

## HACBED's Purpose

*Community Voice, Collective Action*

- HACBED is a statewide intermediary, federally tax-exempt, nonprofit organization established in 1992 that strives to achieve economic, social, and environmental justice in Hawai'i through community-based economic development.
- It seeks to help strengthen the voice and actions of Hawai'i's families and communities so that they have the choice and control they need to become self-sufficient and resilient.
- It works through empowering education and capacity building for communities, and asset policy development and advocacy for positive systemic change.

## **Community Economic Development**

- is a process by which communities can initiate and generate their own solutions to their common economic problems and, thereby, build long-term community capacity and foster the integration of economic, social, and environmental objectives.
- is development designed for and by community residents with the aim of reaching and benefiting all of the community, including low income residents who are not significantly assisted by other strategies. It brings together vision for a community with the requirements of feasibility.

## **Key Questions – Who Benefits & How Will They Benefit**

- leverage economic activity to produce resident benefits
- target low-income/low wealth community residents as beneficiaries
- enable residents to be owners of economic development activities
- build the financial assets of residents
- give residents a voice in decision making

## Economic Renewal – Guiding Principles

- **Plug The Leaks** – Plugging unnecessary economic leaks puts money back into the local economy.
- **Support Existing Businesses** – Too many communities work to recruit outside businesses while overlooking the wealth-creating power of their own entrepreneurs.
- **Encourage New Local Enterprise** – As with existing businesses, new businesses will contribute far more to the local economy if they're locally owned.
- **Recruit Compatible New Businesses** – Having first pursued the previous three steps, a community will be in a stronger position to recruit new businesses that are compatible with its values and needs.

## Types of CED Projects

- **Real Estate Development** – i.e., commercial space such as multi-family housing, shopping centers and commercial marketplaces, and office or industrial space.
- **Business & Industry Recruitment** – i.e., locating commercial businesses and industrial firms to create jobs and business opportunities.
- **Workforce Development** – i.e., job readiness, economic and financial literacy, job skill development training, and programs and services to overcome barriers such as day care, transportation, and so on.
- **Business Development** – i.e., community-owned businesses or assisting small business development with technical assistance, access to capital, co-ownership structures.
- **Development Facilitation** – i.e., advocacy to eliminate barriers or create enhanced opportunities for job and business development.
- **Capital Formation** – i.e., strategies and programs to aggregate capital and disseminate debt or equity capital.
- **Economic & Financial Literacy** – i.e., economic and financial skill development.



## Culinary Business Incubator



The mission of the incubator is to create employment by helping residents of Hawai'i access services, start small business by providing sustainable employment opportunities in food-related service, and elevate client income levels. In addition, training and technical assistance programs are provided in commercial food prep, entrepreneurship, and computer training.



- Commercialize your recipe or product
- Use commercial kitchen equipment
- Comply with safety and sanitation requirements
- Write a business plan
- Fill out loan apps
- Management and marketing for your business
- Use of computers to operate your small business



Business Manager Joy Barua getting tips from the pros.



**Pacific Gateway Center**



## Project Overview

### Project Location

- 10-acre site at the corner of Market Street & Euclid Avenue
- Easily accessible to Highways 805, 94 & 15
- 5 minutes from downtown
- Next to Trolley & Bus Transfer Station
- State Enterprise Zone, Federal Enterprise Community

### Financial Overview

- Total project cost \$23.5 million
- Total Jacobs Center investment to-date \$28 million
- Land doubled in appraised value in the first two years

### Project Innovations

- Development of an innovative network of community teams coming together to build a community vision
- Broad community involvement in design and development of a commercial project
- Creation of innovative program-related investment tools for social-purpose investors
- Design of an owner-builder, mentor-protege construction program which is comprehensive in scope and is providing a vehicle for more than half the project to be built by the neighborhood

### Economic Impact

- More than 1,700 new jobs in the neighborhood
- 360 construction jobs with training for emerging contractors, supported by contractor working lines of credit
- Nine working teams, involving thousands of residents and businesses, build skills in every aspect of project
- Community ownership strategy; hundreds of committed community residents investing their own capital in the project, building wealth by rebuilding their neighborhood

### Social and Cultural Impact

- Chollas Creek restored (part of City's plan), natural vegetation, walking paths
- 500-seat outdoor amphitheater
- Unique architectural character created by multicultural team
- Multi-cultural values expressed in MCP through community art estimated at \$ 1.4 million
- Safe place for intergenerational and multi-ethnic interactions

## **What Makes This Different?**

What sets Market Creek Plaza apart from other developments is its network of teams, which bring out the natural creativity, problem-solving, and risk-taking of residents in their neighborhoods.

### **Building Block #1 – Unity & Understanding**

#### **Market Creek Plaza is Community-Planned**

By working and learning together in multi-cultural teams, we learn about each other's cultures and embrace each other's differences, allowing us to deepen our understanding and accomplish specific tasks. This has led to the creation of a network of people who know how to work and learn together.

### **Building Block #2 – Neighborhood Identity**

#### **Market Creek Plaza is Community-Designed**

The Art and Design Team brought together community artists, residents, and architects to search for an architectural character and style that truly reflects the multi-cultural richness of the neighborhoods. This focus on the history of the area and the diverse cultural roots of residents began to create a picture of who we are today. The result was the creation of a dynamic sense of place with community art throughout the project. Expanding on the work of the Art and Design Team, the Business Development and Leasing Team further developed the theme by creating a plan to bring multi-cultural entertainment and great ethnic cuisine to the Plaza.

### **Building Block #3 – Skills & Experience**

#### **Market Creek Plaza is Community-Built**

Every aspect of Market Creek Plaza is about building skills and experience. Training-to-the-task or building capacity by accomplishing specific work has become a key part of its signature. By keeping the work and jobs in the neighborhood, Market Creek Plaza has provided unique opportunities for removing barriers and open up opportunity. With a goal of being community built, the Construction Collaboration, Latino Builders, MultiCultural Contractors Group, FOCUS Project, and Winning Opportunities for Responsible Contractors (WORC) designed a mentor-protege program that committed to get at least 65% of the construction into the neighborhood (in contrast to the City of San Diego's low rate of only 2% minorities and women on the job.) Until now, there have been no black prime contractors. Through working lines of credit, wrap-around insurance, and business skills training, not only has San Diego's first black prime contractor emerged, but Market Creek Plaza surpassed the 65% participation goal.

### **Building Block #4 – Individual & Community Assets**

#### **Market Creek Plaza will be Community-Owned**

JCNI undertook the challenge of working with the community to develop an ownership strategy for residents and stakeholders. Creating ways to build profits that can be re-invested in the neighborhoods is the backbone of the unique wealth creation strategy that emerged from the Ownership Design Team. The team's work was modeled on the Native American tribes' theory of thirds: a third for personal benefit, a third for community benefit, and a third for on-going development.

What has been launched is a self-generating system of wealth creation in the neighborhood. Profits from the Plaza will go back into the neighborhood through a neighborhood-controlled community foundation. This will provide ongoing access to resources generated from within the community for future projects or services. In addition, a portion of Market Creek Plaza's profits will provide resources for ongoing commercial development within the neighborhood.

### **Building Block #5 – Redevelopment By Community Developers**

#### **Market Creek Plaza is Neighborhood Redevelopment**

What is so unique about Market Creek Plaza is that it ties asset-building and skill-building to a project that rebuilds a neighborhood. It has removed blight, brought a vibrant asset to the neighborhood, stimulated the redevelopment agency and the City to commit greater focus to work in this area, and provided residents a strong voice in holding the public agencies accountable to the community's vibrant vision. The Food 4 Less Grocery Store at Market Creek Plaza has become one of the busiest stores in the area. As other businesses at the Plaza open, their success ripples through the community in jobs, entrepreneurial opportunities, and increase in the tax base - all of which capture wealth in the community. This economic flow into the area transforms the community across the board, street by street, block by block, and neighborhood by neighborhood.

## Asset Building

Assets are essential to:

- have financial security against difficult times – *the dignity of choice and control*;
- create economic opportunities for oneself and family – *realize human potential through education and entrepreneurship*; and
- leave a legacy for future generations to have a better life – *realistically reduce the cycle of poverty*.

*"Assets matter. Assets mean economic security. Assets mean mobility. Assets mean opportunity."* CFED, 2002

*Development of families and communities occurs through asset accumulation and investment."* Michael Sherraden, *Assets & The Poor*, 2001

## WHY ASSET BUILDING?

Assets make the difference between getting by and getting ahead.

- Nearly one in five American households owe more than they own.
- Predatory lending drains billions of dollars from middle and low-income families and communities.
- High drop out rates and the rising cost of tuition make college unattainable for many students.
- Low-income people are less likely to own assets than are people with higher incomes.
- Tax policies generally favor those who already have the most assets.

## Research on Asset Building

Research findings on asset building programs find individuals with assets:

- save more,
- invest in their community,
- aspire towards educational goals, and
- strive towards personal advancement.

## Ancient Wisdom – Modern Context

- Wealth (Old English) – the conditions of well being.
- Economy (from the Greek, *oikonomia*) – management of a household.
- Competition – from the Latin *competere*, to strive together.

*Too much and too long, we seemed to have surrendered personal excellence and community values in the mere accumulation of material things . . . our GNP does not allow for the health of our children, the quality of their education, or the joy of their play . . . It measures . . . neither our wisdom nor our learning, neither our compassion nor our devotion to our country, it measures everything in short, except that which makes life worthwhile.* Robert F. Kennedy, March 1968

## Assets

Assets can have multiple definitions:

- financial wealth
- human capital
- social capital
- political participation and influence
- cultural capital
- natural resources

*"I made it with support from mom, sisters, grandma, and my family networks. They were there emotionally. They gave me a place to go when I left an abusive relationship. Compatibility and open communication are our family's greatest assets." Kaua'i family*

## Ho`owaiwai An Asset Building Framework

- Ho`owaiwai is a Hawaiian word meaning "to enrich".
- Wai means "water". In old Hawai`i, it was everyone's kuleana or "responsibility" to malama i ka wai or "to take care of the water" because it affected the livelihood of the entire village.
- Asset building using a holistic frame.
- Culture and values provide the context and foundation for asset building strategies, programs, and projects.

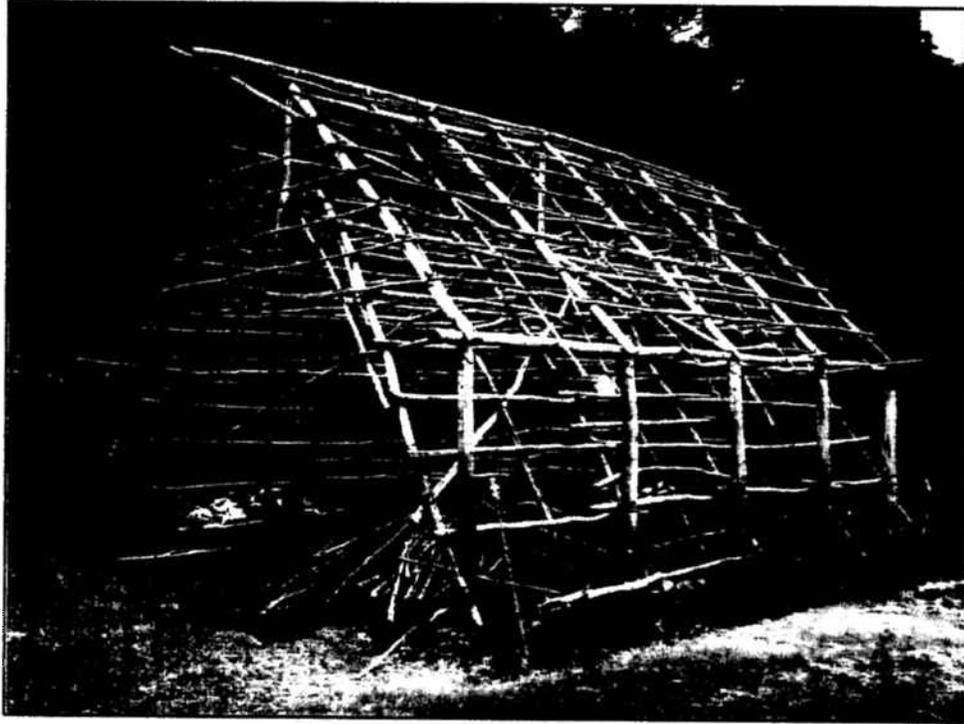
Beneath a County Park in Lahaina, Maui,  
is one of Hawaii's most historical  
and sacred treasures.  
**Moku'ula, a royal and sacred sanctuary**

*Friends of Moku'ula*



Lying virtually undisturbed for almost a century,  
Moku'ula, a political and spiritual center,  
and ancient home of Maui's Chiefly lines,  
awaits its reawakening.





## Asset Building

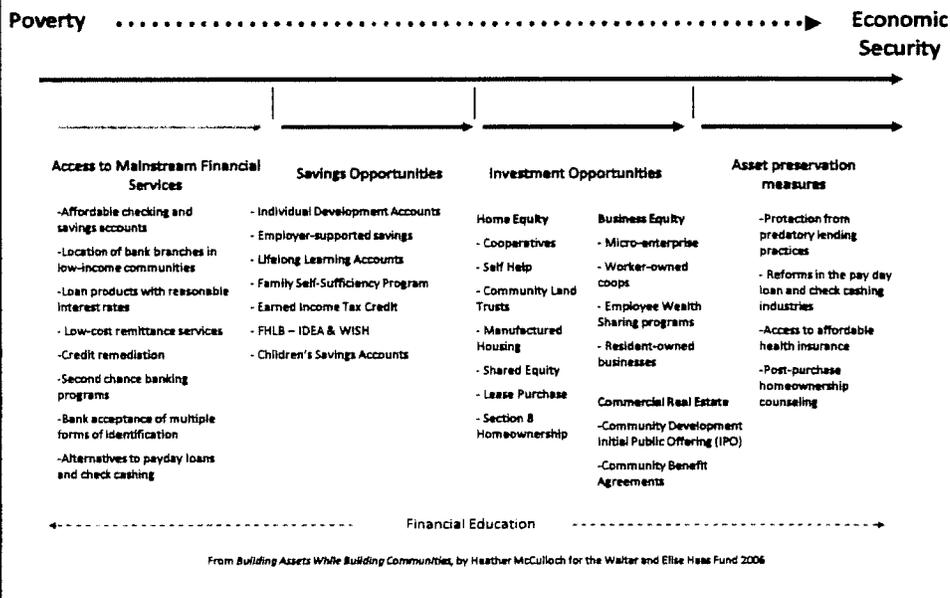
- asset building is a comprehensive approach to alleviating poverty and promoting financial stability by promoting equitable opportunities for asset accumulation.
- strategies, policies, and programs that promote the accumulation of wealth generating assets.
- policies that promote ownership, economic independence, financial literacy, and self-sufficiency and opportunity.

## Earn It, Keep It, Grow It \*

- **Earn It** – increase income
  - readiness to earn – basic education and job training
  - opportunities to earn – living wage jobs and career advancement;
  - closing the earnings gap – earned income tax credit.
- **Keep It** – stabilize financial lives
  - decrease costs of being poor – transportation, child care, health care
  - access to non-predatory financial services – alternative financial services and anti-predatory lending
- **Grow It** – acquire assets and build wealth in thriving communities
  - increasing family assets – IDAs
  - community based economic development – CDFIs, community based ventures

\*Annie E. Casey Foundation – www.aecf.org

## Continuum of Asset-Building Opportunities



## Hawai'i's Asset Policy Agenda

- **Make Work Pay**  
EITC, tax policies
- **Financial Education**  
broad public awareness, schools, workplaces
- **Remove Disincentives & Help People Protect Assets**  
asset limits, predatory lending, insurance
- **Help People Save**  
IDAs, child savings accounts, retirement, education
- **Help People Start Businesses**  
microenterprise, community lending, training
- **Help People Become Homeowners**  
government matches and grants, employee assistance

## A Youth Movement



Youth Financial Education  
Classes

Mala'ai 'Opio – MA'O  
Organic Farm



## Youth Building Assets

### MA`O Youth Leadership Training College Internship

- Receive a Monthly Stipend
- Work Experience on the Farm
- Full Tuition Scholarship to Leeward Community College
- Communication & Cultural Workshops
- Financial Education Classes
- Asset Building Savings Accounts (IDA)
- Opportunities to Travel



## Youth Growing Assets



Learning

Budgeting



Studying



## Youth Individual Development Accounts



Saving to  
Purchase an  
Asset

A Car



Computers for School

## Getting Started in Community Economic Development: The CED Planning Process

December 5, 2009

Brad Caftel

Insight Center for Community Economic Development



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HELPING PEOPLE AND COMMUNITIES BECOME, AND REMAIN, ECONOMICALLY SECURE

## Insight Center Overview

Formed in 1969, the Insight Center for Community Economic Development (formerly NEDLC) is a national research, consulting, and legal organization that develops and promotes innovative solutions that help people and communities become, and remain, economically secure.

### Insight Center Program Areas

Workforce Development  
Early Care and Education  
Savings and Asset Building  
Legal Services



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HELPING PEOPLE AND COMMUNITIES BECOME, AND REMAIN, ECONOMICALLY SECURE

## What Is CED

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A strategy for aiding a community that involves:

- Building business and economic institutions responsive to community needs
- Increasing participation of the community in the economic mainstream as homeowners, entrepreneurs, and employees in good-paying jobs
- Increasing government and private sector investment, collaboratively with local organizations, in the community

## Who Engages In CED?

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- Organizations whose principal purpose is CED that are formed to produce housing, create ownership and employment opportunities, etc.
  
- Organizations that provide human services, such as community centers, health clinics, family support agencies, arts organizations, etc.

## Examples of CED Activities

- Housing development – multifamily rental, single family homeownership, cooperative, special needs
- Commercial development – shopping centers, business incubators, neighborhood commercial strips, office buildings
- Financial institutions – community loan funds, community credit unions, micro-loan programs
- Small business support – technical assistance and loan packaging, lending, equity investment
- Employment creation – training businesses, supporting cooperative development, employment referral
- Human services – develop child care facilities

## Roles in CED

- **(1) Initiate economic development ventures**
  - use org resources to plan, develop, & implement ventures
- **(2) Facilitate economic development ventures**
  - provide improved parcels of land & other infrastructure development
- **(3) Acquire ownership of existing business**
- **(4) Assist in creation/expansion of local business**
- **(5) Improve local business**

## Getting Started In CED

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- Step One: Commitment – Allocate time and resources of board, staff, and consultants; develop clear, consistent, and timely decision-making process
- Step Two: Review and Research – Gather information and assess community resources and needs; understand organizational purpose and mission
- Step Three: Assessment and Analysis – Prioritize community needs; analyze organizational strengths and weaknesses; determine available opportunities; identify the critical issues in addressing these opportunities

## Getting Started In CED

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- Step Four: Develop an Action Plan – Develop project selection criteria to evaluate potential projects; look at start-up costs, impact, fit with mission and goals, etc. Generate project concepts, choose the most promising, and test their feasibility
- Step Five: Implementation – Prepare project development calendar; seek initial capital for project development; determine legal structure

## CED Process

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- **Phase I: Introduction**

- Organizational Development

- Evaluate current resources, experience, & org structure → changes org can make to support sustainable venture

- Venture Development

- Identify venture; identify financial/business support for venture

- Community Involvement

- Develop/strengthen links with public/private sectors and community to support development of venture

- **Phase II: Development**

- **Phase III: Implementation**

## Phase I: Introduction

### Organizational Development, Venture Development, and Community Involvement

## Phase I: Organizational Development

- **Basics**: good mgmt, sound financial/admin practices, commitment to CED
- Staff & Board have **explicit interest/commitment to CED process** (i.e. Board resolution)
- Staff & Board have set aside **sufficient resources for planning/training**
- **Staff & Board capabilities** (i.e. marketing, financing, mgmt & operations, other business planning/development skills)
- Staff person can manage outside technical assistance and training resources (e.g. business planning consultant)

**NOTE**: establish clear roles & responsibilities

## Phase I: Venture Development

### Identify/Select Venture

- Establish **process** for selection
- **Who** will be involved in decisions/selections?
- **How** will decisions/selections be made?
  - CED Advisory Committee



## Phase I: Venture Development

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### Identify/Select Venture

- **Adopt** CED strategies, goals, & venture selection criteria
- **Select** 2-3 venture possibilities for further analysis (i.e. initial feasibility study)
- **Complete** internal assessment of org's policies and operations
- **Create** work plan for the Development Phase (i.e. detailed feasibility study, business plan)

## Phase I: Venture Development

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### Selection Tips (“Do’s”)

- Selection criteria should be **explicitly** linked to org's CED goals
- Set priorities on each criterion
- Balance social & business criteria
- Consider community, org, & business perspectives

## Phase I: Venture Development

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### Selection Tips (“Don’ts”/Common Errors)

- Nonprofits often confuse community need with market or demand
- Nonprofit ventures sometimes have too many goals
- Nonprofits often have a one-year funding mentality and insufficient working capital
- Unrealistic profit expectations
- Management needs for enterprise v. nonprofit

## Venture Development Process

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### Examples of Selection Criteria

- Venture relationship to agency mission
- Risk factors
- Size of profits to be expected, when, self-sufficiency
- Employment/training impact/opportunities
  - # jobs that will be made available to community
  - opportunities for mgmt skill development/job upgrading
- Possibilities for community control/decision-making, ownership
- Community impact
- Support from the community

## Phase I: Community Organization

CED efforts require inclusion of a wider group of people than are traditionally involved in most CBOs

- Public Sector (local, state gov't)
- Private Sector (bankers, realtors, merchants, lawyers, accountants, marketing, advertising, etc.)
- Low-Income Community
- Legal Services Offices, Educational Institutions, Other Community Resources

Participation on CED Advisory Committee may be one way to engage some of these sectors/individuals

## Sample Venture Selection Criteria: Health Care Organization

- Relationship to Mission – Venture should be health service related, provide opportunities for expansion into other health service areas, major market should be low income persons
- Profitability/Growth – Break even within one year, opportunity for growth in profits, make contributions to organizational overhead, increase organizational equity, possibly sell within 4-5 years
- Initial Financing – Little or no cash required, funded by leveraging organizational assets, any debt must be serviced by the venture

## Sample Venture Selection Criteria: Health Care Organization

- Type of Business – Start-up preferred, provides direct services
- Employment Criteria – Create some entry-level positions, provide career ladder opportunities, connects with existing employment and training programs in the community
- Ownership – Nonprofit or for-profit, joint venture possible if control remains with organization
- Location – Within organization's impact area
- Community Impact – Used by local residents, subcontracting opportunities to local businesses, positive impact on organization's image

## Phase II: Development

## Phase II: Development

- Work Plan
  - Feasibility Studies
  - Business Plans
  - Financing
  - Legal Issues
    - Corporate Structuring
    - Operational Issues



## Elements of a Feasibility Study

- Product or service defined
- Market - Overall, define potential customers, estimate #, estimate market share
- Competition - Who, how many, reaction, new entrants
- Organization - Management and personnel needed, legal structure

## Elements of a Feasibility Study

- Finance:
  - Initial capital – development expenses, initial operating expenses, reserve
  - Breakeven analysis – sales needed, when
  - Profit and loss statement/income and expense statement-monthly projection
  - Cash flow projection – monthly
  - Return on investment analysis – ratio of profit to amount invested, compare to industry averages

## Elements of a Business Plan

- Industry and business
- Product and services to be sold
- Market – Size, trends, competition, market share
- Marketing plan – pricing, distribution, promotion
- Timeline – Pre-startup and startup plans and schedules
- Operating plan
- Organization and management
- Community benefit

## Elements of a Business Plan

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- Financial plan – Initial capital, proposed financing, projected profit and loss, balance sheet, cash flow, breakeven analysis
- Monitoring plan
- Critical risks and assumptions

## Phase II: Development

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### Legal Issues: Corporate Structuring

- IRC Section 501(c)(3)
- For-Profit Subsidiary
- Joint Ventures

## Corporation Structuring: 501(c)(3)

- **Incorporation** – check state requirements
- **Tax-exemption application**
  - **Each homestead associations must be an IRC Section 501(c)(3) charitable organization**
    - organized and operated exclusively for charitable purposes
    - activities do not benefit any private person or interest
    - assets are irrevocably dedicated to charitable purposes



## Corporation Structuring: 501(c)(3)

- **Tax-exemption application**
  - **Federal (IRS Form 1023) and State filing requirements**
    - **bylaws** = internal governance document for organization
    - **narrative description of activities** must cover stated purposes and community targeted include who, what, where, when, and how)
    - **financial and compensation information** (actual and projected)

## 501(c)(3): Do's and Don'ts

### Lobbying and Political Activity

- General Rule: organizations exempt under Section 501(c)(3) are permitted to **lobby** so long as lobbying is not a **substantial** part of their overall activities
  - **lobby** = attempts to influence legislation (IRC 4911(e)) through direct or indirect/grassroots communication
  - **substantial**: measured by either (1) facts and circumstances test or (2) IRC Section 501(h) election
- Exception: any involvement in campaigns for elected office is prohibited

## 501(c)(3): Do's and Don'ts

### Business Activity

- General Rule: business activities can be charitable, even if they generate profit (look to how income earned, nature/size of business)
  - However, primary purpose of the business must be charitable (“related business activity”), not income generation (“unrelated business activity”)
  - **business** = income-generating activity regularly carried on
  - 2 factors to consider: (1) is business activity **related**? and (2) is the activity a **substantial** part of the organization’s overall activities?
    - possible outcomes: pay unrelated business income tax (UBIT), establish for-profit subsidiary

## 501(c)(3): Do's and Don'ts

### Compliance Checklist

- Information collection procedures (staff, Board of Directors, transactions with consultants/third parties)
- Tax and financial filings/reports (e.g. IRS Form 990)
- Liability protection
- Personnel policies



## Corporation Structuring: For-Profit Subsidiary

### For-Profit Subsidiary

- Why form a for-profit subsidiary?
- How does a tax-exempt organization form a for-profit subsidiary?
- How does the for-profit subsidiary relate to its tax-exempt parent?

## Why Establish a Subsidiary ?

- **Protect** organization's tax-exempt status
- **Insulate** organization from liability associated with the business
- **Obtain** financing from conventional sources
- **Attract** staff and board members with business experience

## Forming the Subsidiary

### Choosing an Entity – Factors

- Ease of Formation
- Control
- Separation from Exempt Parent
  - Essential for protection of exempt status
- Tax Regime
  - Pass-through or Entity level tax
- Degree of Insulation from Liability
- Limits on Types of Activities

## Forming the Subsidiary: Choice of Entity

### Most common choices

- Limited Liability Companies (LLCs)
- Corporations



## Corporations

### Formation

- Articles of Incorporation
  - Include number and classes of stock authorized
- Stock issued in exchange for contribution
- Stockholders appoint directors
- Directors adopt bylaws

### Operations

- Directors and officers control the business
- Stockholders elect and can remove directors

## Pros and Cons of Corporate Form

- Sophisticated statutory law with ample case law & interpretation reduces uncertainty
  - Established precedent for maintenance of separate identity of parent and sub
- Stock structure facilitates multiple owners with different interests
- Ownership interests easily transferred
  - *But*: may be subject to securities laws
- Flexibility is limited



## Limited Liability Companies (LLCs)

### Formation

- File with Secretary of State
- Membership interests exchanged for contribution
- Members negotiate operating agreement

### Operations

- Controlled by the operating agreement
- LLC may be managed by members or managers
- Multiple classes of members possible

## Pros and Cons of LLCs

- Ease of Formation
- Operating Flexibility
- Ease of establishing complex profit distribution schemes
- Flexible taxation
  - May elect to be taxed as a corporation or partnership
- *But* -Relatively New form of Entity
  - Law of LLCs is relatively undeveloped and many issues remain open
  - May be harder to establish separate identity of parent



## Formation

### Contribution

- Parent non-profit contributes property or services to the for-profit subsidiary
- In exchange for the contribution, parent receives an ownership interest of equivalent value
  - Stock
  - Membership Interest

## Parent-Subsidiary Relations

- The NPO and the subsidiary each have their own Boards of Directors and officers, with separate meetings, minutes, accounts, books and records
  - There can be overlap but the Boards shouldn't be the same
- The NPO is not involved in the **day to day management** of the subsidiary
  - As shareholder, it appoints and removes directors
- Transactions between the NPO and subsidiary should be documented and on **market terms**

## Transfers Between Sub and Parent

### Profits are returned to parent as dividends

- Taxed at subsidiary level
- Tax-free to parent

### Parent can provide services to subsidiary under market rate contracts

- Agreements for space and services are common
- May be taxable as unrelated business income
- Must be negotiated and priced like arm's-length transactions



## Corporation Structuring: Joint Ventures

### Joint Ventures

Two or more persons engage in a joint undertaking

- Individuals, corporations or other entities
- Typically a business venture for profit

Common forms:

- Limited liability company (LLC)
- Limited partnership (LP)



## Joint Ventures: Tax-Exemption Issues

Joint ventures with for-profit organizations  
present a risk of the exempt org's resources  
being used for private benefit

Historically disallowed by IRS

- *per se* determination of private benefit and revocation of exempt status

Courts rejected *per se* rule

- *Plumstead Theatre, 675 F.2d 244 (9th Cir. 1982)*

## **Joint Ventures: IRS Modifies Position**

Rev. Rul 98-15 establishes **2-part test**:

- (1) Does participation in the JV further the org's exempt purpose?
- (2) Does the partnership agreement give the org sufficient authority to ensure:
  - the venture will further charitable activity throughout its term, and
  - for-profit participants will not be unduly benefited?

## **Joint Ventures: Sufficient Authority**

“Good” provisions

- **org had active role in managing the JV**
  - Managing member or general partner
- **limits on the for-profit's ability to:**
  - Remove the org as managing member or general partner or
  - Amend the agreement
- **JV's activities are limited to those that further org's exempt purposes**

## Joint Ventures: New Development

Rev. Rul. 2004-51

Applies to JV's that are not a substantial part of the organization's activities

- *ancillary JVs*

Exempt org may participate in JV with for-profit on a 50/50 basis, so long as:

- JV is ancillary, and
- exempt org retains significant control over substantive aspects of JV's operations

## Phase II: Development

### Legal Issues: Operational Issues

- Board Responsibility, Liability, Conflict of Interest
- Unfair Competition
- Grant Rules

## Phase III: Implementation



HELPING PEOPLE AND COMMUNITIES BECOME, AND REMAIN, ECONOMICALLY SECURE

## Phase III: Implementation

### Monitoring

- Establish **monitoring schedule** and **forms for reporting**
- Possible Qs
  - Are sales as high as expected?
  - Are costs higher than anticipated?
  - Is the venture creating as many jobs for community residents as was expected?



Developing effective monitoring systems is crucial to org's development, success of specific ventures, and overall CED strategy



## Questions

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## Real Estate Development Why Get Involved

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- **Stabilize** real estate costs
- **Build** organizational assets
- **Develop** uniquely suitable space
  - Share with other organizations
- **Expand** programs

## Real Estate Development Overview

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- Organizational Readiness
  - Role of Board, Committees, Staff, and Consultants
  - Frame and Generate Project Concept
  - Prepare, use, and revise a Development Calendar
  - Obtain Seed Capital
- Legal Structure Options
  - Directly
  - Through new nonprofit-controlled affiliate or for-profit corporation
  - Through joint venture, general partnership, or limited partnership with other parties
  - Facilitating cooperative ownership

## Real Estate Development Overview

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- Determining **Market** Feasibility
  - Need v. Demand
  - Feasibility Study
- Determining **Financial** Feasibility
- Securing Financing
- Public Approvals
- Design & Construction Process
- Planning for Operations

## Is Your Organization Ready ?

### Do you have a comprehensive plan ?

- Have a clear project concept – Establish goals for real estate development, use goals to evaluate proposed projects
- Generate concepts through needs assessment or opportunity identification
- Refine project concept – Define tenants to be served, affordable rent, particular physical requirements, site location, estimate project costs, project size
- Test the concept – Review constraints such as financing, market, regulatory issues, community

**PLAN FIRST!**

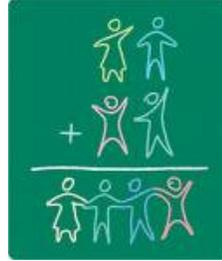
## Is Your Organization Ready?

- Development Calendar – Tasks, deadlines, who
- Budget and Financing plan – Seed capital needed to pay predevelopment costs such as feasibility analysis
- Analysis of effect on existing programs
  - Need for additional staff
- Risk management
  - Development entity
- Operating plan
  - Tax issues

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## More Readiness Questions

- **Have you assembled the team? How were consultants chosen?**
  - Staff capacity to manage project
  - Board readiness
    - Committee structure
  - Attorney
  - Financial consultant
  - Real estate project manager
    - Architect, engineer, contractor
- **Do you have community buy-in ?**
  - “Entitlement” process



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## Building the Project

## Predevelopment

- Form development entity – Direct vs. subsidiary or LLC (related vs. unrelated activity); joint venture to bring in skills, expertise, money, track record, credibility; or facilitate resident ownership
- Identify site
- Negotiate purchase price
- Acquire “site control”
  - Option
  - Conditional purchase
  - Joint venture with owner
- Analyze project feasibility
- Secure entitlements

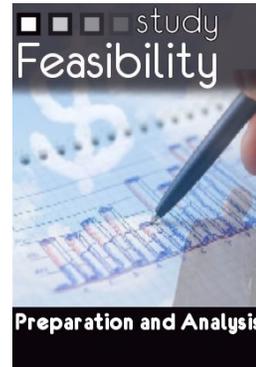
## Predevelopment

### Feasibility analysis should include:

- Inspection of physical site
  - Environmental inspection “Phase I”
- Condition of title
- Regulatory constraints
  - Risk, timing and costs in securing entitlements
- Market analysis: Need vs. demand, finding tenants willing to locate at site, pay enough rent
  - Determine type of tenant that fits project concept;
  - geographic draw of project, analyze demographics;
  - estimate market penetration rate; competition

## Predevelopment

- Community/political issues
- Analysis of financial feasibility



## Predevelopment

### Financial feasibility analysis:

- Determine project development costs
  - Site acquisition
  - Architecture and engineering
  - Construction
  - Legal and consulting fees
  - Financing costs
- Identify financing sources
- Develop “pro forma” operating statements
  - Will project income be sufficient to operate the project and service debt or provide a return to investors ?

## Predevelopment

### Project entitlements

- Zoning/land use
  - Is the proposed use permitted?
  - Design restrictions – set back, height
  - Parking ratios
- Building & Health and Safety Codes
- Environmental requirements
- Public financing approvals
- Other issues - Access roads, utilities, earthquake or flood zones



## Preconstruction Phase

- Design-build team is selected
- Project design and detailed costing
- Negotiate construction contract
- Secure construction financing



## The Design Team

- **Architect**
  - Translates project concept into physical design that meets budget and regulatory constraints
- **Structural Engineer**
  - Works with architect to ensure building is structurally sound
- **Landscape Architect**
  - Lays out site
- **Civil Engineer**
  - Plans for water, utilities, etc.
- **General Contractor**
  - Needed during design phase to estimate cost



## The Project Architect

- Develops schematic designs and detailed plans and specifications for construction
- May assist in obtaining public approvals
- Often acts as Owner's key agent on project
  - Liaison between Owner and design-build team
  - Assists in negotiating construction contract
  - Monitors construction to ensure compliance with plans and specifications



## Construction Phase

- The General Contractor selects and oversees subcontractors
- The Owner or Owner's agent
  - Observes the construction
  - Receives requests for progress payments and verifies that completion targets have been met
  - Reviews change orders
  - Interfaces with the construction lender and government inspectors
  - Keeps the project coordinated



## Project Completion

### As project completion approaches:

- Select and engage property managers, leasing agents, etc.
- Rely on architect and building inspectors to verify project is really finished
- Get lien releases from contractors

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## Financing Sources

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## Financing by Phase

- **Predevelopment** – hard to raise from conventional sources; grants or own equity
- **Preconstruction** – loan and/or equity for assembling and acquiring land
- **Construction** – short term funding, usually a loan. Interest is higher because of risk.
- **Permanent financing** – refinance construction loan with longer term loan and/or equity

## Conventional Financing

- Loans from conventional lenders – banks, savings and loans, etc.
- May provide both construction and permanent financing
- Usually require a first deed of trust
- May require a guarantee
  - Ability to use federal grant funds or property acquired with federal grant funds for guarantee may be limited



## Nonconventional Financing

- Federal funds such as HUD or USDA
- State funding programs
- Local funds such as tax increment financing from redevelopment agency
- Bonds
- Investment attracted through tax credits - Low income housing, historic preservation, new market tax credits
- Grants, capital campaigns

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## Bargain Sales

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- A person who sells property to a tax-exempt organization for less than market value is entitled to treat the difference between the value of the property and the selling price as a donation.
- The organization should have the property appraised and fully investigate its condition.
- The organization should ensure that the seller has its own tax advisor.



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## Owning and Operating a Building

## Owning & Operating a Building: Tax Considerations

- Preserving your tax exemption
- Taxability of project income
- Obtaining a property tax exemption



## Aligning Development with Your Charitable Purposes

- **Charitable purposes** for real estate development:
  - Space for your organization
  - Space for other non-profits at lowest feasible cost
  - Affordable housing
  - Commercial space that meets specific community need for economic development

**Your organization may need to amend its articles and advise the IRS of a new charitable purpose**

## Taxability of Project Income

### Unrelated Business Income Tax (UBIT)

- Business activities
- Regularly carried on
- Unrelated to charitable purpose

Rent is normally not subject to UBIT unless it is earned from **debt-financed property**

## Property Tax

- Real estate owned by charitable organizations and used for charitable purposes is normally exempt from property tax
  - Includes development period



## Owning and Operating a Building: Non-Tax Considerations

- Property management
  - The organization needs a plan for managing the property, including leasing, cleaning and maintenance
  - Have property managers on staff or pay a management company
- Liability
  - It is often advisable to establish a subsidiary to own the building

## Questions

