

The Barnes Fund Recommended Policy and Organizational Changes

Recommended Structure

Affordable Rental Home Track

The Affordable Rental Home Track should focus on the production of rental homes for households earning up to 60% AMI and to offer deeper incentives for PSH and deeply affordable units (homes for households earning 30% AMI or below). This focus is based on existing and projected supply gaps in Nashville, further explained in the housing needs assessment and demand projection. The Affordable Rental Home Track should also invest in critical preservation projects.

Recognizing the need to maximize impact, Metro should adjust eligibility requirements for the Affordable Rental Home Track to allow any affordable housing developer with requisite capabilities—both nonprofit and for-profit—to compete for Barnes funds. All project sponsors awarded funds should be required to propose and implement a plan for stewarding the affordability of the asset, which will encourage partnerships with nonprofits. Stewardship plans may include permanent affordability, tenant boards, or other forms of community-based control, as examples.

All projects should be fully underwritten to determine the amount and terms of funding awarded. Awards may be structured as grants, soft-pay and hard-pay debt. Metro should pursue the necessary changes to the Barnes authorizing legislation to allow for more efficient use of public funds. For-profit organizations will not be eligible for grants.

Homeownership Track

The Homeownership Track should focus on the development of for-sale homes and the provision of financial assistance to first generation homeowners and households earning less than 80% of AMI, as well as rehabilitation of existing owner-occupied homes. When homes are built in a neighborhood of opportunity, the priority should be households that are first-generation homeowners.

Only nonprofit organizations focused on expanding affordable homeownership and rebuilding historically disinvested communities within Nashville should directly receive funding. These organizations may choose to partner with for-profit organizations.

All projects should be fully underwritten to determine the amount and terms of funding awarded. Awards may be structured as grants, soft-pay and hard-pay debt as adjustments to the legislation authorizing the Barnes Fund allow.

Capacity Building Track

The Capacity Building Track should focus on building the capacity and expertise of nonprofit affordable housing developers and operators to produce affordable housing efficiently.

Eligible activities could include training to become more familiar with available and underutilized financing tools, such as bonds, as well as projects that enable recipients to exercise new capacity or learnings through demonstration projects that produce or preserve housing.

Barnes Fund Program Track

	Rental Homes Track	Homeownership Track	Capacity Building Track
Recommended percentage of allocation	60%	30%	10%
Objective or Focus	<p>Increase 50% AMI rental housing, with ability to support up to 80% AMI at discretion of commission with justification;</p> <p>Incent PSH/30% AMI</p> <p>Can support preservation of rental housing of up to 60% AMI if project sponsor has exhausted opportunities for federal funds;</p> <p>Can support production of homeownership units up to 100% AMI</p>	<p>Build high-quality for-sale homes in neighborhoods that have historically been disinvested in.</p> <p>Expand access to HO in communities of opportunity for first-generation homeowners.</p> <p>HO rehabilitation in coordination with MDHA's HO rehabilitation program</p> <p>Support production of homeownership units up to 100% AMI</p>	<p>Build capacity of nonprofit and mission-driven affordable housing developers and operators to effectively produce and preserve affordable housing</p> <p>Can include demonstration projects that produce new housing, training, and skill building</p>
Target or Eligible Recipients	<p>Affordable housing developer with demonstrated capability to deliver 50% AMI multifamily rental</p> <p>Could include mission-driven (e.g. nonprofit, quasigovernmental such as MDHA or redevelopment authorities) or for-profit, but not required (a change from current)</p>	<p>Nonprofit developers with experience creating quality for-sale homes and a commitment to investing in disinvested communities in Nashville.</p>	<p>Nonprofit developer or affordable housing operator/manager with annual budget up to \$4 million (same eligibility as current small business set-aside)</p>

	Rental Homes Track	Homeownership Track	Capacity Building Track
Award Structure	<p>Grants, Soft debt or cash flow loans as the default, hard pay as an option. No grants for for-profit member of the ownership entity.</p> <p>Reimbursable grant optional for entirely non-profit sponsors, if deemed beneficial in underwriting.</p>	<p>Grants, Soft debt or cash flow loans as the default, hard pay as an option. No grants for for-profit member of the ownership entity.</p> <p>Reimbursable grant optional for entirely non-profit sponsors, if deemed beneficial in underwriting.</p> <p>Awarded in coordination with MDHA homeowner rehabilitation program.</p>	<p>Reimbursable Grant</p>
Review Process	<p>Subject to underwriting and utilization/ROI targets</p>	<p>Subject to underwriting and utilization/ROI targets</p>	<p>Subject to underwriting and impact metrics related to organizational capacity building</p>
Terms	<p>Prioritize resource utilization and stewardship of asset – mission-driven organizations will have advantage (e.g. permanent affordability, tenant board, community-based control)</p> <p>30 years affordability – standard, preference for longer-term affordability</p> <p>ROFR requirement</p> <p>Tenant protections</p> <p>Progress reports and clawback provisions trigger at six months</p>	<p>Prioritize first generation homeowners and disinvested communities</p> <p>Terms based on underwriting and project priorities</p> <p>Progress reports and clawback provisions trigger at six months</p>	<p>30 years affordability</p> <p>ROFR requirement</p> <p>Tenant protections</p> <p>Progress reports and clawback provisions trigger at six months</p>

Recommended Policies

Strengthen the Public Benefit Terms Required by the Barnes Fund

The terms in Barnes Fund agreements with sponsors should be strengthened in several areas to increase the impact of the public investment and better protect residents from displacement.

Introducing a Right of First Refusal

Current Barnes agreement templates require consent from Metro to reassign the contract. The Barnes Fund should take a broader approach by requiring grantees to notify the Housing Division in advance of intended sale of the property and establishing a process by which Barnes recipients (and other recipients of Metro financial

support) may sell their properties, retaining the right to find a buyer who will keep the property affordable. Also ensure that notices are sent to the Housing Division (at least some agreements instruct recipients to notify Metro Department of Finance).

As Housing builds out a pre-approved pool of mission-driven affordable housing developers/managers, it should require properties it has invested in to be first offered to this pool. See Action 34: “Support a preservation pool that includes ability to acquire expiring affordable stock.

Institute Tenant Protections

Housing should work with the Housing Trust Fund Commission to add to the agreement templates conditions that improve outcomes for existing tenants for properties that are approved to proceed to market sale. This could include adding requirements for tenant relocation, assistance, and minimum time periods for notice, perhaps in the form of requiring a Tenant Relocation Plan in all circumstances. These protections could help to prevent the displacement of residents.

Strengthening Affordability Requirements

Housing should work with the Housing Trust Fund Commission to (1) require 30+ years of affordability whenever possible; (2) address income requirement by unit size (the number of bedrooms required at different affordability levels); and (3) include guidance about how to address changes in tenants’ income that does not conflict with LIHTC guidance.

Requiring Progress Among Grantee/Strengthening Clawbacks

Barnes grant agreements currently require a clawback provision if the recipient does not complete its obligations within 24 months of grant execution.³ In reality, this means that clawing back funds would likely not occur until 2.5-3 years from execution, given the need to issue warnings and document noncompliance, recognize the accounting change and recommit funds. In practice, many projects encounter delays, while their awards sit in the bank not advancing affordable housing development. For example, across funding rounds 6 through 10, 38 extensions have been approved, with some projects requiring multiple extensions. Lack of project progress has resulted in significant sums of non-deployed awards sitting in the bank accruing approximately \$2 million annually in interest.⁴ While some delays are outside the control of project sponsors, it is probable that a fair number could be remedied by more aggressive action. Housing should work with the Housing Trust Fund Commission to implement progress milestones beginning 6 months from award that are documented in written reports. A grantee falling behind on these milestones should preclude them from receiving an additional Barnes award, until such delays are resolved.

Prioritizing Special Populations

The “Key Findings” sections describe how the housing affordability challenges in Nashville have a greater impact on certain populations, including older adults, single-parent households, and individuals with disabilities. The Barnes Fund should prioritize special populations in their funding. Senior and single-parent households are among those struggling the most with rental affordability. Prioritizing these households and projects that incorporate design standards that support aging in place as well as those with disabilities should be explored. Shifting design standards can have cost implications and those should be balanced against the need to provide homes that meet the needs of the most vulnerable.

Structuring Affordable Housing Fund Awards as Debt, Rather than Grants

Housing should work with Metro’s Law Department, Metro Council and the Housing Trust Fund Commission to allow awards from Barnes to be made as loans as well as grants, either through adjusting the authorizing legislation or entering into a partnership with MDHA, the Catalyst Fund or another nonprofit partner capable of originating loans on the Barnes Fund’s behalf. The ability to originate loans as well as make grants will allow the Barnes Fund to calibrate the terms under which public funds are invested to maximize the public benefit.

In most cases, the soft debt, or cashflow debt, will be the most appropriate form for a loan. Soft debt, or cashflow debt, is public or philanthropic financing that is not 'hard' pay in that interest and principal payments can be deferred if the project cannot afford to pay them, i.e., does not have enough cashflow. There is also often an expectation that the loan will be rolled over at the end of the term in exchange for continued affordability. It covers the 'gap' between the first mortgage, LIHTC or other grant funding, and the total cost of development. It is typically seen as the last money in and the key to unlocking or making a deal go.

There are two main reasons why structuring awards as soft debt would be advantageous for the Barnes Fund. The first is to better position Metro to keep its Barnes-subsidized properties affordable in future decades, beyond the 30 years stipulated in the program. Barnes Fund investments would accrue interest over time and give the Metro greater leverage to protect the affordability of the property in the long term, by agreeing to resubordinate (not require repayment) in exchange for continued affordability or be repaid and reinvest the funds to create other affordable homes. Most local governments use a cashflow or soft debt structure for their investments in affordable rental homes, not to recoup revenue, but to advance affordability goals. This ability to preserve affordability through a loan is a key anti-displacement tool.

Introduce a Dedicated Underwriting Process

Barnes Fund applications for the Affordable Rental Home and Homeownership Tracks should be required to be underwritten by Housing Division. (See Action 11: "Establish underwriting capacity, requirements, and criteria to maximize public investments in housing")

To maximize the public benefits secured by public investment, each project will be underwritten. While scoring each application on a uniform scoring matrix, as the Barnes Fund currently does is a good process, an individualized underwriting review of each project is imperative to ensure that Barnes supports deals that address identified priorities and objectives and actually need public funding, and particularly the type of public funding the project is seeking, or whether it should be able to secure financing from other sources. Additionally, underwriting aims to size the appropriate amount and type of subsidy, identify and mitigate risks to project delivery (i.e., the success of the investment). **Project underwriting is critical to ensuring that Metro achieves the greatest public good with each public dollar invested in affordable homes.**

Underwriting should consider the following factors:

- **Sizing the gap:** How much additional funding a project needs to proceed, independent of what the applicant's request is.
- **Structuring the investment:** What form of investment, grant, soft-debt or hard-debt is most appropriate.
- **Role of public investment:** if Barnes funding is needed to catalyze the development as the first funding source committed, or filling a gap that remains after other sources have been exhausted, and how that should influence the form and amount of funding invested.
- **Validating ownership structure:** The underwriting team should have the financial sophistication to verify that a nonprofit does control at least 51% of a project's ownership entity. In recent years, approximately 20% of awards went to nonprofit/for-profit joint ventures.

- **Evaluation of return on investment:** In assessing applications for public subsidy, underwriting staff should take into account the expected return on investment (ROI). Target ROI performance metrics may include:
 - ◊ Cost efficiency, such as cost per unit created;
 - ◊ Depth of affordability, prioritizing the creation of affordable homes that otherwise wouldn't be produced in the private market;
 - ◊ Amount of local public subsidy;
 - ◊ Leverage of non-local public funding;
 - ◊ Depth of affordability and alignment with income priorities;
 - ◊ Alignment with policy goals including location, special needs population, etc.
 - ◊ But-for test: but for the investment from the Barnes Fund, would this project achieve a similar public benefit?

Program guidelines for each of these areas should be incorporated into the solicitation process such that developers can evaluate the amount and structure of funding they are likely to secure if they are successful.

Coordinate Barnes Funding with Metro's Housing Priorities and Tools

As the body that oversees the largest allocation of Metro's local funding for affordable homes, the Barnes Housing Trust Fund Commission should be well prepared to maximize its impact on affordable housing priorities through its role in guiding Barnes. Metro should work with the Commission to:

- Ensure commissioners have a sound understanding of fundamental affordable housing concepts, the basics of affordable housing finance, Nashville's housing market and the development process through trainings, briefings and experience.
- Audit current conflicts of interest and ethics policies pertaining to the Commission to ensure adequacy and full understanding among Commission members.

The Barnes Fund website lists five diverse approaches to addressing a broad mission, and the enabling code includes additional purposes. These include functions as broad as building capacity of new or smaller nonprofit developers, to funding new rental and homeownership units up to 80% AMI, to activating and sustaining a public land portfolio, to promoting the study of good affordable housing, to supporting education about affordable housing.⁵ The range of priorities was also reflected in a recent meeting and listening session in which Commission members shared a wide-ranging set of responses to questions about how they set priorities and define success. As the primary funder of the Barnes Fund, Metro should define the priorities for the funding it allocates to the Barnes Fund. Housing should work with Metro to establish guidance for which tracks, Rental Homes, Homeownership, and Capacity Building, Metro funds should be allocated to, in which amount and what priorities should be reflected in the scoring criteria for each track.

The Housing Division may need to work with the Metro Legal and other stakeholders to identify necessary changes to the code to effectuate this new approach.