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Development Models for Homeless Housing

Final Report – April 2015

1. Project Overview

Thanks to a grant from Enterprise Community Partners, Settlement Housing Fund (SHF) has identified detailed strategies for creating new Tier II (family) shelter capacity and leveraging shelter dollars to finance permanent housing that serves extremely low-income households. SHF worked closely with government partners, colleagues in the affordable housing industry, and other shelter providers to develop five housing models that will facilitate the creation of high quality shelter and/or permanent housing for homeless households earning 10-20% of Area Median Income (AMI).

The housing models build off existing ideas and pilot projects, but break from past work in three key ways. First, a critical project goal is to design program models that can be brought to scale. To do so, SHF has emphasized standardization to facilitate scalability. SHF has created proposed term sheets for the models so that all potential developers and operators have a common understanding of both benefits available and regulatory requirements. Second, the assumption in all models is that permanent housing for homeless families must be viable in the absence of Section 8. Finally, the SHF models take a relatively long-term approach to shelter planning, because we assume that there will be a need for high quality shelter – either as incremental capacity or to replace lower-quality facilities – over a multi-year time horizon.

These five models are meant to complement other strategies for serving homeless and extremely low income households. The City will have to continue to address short term shelter capacity needs, and will likely continue to use Section 8, New York City Housing Authority (NYCHA) units, and temporary rent subsidies to place homeless families. The programs envisioned through this project add to the toolbox, but cannot solve the City's homeless crisis by themselves.

SHF has worked through a variety of challenges for each model, including regulatory, financial, and operational concerns. For stand-alone programs, SHF has produced a draft term sheet, and where applicable, sample proformas. In addition, the following report discusses process, scope, and implementation issues for each model. SHF will make these materials available to all interested parties in order to maximize the number of permanent housing units that are built to serve the homeless.

2. Development Models

a. Model A: Debt Financed Shelter

Description

Working with private lenders and/or the New York City Housing Development Corporation (HDC), the Department of Homeless Services (DHS) has the tools to create new Tier II shelter capacity by guaranteeing the debt service payments on loans for the new construction or substantial renovation of existing buildings. DHS has already enabled the construction of five adult shelters in a similar manner. This model standardizes new shelter construction and contemplates using private bank debt and/or HDC's capacity to issue 501(c)3 bonds to finance the construction.

Under this model, a shelter developer and operator – either as one entity or two entities working in partnership – would obtain a commitment from DHS for a new 20 year shelter contract. The contract would provide for debt service payments to a lender to cover the hard and soft costs to develop the shelter, as well as payments for operations. All of these costs combine to make up the 'per diem' paid to the provider, but the payments to the lender are made directly by DHS and guaranteed for the life of the mortgage.

Model A allows DHS to work with preferred shelter operators to plan its long-term capacity. DHS practices will align more consistently with real estate development standards by relying on term sheets, and incorporating development principals such as developer fees and capitalized operating and replacement reserves.

Preference will be given to proposals that result in an all-in per diem below \$130. This per diem includes some cost items that were not previously part of DHS's standard practice:

- A 10% developer fee (included in capital budget)
- \$1,300 per unit capital reserve (included in capital budget)
- Operating reserve sized at 3% of maintenance and operations for the life of the contract (included in capital budget)
- Regular contributions of \$1/day/unit to the replacement reserve (in the operating budget)

Process

Developers and shelter operators would approach DHS with a proposed site and submit a development budget and shelter operating budget along with a letter of interest from a lender, either a private institution or HDC. DHS may either accept applications on a rolling basis, or issue a Request for Proposal (RFP) specifying the number of facilities and types of units it is seeking to develop in its Tier II stock. While a rolling application allows for maximum flexibility, a specific RFP deadline can create a sense of urgency and generate more units and cost efficiencies in a designated period of time.

Key considerations

Success of this new construction model depends on DHS incorporating items into its scope that have not been typical for the agency or for City budgeting practices. A chronic complaint from shelter providers is that DHS per diem budgeting does not acknowledge growing operational costs of managing real estate, such as the costs of utilities, staff benefits and salaries. It is

crucial to the long-term health of the stock, and to attracting high caliber developers, that DHS allow for an operating reserve. This will improve administrative efficiency, as it – along with the replacement reserve recommended here -- will significantly reduce the new needs requests that require DHS response.

Family shelters have not been financed in this way yet, and while private lenders have expressed a willingness to provide the interim construction financing, an upfront commitment for mortgage insurance on the permanent loan would be needed. One solution could be the State of New York Mortgage Agency (SONYMA) providing mortgage insurance and the New York City Employees Retirement System (NYCERS) purchasing the mortgage once the project is complete.

Potential Scope

New shelter construction can be scaled up or down depending on upon DHS's needs. Because new construction and substantial rehab is a lengthy process, DHS's planning for these units will be longer-term. Shelters developed under this model are not intended to meet emergency needs, but rather should be considered DHS's baseline, long-term stock. Planning should be done in conjunction with the preservation of existing shelters, so that a baseline of non-profit controlled, stable, and well-maintained family shelters are available city-wide. Because DHS currently uses scatter site units and older, non-purpose built facilities that are inefficient for shelter use, there is need for new shelter development even if demand for Tier II beds declines.

Term sheet

See attached term sheet.

b. Model B: Shelter Preservation

Description

This model creates a system and structure for preserving the existing stock of nonprofit-owned family shelters. There are currently 27 nonprofit owned and operated family shelters with a total of 1,314 units. This model will fund much needed capital upgrades and improvements to the shelters, and to maintain them as shelters for an additional period of time, most likely 20 years. Model B seeks to provide a framework for the City to preserve assets that are still very much needed, and in which the City has already heavily invested. These assets are – in some cases – a blight on neighborhoods, so upgrades to them will have a community development benefit. Preserving these shelters is much less expensive than creating new capacity.

The preservation option would be extended to nonprofit owned family shelters within 5 years of contract expiration. Similar to Model A, this model utilizes private debt or 501(c)3 bonds to finance the cost of capital improvements to the shelters. DHS would renew its contract with the provider at a per diem level that covers both the cost of the permanent debt service and operating budget. DHS would guarantee the debt service, and make payments directly to the lender. The permanent loan and service contract would be coterminous, with a maximum period of 20 years.

In addition to providing capital improvements to the shelters, the contract renewal would also update the operations portion of the per diem. Because of DHS's past practice of locking in the per diem for the life of the contract, the vast majority of older shelters operate in a constrained budget environment, often having to defer maintenance, reduce staff or cut programs in order

to keep up with escalating operating costs beyond their control. Preservation is an opportunity to update and rationalize contracts. Like in the new construction model, the per diem paid under renewal contracts will include payments for replacement and operating reserves. Preference will be given to proposals that result in an all-in per diem below \$130.

Process

The first iteration of the preservation program entails DHS proactively reaching out to nonprofit-owned and operated family shelters and inviting them to renew under this new program. DHS would send notices to any of the 27 operators approaching contract expiration to give an overview of the program and ask for letters of interest. DHS will provide funding to complete a capital needs assessment of the facility (by a company approved by HPD) in order to develop a scope of work. The provider would then be responsible for submitting a development budget to DHS that address the capital needs as well as an updated operating budget for the new 20-year contract.

Similar to the Model A program, it is contemplated that either a private lender of HDC could provide construction financing for the renovation. However, an upfront commitment for mortgage insurance on the permanent loan would also be needed.

In the future, DHS should periodically reach out to any nonprofit owned and operated shelters that have not participated, such as those that were further from their contract expiration date when previous requests for letters of interest were solicited.

Key considerations

There may be some nonprofits that require technical assistance in developing scopes and financing packages for DHS consideration, and the City should consider partnering with a financial intermediary to provide such assistance to nonprofits.

Potential Scope

Initially, the maximum universe of units to be addressed under this program is 1,314. If new shelters are created through a new construction program, those additional units may be eligible when those contracts near expiration. DHS may also consider a variation of this program to address the needs of shelters operated by nonprofits in buildings owned by for-profits that are working in partnership with the nonprofit operator.

Term sheet

See term sheet attached.

c. Model C: ELLA + Rent Subsidy Reserve

Description

The Department of Housing Preservation and Development (HPD) and HDC routinely finance thousands of units of low income (60% of AMI and below) housing each year through what is now known as the Extremely Low and Low Income Affordability Program (ELLA). Many of these buildings include a tier of units designated for homeless households. However, if Section 8 vouchers are not available when the property converts to permanent financing (or when a rental vacancy opens) the homeless set aside requirements are often waived. Models C and D

are add-ons to the existing ELLA program to ensure that the units already designated for homeless families can be used as intended.

Model C creates a rent subsidy reserve sized to cover the difference between the underwritten rent and what households can afford to pay. There are several temporary rent subsidies available at this time (e.g. DHS's Living in Communities (LINC) program), so we assume that for the first three years of tenancy, there is no need for reserve funds. At the back end, we assume that ongoing needs will be addressed during Year 15 refinancing. Therefore the rent subsidy reserve would be sized to cover 12 years' of shortfall. A family of 3 earning 20% of AMI can afford to pay \$325/month in rent, relative to a 60% AMI rent of \$1,082. To cover the 12 year period, the capitalized reserve account needs to be approximately \$109,000 per homeless set aside unit.

Process

Developers regularly bring HPD and HDC potential projects that could include such a reserve account. HPD projects Section 8 availability over time. As the ELLA pipeline for a given year takes shape, HPD can identify projects for which Section 8 vouchers are unlikely to be available, and which will therefore need an alternative mechanism to meet homeless set aside requirements. The developer and City officials will then size the rental subsidy reserve based on the methodology described above, and include that reserve in project underwriting.

The rent subsidy reserve will actually be created at project conversion, and will be held by HDC.

When the project is completed and ready to lease up, DHS will refer homeless families using the existing homeless referral process, giving priority to households who have LINC subsidies but who have not yet found apartments in which to use them. While a LINC or other temporary subsidy is in place, the rent subsidy reserve should remain untouched. As temporary subsidies burn off, owners may request disbursements from the rent subsidy reserve based on the loss of the subsidy. Owners should be able to show actual operating costs/revenue for the prior year, and budgeted amounts for the current year, and reserve withdrawals will be sized based on the loss of the subsidy. In most cases, reserve withdrawals will be done on a planned bi-annual schedule, although additional disbursements may be done on an as needed basis.

Rents on homeless units should be registered at tax credit rents, and adjusted annually based on the NYC Rent Guidelines Board (RGB) increases. The homeless households receive a preferential rent based on income.

Key considerations

Rent subsidy reserves are not an eligible use of City Capital funds, nor do they count towards Low Income Housing Tax Credit (LIHTC) eligible basis. The reserve accounts will have to be funded with private sources in the deals, usually debt. Those sources are typically already at maximum utilization, so City Capital would have to be added to projects in order to fill the gap created by the rental subsidy reserve.

Potential Scope

HPD projects that it will start an average of 8,000 units of non-Supportive Housing new construction each year of the Housing New York Plan. It is likely that the majority of these units will be financed through ELLA, and although there is no formal target for homeless units, developers will be required to include either homeless units or tiers at 30%, 40%, and 50% AMI. Although it is too soon to tell what share of developers will elect to do homeless set asides versus tiers for a variety of other very low income households, it is reasonable – even conservative - to think that HPD could be starting around 1,000 units of homeless set aside housing each year. There will likely be some Section 8 to meet this need, but creating reserve accounts for 20% of these units would alleviate pressure on Section 8 demand.

Creating reserve accounts for 200 units per year would cost about \$21M in HPD Capital funds. As noted above, the Capital will not be used directly for the rent reserve account, but will instead fill gaps created by reallocating other sources.

Term sheet

This model is an add-on to ELLA, and therefore does not require a stand-alone term sheet. HPD can add a bullet to the “HPD loan amount” section that says:

- Projects that elect the homeless set aside option may be eligible for additional HPD subsidy to facilitate creation of a rent subsidy reserve sized to cover gaps between underwritten rents and homeless household tenant share. Projects must serve homeless households without Section 8 or other long term rental subsidy.

d. Model D: ELLA + Rent Subsidy

Description

Like the previous model, Model D is an add-on to ELLA to ensure that homeless set aside units are allocated to homeless families, even in the absence of sufficient Section 8. However, rather than capitalize funding needed to do so, under Model D owners receive an annual allocation to offset the gap in revenue caused by serving households at 20% AMI.

Owners that elect the homeless set aside option through ELLA and this add-on will receive an annual payment sized at 95% of the difference between underwritten rent and the rent to be paid by the homeless family (the 5% haircut mimics the vacancy allowance that is routinely included in underwriting). A family of three at 20% of AMI can afford to pay \$325/month; the annual subsidy for this household would be about \$6,800. In many cases, however, the homeless households will be on Public Assistance, and the landlord can receive Shelter Allowance payments directly from HRA - \$400 for a family of three. The total subsidy will assume that at any given time, half the units will be occupied by households eligible for Shelter Allowance payments, and half are at 20% AMI. The blended cost per household is approximately \$5,900/year.

Process

The City will have to add funds to HPD’s budget for this program. HPD will then make a grant to HDC under §661 of the Private Housing Finance Law. HDC will in turn allocate the funds to its subsidiary, the Housing Assistance Corporation (HAC). Under §654-b of the Private Housing Finance Law HAC is allowed to receive funds for the purpose of assisting rental developments to

maintain housing affordability, which can reasonably be interpreted to include ongoing operating support.

Similar to Model C, HPD will identify ELLA projects for potential participation in this subsidy stream based on anticipated Section 8 availability. Projects should be selected in advance of closing so that the rent subsidy can be included in project underwriting.

When the project is completed and ready to lease up, DHS will refer homeless families using the existing homeless referral process. Re-rental units must also be filled with homeless households, and owners will have to document compliance in order to receive each year's subsidy payment. HDC will administer the payment process. Virtually all ELLA projects are financed jointly by HPD and HDC, so HDC may be able to add the annual payment of the rent subsidy to its existing asset management role. The size of the subsidy payment will be adjusted annually based on changes in AMI and RGB increases.

The subsidy payment will not be adjusted (up or down) based on actual tenant incomes or building cash flow. Although this means that in some cases, owners will collect more than underwritten cash flow, and/or tenants may have rent burdens under 30% of income. The cost of establishing the infrastructure to complete the annual analysis may be greater than the potential savings to the City.

Key considerations

This operating subsidy must be paid for with City Tax Levy dollars.

The funds to pay for this operating subsidy are subject to annual appropriations, and all documents must indicate this. While this is also the case with other project-based subsidies (e.g. Project Based Section 8) this particular subsidy stream has no history on which funders can rely. As a result, there will likely be some reluctance to include this revenue in underwriting. The City could potentially appropriate and pass through to HDC/HAC several years' worth of funds upfront, which could make it less risky.

Potential Scope

Like Model C, we assume that 20% of each year's homeless set-aside units, or 200 units annually, are filled using this operating subsidy. The annual cost for 200 units is approximately \$1.2M. However, it is important to note that this is the one year cost for one year's worth of units. In year two, the cost will be \$2.3M (plus cost adjustments) in year three \$3.5M, etc.

Term sheet

This model is an add-on to ELLA, and therefore does not require a stand-alone term sheet. HPD can add a bullet to the "Units for Formerly Homeless" section that says:

- Projects may be eligible for an ongoing rent subsidy through the Housing Assistance Corporation if serving homeless households without Section 8 or other ongoing subsidy.

e. Model E: Shelter/Housing Hybrid

Description

The final proposal involves co-locating shelter and permanent low income housing. This development model has been discussed for several years, and some projects are in process for homeless single adults (the first project's construction closing is anticipated in June 2015). However, creating hybrid housing/Tier II projects for families creates additional challenges.

Under the hybrid model, developers will create a single building envelope, with at least two distinct spaces, the shelter and the housing (if the project involves retail, separate community space, etc. there could be further subdivisions). The shelter operator will lease their space from the owner of the permanent housing and these lease payments will be an income source for the permanent housing, which will set aside units for homeless families in a percentage that meets or exceeds current ELLA guidelines (30%). Unlike previous versions of this "hybrid" concept, this development will be "purpose-built" as new construction or substantial rehabilitation to meet the design and operational requirements of each type of housing. The shelter units will be accessed separately from the permanent housing, will be smaller than the permanent housing units, and residents will be subject to standard Tier II rules and regulations.

While co-located and owned by a single entity, the shelter and housing will be financed separately. It is anticipated that the shelter will be financed through a construction / permanent loan from private institutional lenders or HDC 501(c)3 bonds (if applicable), whose debt service shall be paid directly by DHS. Other sources may include, but not be limited to, the NYS Homeless Housing and Assistance Corporation (HHAC) and the NYS Office of Temporary and Disability Assistance (OTDA)'s Homeless Housing and Assistance Program (HHAP). Financing for the permanent housing will be provided by, but not limited to, the following sources: private institutional lenders, HDC, New York State Homes and Community Renewal (HCR) and New York State Housing Finance Agency (HFA) programs.

Process

Developers will approach HPD and DHS about developing this type of project and provide a project description and budgets for the development and operation of both the shelter and permanent housing. Preference will be given to projects that achieve a total shelter per diem – which will include debt service on new shelter construction; lease payments made to the property owner; and social services / maintenance and operations (including staff, security, management, etc.) – that does not exceed \$140. HDC and HPD subsidies for the permanent housing should remain within term sheet guidelines.

Key considerations

For tax credit projects, a portion of the Transitional Residence may be claimed as community facility in accordance with the Internal Revenue Code Section 42(d)(4)(C)(ii) in the amount of the sum of a.) 25% of so much of the eligible basis of the qualified low income housing credit project of which it is a part as does not exceed \$15,000,000; and b.) 10% of any excess over \$15,000,000 of the eligible basis.

SHF considered options to include the entire shelter in eligible basis as housing for low income tenants. Interpretations of regulations vary, but in order to do so, some lenders and syndicators would require DHS to offer a license agreement to shelter residents giving them six months'

residency in the unit. This creates significant policy challenges for DHS, and the model is viable if a portion of the shelter is in eligible basis. As a result, the term sheet uses the community facility structure.

Potential Scope

If the City closes on 2 to 5 of these projects every year, with approximately 300 units of shelter and 300 units of permanent housing, costs would be \$36M of capital funds annually and \$14M annually in shelter per diem.

Term sheet

See attached term sheet and sample proforma for a 100-unit shelter and 100 units of permanent housing.

3. Rollout and Implementation Plan

In the current project scope, SHF has a limited role to play in rollout and implementation. Ultimately these programs must be driven by HPD and DHS, and as an outside nonprofit organization, SHF cannot take on implementation responsibility. However, SHF has outlined implementation and rollout key questions and steps that the City could adopt.

Implementation

Several of the program models described above require DHS and HPD to operate and/or collaborate differently than has happened in the past. In order to launch the programs, DHS needs to establish a protocol for receiving project proposals, and processes for reviewing. HPD and DHS also need a process for collaboration on projects that involve both agencies. In order to do so, each agency will have to identify the appropriate point person/people for each initiative. In some cases, there may be staffing or reorganization needs.

There are other, more specific tasks that also must be done before the programs are ready for launch. In particular, the agency staff and OMB also need to agree on program budgets, and the term sheets must be vetted by City attorneys.

These are significant operational questions that require additional discussion. While this level of agency decision making was outside the scope of the original grant-funded project, SHF may participate in a second phase that addresses these issues.

Rollout

Once the general implementation framework has been established, the programs are ready for roll out. First and foremost, DHS and HPD should release the term sheets. These should be posted online, but SHF also suggests that the agencies reach out to industry groups to introduce the new programs.

Other key rollout steps are model specific. Model A, debt financed new shelter development, could be launched as an open-ended RFP, or with specific deadlines to allow for comparison of proposals. For shelter preservation, DHS can reach out to the nonprofit owned and operated facilities to assess interest, and to start the Capital Needs Assessment process. The two ELLA add-ons, models C and D, will be linked to HPD's ELLA pipeline; HPD should assess what is

closing in the next cycle, and which need a subsidy other than Section 8 to meet homeless set aside requirements. Finally, SHF suggests launching a “Request for Expressions of Interest” (RFEI) process for Model E, the shelter/housing hybrid, to identify potential sites.

There are other entities working on related projects right now; for example, the Robinhood Foundation is looking at ways it may be able to provide gap financing for innovative shelter/housing hybrid projects. There will likely be opportunities to roll out ideas together to generate maximum attention and creative project ideas.

4. Conclusion

As of February 25, 2015, there were 11,900 families in the shelter system, or almost 42,000 people, including more than 24,000 children. Housing these families is an enormous challenge for many reasons, not the least of which is that many of the traditional tools for doing so are dependent on increasingly constrained federal resources. The City needs new options for housing homeless families to add to the array of tools available.

The models above do just that. By bringing real estate finance tools into shelter development, and using existing funding sources differently to subsidize permanent housing operating costs, the City can improve the quality of homeless shelters and increase the number of permanent housing placements for extremely low income households.

5. Appendix

a. Working Group

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b. Glossary

501(c)3 Bond: The 501(c)(3) Bond Financing Program makes the proceeds of tax-exempt bonds available to federally eligible 501(c)(3) non-profit organizations for the new construction, rehabilitation, or preservation of existing affordable multi-family rental housing projects. The program provides more flexibility than private activity bonds. Recipients of the bond financing are chosen based on how their activities demonstrate benefits to low-, moderate-, and middle-income residents. These types of bonds can be used to finance the construction or preservation of non-profit owned shelters.

Area Median Income: The Department of Housing and Urban Development (HUD) sets income limits that are widely used to determine the eligibility of applicants for affordable housing programs, such as the Section 8 Housing Choice Voucher program and Low Income Housing Tax Credits. In 2014, the AMI for a family of four in New York City was \$50,340. Low-income families are defined as families whose incomes do not exceed 80 percent of the median family income for the area. Extremely low-income families are defined as families whose incomes do not exceed 30 percent of the median family income for the area.

Maintenance and Operations (M&O): Costs associated with operating a building, including utilities (electricity, heating oil or gas, water/sewer), property & liability insurance, cleaning/repairs materials and payroll, etc.

Per Diem: The amount paid by the Department of Homeless Services to shelter providers as a per unit daily rate for each family shelter unit. The per diem represents the totality of the Department's payments to family shelter providers, and includes maintenance and operations, staff expenses, facility rent and/ or debt service payments, among other things. The per diem is calculated by dividing the annual budget into a daily per unit amount.

Provider: The “provider,” or “operator” contracts with DHS for terms between 9-20 years to operate a shelter. The operator is responsible for the day to day management of the shelter, including service provision.

Rent: In permanent housing, rent constitutes the monthly payments made by tenants as defined by their lease agreement. The federal standard of affordability states that tenants should pay no more than 30% of their income on housing costs (including rent and utilities). Shelter providers may use this term to refer to the rent payments they make to the fee simple owners of the buildings they occupy.

Shelter Allowance: The portion of a household's Public Assistance benefit that is tied to housing costs. The value of the shelter allowance varies by county and family size. For a family of four living in permanent housing in New York City, shelter allowance is \$450/month. In most cases, the shelter allowance is paid directly to a landlord. For a family in shelter, the shelter allowance is used to cover the cost of emergency shelter provision, and is generally significantly higher than the shelter allowance for a family in permanent housing.

Shelter Owner: The owner of a shelter is the entity that owns the real estate in which the shelter is run. The owner could also act as the shelter provider/operator, but may also rent space to the provider.

Temporary Assistance for Needy Families (TANF): The federal block grant that supports Public Assistance payments for eligible families. In New York City, approximately 25-30% of funding for emergency shelter comes from TANF.

Term Sheet: A document summarizing the key business terms for a program or project. In the context of affordable housing or shelter development, the term sheet is the agency's tool to communicate the threshold requirements that make a project potentially eligible for City financing.