San Diego Capital Collaborative
Double Bottom-Line Private Equity Fund

- ✓ Double bottom-line private equity fund
- ✓ Creative public-private collaborations
- ✓ For profit-nonprofit partnerships
- ✓ Tax increment financing
- ✓ Infill development

San Diego has found establishing a double bottom-line private equity fund to be a complex process, but as a financial tool that can make millions of dollars in capital available for affordable and workforce housing, one worth taking the time to understand.

The San Diego Capital Collaborative is a non-profit organization chartered by the San Diego City-County Reinvestment Task Force, which secured $200,000 from banks to study how an equity fund for affordable housing in the county could be created. The primary purpose of the Collaborative is to initiate and administer private equity funds.

"The idea behind creating the San Diego Capital Collaborative was to facilitate private investment of capital in low- and moderate-income communities," said Barry Schultz, chief executive officer of the Collaborative. Although the Collaborative's primary focus is more on community revitalization than creating housing, the organization's efforts will result in hundreds of new units of workforce housing.

The Collaborative raised $90 million in 2005 for its first private equity fund, the San Diego Smart Growth Fund. Investors included the California Public Employees Retirement System (CalPERS), Washington Mutual, and Northwestern Mutual Life Insurance. The San Diego Smart Growth Fund is the first of a "family of funds" that the Collaborative intends to launch.

In general, a private equity fund raises capital from investors, invests the capital in profit-making ventures, and earns a return on its investment. Funds are established for a period of time, often seven years. The capital raised is invested within the first two to three years of the life of the fund, and money is returned to investors by the end of the seventh year.

The San Diego Smart Growth Fund is different from other private equity funds in only one respect, according to Schultz, and that is its mission of social responsibility. To achieve this mission, the fund targets its investments to underserved communities.

Although the Fund is intended to earn market rates of return, "All investment is evaluated based on social criteria," said Schultz. These criteria include creating workforce housing (housing affordable to households earning from 80 to 150 percent of the area median income), increasing homeownership in the targeted communities, creating jobs, and creating opportunities for entrepreneurship.

> ***"All investment is evaluated based on social criteria."***
>
> -Barry Schultz

The Fund, which is managed by Phoenix Realty Group, LLC, invests in projects primarily by private-sector, for-profit developers. Schultz says developers can get financing to fund 75 percent of the cost of the project, but need equity to cover the remaining 25 percent. The Fund's investment in the project provides most of the equity requirement (about 90 percent); the developer's own capital provides the rest.

Schultz stresses that the Fund's investments don't come with onerous restrictions. All aspects of the social goals of the project are voluntary. "We work with the developer to identify some goals – we do a project enhancement plan – and develop a strategy to meet the goals and then we bring the resources to the table to meet the goals," he said.

For example, in a project with inclusionary housing requirements, the Collaborative encourages the developer to build the affordable units on site rather than paying an in-lieu contribution, and works with the developer to make that financially feasible.

The San Diego Smart Growth Fund fills a void in low- and moderate-income communities, where Schultz says traditional forms of capital are often not available. "There are perceptions that these communities are not a good investment," said Schultz. The communities lack a track record, or comparable forms of new development that can be used by a traditional lender to appraise the project. "From an investor standpoint, they perceive them to be high risk," he said.

"Truthfully, there are challenges that exist in these communities," said Schultz. The Collaborative tries to address these challenges by working with stakeholders to improve the environment. For example, the Collaborative may help develop a community revitalization strategy that will create amenities buyers of workforce housing want, such as access to shopping and employment.

Because the Fund's investments are in distressed communities, projects blend the Fund's market-rate capital with some public funds, typically tax increment financing revenues, to achieve the social goals of the project. Schultz said the Collaborative is also working to find ways to use federal Community Development Block Grant (CDBG) funding in the projects. In addition, the Collaborative is working to raise below-market rate funds from foundations.

The Collaborative focuses on workforce housing because it sees a void in this segment of the market. "From our standpoint, if [a community] needs affordable housing, they have LIHTC. The market takes care of the higher end, what's missing is the middle."

To date, the Fund has invested $30 million of its $90 million in capital. The first project is a 75-unit condominium near San Diego State University. Condos will range from one to three bedrooms and for an average price of $400,000. The development, which replaces a vacant, dilapidated hotel, will also include 3,000 square feet of retail space.

The Fund recently invested in a similar mixed-use project that will include townhomes. Schultz is working to encourage employers to participate in the project using an employer-assisted housing strategy. "We're talking with educational and medical institutions about buying some of these units," he said. He noted that large local employers are having difficulty attracting and retaining professionals because of the high cost of the area's housing.

The third project is an office condo development in Chula Vista, which Shultz said he hopes will help small businesses to develop, creating wealth in the community. "There's been a lot of residential, not commercial, development in that area," he said, "so we're bringing jobs to where people are." The commercial development also helps to balance the Smart Growth Fund's investments in residential projects.

Schultz advises other communities considering launching a private equity fund: "You have to be very clear on the ultimate goal." He said a focus on investment to promote community revitalization is more complicated than funds with an ultimate goal of simply creating workforce housing units. "Ours is a more complicated process," he said. "You have to establish relationships with stakeholders and you have to get buy-in."

According to Schultz, the right market conditions are important for a community revitalization strategy to work. "The reason it will be successful here is there is a convergence of trends," Schultz said. He noted that San Diego is largely built out, and developers realize they have to do urban projects rather than the greenfield development they are more accustomed to.

"We have people around the table looking for solutions as opposed to being dragged in," he said. "It's a whole different game," Schultz said. "We bring the money and the expertise."

Schultz stresses that the process is complicated and requires careful relationship building. "It's taken the cooperation of everyone – that's why we're the Collaborative," he said.

Contact Information:

Barry Schultz
San Diego Capital Collaborative
2150 W. Washington Street, Suite 402
San Diego, CA 92110
619-299-0422
schultz@capitalcollaborative.com

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National Association of Home Builders
1201 15th Street NW
Washington, DC 20005

Prepared by
Kimberly Burnett
Jill Khadduri
Justin Lindenmayer
Abt Associates Inc.
55 Wheeler Street
Cambridge, MA 02138

Abt

NAHB