

CONRAD N.



FOUNDATION

**IN PRACTICE**  
**PROGRAM RELATED**  
**INVESTMENTS FOR**  
**SUSTAINED IMPACT**

Lessons Learned from a Decade of Permanent Supportive Housing Lending in Los Angeles

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September 2017

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**Laurie Gould** has been engaged in the financial structuring of affordable housing development and preservation projects for more than 20 years. She has structured over \$650 million in financing to develop and preserve thousands of affordable units, as well as financing for commercial space and community facilities. Gould splits her consulting practice between real estate finance, business and strategic planning for community development organizations, and teaching on topics related to affordable housing. Her on-the-ground expertise also informs her research on such topics as best practices in the management of supportive housing and outcomes for the national Low-Income Housing Tax Credit (LIHTC) portfolio at Year 15.

## ABOUT THE CONRAD N. HILTON FOUNDATION

The **Conrad N. Hilton Foundation** was created in 1944 by international business pioneer Conrad N. Hilton, who founded Hilton Hotels and left his fortune to help the world's disadvantaged and vulnerable people. The Foundation currently conducts strategic initiatives in six priority areas: providing safe water, ending chronic homelessness, preventing substance use, improving outcomes for young children affected by HIV and AIDS, supporting transition age youth in foster care, and extending Conrad Hilton's support for the work of Catholic Sisters. In addition, following selection by an independent international jury, the Foundation annually awards the \$2 million Conrad N. Hilton Humanitarian Prize to a nonprofit organization doing extraordinary work to reduce human suffering. In 2017, the Humanitarian Prize will be awarded to icddr,b, an international health research institute dedicated to solving the most serious health issues facing low and middle-income countries. From its inception, the Foundation has awarded more than \$1.5 billion in grants, distributing \$109 million in the U.S. and around the world in 2016. The Foundation's current assets are approximately \$2.6 billion. For more information, please visit [www.hiltonfoundation.org](http://www.hiltonfoundation.org).

## ABOUT IN PRACTICE

**In Practice** is a series of knowledge papers published by the Conrad N. Hilton Foundation. It reports on Foundation program strategies and partnerships, and seeks to help inform the practice of other funders and policymakers working in areas of great human need.

The views expressed in this report are those of an independent consultant and are not necessarily shared by the Conrad N. Hilton Foundation staff or its board of directors.

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# Foreword

Since 1994, the Conrad N. Hilton Foundation has made over \$40 million in Program Related Investments (PRIs) to complement and enhance our grant activity. These investments, or loans, can be an incredibly catalytic force in helping to scale the work of our partners and are made for the primary purpose of generating a social impact. One example of using PRIs to effectively enhance our grantmaking is in the area of chronic homelessness.

For more than 25 years, the Hilton Foundation has been supporting solutions to homelessness in the U.S. Over this period, the Foundation has granted more than \$120 million to this core focus, \$80 million of which has targeted our current strategic initiative to end chronic homelessness in Los Angeles County. According to the 2017 Point-in-Time count, Los Angeles is home to more than 15,000 individuals experiencing chronic homelessness on any given night. These people are among the most vulnerable in our society and are very costly, absorbing a disproportionate amount of health and public safety services. A wide body of research shows that Permanent Supportive Housing (PSH)—which combines affordable housing with a comprehensive system of wraparound support services—is the best, most cost-effective solution to chronic homelessness. Through an active collaboration of partners in the nonprofit, government and philanthropic sectors, the Foundation has worked to establish functional, sustainable systems with resource commitments to scale PSH.

The Corporation for Supportive Housing (CSH) is one of the Foundation's longest-term partners, receiving a total of more than \$50 million in grants and PRIs since 1992. CSH has used \$8 million in PRI funds from the Foundation to help create thousands of PSH units. Over the years, these PRIs have met significant needs and increased the access and availability of capital to organizations in order to maintain momentum in PSH development. In this time, CSH has also developed particular expertise in providing loans combined with customized training and technical assistance to build organizations' capacity to develop PSH.

The Hilton Foundation and CSH have built a replicable model for how deep, flexible, long-term lending partnerships can advance innovative and timely solutions to difficult social problems. We are pleased to share this model and lessons learned through this *In Practice* paper, which examines a series of PRIs that we have provided to CSH.



**Peter Laugharn**

President and CEO, The Conrad N. Hilton Foundation

September 2017

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# A Partnership with Impact

*Program Related Investments (PRIs) can be a powerful complement to foundations' grantmaking—enabling mission-driven organizations to expand their impact and influence. This In Practice paper examines a series of PRIs that the Conrad N. Hilton Foundation provided to the Corporation for Supportive Housing (CSH) between 2004-2016 as part of a broad program to end chronic homelessness in Los Angeles. These PRIs have had demonstrable impact, contributing to the creation and growth of a robust pipeline of Permanent Supportive Housing (PSH). With the recent renewal of these PRI funds, their impact is poised to expand further still.*

*Several themes have emerged from this successful deployment of PRI funds:*

- **A willingness to absorb real financial risk** by the Hilton Foundation has enhanced CSH's ability to leverage other capital, innovate and respond to changes in the environment.
- **The long-term commitment** of the Hilton Foundation to CSH has helped CSH plan and operate efficiently, facilitating CSH's ability to make deep investments to build the capacity of developers in Los Angeles.
- **Strong and durable relationships** have formed the basis for effective deployment and leveraging of loan funds and expertise, maximizing their impact. This includes relationships between the Hilton Foundation and CSH, between CSH and PSH developers, between financial partners, and between CSH, the public sector and other stakeholders involved in the effort to end homelessness. Among the strongest and most durable relationships are those between the Hilton Foundation and CSH. From the outset, the parties have described this partnership as based on trust, with PRI business terms kept simple and flexible. The Hilton Foundation cultivated a supportive engagement, rather than a directive one, further fostering a relationship characterized by transparency and trust.

The results are clear and measurable: Over a 13-year period, CSH leveraged \$8 million in Hilton Foundation PRI investments into over \$1 billion in permanent capital for PSH development.<sup>1</sup> This collaborative effort facilitated the production of 2,354 units of supportive housing plus an additional 1,014 units of conventional affordable housing. The Hilton Foundation's partnership with CSH provides important insights as to how PRIs can enable private lenders, foundations and governments across the U.S. to partner with mission-oriented lenders and advance shared goals. The hallmarks of the Hilton Foundation's strategy—a willingness to share risk, to commit for the long term and to invest in building strong and durable relationships—can also inform other foundations seeking to shape their own PRI activities to advance sustainable social change.

<sup>1</sup> \$2 million of these funds were invested nationally, supporting the development of PSH nationwide. While the \$1 billion figure includes only those funds directed to and leveraged within Los Angeles, total national impact was significantly broader.

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## METHODOLOGY

This paper draws on interviews with 16 stakeholders, including current and past employees of both CSH and the Hilton Foundation, public funders, private lenders and investors, PSH developers and representatives of partner foundations. CSH provided data on its loans, the projects supported with those loans and any permanent funding leveraged. Additional information and context was provided by Abt Associates' multi-year evaluation reports of the Hilton Foundation's Chronic Homelessness Initiative and publicly available online data such as term sheets and census reports.

**Permanent Supportive Housing (PSH)** is a model that combines low-barrier affordable housing, health care and supportive services to help individuals and families lead more stable lives. PSH typically targets people who are homeless or otherwise unstably housed, experience multiple barriers to housing and are unable to maintain housing stability without supportive services. This model has been shown to not only impact housing status, but also result in cost savings to various public service systems, including health care.

Source: National Health Care for the Homeless Council, [www.nhchc.org/policy-advocacy/issue/permanent-supportive-housing](http://www.nhchc.org/policy-advocacy/issue/permanent-supportive-housing).

Supportive housing links decent, safe, affordable, community-based housing with flexible, voluntary support services designed to help the individual or family stay housed and live a more productive life in the community. It looks and functions much like any other brand of housing. People living in supportive housing have a private and secure place to make their home, just like other members of the community, with the same rights and responsibilities. The difference is that they can access, at their option, services designed to build independent living and tenancy skills, assistance with integrating into the community, and connections to community-based health care, treatment and employment services.

There is no time limitation, and tenants may live in their homes as long as they meet the basic obligations of tenancy. While participation in services is encouraged, it is not a condition of living in the housing. Housing affordability is ensured either through a rent subsidy or by setting rents at affordable levels.

Source: United States Interagency Council on Homelessness, [www.usich.gov/solutions/housing/supportive-housing](http://www.usich.gov/solutions/housing/supportive-housing).

**Program Related Investments (PRIs)** are loans made by foundations to support charitable activities that involve the potential return of capital within an established timeframe. PRIs include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits and even equity investments in charitable organizations or in commercial ventures for charitable purposes. Foundations make PRIs to further some aspect of their charitable mission (e.g., in the areas in which they make grants). PRIs are often made to organizations with an established relationship with the grantmaker.

Foundations commonly make PRIs as a supplement to their existing grant programs when the circumstances of the request suggest an alternative form of financing, when the borrower has the potential for generating income to repay a loan and as a last resort when an organization—in most cases a charitable nonprofit but occasionally a commercial venture—has been unable to secure financing from traditional sources. For the recipient, the primary benefit of PRIs is access to capital at lower rates than may otherwise be available. For the funder, the principal benefit is that the repayment or return of equity can be recycled for another charitable purpose. PRIs are valued as a means of leveraging philanthropic dollars.

Source: Foundation Center, [www.grantspace.org/tools/knowledge-base/Grantmakers/PRIs](http://www.grantspace.org/tools/knowledge-base/Grantmakers/PRIs).

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# A History of Investments

## SUPPORTIVE HOUSING IN LOS ANGELES

*"I know that without CSH there would not be the level of Permanent Supportive Housing development that we have today in Los Angeles. I know that for a fact."*

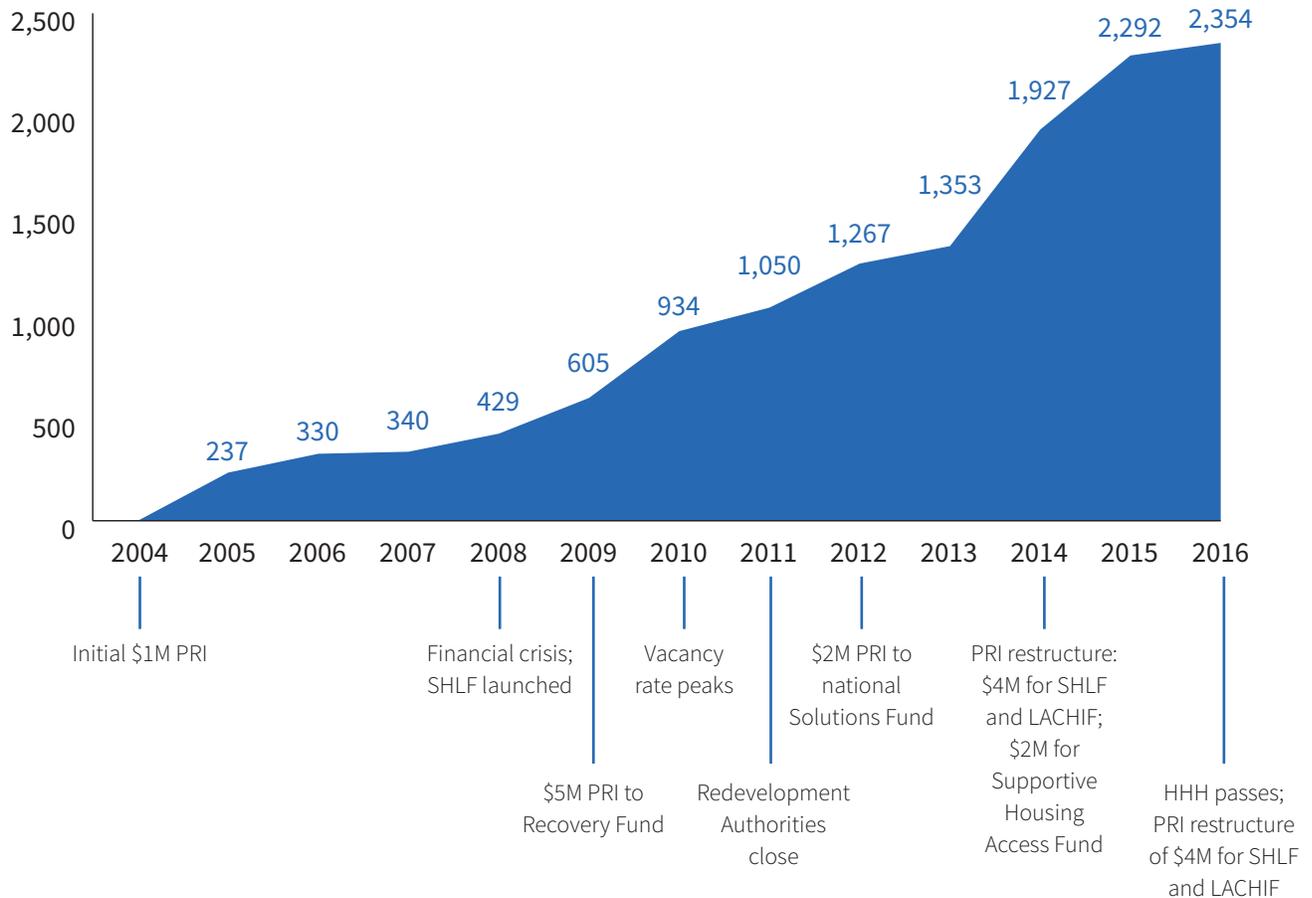
– Investor in CSH projects

### **HILTON FOUNDATION PRI FUNDING TO THE CORPORATION FOR SUPPORTIVE HOUSING**

Since 1991, CSH has been a leading national proponent of PSH—affordable homes paired with comprehensive support services—as a solution to homelessness. In 2004, after 10 years of grantmaking support for CSH efforts around the country, the Hilton Foundation seeded CSH's entry into the Los Angeles market with an \$8 million commitment that launched an ambitious local effort to end chronic homelessness. Seven million dollars of this commitment represented grant funding for CSH's own local capacity development, and for CSH to create grants in turn that increased the capacity of local organizations to provide PSH. The remaining \$1 million was a PRI loan.

Since this initial \$1 million, the Hilton Foundation's PRI loans to CSH have expanded to a total of \$6 million in Los Angeles, plus an additional \$2 million invested at the national level (some of which has been deployed in Los Angeles). In its capacity as a Community Development Financial Institution (CDFI) lender, CSH has deployed the Hilton Foundation PRI funds in a series of loan pools to help PSH developers acquire land and pay the initial costs involved in getting a project ready to close on long-term financing. These PRIs have been recycled and reprogrammed several times over the past 13 years to meet the needs of an evolving environment.

## PSH Units Initiated with Hilton Foundation-Supported Loans



Source: CSH data. Includes both completed PSH projects and those in the pipeline.

### INITIAL PRI

In 2004, the Hilton Foundation advanced an initial \$1 million in PRI funds to CSH—a five-year loan at 2 percent interest. CSH blended these funds with its existing loan products to offer acquisition/predevelopment loans to PSH developers in the Los Angeles market. Thanks in part to the favorable terms of the Hilton Foundation capital, CSH was able, in turn, to offer relatively favorable terms to its PSH developer borrowers, including the ability to advance loans in excess of property acquisition costs and to cover predevelopment expenses. Using its full range of training, grantmaking, technical assistance and lending tools, CSH and its developer partners began building a pipeline of PSH projects, with over 340 units underway in the first three years.

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## **LOS ANGELES SUPPORTIVE HOUSING LOAN FUND**

Engaging support from the public sector has been a critical part of the Hilton Foundation/CSH strategy from the beginning of the Chronic Homelessness Initiative. In fall 2007, the City of Los Angeles committed \$5 million to the Supportive Housing Loan Fund (SHLF), a PSH loan pool which CSH launched in 2008. The City's \$5 million investment, plus an additional \$500,000 from CSH, served as loss reserves for the loan pool and mitigated much of the risk for other participating lenders, including commercial banks. The Hilton Foundation's \$1 million PRI became part of this \$30 million pool as well—at this point, Hilton Foundation funds bore the same level of risk as funds from other lenders.

## **SUPPORTING HOUSING RECOVERY FUND**

As the national financial crisis unfolded over the course of 2008-2009, however, a need arose for much higher-risk loan funds. Financial markets froze; in particular, the market for Low-Income Housing Tax Credit equity—the main source of funds for affordable housing development projects—ground to a halt. Without access to permanent capital, many developers with planned PSH projects found themselves unable to move their projects forward. To further complicate the situation, some acquisition lenders began demanding partial repayment of their loans, as the real estate that was serving as collateral had begun to decline in value. Confronted simultaneously by repayment demands and frozen financial markets, developers found themselves in a liquidity crisis.

In response, the Hilton Foundation and CSH partnered to create a Supportive Housing Recovery Fund to shelter pipeline projects from failure, and developers from bankruptcy, by enabling them to refinance through CSH. The Hilton Foundation made a \$5 million PRI to launch this fund. This new PRI capital was truly at-risk—to the extent that the Recovery Fund suffered losses, under the terms of this new PRI, those losses could be credited against the PRI balance. In the end, the Recovery Fund succeeded in saving 480 units of PSH that were at risk of failure. There were no losses: While it took some years for all of the projects to emerge, all did eventually proceed to construction and completion, and the fund was repaid in full.

## **DEPLOYING FUNDS NATIONALLY**

The power of using high-risk capital to leverage other funds—called “top loss” because it looks to a top tier of higher-risk capital to insulate other lenders—became apparent both in the initial SHLF during which the City's funds absorbed risk, and in the Recovery Fund with the Hilton Foundation PRI serving that purpose. In 2012, the Hilton Foundation supported CSH efforts to replicate this structure at the national level. CSH launched its Supportive Housing Solutions Fund, initially with a total of \$46 million in capital that included \$2 million in PRI dollars from the Hilton Foundation and \$10 million additional PRI dollars from the Robert Wood Johnson Foundation. The goal was ultimately to attract funding from commercial lenders at a rate of \$3.00 of commercial debt for every risk-bearing dollar of CSH funds or Foundation PRI debt. The Solutions Fund, which can be deployed anywhere in the country, has grown since its launch and is currently CSH's primary lending vehicle. To date, the Solutions Fund has supported the development of six projects in Los Angeles, totaling 300 PSH units, as well as development of many more units across the country.

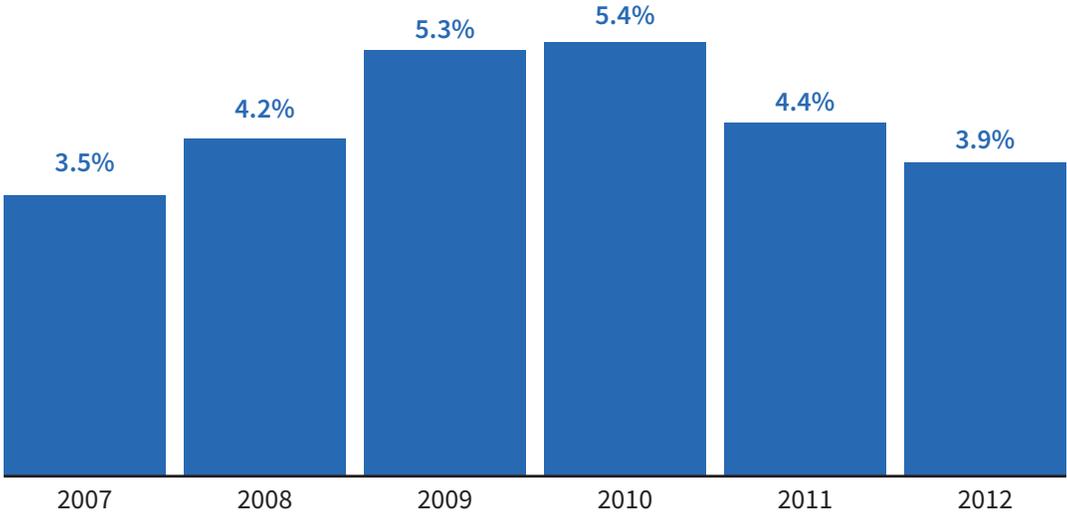
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### PRI RESTRUCTURING AND TERM EXTENSION IN LOS ANGELES

By 2014, the worst of the financial crisis had passed in Los Angeles. The Hilton Foundation partnered with CSH to restructure its two outstanding PRIs for work in Los Angeles—the initial \$1 million, plus the \$5 million invested in the Supportive Housing Recovery Fund—into two new PRIs. A larger loan of \$4 million was redeployed to continue providing acquisition/predevelopment financing for PSH through both the SHLF program in the City of Los Angeles, along with a similar County program, the Los Angeles County Housing Innovation Fund (LACHIF). This \$4 million PRI at 2 percent interest was repayable only to the extent that CSH received repayment on the underlying loans.

The remaining \$2 million was restructured at 0 percent interest; this new Supportive Housing Access Fund was designated for more experimental uses. Two such uses, both aimed at creating more PSH by placing homeless households in existing privately-owned properties, did not play out as anticipated. The first program offered low-interest capital to help private property owners make units available for PSH, a goal that ultimately proved elusive and resulted in the program being dropped. In retrospect, CSH staff believe that they missed the market: While occupancy had in fact dipped during the recession, the vacancy peak was actually in 2010. By the time the landlord loan product was launched in 2014, occupancy had already rebounded. The second program, which loaned funds to formerly homeless tenants for use as security deposits, was later converted from a loan program to a grant program when it was found to not be viable.

### Los Angeles Metro Area Vacancy Rates



The other two uses of the Supportive Housing Access Fund did prove successful and are still active tools today. The Stalled Projects Fund provides acquisition/predevelopment financing at a very low cost for projects that are likely to proceed in the long run, but have been delayed for various reasons. Additionally, Project Incentive Loans (PILs) provide \$50,000-\$100,000 in funding with which developers can explore the feasibility of out-of-the-box projects. To the extent that a project proves feasible, the original PIL can be rolled into a bigger acquisition/predevelopment loan and repaid from permanent proceeds.<sup>2</sup> To the extent that the answer is negative, the loan is forgiven. This product encourages developers to pursue a broader range of projects with the Hilton Foundation and CSH sharing the risk.

<sup>2</sup> If the PIL is refinanced with a larger CSH loan, then the 3 percent interest on the initial loan is forgiven.

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## **CURRENT RESTRUCTURE: PARTNERSHIP AND EXPANSION**

As of 2017, the Hilton Foundation and CSH are partnering to prepare for another significant change in the environment. In the most recent election cycle, Los Angeles City and County voters passed a pair of initiatives that will provide a sizable expansion in resources for creating and sustaining PSH, moving many more homeless individuals into permanent housing. The City's goal for ramping up PSH production over the next 10 years is moving from 300 PSH units to 1,000 PSH units developed annually. Further PSH expansion is planned elsewhere in the County as well.

In order to increase its production, the PSH developer community needs a new infusion of capital. The California Community Foundation, The Kresge Foundation and the Weingart Foundation have joined forces with the Hilton Foundation to meet this increased demand. Together, these foundations are providing \$20 million in top-loss funds for an expanded SHLF. This total includes the \$4 million Hilton Foundation loan that was last restructured in 2014 and which the 2017 renewal will extend for a further 10 years. Combined with the City's \$5 million SHLF commitment, this top-loss tier provides a powerful tool for leveraging additional funds. CSH intends to eventually raise \$80 million or more to seed PSH developments in Los Angeles.

### **The Value of Acquisition and Predevelopment Lending**

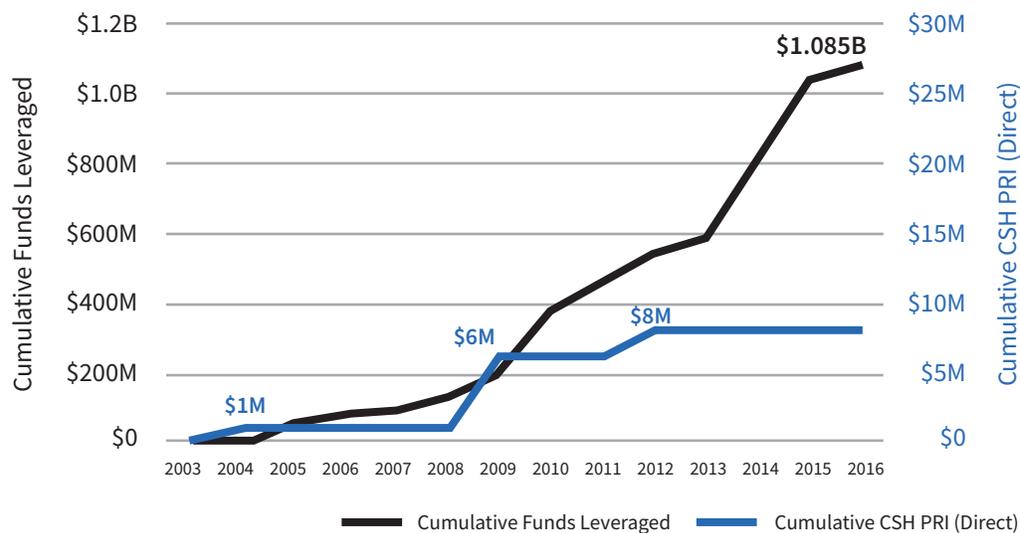
CSH uses the risk capital from Hilton Foundation PRIs to make loans to PSH developers that cover the costs of acquiring property and moving a project forward up until those developers are able to close on longer-term financing. These acquisition and predevelopment costs can be substantial—one developer named \$2 million as the cash outlay needed to reach the start of construction on a typical project. Few PSH developers, which are predominantly nonprofit organizations, have the liquidity to advance such sums from their own resources.

Further, the timing can be tricky. Developers take initial steps for site control, sometimes including purchase of the property, and must then run through a demanding development process during which they create the development program, plan for site design and construction, secure zoning and other public approvals, and raise permanent project financing. PSH developers must also ensure that resources are in place to provide support services for residents once the project is in operation. In addition, developers seeking to house homeless individuals usually need to secure rent subsidies for these extremely low-income tenants, in order to provide sufficient income to cover the projects' operating expenses. The entire process can take between one to three years before a developer can close on financing to start building—or even longer, in an environment of scarce public resources. As a CDFI lender, CSH provides loans that allow PSH developers to fund these acquisition and predevelopment costs for several years, until permanent financing is available.

## PRODUCTION AND IMPACT

Through these various iterations between 2004-2016, the Hilton Foundation PRI loans have supported the development of 2,354 units of PSH in 61 properties in Los Angeles, plus another 1,014 units of affordable housing. The \$6 million in PRI funds, plus a portion of the \$2 million committed to the national Solutions Fund, have been combined with other resources, repaid and redeployed to provide almost \$83 million in loan funding to help advance these projects. More than \$1 billion in permanent financing was ultimately raised to support these properties.<sup>3</sup>

### Cumulative Funds Leveraged vs. Cumulative CSH PRI (Direct)



Source: CSH data. Includes both completed and pipeline projects.<sup>4</sup> Note that the \$2 million provided in 2012 was part of a national fund deployed all over the U.S., including but not limited to Los Angeles. Only the funds leveraged within Los Angeles are represented in this visual.

Between 2011–2015, CSH loans supported by the Hilton Foundation provided financing for 43 percent of the new project-based PSH units completed in Los Angeles.<sup>5</sup> It is possible that these projects may have been built without these funds—there are at least four other CDFIs in the Los Angeles market that provide acquisition/predevelopment financing, not to mention commercial lenders that might take on this role under the right circumstances. However, many developers, public funders and other lenders have described the Foundation-supported CSH loan funds as a uniquely helpful alternative that is particularly responsive to the needs of PSH projects, with underwriting and technical aid that results in service-supported housing of uniformly high quality. Further, for the eight nonprofit developers, 12 projects and 480 units that were served by the Recovery Fund, it is not clear that there would have been another option to help them preserve liquidity at the height of the financial crisis. With the help of the Recovery Fund, these developers survived, thrived and are positioned to take an active role in the current expansion of PSH production within the City and County of Los Angeles.

<sup>3</sup> Source: CSH data. Includes both completed and pipeline projects.

<sup>4</sup> Data on leveraged funds was collected with greater precision beginning in 2011, when Abt Associates undertook a long-term evaluation of the Hilton Foundation's global efforts to end chronic homelessness in Los Angeles. Leveraging data from 2004-2011 is more approximate, though still informative.

<sup>5</sup> Source: Abt Associates, *Evaluation of the Conrad N. Hilton Foundation Chronic Homelessness Initiative: Phase I Final Report*, October 2016.

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# Elements of Success

## RISK AND INNOVATION, LONG-TERM COMMITMENTS, STRONG RELATIONSHIPS

A unique combination of shared risk and innovation, long-term financial investments coupled with long-term grantmaking commitments, and the support of CSH's relationship-building with key stakeholders in the City and County of Los Angeles are the hallmarks of the Hilton Foundation PRI strategy. Understanding how these elements worked in tandem to affect structural and sustainable change is critical to the replicability of this model, with useful learnings and insights uncovered through the experiences of the Hilton Foundation and CSH.

### Element #1: Risk and Innovation

As a private foundation, the Hilton Foundation is legally required to distribute 5 percent of its assets each year. The Foundation makes its PRI loans from these grant dollars, rather than from its investment capital. There is potential financial upside to deploying the grant funds as PRIs: The loans will pay interest over time, and the full principal may eventually be returned. Further, because they are loans, they remain on the Foundation's balance sheet as assets.

Throughout the 13 years of investment, the Hilton Foundation has assumed a level of risk with these funds that other lenders would not. The Foundation recognizes that should the PRIs fail as loans, they will effectively become part of the pool of distributed grant funds. In the best case—and, in fact, what has happened with all the CSH PRIs—the loans will pay interest, earn additional revenue for the Foundation and be recycled to continue to support the Foundation's charitable purposes. Additionally, the Foundation's willingness to accept risk has benefited CSH in several significant ways, including three primary dimensions.

### RISK CAPITAL ENABLES RESPONSIVENESS

The Hilton Foundation's risk capital has enabled CSH to offer loan products that are deeply responsive to the needs of PSH developers. CSH is not the only CDFI to offer acquisition/predevelopment loans to affordable housing developers in the City and County of Los Angeles. However, CSH is able to provide loan terms and processes that many stakeholders perceive as being particularly helpful for the unique needs of PSH developers.

Commercial lenders who fund real estate projects are constrained by the value of the real estate against which they are lending—loan-to-value ratios are typically 80 percent or less for conventional lenders. By contrast, CSH is able to provide loans of up to 130 percent loan-to-value, allowing developers to borrow funds for not only the full cost of acquiring a site, but also to cover predevelopment expenses such as architecture and engineering fees, legal costs, surveys and appraisals. While the 130 percent target is the highest published ratio for CDFIs providing acquisition loans in Los Angeles,<sup>6</sup> many of these lenders are willing to provide separate predevelopment loans—secured by a pledge of the developer fees that will be earned when a project reaches milestones such as construction start and stabilized occupancy of the completed project. Thus, it is possible that developers could secure the same (or even

<sup>6</sup> Based on a review of the published term sheets for four other CDFIs and loan pools.

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larger) total loan amounts from other sources, albeit in exchange for a greater pledge of assets. However, the fact that CSH wraps these two products into a single loan, with a single application and an easy renewal process, is very helpful to developers who are trying to move ahead quickly on projects.

Like other lenders, CSH charges interest for its loans—6 percent in most cases, a rate that is in the middle of the range for CDFI lenders in the market. However, unlike most other lenders, CSH capitalizes a reserve for interest from additional loan proceeds, outside of the 130 percent loan-to-value cap. This interest reserve is ultimately repaid from permanent project financing, relieving the pressure that developers would face if required to float the cash to pay for mortgage interest during the entire loan period. Said one developer, *“The fact that we’re not making monthly or quarterly interest payments has helped us increase our pipeline.”*

While some predevelopment lenders limit their terms to two years, CSH is willing to advance predevelopment funds for terms of up to three years, with extensions available. This practice recognizes the reality that, in an environment of scarce funding resources, it may take a protracted period for a developer to fully assemble all the resources needed for a closing. While most lenders only advance significant funds for development projects if their loans can be secured by real estate assets, CSH is willing to consider unsecured predevelopment loans for cases in which the borrower does not yet own the property—for example, if a potential PSH site is publicly owned or under option agreement. Of the 61 loans advanced to developers using Hilton Foundation funds, 26 have been unsecured.<sup>7</sup> As one developer said, *“Whenever I am looking for something to buy in L.A. County, I’m always functioning with the expectation that I’m going to go to CSH for my funding...to secure my property and...help me start the project...They certainly understand our product, therefore they understand the issues that we’re dealing with.”*

<sup>7</sup> Source: CSH data.

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## Risk and Responsiveness Amid the Financial Crisis

CSH's alignment with PSH developer needs became particularly apparent during the financial crisis in 2008-2009. Developers of affordable housing faced demands from many lenders, including both CDFIs and commercial lenders, to pay down acquisition loans that were secured by properties with appraised values that had dropped. This requirement forced developers—many of which were nonprofits with relatively modest access to capital—to come up with cash to partially pay down these acquisition loans, causing enormous financial strain. Said one developer, *“I had to write a check for \$103,000. I will never forget that.”*

In this atmosphere of crisis, CSH was perceived as being more responsive to supportive housing developer needs than other lenders. As one developer said, *“CSH was considered the best CDFI to work with because of their understanding of our work, the understanding about the mission orientation and the willingness to...work with us because we were at the mercy of an environment that we were not controlling, and they understood that.”* Through the Recovery Fund, CSH was able to restructure its predevelopment loans and extend their terms, allowing developers to preserve their liquidity and keep their projects and organizations going. Said one observer, *“CSH...especially when we went through that supportive housing loan acquisition crisis, they were the most closely aligned with the developers. The most supportive.”*

CDFIs are ultimately limited by their own sources of funds—to the extent that other CDFIs' capital sources were demanding loan-to-value realignment during the financial crisis, those CDFIs needed to pass those demands through to their borrowers. CSH proceeded on the faith that the PSH projects would ultimately proceed, given enough time. A CSH staff member described the situation:

*“We were sitting in the middle of it thinking, we don't think our projects are going to get foreclosed... CSH, the eternal optimist, that's for sure. But Hilton joined us in that optimism and said, ‘We'll give you some money and you can fund the carrying costs of the projects.’ Because basically what we're trying to prevent is borrowers going under, or the developers going bankrupt. ...The way to prevent that was giv[ing] them the cash to hobble through, until...the market picks up again, and so that's what we did.”*

Due to unavoidable regulatory control on banks and their balance sheets, many other lenders to CDFIs were focused on the traditional measure of risk in real estate lending: the ratio of the loan to the property's value. This loan-to-value measure makes sense only in the scenario of a loan default and foreclosure, during which a lender repossesses a property and sells it, hopefully for more than the value of the loan (thus the ratio limits). This foreclosure scenario rarely occurs with PSH developers; as one former CSH staff member said, *“These developers never let a deal go. It may take 10 years, instead of two years, but they never let a deal go. It eventually is going to happen. One way or another.”* CSH had confidence that the question was not of whether the projects would proceed, but when. That confidence was borne out—every project eventually proceeded and those developers were able to move on to other work.

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## RISK CAPITAL LEVERAGES NEW FUNDS

The Hilton Foundation risk capital has allowed CSH to raise other funds, and to do so efficiently. Building on its experiences with the Recovery Fund and SHLF, CSH has cultivated a financing strategy around leveraging high-risk capital—primarily from PRIs, but also from public sources—to attract a much broader pool of loan funds. The presence of this top-loss tier is tremendously attractive to other lenders because it enables them to manage their own risk. Such risk mitigation is particularly important in light of banking regulations, which place restrictions on bank balance sheets and the amount of risk they can carry, and which specify the measures of that risk. Said one lender:

*“[CSH has] all this risk-mitigating capital, the credit enhancement...that is provided by Hilton and other foundations...it protects the capital providers in the regulated world so that we can do stuff that we could never do without it. ...That’s why we can bring in the bucket loads of capital versus the cup loads of capital that [the foundations] do; but it is so strategic.”*

For CSH, the top loss PRI funds have enabled them to create loan funds from which all the money can be deployed, rather than saving some for reserves. CSH has also achieved efficiencies by streamlining its loan pool into the national Solutions Fund, the nature of which allows it to be locally branded and deployed anywhere in the country for greater efficiency and flexibility. Further, by creating an environment that is attractive to larger commercial lenders, CSH is able to secure its other funding in relatively large increments. This allows CSH to work with only a modest number of lenders and avoid the complexity that emerges as players proliferate. From the perspective of CSH, the risk capacity of the PRIs is critical to their usefulness. Said a CSH staff member, *“We definitely increasingly see PRIs that look like bank loans. There’s not much we would do with those.”*

## RISK CAPITAL FOSTERS INNOVATION

The willingness of the Hilton Foundation to accept risk in its PRI loans to CSH has fostered experimentation and innovation, which has been valuable even when the associated work has not succeeded, as was the case in the previously mentioned loan programs to establish PSH in privately-owned properties. The Foundation’s commitment to the larger goal has meant that CSH, and its PSH developer-borrowers in turn, can try out a range of new product development with mitigated risk and that CSH can respond to changing conditions in the larger economic arena.

### Element #2: Long-term Commitments

Many foundations make two- to four-year grants but no PRIs, or make short-term grant investments coupled with PRIs that have unwavering repayment arrangements. As the Hilton Foundation seeks to make its greatest impact, the addition of PRI loans to its strategy has allowed CSH to plan, act and respond to community needs as it sees fit and become an active player in the Los Angeles market. Innovative, quality projects have been developed—many of which could not have been accomplished through grant funds alone. Said a partner foundation:

*“PRIs come either directly with grants or grants are a part of the package because you need both. It’s not one or the other. What’s been so great about Hilton being this deeply involved and deeply involved on the national level is they’ve really been able to push the issue locally, and they’ve been able to bring in what they’ve learned from around the country too. It’s the depth and the long-term commitment that’s been really tremendous.”*

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## QUALITY PROJECTS

The Hilton Foundation's long-term commitment also gives CSH the resources to offer both capital and expertise to new developments, improving the quality of projects overall. CSH's participation as a lender ensures that a highly skilled and experienced underwriter is part of the discussion and can help influence development. In this process, CSH can help shape a project to fit the requirements of the public funders—on whom the project's success will ultimately depend—and to best meet the needs of the homeless residents who will live there. CSH has frequently fostered partnerships to ensure that projects benefit from experienced real estate developers, property managers who understand the particular demands of supportive housing and service providers with intimate knowledge of the target population. As a CSH staff member said of this process, *"We're hoping it will result in better outcomes for the tenants. Because ultimately, we're looking not just for the building which is important, but the proof is in what happens to residents once they move in, and are they succeeding and thriving?"*

## CONFIDENCE

Lenders and other foundations view the Hilton Foundation's long-term commitment as a positive factor when evaluating their own potential investments in CSH. Many comments demonstrate the different ways in which these investments have helped attract new stakeholders and resources:

*"I think it is memorable to have Hilton be a lead in identifying CSH as a vehicle to do this work. I just think that it's definitely added value and visibility to what CSH was doing. It sure got us to the table."*

– CSH Lender

*"I was impressed that they brought this PRI relationship to the table and they said, 'We have this relationship and we want to leverage senior capital around that relationship.' So I was comfortable proceeding because I knew... Hilton was really committed to doing something that was more innovative and not just the same old PRI or EQ2 kind of credit facility. So that was very comforting to me and certainly to our credit officers as well. ...It's like, you take this smaller pot of PRI capital and then you leverage a tremendous amount of senior debt on top of that and everyone's happy, it really is a sort of a win-win-win."*

– CSH Lender

## Element #3: Strong Relationships Between Stakeholders

The Hilton Foundation PRIs empowered CSH to grow its capacity and deepen the network of relationships within this existing community of funders, developers and service providers, letting them go much further than they could with only their existing balance sheets. Extending credit on generous terms for acquisition/predevelopment costs also opened the door to new PSH development opportunities—and to new relationships. Service providers entered into housing development, developers partnered with providers and lenders learned to ask for a more comprehensive approach, which became the norm. CSH's expertise became a resource to multiple stakeholders, and work began moving forward with greater confidence, speed and engagement than in the past.

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## **RELATIONSHIPS BUILT ON MISSION AND TRUST**

The written PRI loan agreements between the Hilton Foundation and CSH are very simple. They consist of an unsecured, interest-bearing loan with no collateral—one CSH staff member described the agreements as lending against the “*full faith and credit of the organization.*” PRIs do not have to be complex transactions: The simpler the structure, the more flexibility all parties will have to deploy funds in ways that make sense for all involved. CSH has remarked that the Hilton Foundation adopts a supportive rather than a directive role. As one observer shared, “*What I love about [the Hilton Foundation] is that they stay out of the ‘weeds’ that they don’t need to get into.*” The Hilton Foundation strives to invest in the CSH model and process, and then leaves CSH to build the necessary relationships, rather than putting the Foundation into an intermediary role among the stakeholders. As a result, CSH is transparent with the Hilton Foundation staff about its successes and challenges, and consults to brainstorm, conduct research and learn from past experiences and to leverage the Foundation for its leadership role in the City and County of Los Angeles. The result is that PRIs become tools in the larger process of expanding and sustaining PSH, while also enabling development of a multi-faceted, long-term relationship—not simply an investment relationship.

## **STAKEHOLDER LEARNING AND MODELING**

The Hilton Foundation has freely shared its PRI documents with other foundations, and the simplicity of these materials has also served as a model during CSH’s work with additional foundation partners. The flexible PRI model can prove challenging for others. For most foundations engaging in a PRI with a 10-year term, originations would stop around year seven to include a wrap-up period, allowing time for loans to be repaid to the CDFI. In this way, the full PRI capital could be repaid to the foundation by the end of 10 years. Under the Hilton Foundation’s flexible terms, CSH has felt comfortable originating loans for the full term of the PRI, knowing that it will only be able to repay the Foundation when its end users repay CSH. As a result, CSH has had the flexibility to develop a strong record of accomplishment that is attracting new investors to build their own relationships with CSH.

## **LONG-TERM RELATIONSHIPS WITH DEVELOPERS**

Developers see CSH as making a long-term investment in their capacity. The willingness of CSH to extend credit on multiple projects with each developer has helped those developers expand their project pipelines. Developers also greatly value the total package of training resources, grants and technical assistance that CSH provides in addition to its loans. In particular, developers appreciate that CSH makes its technical expertise generally available to partners, beyond the formal channels of training and rigorous loan underwriting. Said one developer, “*I think CSH is an incredible resource. ...I just readily pick up the phone when I have questions and call somebody over there.*”

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### **Case Study: PATH Ventures**

PATH (People Assisting The Homeless) has been providing supportive services to individuals experiencing homelessness in Los Angeles, and throughout California, since 1984. In 2004, this seasoned service provider committed to developing PSH as a key element of its strategy to facilitate the transition from homelessness to permanent housing for as many people as possible. PATH Ventures, the organization's real estate development arm, was incorporated as an independent nonprofit and began operations in 2007.

While PATH Ventures was able to recruit staff leadership with substantial development experience, its lack of a real estate development track record was an obstacle to receiving tax credits and other funding commitments from the state. As a result, PATH Ventures planned its first round of PSH projects in partnership with other developers.

PATH Ventures sees CSH's predevelopment financing as an important tool in the growth of its organizational capacity and independence. Said PATH Ventures Executive Director Amy Anderson, *"PATH Ventures as an organization is still maturing and establishing itself, so accessing lines of credit and other predevelopment financing is key to its success."*

With 675 completed PSH units under its belt and another 400 in the pipeline, PATH Ventures is now poised to continue developing projects on its own, without the support of a development partner. The organization sees this as a great improvement in terms of *"control, mission and developer fees."* PATH Ventures expects to close construction financing for its first independent project in November of 2017. Anderson reflected, *"It's a project on which CSH provided acquisition financing, so they're a significant part of that success."*

### **STRONG RELATIONSHIPS WITH THE PUBLIC SECTOR**

The acquisition/predevelopment loans made by CSH and facilitated by the Hilton Foundation PRIs are only bridge funding until permanent financing for PSH developments is committed and closed. Such permanent financing comes overwhelmingly from commitments of public resources awarded by city and state agencies, such as tax credits and other "soft loan" financing, plus rent subsidy and service dollar commitments. These public dollars have been the greatest constraining factor on PSH production—without funding commitments, projects cannot be built. Said one interviewee, *"I can have all the acquisition dollars I want, but it doesn't do me any good unless I've got the take-out financing."* The engagement of the public sector, including both elected officials and agency personnel charged with implementing policies, is critical in opening the door to PSH development.

CSH, with the Hilton Foundation's support, has cultivated very strong public sector relationships. Today, CSH plays a trusted role with the City of Los Angeles in underwriting projects and in developing quality standards. This engagement is becoming even more critical as the City prepares to expand PSH production with new resources from Measure HHH, an increase in City property taxes with funds used in part to move from production of 300 PSH units per year to 1,000 PSH units per year. The City has looked to CSH to develop guidelines that will ensure high-quality production—guidelines that the City intends to be *"prescriptive on who we can work with, what kind of qualifications, what kind of experience or what kind of partnering we would want to work with."* The City regards CSH as very closely aligned with its objectives in PSH development, capable of representing the City's goals. CSH staff are described by

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City staff as “active partners...in essence an extension of the City to a certain degree, and provid[ing] a level of technical expertise and technical assistance. ...We meet regularly with CSH and their team, and it’s a collective team, and we’re very appreciative of their support.”

A concrete representation of this trust is the City’s investment of \$5 million in the SHLF. The City is among other top-loss tier funders in the latest incarnation of this fund, alongside a group of foundations that includes the Hilton Foundation. Unlike the New Generation Fund (an acquisition/predevelopment loan fund aimed at affordable housing development more generally), the City does not have a representative on the SHLF committee. The City instead places confidence in CSH to deploy the funds in accordance with City policies and objectives.

The City’s SHLF money is at risk when deployed by CSH, but the principal risk in question involves the resources that the City itself will provide. The source of repayment for acquisition/predevelopment loans is the permanent financing for each development—financing that is awarded for projects within the City by the City itself. Thus, the City has demonstrated a high degree of confidence that CSH will choose to provide loans to projects that the City will ultimately want to fund. While developers do not consider CSH SHLF funding a guarantee of eventual public funding awards, developers do speak of confidence in the ties between CSH and the City, and of CSH staff’s ability to provide input that will make the ultimate award of public funds more likely.

### **MUTUALLY REINFORCING AND INSTITUTIONALIZING RELATIONSHIPS**

The Hilton Foundation, CSH and a number of other philanthropic and nonprofit partners have been deeply engaged in advocacy to expand financial resources for PSH creation. These parties all played a central role in the passage of the Measure HHH ballot initiative in the City of Los Angeles, as well as a sales tax increase in the County, which have both dramatically increased resources available for PSH. As described by a colleague in the foundation community, this work has shifted the stakeholders from “*amiable, pleasant colleagues to people who’ve run two campaigns together, and been in the trenches, and stayed up tweeting until 1:47 in the morning.*” This coming together to further a mission-driven effort around a large infusion of capital has resulted in more trusting relationships and cooperative processes. Even when there are challenges, one stakeholder remarked, “*I know we can trust each other to work these out and we can be clear about what’s happening. ...So, I’d say it’s a really different relationship. Not so much in what we’re doing, but I don’t hesitate to go to Hilton with, ‘Hey I’m seeing this. Are you seeing this? This is a problem, should we get involved? ...What do you think, are you part of the solution to this? Is there something we can do together?’ I think it’s just a much more active collaboration.*”

Such institutionalization of inter-organizational cooperation and relationships results from multiple forms of investment, and the PRI is only one of the tools that the Hilton Foundation uses to advance its goal of ending homelessness in Los Angeles. That said, it is clear that the combination of grants and PRIs has supported the development of collaborative relationships that run deeper than the individuals involved. PSH development in Los Angeles now benefits from a sustainable process and a broad stakeholder base that owns and drives the mission forward—in partnership with, but not led by, the Hilton Foundation.

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# The Synergy of Program Related Investments for Sustained Impact

## LESSONS LEARNED FOR FUTURE WORK

PRIs complement grantmaking by allowing mission-driven organizations to leverage capital that gives them a seat at the table, enabling them to build relationships, make commitments and innovate. The Hilton Foundation PRIs would not have produced the same impact without the accompanying grants that helped build CSH's technical expertise and networks. The Foundation's PRIs provided a multiplier effect to the grants also provided to CSH over the length of the partnership. Through technical assistance and operating support subgranted to local developers as well as its lending and underwriting activities, CSH developed an intimate knowledge of local needs and conditions, enabling the organization to take on a distinctive capacity-building and resource-leveraging role within the Los Angeles PSH community.

**Four key insights have emerged from this work** that can inform future supportive housing initiatives and other mission-driven endeavors.

- 1. Long-term investments produce sustained outcomes.** Ultimately, impact emerges over time as trust is established, capacity is broadened, expertise is developed and relationships are built and cemented through shared experiences. This process requires a long-term commitment of resources focused on addressing a well-understood and clearly identified social problem. The nature of the Hilton Foundation commitment to CSH enabled a transparent and honest partnership to develop between the two institutions.

Building on this long-term, committed engagement, CSH was able to grow the confidence of other key participants. The length of the commitment has strengthened relationships, expanded investment horizons and allowed for greater follow-through. Being “in the game” for the long haul, understanding that results may be years out and assuming a share of the risk have all contributed to the Hilton Foundation and CSH making greater impact—through both PRIs and grants.

- 2. Organizations learn and improve impact through shared risk and shared experience.** CSH has used the Hilton Foundation PRIs to engage and support new developers, tying loan access to its technical assistance and development coaching. Further, the PRI loan pools are structured in a way that enables CSH itself to take on some risk—giving CSH credibility with both developers and public funders, and strengthening its voice in larger system-wide discussions. Having “skin in the game” by engaging financially and taking on some risk gave CSH greater involvement and ownership than if the organization had simply entered Los Angeles as a technical assistance provider.
- 3. Flexible and patient capital fosters new product development and innovation.** The flexibility of the PRI resources brought greater responsiveness to emergent situations, such as the economic downturn of 2008-2009 or the apparent low vacancy rate of privately-owned apartments in the City of Los Angeles a few years later.

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Flexibility of use, along with patient capital and a willingness to reprogram funds over the long term, combined to foster out-of-the-box thinking and experimentation. While it is true that some of the CSH innovations were not fruitful, others proved tremendously valuable—most notably the unique structure of the Recovery Fund that eliminated the fear of failing by allowing a measure of informed risk. Such exploration facilitated the kind of problem-solving that contributes to systems change, essential to solving a seemingly intractable problem such as chronic homelessness.

- 4. PRIs bring resources to the table, supporting the institutionalization of relationships and practices within the community.** Grantmaking alone, without resources for investment, is often not sufficient to drive institutionalization of interorganizational relationships and practices beyond individual leadership. Grants help with technical assistance and capacity building, while PRIs for activities such as PSH development open the doors to new players, inviting new ideas and processes to the pursuit of shared social goals. Shared funding and shared risk, as exemplified by the SHLF, helps to institutionalize the relationships between all stakeholders engaged in the common effort. This leads to greater clarity about solutions for enduring problems and greater sustainability of the effort to solve these problems. In Los Angeles, the strong support of both City and County voters for critical ballot measures was in many ways the result of this expanding, deepening network of relationships between public, private and nonprofit stakeholders engaged in the pursuit of a common goal.

The experiences of the Hilton Foundation and CSH have resulted in a replicable model for how foundations, nonprofits, private lenders and public decision-makers across the country can become real partners to advance ambitious solutions to difficult social problems.

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