# When Bad Things Happen to Good Intentions

It was not supposed to happen like this.

Congress, responding to a deep recession, intended to stimulate the economy with federal spending, a healthy chunk of it dedicated to affordable housing. And Congress, recognizing that nonprofit developers have been a key partner in the creation of affordable housing, invited nonprofits to compete for the funds along with local governments and for-profit developers. The intention was a big win-win: low- to middle-income residents get decent affordable housing, homebuilding creates new jobs for workers, and nonprofits perform the work efficiently.

But sometimes good intentions end up paving roads to other places. The story of the Neighborhood Stabilization Program is a case in point.


The Neighborhood Stabilization Program (NSP I) was first approved by Congress in July 2008. The City of Baltimore received $5.8 million; of that $2.6 million was allocated to acquire, rehabilitate and resell foreclosed homes to low- to middle-income buyers. Low- to middle-income was defined as a family income at or below 120% of Area Median Income (AMI) — for a family of four in Baltimore, under $98,640. Putting foreclosed homes back on the market was seen as a way to prevent neighborhoods from deteriorating.

The City selected St. Ambrose Housing Aid Center and Habitat for Humanity of the Chesapeake to undertake the homeownership development work. St. Ambrose was awarded $1.1 million in subsidy grants, which were used to close the gap between what a house cost to rehab and the price the house could sell for in its neighborhood. (See "Do the Math" in our Summer 2010 issue.) St. Ambrose acquired 26 houses; eight have been sold and the others are in different stages of going to market.

The City's money worked as a revolving fund. As St. Ambrose generated "program income" by selling its houses, it repaid the City, which recycled the money to pay for more foreclosed homes. By recycling the money, says David Sann, Director of Housing Development for St. Ambrose, "it's likely that we can rehab 40 properties before the money is all spent."

### The Development Fee

What makes the NSP I program work well is the way the City structured its relationships with its nonprofit developers. The City specified that nonprofit developers were entitled to earn a "reasonable" development fee, defined in the agreement as 10 percent on acquisition costs and 15 percent on all other development costs. The development fees help nonprofits pay for the many services they provide that do not pay for themselves. It can also provide capital for future housing projects. The development fee for nonprofits is also standard practice in many federal affordable housing programs. For example, St. Ambrose has earned a 15 percent development fee for its work for the U.S. Department of Housing and Urban Development (HUD) to acquire, rehab and resell houses in an Asset Control Area.

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NSP I has been a good experience all around, says Sann. "We've had a very good working relationship with the City, and they've been very good development partners." Everyone wins: Homebuyers get quality affordable houses, the City stabilizes neighborhoods, and the nonprofit developer earns enough to keep its doors open.

That is how it ought to work.

### Then came NSP II

NSP II was a product of the American Recovery and Reinvestment Act (ARRA), the stimulus bill approved by Congress in 2009. Instead of allocating funds by a formula, grants were awarded on a competitive basis. Local governments were permitted to apply, and so were consortia of governments, nonprofits, and for-profit corporations. The City of Baltimore chose not to submit its own bid for the funds, but a consortium of nonprofits led by Healthy Neighborhoods took the lead and submitted an application. The Healthy Neighborhoods consortium won a grant, bringing $26 million in federal funds to the city. St. Ambrose was awarded more than $8 million, bidding to develop 186 properties with those funds. The assumption was that the new funding would be administered as NSP I had been.

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### Surprise! New Rules

Shortly after the award was announced, members of the consortium attended a three-day "NSP Boot Camp," where they learned how to administer the funds. It was hard work, but nothing out of the ordinary, until HUD's deputy housing commissioner dropped a bombshell: Nonprofit consortium members would be treated as "sub-recipients." Translation: nonprofits would be in the same category as cities and states — and therefore not permitted to earn a development fee.

"We were all shocked," Sann says. "Nonprofit developers have created a business model that is based on the ability of housing development to generate income to support the services we provide. It's a viable, mission-driven economic model that has been in place for a long time. If we had to produce the 186 housing units without generating any return, we'd go out of business."

Nonprofits thought there had been some mistake, or perhaps an exercise in poor judgment that could be corrected. They continued to question HUD. HUD stuck to its rule. It contended that the development fee is unjustified because with the grant guaranteeing their costs, nonprofits have no risk.

The nonprofits went a step farther. The Healthy Neighborhoods consortium asked Maryland's Congressional delegation to intercede and plead their case. Letters went out in June and July to Shaun Donovan, Secretary of HUD, from Senator Barbara Mikulski and Representatives Elijah Cummings, C.A. "Dutch" Ruppersberger and John Sarbanes. HUD responded with the same answers as before: the risk is reduced so the fee is unjustified. Moreover, in place of a development fee, nonprofits can cover their staffing and overhead costs by charging "indirect" costs according to formulas approved by the Office of Management and Budget.

This is true, as far as it goes, but it ignores an important reality. Companies that do business with the federal government have developed systems for dealing with indirect costs, at considerable expense. But because many nonprofits have not developed business models that apply indirect costs, they face a large, unanticipated expense in learning the federal contracting rules, changing their accounting systems and retraining staff. At best, Sann says, charging indirect costs will recover about half of the money that nonprofits would earn through development fees.

### What Happened?

How did this happen? Why did the rules change for nonprofits?

HUD was under tremendous pressure to allot the stimulus money as quickly as possible. Rather than taking time to develop new rules and regulations for dispensing the funds, HUD officials decided they would take an existing program as their model and adapt it to the stimulus program.

The model HUD chose was the Community Development Block Grant (CDBG) program. In most respects, that seems to be a reasonable model. In fact, it was the model for NSP I. But there was a difference: CDBG money is distributed only to local governments. That was fine for NSP I, when cities such as Baltimore received the money and then made contracts with nonprofits to implement. In NSP II, however, money could go to either local governments or coalitions of local governments and nonprofit and for-profit developers. HUD needed to make a rule on how these non-government players should be treated. HUD officials took the easy route: they treated all groups in the same way. Therefore, like local governments, nonprofits could not receive a development fee. Like local governments, they could cover overhead and staffing through indirect cost accounting.

Oh, but there is one exception. For-profit developers are not treated the same as government. For-profit developers can charge a development fee.

Nonprofits pointed out that, unlike cities and counties, they lack the ability to raise taxes or issue bonds. They noted that they still face risk if the houses they develop do not sell. They pointed out the unfairness of allowing for-profit developers to earn a development fee while they cannot. But HUD officials dug in their heels.

Amanda Shelton Roberts, Housing Director in the Public Policy Department of Enterprise Community Partners, estimates that 100 nonprofits nationwide, taking part in 35 consortia, are affected by the HUD decision. "Everyone has struggled with this problem," she says. "It has not gone away — it continues to be bandied about."

## St. Ambrose Reacts

Most nonprofits have decided to remain in their consortia. "Many are hiring consultants and technical assistance to adapt their systems to capturing indirect fees," Roberts adds.

Faced with the change of rules, St. Ambrose had to decide how to respond. "If we walked away from the consortium," Sann says, "Healthy Neighborhoods would probably lose the grant, and it would not help our relationships with the City of Baltimore. On the other hand, if we completed 186 houses, we would lose $1.2 million in development fees over three years, which would slow down our other activities."

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St. Ambrose's decision was to move forward on a reduced number of properties — in the range of 25 to 30 homes in the first year. This is partly an attempt to limit losses, but it also reflects changes in the real estate market. Sales prices for homes have fallen since the grant application was submitted in Spring 2009, and each property requires more subsidy dollars to close the gap between the cost of renovation and the selling price. Therefore, fewer homes can be developed with the same amount of money.

So the work continues. The money will be spent. Homebuyers will purchase rehabilitated, affordable homes. But it could have been different.

"The federal government is making it far more difficult than it needs to be or should be," Sann says, "and that will adversely affect the results. A lot of good people are working hard to make this program succeed. We moved forward in good faith, and we want to be good team players. But frankly, we won't have as great an impact as we could have because this opportunity was managed badly."

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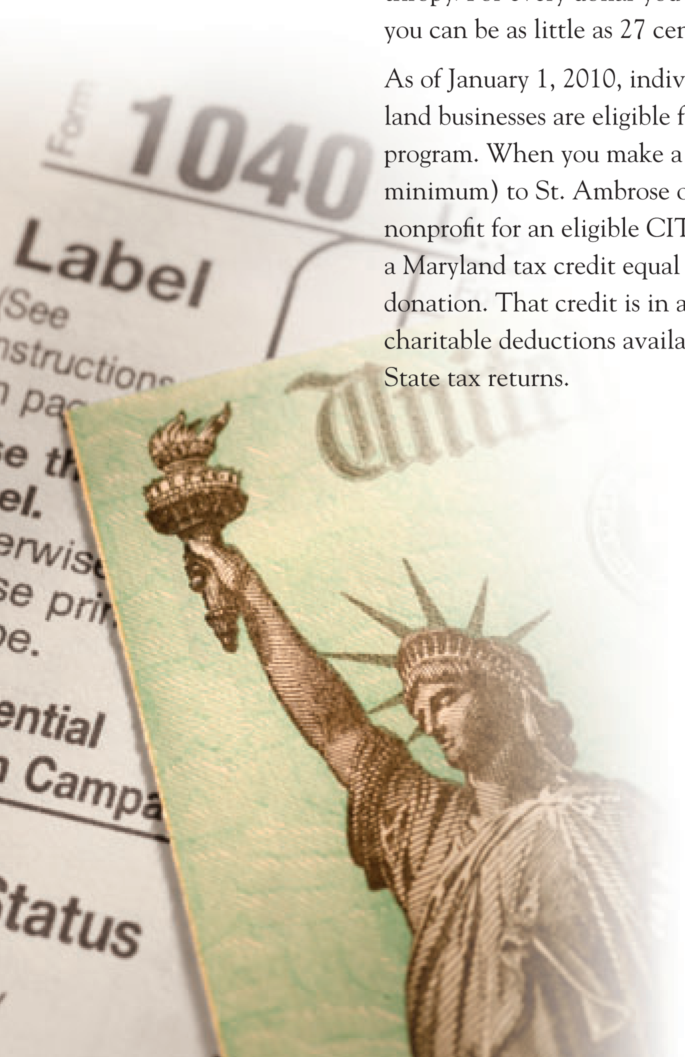
# This Contribution Has Huge Tax Advantages




Maryland's Community Investment Tax Credit (CITC) has to be one of the best buys in philanthropy. For every dollar you give, the net cost to you can be as little as 27 cents.

As of January 1, 2010, individuals as well as Maryland businesses are eligible for this innovative state program. When you make a contribution ($500 minimum) to St. Ambrose or another participating nonprofit for an eligible CITC project, you receive a Maryland tax credit equal to half the value of the donation. That credit is in addition to the regular charitable deductions available on Federal and State tax returns.

The state program is designed to encourage private contributions that help nonprofits achieve essential community goals. Two projects at St. Ambrose are eligible to receive CITC funds: Foreclosure Prevention Counseling and In My BackYard (IMBY), the rental services program that is purchasing vacant properties to create more affordable rental opportunities.

The CITC is a great opportunity for businesses and individuals to make targeted contributions, for a minimal cost. To learn more about the community investment tax credit program, go to the state website at http://www.neighborhoodrevitalization.org/Programs/CITC/CITC.aspx. For more information about the eligible St. Ambrose programs, contact Karen Griffin at 410-366-8550, extension 251, or kareng@stambros.org.

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