration (RAD) in the US.

One fundamental observation is that transferring council housing to nonprofit housing associations expanded the role of mission-oriented private housing providers in the U.K. The Large Scale Voluntary Transfer drove a broad shift in responsibility for affordable housing management in the U.K. away from public sector local councils (the British version of public housing) and toward nonprofit housing associations. This caused housing associations to grow in scale and prominence within the U.K. housing system. Today, housing associations manage

almost half of the country's social housing stock and nearly a quarter of its total rental stock, with the largest associations managing more than 100,000 units. Housing associations have adopted sophisticated property and asset management operations to manage this scale, including asset management systems that allow for pooling of revenues and costs across a portfolio of properties. This structure strengthens housing associations' balance sheets, which helps leverage private capital that can be used to finance development or recapitalize existing properties.

The first large stock transfer happened under Conservatives, though almost 75 percent of all transfers have taken place since 1997 under Labour governments. The modern transfer process involves several phases of planning and approval. First, a local authority sponsors a competitive process where tenants get to vote whether they want to transfer the ownership and management responsibilities. If so, they choose from alternative ownership and management proposals – which can include an existing nonprofit housing association in the area or the transformation and spin off of the public council management itself into an independent nonprofit. At least 50% of the council tenants must approve a transfer and the selection of the receiving entity. Once approved, the housing association is tasked with drafting a 30 year business plan for the council properties that includes how they will assemble the private funds to rehabilitate the homes.<sup>1</sup> Since 1988 over one million units transferred ownership from local authorities to housing associations.

### **Investment in Housing Associations and Residents**

It is important to emphasize that housing policy in the UK has directed significant capital grants to housing associations that have put them in the position today to use this collateral to raise private financing. Unlike the US system which typically allocates grants to individual projects (regardless of whether it has a nonprofit or for profit sponsor), the UK has invested their public grants in nonprofits at the enterprise level and encouraged housing associations to own real estate on a portfolio basis. Although this public funding has been substantially reduced due to budget limitations, the historic level of investment has enabled nonprofits to build substantial balance sheets which today they use to leverage private investment.

In addition, the UK used to provide a shallow but universal housing benefit to all eligible tenants which provides support to help them afford their homes. This benefit also created a rental income stream to the housing associations which they can flexibly use at the enterprise level to raise private financing. Project-based rental assistance in the U.S. provides a much deeper subsidy but this rental income is restricted to an individual project. While it can help an owner secure or finance a mortgage on the specific property, this approach does not allow the efficient leverage of private capital on a portfolio or enterprise basis as in the UK. This has greatly expanded the capacity of British housing associations to raise funds to rehabilitate stock transfer apartments.

The UK housing system has undergone dramatic change over the last thirty years, and has accelerated significantly since HPN began working with British housing associations in 2003. The deep reductions in the housing grants have encouraged nonprofits in the UK to pursue a more entrepreneurial model which relies on greater private financing. This shift has generated strong interest in the UK nonprofit sector in learning more about the US system which has

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<sup>1</sup> The Impacts of Housing Stock Transfers in Urban Britain. Joseph Rowntree Foundation, 2009. <http://www.jrf.org.uk/sites/files/jrf/britain-housing-urbanFULL.pdf>

always relied on a greater mix of private funds. The British have also sought to learn about and incorporate a second aspect of the US approach – our focus on individual assets. While the British portfolio model facilitates greater leveraging of private debt financing, the US asset based approach has generated more knowledge and investment discipline in individual properties. We believe there is enormous value in incorporating the strengths and aspects of both systems.

### **Social Enterprise in the U.S.**

Social enterprises in the U.S. represent a smaller proportion of the country's total rental housing stock, but are still critical to preserving and developing affordable housing. As capital subsidies to develop new public housing were cut off in the 1980s, for profit and nonprofit housing developers filled the gap, using the Low Income Housing Tax Credit (Housing Credit.) The Housing Credit gives investors a credit on their taxes for investments in affordable housing, and today it is responsible for nearly all new affordable housing development in the U.S. The Housing Credit also spurred the growth of the social enterprise sector in the U.S. because it required business discipline and expertise to attract investors, but it was aligned with the social purpose of creating affordable housing. The growth of social enterprises like HPN members in the U.S. has been helpful in the drive to preserve affordable housing for the future. Social enterprises leverage public funds to access private and philanthropic capital to finance housing and key services for residents, and use private-sector approaches to increase the impact of each dollar of subsidy. The entrepreneurship inherent in the U.S. system – which has been a byproduct of our more patchwork, partnership based approach - has been a key driver for the innovation and impact achieved by the leading nonprofits in the United States.

During the IHP exchange process, HPN and our members began looking to the British system for ideas that could help strengthen our own policies, programs, and resources to help us become more effective and efficient stewards of affordable housing. We saw potential to build on our existing capacity through programs that created access to entity-level capital and provided greater regulatory flexibility to manage resources across a portfolio of properties, particularly to facilitate deals that preserve legacy senior housing and Housing Credit properties reaching the end of their 15-year affordability contracts. We were especially interested in LSVT as way to recapitalize and preserve the aging affordable housing stock and the British system's emphasis on well-capitalized, mission-oriented housing providers as central to its housing strategy.

British housing associations are currently facing declines in government funding for their system, which is in turn spurring them to become more entrepreneurial and commercially engaged in the private markets. U.S. nonprofits face many of these same challenges, and as a result have been pursuing more market based transactions which use private equity to acquire naturally occurring affordable or workforce housing. HPN launched the Housing Partnership Equity Trust, a social purpose REIT, to raise equity on a portfolio basis to help twelve nonprofits acquire and rehabilitate more than 2000 apartments with \$140 million of equity investments from the MacArthur and Ford Foundations, Prudential, Citibank, Morgan Stanley and Charles Schwab. The HPN REIT combines the portfolio flexibility of the British system with the asset based ownership and management structures utilized in the United States.

Although there are profound differences between the two systems in terms of the extent of the government role, there are also growing convergences. British practices that bolster the social enterprise model could be adapted to the American context, while maintaining the strong U.S.

asset based focus. We believe this integrated approach which leverages the strengths of both models can enable nonprofits in the United States to significantly scale their impact, particularly in preserving naturally occurring affordable housing and in helping to revitalize public housing. In the following section, we outline HPN's policy priorities that evolved from our consideration of the British affordable housing model and its applications to American programs, policies, and resources.

## **Five policy recommendations that aim to expand the role of social enterprises in the US affordable housing system**

The following recommendations emphasize policies that increase the scale and reach of social enterprises so that we can create more affordable housing efficiently and improve communities. Our recommendations all build on features of the U.S. system that are working well now.

### **1: Expand the Capital Magnet Fund**

The Capital Magnet Fund allows nonprofit housing developers and Community Development Financial Institutions (CDFIs) to raise capital at the entity level, as the British housing associations do. This has proven to be one of the most efficient and effective ways to use public funds to attract private investments for housing in low-income families and underserved communities. Through the Capital Magnet Fund, the US Treasury's CDFI Fund provides competitively awarded grants to CDFIs and qualified nonprofit housing organizations. CMF awards may finance affordable housing activities, as well as related economic development activities and community service facilities. Unlike traditional housing programs, which fund individual projects and developments, CMF grants are awarded at the entity level, and awardees must commit to leveraging grant dollars with other private and public funds at a ratio of at least 10:1.

Even after just one funding round, it is clear that Capital Magnet Fund grants are spurring innovation and production among nonprofit housing providers. The average leverage ratio for the first round of awards in 2010 was 16:1, substantially higher than the mandated 10:1 leverage ratio. CMF grants supported the creation of 7,000 new units of affordable housing. CMF awardees used this flexible funding source in variety of ways including to capitalize revolving loan funds, provide bridge financing and extend their reach into hard to serve markets. . The success of the Capital Magnet Fund, even after a relatively limited \$80 million dollar grant round, is a demonstration of the effectiveness of entity-level investments in high-capacity, mission-driven nonprofits. The funding for the Capital Magnet Fund should be increased to at least \$500 million to improve the scale and efficiency of mission driven housing providers.

### **2: Prioritize Preservation**

Preserving the existing stock of subsidized housing is a necessary component of a forward-looking national affordable housing strategy. The U.S. stock of subsidized housing provides over three million units of critical affordable housing for low-income people. This stock is under threat, however, by an overwhelming backlog of deferred maintenance and capital needs, with no prospect of additional funding to address them. In recent years, we've seen successes with nonprofit social enterprises that acquire, rehabilitate and recapitalize HUD-assisted housing stock, much of which was nearing the end of contracted affordability periods or at risk of obsolescence without substantial reinvestment. Social enterprises are uniquely qualified to do

this work because they have the business skills to structure complex preservation transactions, but social mission keeps them focused on preserving affordability for the long term.

Preservation is also a key challenge with public housing properties. Years of deferred maintenance have put thousands of public housing units at risk of demolition or sale into the private market; since 1990, more than 200,000 units of public housing have been lost from the affordable housing stock.<sup>2</sup> HUD's Rental Assistance Demonstration (RAD) permits public housing authorities to convert public housing and a small number of legacy HUD project-based subsidy programs to long-term project-based subsidy contracts. In some cases, this process essentially transfers property operations to social enterprises, which can leverage private capital and other public funds to rehabilitate and recapitalize the properties.

RAD has some elements in common with the LSVT, particularly the motivating principle of transferring public-owned stock to private entities for preservation, but there are some differences. For instance in many RAD transactions, the public housing authorities may retain ownership in the partnerships managing the housing stock after conversion to project-based Section 8. In contrast, the LVST involved a full transfer of title and ownership to housing associations – which can be either existing nonprofits or councils that have transitioned their housing operations to nonprofit status and have become part of an augmented housing association sector. In this new configuration, the council maintains its role in setting overall local housing strategy and priorities, referring tenants to the associations for lease up and, in many cases, funding services for residents.

The city of San Francisco is pursuing a broad-based RAD public housing initiative that is intended to revitalize and preserve its public housing. San Francisco transferred ownership of public housing developments to high performing housing developers, including some HPN members. San Francisco used local funds, project based vouchers, HUD funds and tax credits to pay for redevelopment and preservation of the public housing. The city retained ownership of the land below the buildings as a safeguard to preserve affordability and public purpose over the long term. HPN supports lifting the current cap on the number of units that can be transformed under RAD and suggests that after RAD has been evaluated, a broader program of stock transfer should be considered. We also support providing a stronger decision making role for public housing residents in selecting and approving plans for this transformation, including selection of the new ownership and management entity. This will insure that revitalized former public housing developments serve existing low income residents and become vibrant mixed income communities.

### **3: Use a portfolio model for multifamily housing preservation**

The Rental Assistance Demonstration aims to preserve public housing and some legacy project-based subsidy programs, but this still leaves thousands of aging subsidized properties in need of preservation, lest they fall out of the affordable housing stock. In particular, older HUD Section 202 housing for the elderly and Housing Credit properties approaching the end of their 15-year contracted affordability periods are at significant risk.

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<sup>2</sup> CBPP, "Expanding Rental Assistance Demonstration Would Help Low-Income Families, Seniors, and People with Disabilities". November 2014.

A key difference between the British and American systems is that the system of private sector capital invested in affordable housing in the U.S. through the Housing Credit requires properties to be managed separately, which means American developers manage their assets at the property level, rather than with a view to their entire portfolio of assets and their balance sheet. We do not propose changing the compliance structure for the 9% Housing Credit for new development, but HPN has long advocated for reforms to legacy HUD multifamily programs and the 4% Housing Credit that could create opportunities for portfolio acquisition and management models.

U.K. housing associations have demonstrated the potential for portfolio asset management models to unlock new revenue sources, streamline operations and compliance, and drive scale and performance for nonprofit housing providers. In the U.S., at the end of the initial investment period of fifteen years for Housing Credit developments, there would be efficiencies in allowing this housing to be managed as a portfolio, as in the U.K. Similarly, aging HUD-funded housing would be more efficiently maintained as part of larger portfolios.

A shift in orientation from project-level finance to enterprise-level finance for aging properties would empower social enterprises to more flexibly manage their housing portfolios, increasing their efficiency and lowering the cost of deals to acquire and preserve several affordable housing properties. A portfolio approach also would allow these organizations to take better advantage of economies of scale, facilitate new approaches to managing stock to strengthen property performance, and help scale their capacity to acquire and preserve more affordable housing.

This portfolio approach can also be used to preserve and rehabilitate the large inventory of naturally occurring affordable housing which is home to millions of low- and moderate-income Americans. This stock, which is typically non-subsidized and not rent restricted, is generally owned by for profit developers who often reposition properties for more upscale rental when market conditions allow. This forces out many lower income families – leaving cities and metro areas with an acute shortage of work force housing that is an essential component of a sustainable community and economy. The Housing Partnership Equity Trust, a social purpose REIT created by HPN, demonstrates the important role that social enterprise nonprofits can play in preserving and revitalizing this stock using a portfolio financing model. These properties can also serve the housing needs of extremely low income families because they will accept tenants with vouchers.

#### **4: Make housing a platform for improving communities and building assets for residents**

High-performing housing nonprofits are well suited to link affordable housing development to broader programs of community and individual improvement. These organizations can advance opportunity for low-income people because they combine skill in housing development with an extensive network of relationships with social service providers. Policies connecting housing with opportunity can help to expand housing providers' capacity to do this critical work of linking affordable housing with residents' economic well-being.

The Family Self-Sufficiency Program (FSS) is one example of a policy that, at scale and with effective management, could help residents of subsidized housing access economic opportunity and reduce their reliance on public programs. FSS combines an innovative savings program with

financial coaching and counseling, with the goal of helping residents of public and project-based Section 8 housing accumulate savings over time. The best FSS programs help residents build assets and achieve financial goals. HPN members have been among the first private owners of properties with project-based subsidies to use FSS, and have adopted innovative methods and partnerships to maximize the program's effectiveness for residents. This committee should permanently expand FSS to the project-based rental assistance inventory.

There are many examples besides FSS of HPN members expanding their reach beyond housing to improve the communities where their residents live. Holistic community development initiatives through programs like Promise Neighborhoods and Choice Neighborhoods make it possible to address the problems facing neighborhoods of concentrated poverty. These efforts help residents who choose to remain in their communities avoid displacement due to disinvestment or gentrification. HPN members are able to do this difficult community transformation work because they combine the business acumen necessary to do affordable housing redevelopment with a focus on resident needs. They can address job training, education, transportation and other needs directly or through partnerships.

### **5: Improve Access to Affordable Homeownership**

The aftermath of the Great Recession has driven the U.S. homeownership rate down. Young people and families still strive for the goal of homeownership, but many do not have the savings, income, or credit history to access a mortgage. A dramatic increase in the stock of single-family renters reflects a broad shift to renting across household types, even households that would typically be homeowners.<sup>3</sup>

A similar phenomenon has been taking place in the U.K. which has witnessed a steep drop in homeownership rates in the past several years. Young people in particular are feeling the impact of lower ownership rates, to the extent that people under 35 years old are referred to as "generation rent." The key issue in the U.K. is a steep rise in homeownership costs, coupled with – and often driven by – a dearth of housing supply. The British system has developed some variations of homeownership that somewhat mitigate the problem. These include shared ownership models, in which a household owns a portion of their home on which they pay a mortgage, and pay rent to the housing association that owns the balance. As a household's income increases, it can purchase a larger share of the home's value, and if their financial circumstances deteriorate they can sell back a portion of the unit – thereby avoiding foreclosure or more serious economic hardship.

U.K. affordable housing providers also have managed to scale single-family rental models as a viable alternative to homeownership where this makes more market sense, using highly effective property management systems and portfolio financing. In the U.S., these models are being piloted in some areas, but the private equity to support acquisition and ownership is so expensively priced that it undermines the long term stability of the housing for low and moderate income families. Instead, investors seek to generate high yields and short term profits from flipping or reselling properties. Government support for more cost effective and efficient financing – possibly provided through the GSEs – would enable social enterprise nonprofits to acquire and serve as long term stewards of these homes while incorporate rent to own or lease purchase agreements to promote eventual homeownership.

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<sup>3</sup> State of the Nation's Housing 2015, Joint Center for Housing Studies



American social enterprises are pioneering other innovative homeownership programs aimed at new homebuyers and underserved communities that have much in common with the innovative shared ownership and single-family rental models adopted in the U.K. These programs often combine homebuyer education, affordable credit products or down-payment assistance, and access to an ongoing relationship with a housing counselor. Homeownership can also be part of a strategy to revitalize communities hit hard by the economic downturn, acquiring and rehabbing vacant or abandoned properties. After renovation, housing providers help first-time homebuyers purchase these properties with affordable credit products or through rent-to-own programs that help families transition to homeownership over time.

HPN and its members have used existing housing program such as the Low Income Housing Tax Credit and the HOME program in imaginative way to create a bridge between renting and owning a home. Policymakers should build on these successes to support products and programs focused on innovation and scale, such as government-backed credit products that incorporate high-quality homebuyer education and counseling, and comprehensive neighborhood revitalization programs that emphasize homeownership as a tool for spurring community investment.

### **Conclusion**

The U.S. needs to serve more people with decent, affordable housing in safe neighborhoods because three quarters of Americans income eligible for housing assistance don't receive it. Our reflections on the differences between the U.S. and British systems come at a critical moment in U.S. housing policy, as affordable housing providers face growing pressure to combat a mounting affordable housing crisis with declining resources. The lessons of the growth of British housing associations due to Large Scale Voluntary Transfer as well as portfolio flexibility and financing should be used to expand the role of social enterprises in the U.S. so that innovative, effective solutions to housing challenges facing society's most vulnerable people and communities are scaled up. I encourage you to look for ways to combine the best features of the British system with the best aspects of what is working well here. Expanding the role of social enterprise to take advantage of the combination of social purpose and business discipline will help the U.S. system for affordable housing stay resilient, sustainable, and dynamic for years to come.