

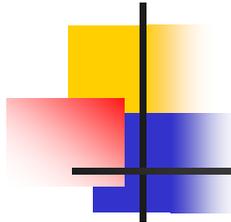
# Introduction to Affordable Housing Development

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Monte Franke  
Franke Consulting Group

Sponsored by:  
NY State Housing Trust Fund Corporation





# Topics

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- Development process
- Your role in development
- Project selection
- Preliminary feasibility/gap analysis



# Objectives

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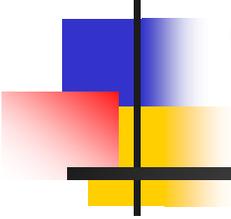
- Understand dev process & dev skills required
- Select better projects and sites
- Conduct preliminary feasibility analysis



# HTFC Small Rental Projects Initiative

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- Most HTFC rental applications had been LIHC
- DHCR made adjustments to scoring to make non-LIHC projects competitive
  - Compared with other small projects, not with higher scoring LIHC projects
  - Alternative scoring methods for income level served and subsidy/unit
  - Change in leverage points



# Overview: Development Process

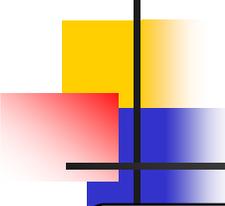
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# The Development Process

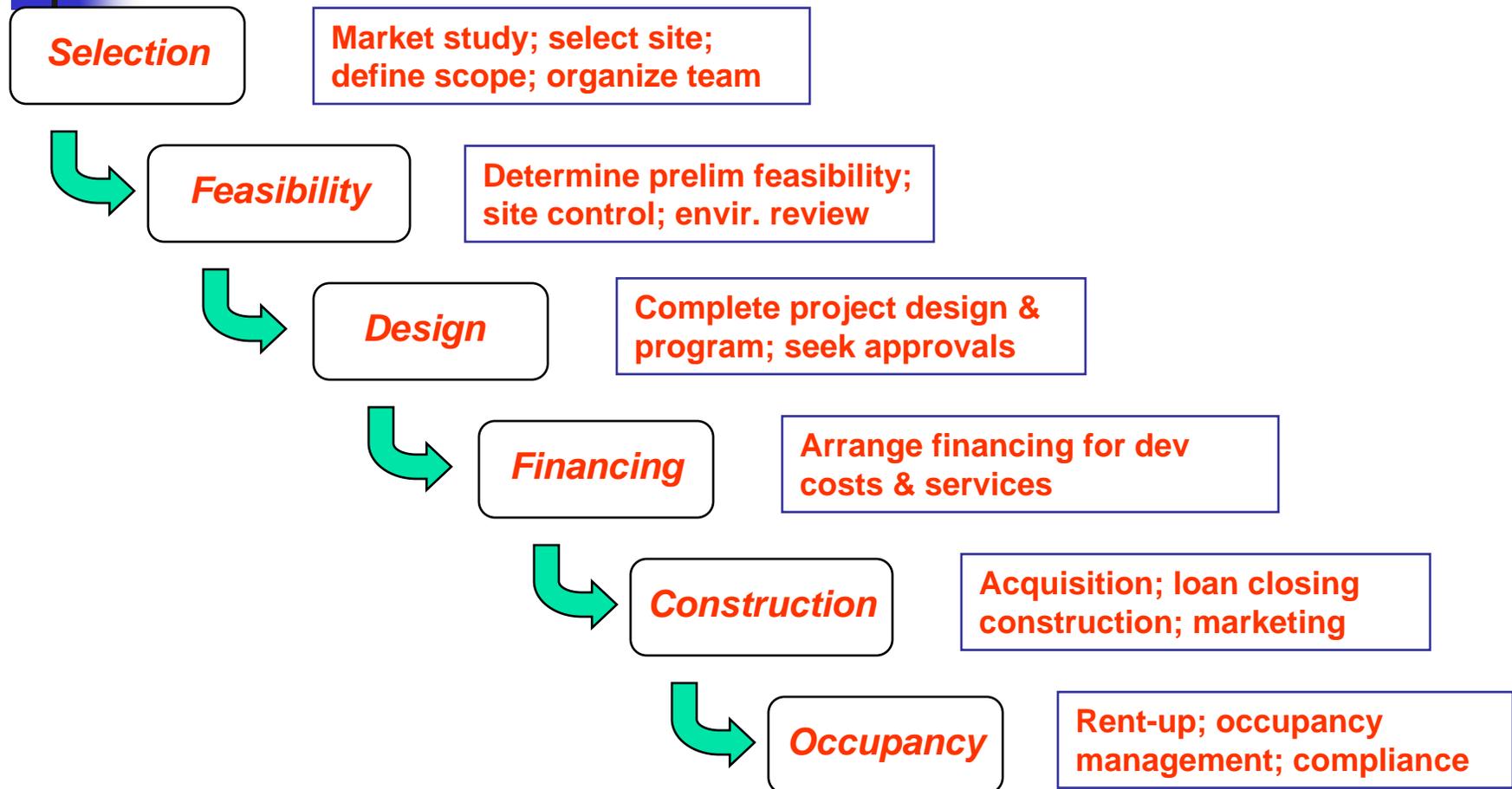
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- Process: multiple activities, actors, skills
  - Success defined as delivering feasible & viable housing occupied by LI HH
- No single process or fixed stages
  - Varies by local factors, site, project, team
  - Phases are not mutually exclusive; many simultaneous activities
- The “Critical Path”: time-sensitive activities
  - Site control/acquisition
  - Design/specifications
  - Financing commitments
  - Construction
  - Marketing
- The Developer is the manager



# The Development Process

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# What A Developer Does

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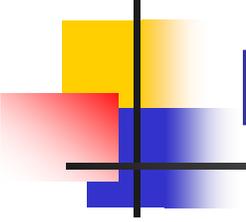


- Define the project scope
- Select and supervise the team
- Obtain local approvals
- Manage community relations
- Secure the financing
- Manage the budget and schedule
- Oversee marketing and occupancy

# The Development Team

- Key Team Members
  - Architect/Engineer
  - Contractor
  - Marketing/Occupancy Manager
  - Investors
- Others at the Table
  - Lender(s)
  - Municipality and Neighbors
  - Customers

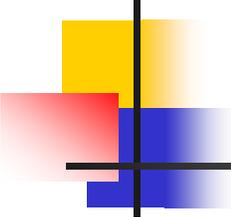




# Role of the Board & Others

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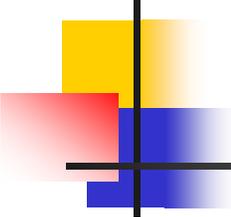
- Responsibilities of the Board
  - Determine project “focus”
  - Approve development team members
  - Approve final program/design
  - Approve financing & closing
  - Monitor progress
- Use of Consultants & Volunteers
- Partnering – a future seminar



# Discussion Activity

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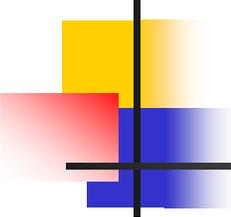
- In small groups, discuss what it takes to be a successful developer:
  - What skills/characteristics?
  - What tools/practices?



# Developer Tools

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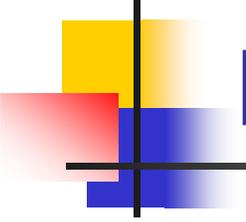
- Market study: Keeping focus
- Critical path and schedule: Time Is \$
- Budgets: Realistic and formula-based
- Team meetings: They work for you (TBV)
- Disbursements: The Golden Rule!
- Lender relations: Silence is not golden
- Neighbor relations: You can't hide



# Why Non-Profits Develop Aff Housing

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- Community needs
  - Address low-income housing needs
  - Build/revitalize communities
  - Create jobs/economic flow
- Organizational goals
  - Expand asset base
  - Earn fees/income
  - Build capacity, skills, job opportunities



# Financial Rewards of Development

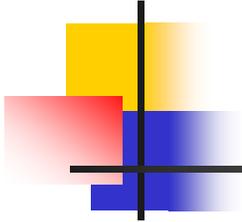
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- Fees
- Cash flow
- Tax benefits
- Sales proceeds/residuals

# Developer Fees

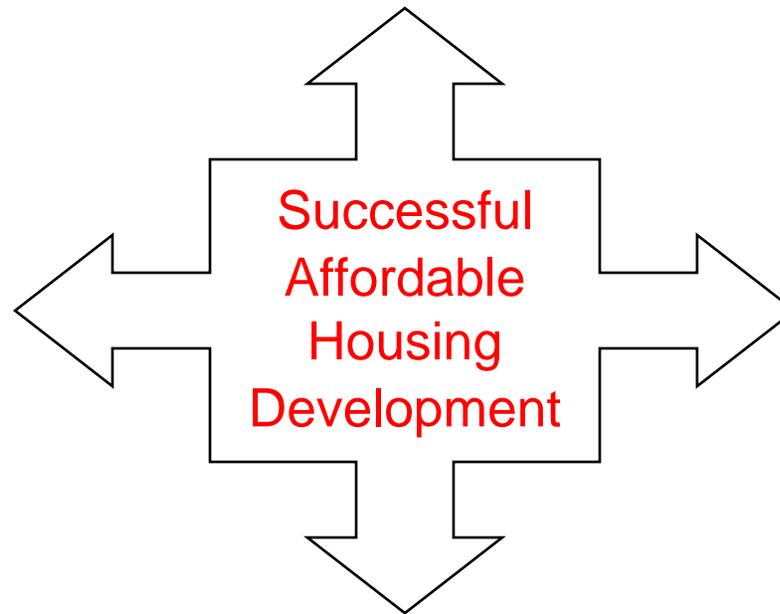


- Fees are for developer services rendered
  - Consultant costs – out of fees
- Profit (cash flow) is return on equity invested
  - Many nonprofit deals have no equity or cash flow
- Fee v. cost structure
- What's an appropriate fee?



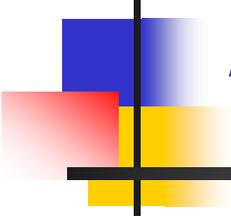
Select good projects

Build developer skills  
& team



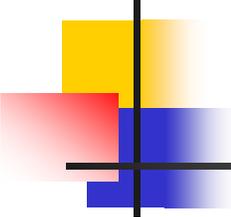
Design feasible &  
viable project

Perform on schedule  
& budget



Are You Ready To Be A Developer?

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# Nonprofit Roles in Development

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- Promoter/advocate/catalyst
- Lender/funder/equity investor
- Developer
  - Sole developer
  - Joint venture partner
- Turnkey owner
- Manager/service provider

# Should You Be a Developer?

## ■ Compatibility

- Does it further our organization's goals?
- What are the **opportunity costs**?

## ■ Capacity

- What are our organizational competencies?
- What is our staff capability?

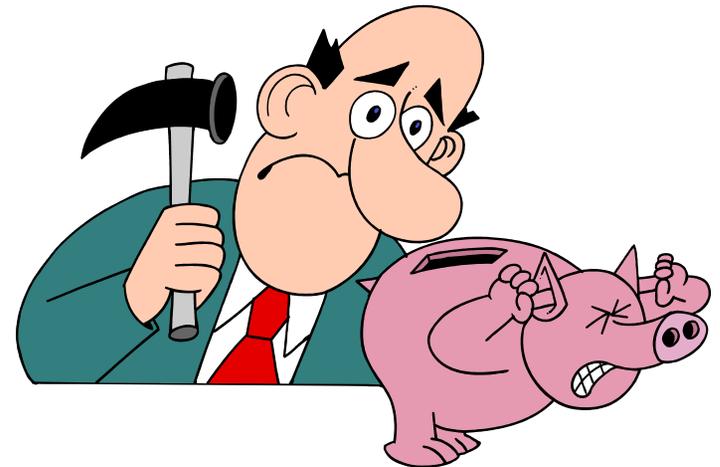
## ■ Cost

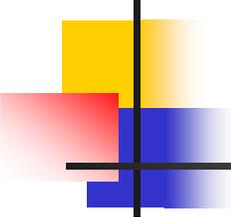
- Can we afford the investment?
- Can we absorb the **risk**?



# Liquidity Requirements

- Upfront planning costs prior to drawing fees
- May need to advance 5 – 10% of TDC
- Potential sources

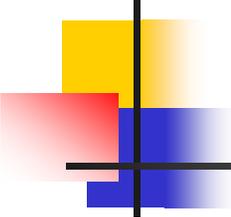




# Organizational Self-Assessment

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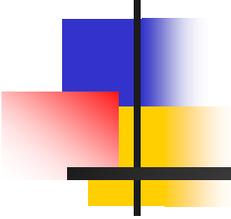
- Scan the Assessment Tool
- Discuss your organization's strengths & challenges in small groups



# The Key Questions on Readiness

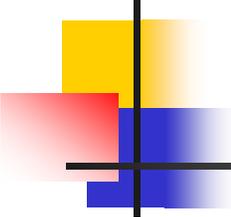
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1. Will a focus on development “displace” other activities?
2. Do you have the liquidity to meet capital advance needs?
3. If your key development person leaves, are your projects “dead”?
4. Do you have procedures to safely manage this volume of cash (development capital & project revenue)?
5. Are you structured to insulate your other activities from the risks of development?



# Selecting a Good Project & Site

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# Selection Topics

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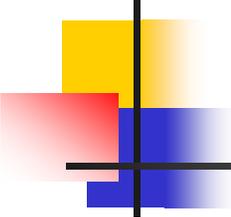
- Site Selection Tips
- NIMBY
- Environmental review



# Project Selection: Quick Tips

## 1. Understand your market first

- Design for a market; don't market a design
- Nonprofit pitfalls:
  - Confusing "demand" with "need"
  - We know what they want
  - Low-income housing doesn't have to compete
- If we build it, will they come?



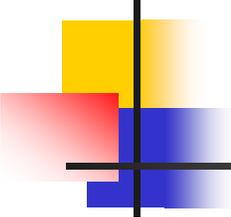
## Quick Tip 2

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### 2. Beware free and cheap “problem” sites

- Free sites aren't always free
  - Environmental issues: subsoil, wetlands, flood plains, noise, historic = costs and delays
  - True acquisition cost = Price + prep costs (demo, relocation, remediation, infrastructure, site improvements)
- Unsuitable locations for housing
  - If not suitable for market housing, then why is it suitable for affordable housing?
  - Accessibility to services and transportation



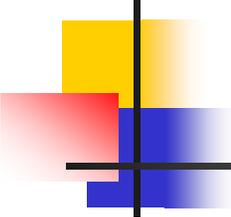


## Quick Tip 3

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### 3. Approach occupied sites with caution

- HOME/CDBG: trigger URA & Section 104(d)
  - Notice requirements
  - Replacement housing requirements
- Identify tenants & approx income levels
  - Do any tenants have to be displaced?
  - Will rents trigger economic displacement?
- Budget for relocation costs

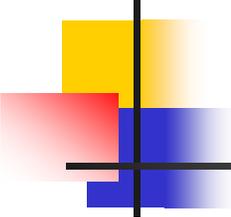


## Quick Tip 4

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### 4. Gauge community support & NIMBY

- Will the neighbors be behind us...or in front of us?
- Consult community early in process – see NIMBY
- Prioritize sites where development is a “matter of right”
- Be ready to compromise
- Be ready to utilize fair housing laws



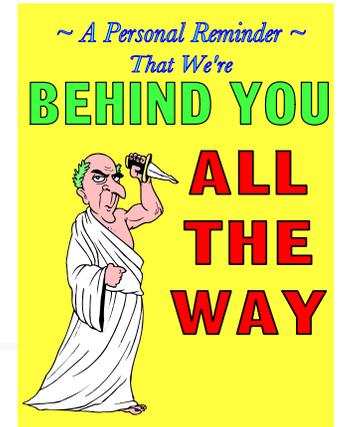
## Quick Tip 5

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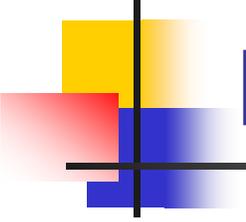
### 5. Be prepared to walk away!!!

- There will always be another opportunity
- The opportunity cost of a bad choice
  - Missed development opportunities
  - Draining corporate resources
  - Loss of community goodwill
  - Damage to reputation

# Dealing with NIMBYism



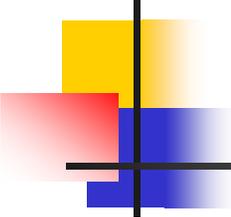
1. Consider NIMBY when selecting properties
2. Be proactive: disclose
3. Seek 1<sup>st</sup> to understand: don't assume or take it personally
4. Always remain polite, cordial, respectful
5. Don't proselytize
6. Respond to fears/concerns; validate but address negatives
7. "Put a face on it": the Reagan strategy
8. Think/talk community: be a good & concerned neighbor
9. Think win-win; seek the 3<sup>rd</sup> alternative
10. Make sure you deliver



# Environmental Review

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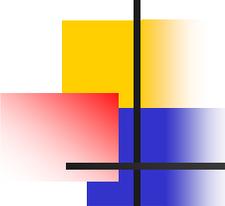
- Federal (24 CFR Part 58) & SEQRA
  - Federal rules amended last Sept.
- HUD: can't take "limiting actions" prior to clearance
  - Acquisition – tight market concerns
- What kind of env review?



# Environmental Clearance is Critical

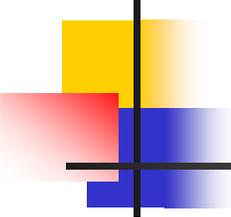
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- No HUD or non-HUD project funds committed or expended until approval
  - Except certain planning activities
- Stop work – after application & prior to approval
  - No “**limiting**” actions: incl acquisition & physical actions
  - May still fund other actions in project after clearance



# Federal Environmental Review

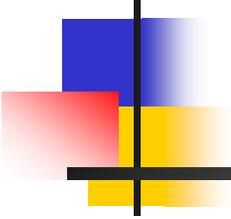
<i>Project Action</i>	<i>NEPA</i>	<i>Other Authorities</i>
New Construction (5+ units)	Environmental Assessment	Compliance Determination
Major Rehab >If 5+: 75% RC; 20%+ density; conversion >If 1-4: increase to 5+, change of use; footprint change in floodplain/wetland	Environmental Assessment	Compliance Determination
Minor Rehab (5+) or Acquisition	Excluded	Compliance Determination
Any Single Family Action (1-4 unit) >If no density>4 units; change of use; or change of footprint in floodplain/wetland	Excluded	Compliance Determination



# Discussion

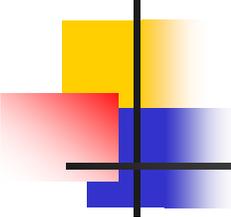
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- In small groups, discuss the following:
  - What are the project opportunities you have before you now?
  - What are the potential issues that might cause you to walk away?



# Preliminary Feasibility Analysis

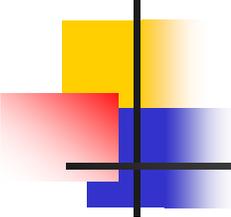
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# Feasibility v. Viability

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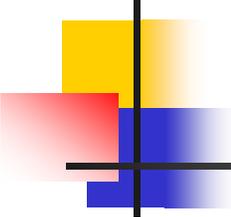
- Feasibility – project is “doable”
  - Funds sufficient to get it built
  - Market sufficient to get it occupied
  - Rents/revenues sufficient to cover costs
- Viability – project is “sustainable”
  - Physically maintainable
  - Marketable; sustainable occupancy
  - Economic health maintainable
- Focus: feasibility this time; viability next time



# Preliminary Feasibility Issues

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- Realistic budgets
- Adequate capital funds – gaps covered
- Revenue covers expenses
- Affordability – to low income occupants



# Budgets

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- Operating pro forma
  - Rental: projection of Income & Expenses
  - Homebuyer: affordability analysis (PITI, debt)
- Development pro forma
  - Sources and Uses of capital funds
  - 2 phases of sources: development & permanent
  - Homebuyer: sales proceeds analysis

# Budget principles



- Budgets are **estimates**
  - You are predicting the future!
- Budgets have to **balance**
  - Revenue  $\geq$  Op. Expenses + Debt Service
  - Dev. Sources = Uses
- Budgets are **dynamic**: subject to constant refinement
- Budgets are **linked**
  - Dev & Op budgets are linked
  - Changes in one, possible impact in other

# The Budgets

## Development Budget

### Sources

**Equity**

**Debt**

**Dev. Subsidies** \_\_\_\_\_

### Uses

**Acquisition/SI**

**Construction**

**Soft Costs**

**Working Capital** \_\_\_\_\_

## Operating Budget

### Revenue

**Gross Rents**

**Vacancy/CL** \_\_\_\_\_

**Eff. Gr. Income** \_\_\_\_\_

### Op. Expenses

**Admin/Mgt**

**Maintenance**

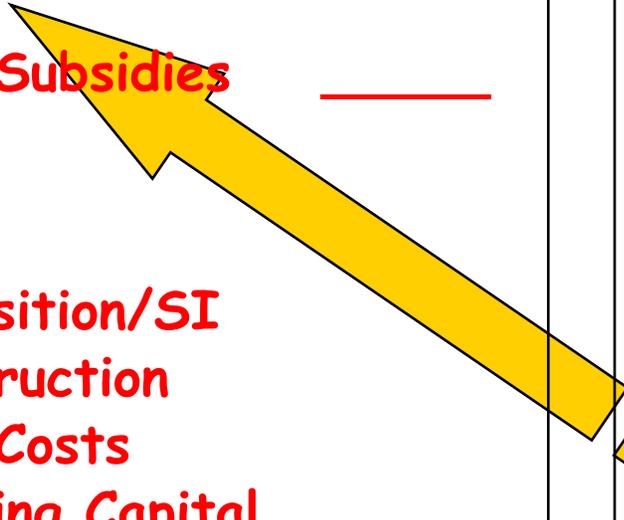
**Taxes/Util/Insur**

**Reserves** \_\_\_\_\_

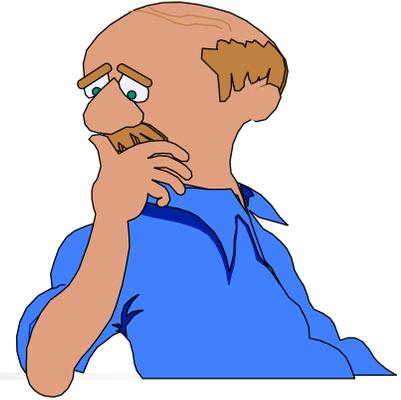
**NOI**

**NADS**

**Cash Flow**



# Market v. Affordable Feasibility Analysis

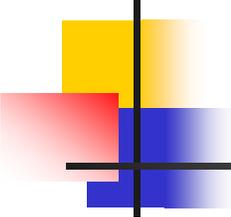


## ■ Market: "Front end"

1. Dev Costs
2. Max loan & equity req
3. Market rents
4. Op. costs & debt service
5. The decision: adequate return on investment

## ■ Affordable: "back end"

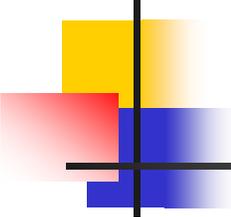
1. Determine rents & revenue
2. Determine expenses & NOI
3. Compute maximum debt
4. Total Dev Costs
5. Determine the Gap: can the Gap be filled?



# Step 1. Determine Rents & EGI

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- Determine Rents:
  - What is affordable?
  - What is permissible (by program)?
    - Maximum Rent
    - Utility Allowance
    - Max. Contract Rent
  - What is necessary?
    - Min Rent to Cover Op. Exp + Debt Serv.
- Set rents; compute Gross Potential Rent (GPR)
  - Contract Rents X Unit Types



## Step 1, cont.

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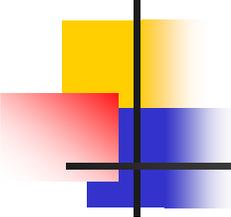
$$\begin{aligned} & \text{Gross Potential Rents (GPR)} \\ & + \frac{\text{Other Income}}{\text{Gross Annual Income}} \\ & - \frac{\text{Vacancy/Coll. Loss (5\%+)}}{\text{Gross Annual Income}} \\ & \textbf{Effective Gross Income (EGI)} \end{aligned}$$



## Step 2, cont. Estimating Expenses



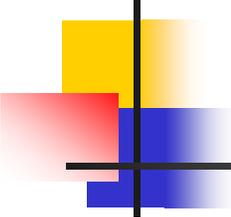
- Key Operating Expenses
  - Management/Administration
    - Legal and Professional
  - Maintenance and Repairs
  - Taxes, Insurance, Utilities
  - Reserves
- Rules of thumb: PUMs & PUPAs



## Step 3. Compute Max Debt

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- Capitalization: reverse of amortization
  - NOI => NADS
    - debt service coverage factor: varies 1.05 – 1.3
  - Compute maximum debt
    - Conventional or tax-exempt rates
  - Amortizing public debt
    - Required amortization reduces NADS for primary loan
    - “Interest if earned” or “residual receipts”



## Step 4: Total Development Costs

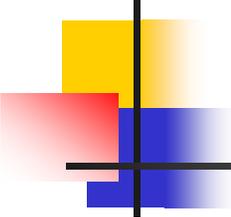
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- Acquisition
- Construction
- Soft costs

# Construction Cost

- Initially ballparked on ave Cost/SF
- What level of design & cost estimate?
- Construction cost factors:
  - Property standards
  - Davis-Bacon Act
  - Procurement (M/WBE, EEO, Section 3)
- Builder Overhead & Profit
- Contingency

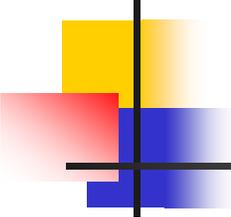




# Soft Costs

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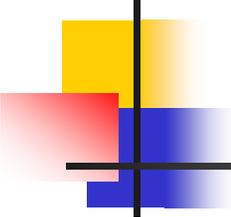
- Non-acquisition/construction costs
  - Professional fees
    - Architectural/Engineering
    - Other: legal, accounting, env review
  - Financing Fees
    - Application, appraisal, commitment pts, closing
    - Acquisition, construction/bridge, permanent loans



## Soft Costs, cont.

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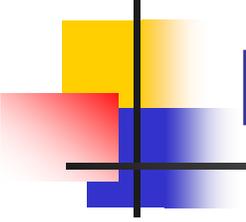
- Construction period expenses:
  - Operating costs during dev phase
  - Constr loan interest
  - Insurance, utilities
  - Interim management
- Construction supervision
- Marketing
- Developer Fees (incl. consultants)



## Soft Costs, cont.

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- Working capital & capitalized reserves
  - Start-up costs: deposits, furnishings, equipment
  - Lease-up Reserve (Initial Operating Deficit): operating expenses during lease-up
    - Based on absorption rate & break-even occupancy
  - Operating Deficit Reserve: operating shortfalls
    - Sometimes incl. debt service or separate reserve
  - Replacement Reserve
    - Capitalized if cash flow can't support or near-term improvements anticipated

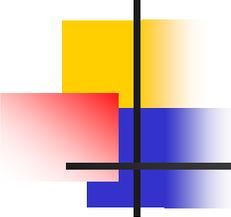


## Step 4, cont.

# Estimating Soft Costs

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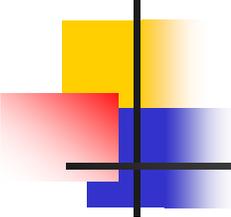
- Typical range 20 – 30% of hard costs
  - Depends on project/financing complexity
  - A+E: 4 – 10% of hard costs
  - Developer fees: 5 – 15%
    - Smaller projects v. large projects
    - Complex projects v. simpler projects
  - Financing fees/costs: 1 – 2% of loans
  - Constr. interest: 50 – 60% of loan for constr period



## Step 5. Compute the Gap

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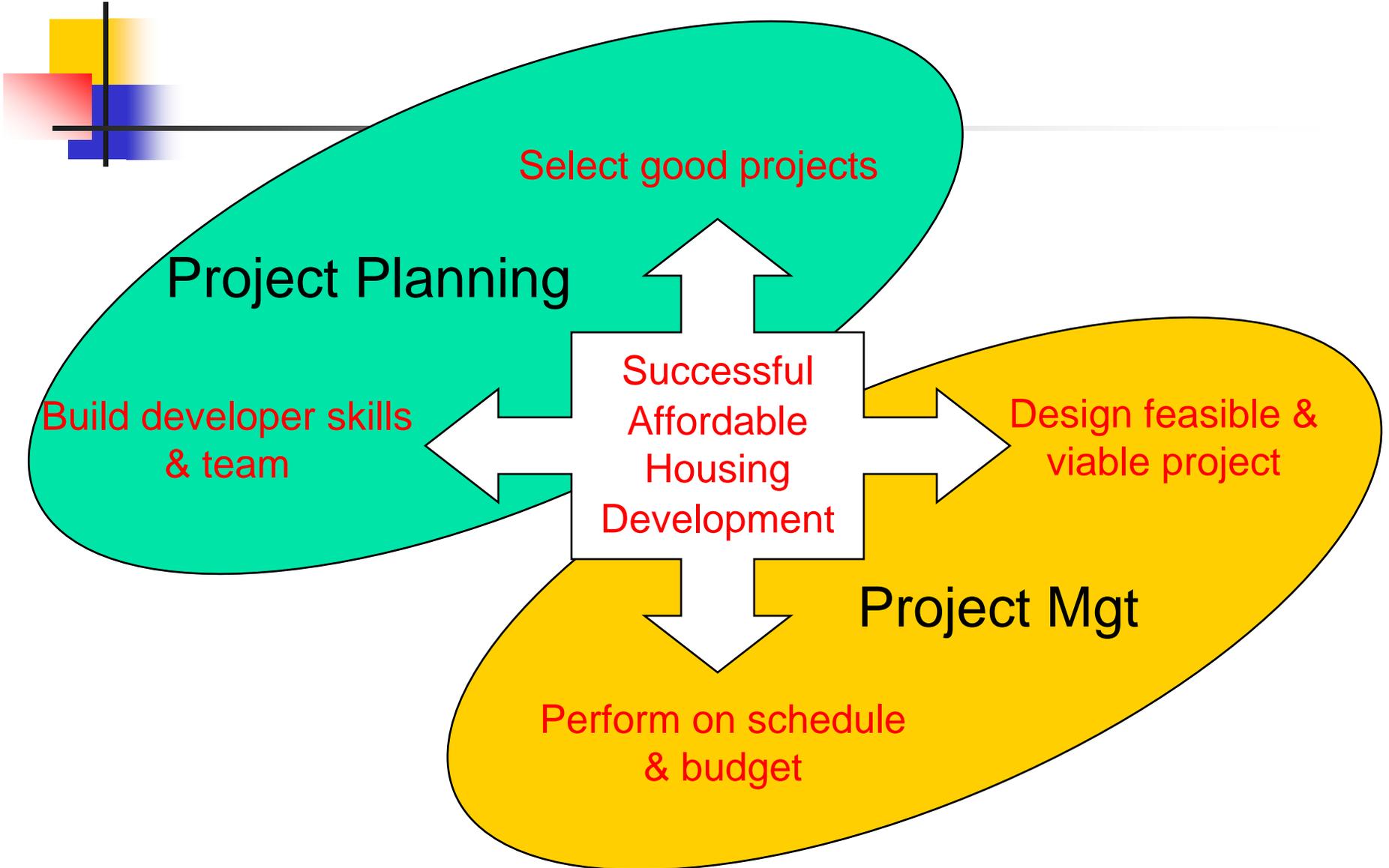
- Estimate Uses of Funds
  - Acquisition/site improvements
  - Construction
  - Soft Costs & Fees
  - Working Capital
- Sources – Uses: negative means GAP

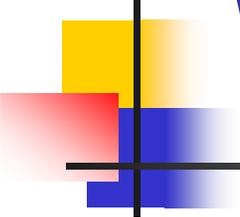


# Preliminary Feasibility Activity

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- Review case
- Compile budgets
- Compute gap and identify possible source





# Wrap up

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- To Do
  - Assess your development capacity
  - Identify several potentially good projects
  - Do preliminary feasibility analysis
- Next session:
  - more on budgets, financing and viability
- Evaluation