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AMERICA'S POVERTY FIGHTING NETWORK

TOOLKIT

MULTI-UNIT AFFORDABLE HOUSING

MULTI-UNIT NEW AFFORDABLE RENTAL HOUSING

Community Economic Development Toolkit

REAL ESTATE SERIES

CCEDA California Community Economic Development Association

Disclaimer

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COMMUNITY ECONOMIC DEVELOPMENT **TOOLKITS**

HOW A PROJECT PROCEEDS

Most projects –– whether physical development or business development –– follow a similar planning track. They go through planning and predevelopment, and then face a GO/NO GO decision. Each stage carries financial implications and require a set of skills. The following table summaries the stages of a project, and their financial (the size of the financial commitment is signified by the number of dollar signs) and skill needs.

As you read the following Tool Kit, keep in mind the Project Steps outlined below.

PLANNING	PREDEVELOPMENT	DEVELOPMENT Go/No go decision	PLANNING
ACTIVITIES Form project idea Examine community plans Do preliminary needs analysis	**ACTIVITIES** In-depth analysis Secure financing Finalize project team Attain site control	**ACTIVITIES** Construction or start up	**ACTIVITIES** Ongoing administration
MONEY IMPLICATIONS $	**MONEY IMPLICATIONS** $$	**MONEY IMPLICATIONS** $$$$$	**MONEY IMPLICATIONS** $$
SKILL/ ORGANIZATIONAL NEEDS Planning Community Outreach Funding Fund Raising Legal	**SKILL/ ORGANIZATIONAL NEEDS** Architectural/ Engineering coordination	**SKILL/ ORGANIZATIONAL NEEDS** Project Management Administrative	**SKILL/ ORGANIZATIONAL NEEDS** Asset Management Property Management

Use of this Guide: An Overview

MULTI-UNIT AFFORDABLE RENTAL HOUSING:
New Construction – Using 9% Low Income Housing Tax Credits

THIS GUIDE SHOULD BE USED FOR THE FOLLOWING TYPES OF PROJECTS:

1. For multi–family rental housing, 9% Low Income Housing Tax Credits (LIHTC) have become the most important source for your projects equity. 9% tax credits are federal tax credits allocated to states. Each state determines its priorities (type of housing or geographic targeting) and then allocates the credits to projects. The credits are sold to investors and become a major source of project equity that allows your project to be affordable (see "Financing Notes" for detailed information on the LIHTCs).
2. You can use 9% LIHTCs for new construction and for rehabilitation (usually substantial rehabilitation, where you may wish to change a use of a building (office to housing) or to reconfigure a building (one bedroom units into larger family units)). These projects are very expensive and the 9% credits will attract the large amount of equity needed to maintain affordability.
3. If you wish to use 9% Tax Credits for acquisition/rehabilitation, please review the Acquisition/Rehabilitation Guide and focus on the items needed for your due diligence (the 3rd party reports are the items needed for substantial rehabilitation). Acquisition/ Rehabilitation projects will usually require substantially less rehabilitation so there is less need for the higher amount of equity generated by the 9% Tax Credits. In these projects, 4% LIHTCs are used with tax exempt bond financing which has a lower interest rate. These combined resources create affordability. 4% credits generate about ½ the equity generated by the 9% credits.
4. If you are building a project (new construction) without tax credits, but have significant local government or "other" equity type financing that replaces the 9% LIHTCs, use this guide and skip sections discussing 9% LIHTC. You are essentially replacing the equity from the sales of the 9% credits, with equity created by grants.
5. In the typical 9% Tax Credit structure the financing is usually comprised of the following sources:
   a. Equity created by sales of the tax credits to an investor (50%–70% of the development costs)
   b. Other Equity from local, state, federal or other sources (15%–25% of the development costs)
   c. Conventional Debt: Usually in the form of a loan for (15%–25% of the development costs)

In most 9% LIHTC projects the funding comes from many sources. Developers use the term "layering" to define the multiple sources needed to finance a project.

INTRODUCTION

This guide is intended for use by community development practitioners considering becoming developers of multi–unit affordable rental housing projects. Multi–unit projects are built to serve specific populations including seniors, families, homeless, transitional and housing for mentally or physically disabled. This guide will help organizations understand the complexities of development and the commitment needed to proceed. It will also detail the degree of support needed by community, local government, and public and private sector partners.

Most importantly, this guide will outline and take you through the key steps in the development process. As non–profit developers, it is important to minimize unnecessary costs. To assist you we have divided the development process into phases. The first phase can be accomplished with existing staff interested in community development. Staff time must be dedicated to conduct the preliminary work that allows you to make a sound decision on whether you should invest funds to take the project through the more extensive development process. Much of the initial preliminary analysis describes a process that once learned, could apply to most real estate development.

In the second phase, we have detailed the steps needed to complete a project. This step will require your organization to invest predevelopment funding to conduct the necessary "due–diligence" to ensure the project is feasible. The second phase will also detail what needs to occur to complete development.

Projects might be designed to provide added benefits by including "green" or other energy–efficiency measures. Projects could incorporate service programs and include added features such as community gardens, swimming pools, child care facilities, learning centers or libraries. These added community benefits may incur additional development costs that you or your partners will need to consider.

For experienced developers, this guide could also be used as a checklist to remind you about key issues and provide a refresher on the process for this type of development.

Use of Low Income Affordable Tax Credits (LIHTC) has become the most common way of creating affordable housing units. Tax credits create affordability by attracting substantial private sector equity into projects. The federal government allocates credits to states on a per capita basis. States develop an allocation plan that will provide credits to projects on a competitive base. Projects subsequently sell the credits to investors. With the added investment equity along with other public sector support, less debt is required which results in the project not needing high rents to make large loan payments.

The development of affordable projects is difficult and complex, yet projects have been developed by nonprofit community development organizations for over 15 years. In many states, use of LIHTCs is very competitive (the competition and standards for applying have grown year to year). Some of the requirements for applying for credits now include a successful track record of developing LIHTC projects.

In many regions community development organizations have grown and specialized in developing affordable rental housing for a larger region and it may be beneficial to partner with an experienced developer for your initial project. You would build capacity and ensure that the project retains the amenities and services your community needs by participating in the ownership structure and management.

Development is a team effort. This describes who needs to be development team members, what partners should be included in the process, and identifies ingredients and steps that are essential for a successful project.

This guide includes the following sections:

1. Use of this Guide: An overview of what types of affordable housing development projects can be developed with assistance from this guide.
2. First Phase: Initial Development Steps. This section includes the steps needed for an organization to clarify its development concept and to determine if a project is possible. It explains who you should initially talk to and what information you would need to decide to proceed with your project. These are the steps needed to clarify what you want to do and gather the data needed

to clearly explain your project in the hopes of garnering interest by project funders and partners. In many ways, this is the basic information needed to develop your concept paper. Once you decide to proceed, we will retrace many of these activities to include greater details needed for project and financing approvals.

3. Go/No Go: This is the point that you and your organization would use the data collected to decide if you should proceed. If you do proceed, you will know what resources or assistance are needed. This guide suggests ways to keep costs minimal prior to the Go/No Go decision (main resource will be staff time). The next phase entails more time and financial commitments by your organization. You will incur predevelopment expenses (a great portion will be funds used for consultants that will verify many of the development assumptions such as market demand, development cost, and appraised value)
4. Second Phase: Detailed Development Process: These are the steps that outline the development process. It will identify key development steps and important project resources. This section will provide insight into the essential steps needed for the successful completion of your project.
5. Financing: This section will provide some detail on the sources of financing and how they are used in the development of affordable housing.
6. Development Notes: These are some "tips" that we have compiled from experienced developers that highlight important considerations.

First Phase: Initial Development Steps

FIRST PHASE: INITIAL DEVELOPMENT STEPS

If you and your organization decided to explore the feasibility of developing a multi unit affordable project, this section outlines key items you need to know before spending predevelopment funds that will not be recovered unless the project is completed. You will need to invest staff time to investigate initial feasibility, but in the long run, it will save time and money. It is likely that you will look at several projects before one has the right attributes needed for success. Most of the general data gathered in this process will allow you to complete a concept paper that your organization can use to decide whether to invest the time and financial resources to move forward. It will also be used to generate support from future financing and development partners.

1. Determine the market need by target population: The first step is to make sure there is a need for affordable rental housing in the targeted community. This will be your initial understanding of the scope and type of affordable housing needs in your community. This can be verified by various sources including:
   a. Community Plans: Do the plans outline the need for affordable housing?
   b. Community Planning Meetings: What has the community said about housing needs?
   c. Local Government: Is housing a priority and if so where?
   d. Community Organizations: Do their constituents ask for more affordable housing? Do other local community affordable housing developers and projects have waiting lists?
2. Is there local government funding available? Local government funding will be needed unless there are other sources of project equity. Government equity includes grant funds or deferred/residual receipt loans from local government and will usually be anywhere from 15% to 25% of the total development costs. Deferred/residual receipt loans are structured so the payments are not due unless there is residual cash flow that the project can afford to pay. Additionally, these loans are usually at a very low interest rate. The funding takes the deferred/residual receipt form instead of an outright grant to meet IRS tax credit eligibility requirements but is generally viewed as project equity. In some cases, a locality might commit funding over two budget periods. For your investigation, check to see if funds are available, and if so, what are the requirements and timing of applications? Key resources for deferred/residual receipt loans include:
   a. Funding Sources include:
      i. CDBG (Community Development Block Grants): These are federal funds passed through to most local jurisdictions (Cities, Counties and the State (for rural areas)). Use of funds is determined by the local jurisdiction's annual request to the Department of Housing and Urban Development (HUD). Developers apply for funding on an annual basis.
      ii. HOME (HUD funds to State and eligible local governments) for affordable housing development for low and moderate income communities and individuals
      iii. Redevelopment Agency: Tax Increment funds from redevelopment projects
   b. Key departments that administer funds include:
      i. Housing Department
      ii. Redevelopment Agency
      iii. Community Development Department

      Local government and federal pass–through funding require significant levels of public benefit, meaning that the funding is minimally targeted to meet the needs of low and moderate income individuals, families and communities. The more public benefit your project generates the greater likelihood of support.
3. State, Federal and Other Funding Sources: These sources are needed to complement, augment and sometimes replace funding from the local level. The funding will look similar to local government funding: residual

receipt or deferred payment loans. In some cases it may be a substitute source for local support; however these sources vary significantly from state to state. It is not uncommon to have local sources augmented by state or other sources.

a. State Sources/Programs (Grants and Project Equity)

   i. CDBG/HOME: If you are in a smaller jurisdiction, your CDBG/HOME funds may be administered by the State. (Check with the community development or housing department).

   ii. Bonds, Housing Trusts, Permanent Sources: In many states, affordable housing bonds may have been approved or an affordable housing trust fund created to support affordable housing development.

b. Federal Sources:

   i. Low Income Housing Tax Credits (9%) represents the primary federal tool used to attract equity financing for affordable housing development. These tax credits are federally allocated to states based on population (credits allocated per capita). Each state decides how these credits are allocated to projects. In a given year there may be geographic, income, type (senior or family) or other priorities (LEED Green Standards, Transit Station Development or Mixed Use) that are part of the allocation process. See more on Tax Credits in "Financing Notes" below.

   ii. Affordable Housing Program (AHP): Although this is not a direct federal program, the AHP program is a grant program sponsored by the Federal Home Loan Bank (FHLB) system. Each regional FHLB bank will use a part of their profits to provide grants to support affordable housing development. Each regional bank will have its own competitive process to support projects which can be as high as $15,000 per housing unit.

c. Other Sources: Foundation and corporations may want to support an important local project and can provide grant funding (equity).

For all of these potential sources, make sure you know the timing for each funding cycle and know when proposals are due. The "art" in many of these developments is having the right application ready for each of the funding cycles. It is also very important that you confirm that your project is eligible. Some sources may require approval from other funding prior to being eligible to apply. Is your project in the right location and do you meet all of the organizational eligibility requirements?

4. Locating a Site: Locating a site is a key step and should be initiated about the same time as you research funding resources. When looking at a site you will need to research:

   a. Zoning/Allowable Use

   b. Amenities: The investigation of the funding sources will result in an outline of requirements for site and project area amenities (bus stops, markets, recreation, schools, etc.)

   c. Restrictions: Check the deed and planning restrictions for the site.

   d. Use Compatibility: Is the project compatible with neighboring uses?

   e. Availability/Ownership: Is the site available? If it has been available, why? (Issues include cost, environmental issues, development constraints, etc.)

5. Preliminary Development Team: The informal development team is tasked to investigate and define the project. In some instances the same members might participate in project development. The team will represent the organization and its activities may be bound by board or organizational approvals. In this preliminary phase, your organization is trying to minimize costs by looking for volunteers and friends to provide estimates.

   a. Project Manager: The project manager might be a hired professional or a member of management. The manager must have adequate time to investigate the project. If the manager does not have development skills or experience, a development consultant, interested volunteer, or board member should be recruited to support and offer guidance to the manager.

b. Architect/Contractor: The architect/contractor could be a board member or friend of the organization who can provide some input and insight into project design and development issues, and can provide rough cost estimates. Local contactors can also provide a rough cost per square foot estimate based on design and use.

c. Consultant (If needed for financial structuring, development and planning): At this early stage the consultant could be a volunteer, board member or someone who might be interested in supporting the project and would have development and finance experience and skills. If the organization has an experienced project manager, a development consultant would not be needed.

d. Attorney: At the outset, certainly in the planning stage, you should consult an attorney. He or she might also be a board member, but it is important that the attorney have experience in working with SEC.501(c)(3) organizations and in real estate development. There are unusual tax issues presented when non–profits engage in for–profit real estate development. Also, there are many land use issues (zoning, height/density/use, etc.) which may call for legal analysis.

6. Preliminary Feasibility of the Project: Now that you know the resources are available to develop a project and you have the team to support your efforts, the next steps will help you clarify the scope of the project and determine work tasks. By the final steps your organization should be able to make an informed decision to proceed with the project (or to proceed by meeting certain conditions).

   If you proceed, predevelopment funds will be needed and a portion will be "at–risk", meaning that compensation for the expenses incurred is unlikely unless the project is completed. Remember, this analysis is for you to determine if you should proceed and if so under what conditions. Any issue or potential problems that you have identified will need a solution to allow you to continue. These steps include:

   a. Planning:

      i. Local Plans, General Plan: How is the intended use reflected in local/community plans? Is it consistent with the general plan?

      ii. Previous Development Efforts: What has happened to the proposed site? Why is it available? Has anyone else attempted similar development activities?

   b. People: You must identify the supporters and opposition. What would they want to see in the project if you were to proceed? Community support is essential. Organized "Not in My Back Yard (NIMBY)" efforts can end or significantly delay your project. Talk to:

      i. Local Planning Staff

      ii. Local Elected Officials

      iii. Community (Homeowners association, neighborhood councils, community organizations and key community leaders)

   c. Preliminary Design: Your project team and the data gathered will enable you to determine the following:

      i. Unit Mix: Bedroom mix and scheduled rents

      ii. Project Use: Will this be a senior, emancipated youth, family or housing for the disabled?

      iii. Amenities: Will you include a community garden, play area or pool?

      iv. Density: What densities are allowed? What makes sense for your community?

      v. Local Design Standards: What must be included in design?

      vi. Funding Design Requirements: What do the funding sources require?

   d. Preliminary Financial Feasibility: Financial feasibility is the most important step in your preliminary project analysis. Here you will begin to make adjustments based on resources and what you can afford to develop.

      Now that you know what you are building and where, this is your initial attempt at determining project costs, sources of financing and ultimately the overall feasibility of your project. Your lenders will always ask for sources and uses: who is paying and what are they paying for. Our analytical steps will look at uses (costs) first and then look at what sources you have to pay for it.

i. Uses (Costs): Together, the two following cost items will equal your project's development cost.

   1. Hard Cost / Construction Cost Estimate: Based on square footage and uses, your development team will be able to estimate construction hard costs (what it costs to build the project). You also will be able to estimate the offsite costs (curbs, gutters and utilities).

   2. Soft Cost Estimate: These are all of the other costs that are not part of the actual construction. This includes some consultants, reserves and fees.

ii. Sources: This is your estimate of what funding sources might be available to you, how much you may be able to obtain and what the financing terms are. Sources will need to match uses and any debt (loans) must be able to be repaid from the project's cash flow.

   You should also check the funding requirements for these sources. Do you and the project team qualify for the tax credit or financing? Does your project meet the requirements and financing guidelines for all other sources?

   This is your preliminary analysis, so be CONSERVATIVE. Do not use lower estimates just to be eligible for a funding source. Ultimately, development expenses will usually be higher due to unforeseen events. Additional expenses will be harder to support after you have already been approved at a lower amount.

   1. Equity: Based on project cost, you can estimate the amount of equity generated by the sales of the 9% LIHTC's. (See Notes Below on how this is calculated).

   2. Other Equity: Include "soft debt" from local government. These are the CDBG, HOME or RDA funds that are at a low interest and/or repaid on a deferred basis (when there is available cash flow). This is included in equity and is generally "valued" as equity by the appraiser and/or lending institution to determine a project's value.

   3. Debt: The maximum conventional loan a lender is willing to provide to a project is based on the cash flow generated by the project. For a construction loan, this would be the maximum loan (ultimately "taken–out" or "repaid" by the permanent loan). In many instances the construction lender is willing to provide "bridge financing", e.g., financing to bridge other funds such as City financing or tax credit equity that will not fund during construction.

      There are two measures used by banks and lending institutions to determine the maximum loan they will provide a project. The bank will use the loan size equal to the lower of the two following standards. They are:

      - Loan to value (LTV) is a ratio (percentage) used by banks to determine the maximum loan a project could receive based on its calculated value. A 75% LTV would mean that the maximum loan for project valued at $1 million dollar project would be $750,000. A 75% LTV is typical for projects.

      - Debt Service Coverage Ratio (DSCR) is a ratio of what the maximum loan for a project would be based on its ability to make loan payments. A DSCR of 1.20 would mean that a project would need total income per month (less expenses) to be greater than 120% of the monthly debt payment. You would have 20% extra cash available after you make your monthly payment to the bank. DSCR might be as low as 1.10 in some economic markets.

4. Gap: This is the additional amount for which you have not been able to identify a source. As a result, you will need to go back and locate "other equity" sources or seek increased commitments. You might also look to cut costs by reviewing materials and amenities. More units or higher rents can also be part of your analysis.

7. Securing Preliminary Support: Based on this more in–depth analysis, you will need to loop back and conduct additional meetings to ascertain the level of support and level of funding commitments from the sources noted below. This is the phase of work where your organization will maximize its local community support, political connections, board connections and goodwill to obtain commitment from key sources of financing. You will need support from:
   a. Organizational Support (Board, Staff)
   b. Local Community
   c. Local Government
   d. Debt, Equity, and Gap Sources

GO/NO GO/MODIFY

This is the point where the organization can determine if it is willing to spend the funds to start project predevelopment. Remember, to this point have committed some staff time and incurred very little expenses. The information you have gathered will give you an indication of whether or not you have a feasible project that you would be willing to invest predevelopment expenses on.

Second Phase: Detailed Development Process

MULTI-USE AFFORDABLE RENTAL HOUSING – NEW CONSTRUCTION

SECOND PHASE: DETAILED DEVELOPMENT PROCESS

Now the work begins. The following steps will help you and your development team and partners proceed through the development process with the intent of closing financing and developing the project. You will need a technically competent development team and partners who will conduct the detailed analysis and work. Project details will be researched and completed. Designs will be finalized. Costs will be confirmed. Loans and grants will be approved by lenders, public and private sector funders. Agreements will be consummated. Construction will start and the project will be completed.

8. Predevelopment (Refine Assumptions)
   a. Site Control: Begin the process to gain site control.
      i. Letter of Intent: The letter of intent (LOI) is your written offer to the seller that outlines the terms and condition of the sale. This is drafted with your broker or real estate specialist and will include clauses to ensure your deposit is refundable and that there is ample time to conduct the studies needed to proceed. These projects take an enormous amount of time (negotiating multiple sources of financing where many have a long approval process). It is critical that ample time is negotiated. If there appears to be strong interest from a funding source, it might be prudent to allow payments to be made to the owner (portions of the deposit going "hard").
      ii. Negotiations: Site acquisition is a negotiation with offers and counteroffers. The actual sales price will usually be determined by the appraisal (most local governments cannot pay for a site above the appraised value). In some cases when the appraisal is lower than the seller is willing to accept, other costs borne by the seller might be paid by you.
   b. Site Due Diligence: Most of the following items are required by lenders and investors and will require predevelopment funds to engage these 3rd party studies.
      i. Title Report
      ii. Appraisal
      iii. Soils
      iv. Environmental
      v. Seismic
      vi. Flood
      vii. Noise
      viii. Traffic Studies
      ix. Historic and Local Public Development Requirements
   c. Entitlement/Planning: The planning department will confirm that your project meets all local planning restrictions, code and utility easement requirements.
   d. Market Assumptions (Market Study): The market study will assess the marketability of the proposed units based on location, amenities and rental rate. The study will estimate the time needed to lease–up the project. Some funding sources may require a 3rd party study.
   e. Design: Design and site plan work should begin.
   f. Confirm Construction and Operating Assumptions: Based on the more formal plans, you will be able to confirm construction costs.
   g. Appraisal: You may need to engage an appraiser to determine the sales price of the land. If it is not absolutely needed it is a cost that could be avoided and be included in the appraisal commissioned by the lenders. The appraisal will be needed if you have predevelopment funds that are to be used for site acquisition (funding from another source, usually local government).
9. Refine Development Team: This is the project development team who will close the financing and build your project. The team will consist of professionals who are hired to assist in the completion of the project. Bids will usually be taken to decide on key project participants such as the contractor and engineer.

   It is incumbent on you to do your due diligence (homework) to ensure that the parties have the skills, experience, time and financial capacity to complete the work. You may also want to talk to your lending sources (public and private sector) to make sure the team members meet their requirements (license and bonding). They may also have recommendations and provide insight from past experiences. Key members of your team include:

a. Architect: Will move from design to working drawings and specifications

b. Contractor: Your lenders will have certain bonding and insurance requirements for the contractor.

c. Engineer

d. Attorney: Make sure they have experience with LIHTCs.

e. Accountant

f. Energy Consultant: Especially if you are trying to meet certain energy efficiency goals.

g. General Partners (Ownership Structure): The attorney will begin to structure the limited partnership that brings the equity investor (buyer of the tax credits) into the project. The investor becomes the limited partner and your organization will become the managing general partner. At this early stage, you will want to talk to several investors. All have different terms (how much, how early they can provide equity and what they require when they leave the partnership in 15 years).

h. Funding Sources: This would include all of the sources of debt and equity needed in the project. These sources must in agreement about the project; its cost, who is paying for what, when the funding occurs, the development time frame and in the case of debt and bridge–loans), when they will be repaid.

10. Financing

a. Review Debt, Equity and Gap Financing Application: Each source will have specific requirements for approval. There are separate checklists of forms, documents and studies that are needed for each lenders approval. Be aware that any unforeseen condition will likely trigger the need for more information and may create additional financing requirements or contingencies. Also note the timing requirements for the sources of financing, some may require a prior commitment from other sources before they can approve or consider your application.

b. Refine Development Pro Formas Based on Funding Source Requirements and Conditions: Each source will determine the size of their commitments and the conditions of their funding. There is a possibility that many of the conditions will not be in sync with others, and there will be a need to negotiate a solution. In addition, the loan amounts will typically be less than anticipated and/or additional funds may need to be set aside to meet unanticipated conditions. There may be a need to locate additional sources or request more funds.

c. Commission Appraisal: The appraisal is usually commissioned by the first trust deed lender and might be shared by other participating lenders and funding sources. Make sure you check to see how this process could be combined to save costs. The appraiser will determine an "as is" appraisal, the value upon completion of construction, and a value upon lease–up. If you have a mixed use project, they will need to value each segment and determine an overall value (appraisal costs will be higher).

d. Obtain Conditional Commitments: After review of the application and underwriting the project, the lenders will make a "conditional commitment" subject to a number of items that can include but not be limited to: appraisal, review of environmental, review of architectural design and specifications, approval from participating lenders, approval of related entitlements, and conditions as a result of other findings from 3rd party reports.

11. Site Acquisition: During this process (preferably early as possible), you should have an approved letter of intent (purchase agreement) and have opened escrow.

12. Project Entitlements: Project entitlements include:

a. Preliminary Plans: Your architect will submit preliminary drawings to the City for initial review. The City will note changes and other requirements

b. Plan Check: Plan review undertaken by the planning department

c. Design Review: Local or community review or review by lender(s).

d. Building, Utility, Public Safety, Public Works Requirements

e. Community Input/Approval

f. Finalize Plans, Specifications

g. Final City Approval (community hearings and approval from the Land Use and Planning Commission and from the City (Council)): You must know beforehand that approval is likely. If there is opposition, you should be ready to "prove your case" for project approval. This may include bringing a busload of seniors or supporters and have them call the council or commissioners offices.

13. Additional Construction Loan Requirements: These are the key items outlined by lenders as a condition of closing

    a. Final Working Drawings: This includes drawings and specifications

    b. Construction Contract: Lenders or investors may require certain types of contracts (cost or cost plus). Note on Construction Bids: The bid process begins when the working drawings and specifications are ready. Check with participating lenders on their requirements for the contractors bidding on the project (credit history, bonding capacity, prevailing wage compliance, insurance, etc.)

    c. Architect Agreement: Usually standard American Institute of Architects form

    d. Property Management Contract: This is the firm that will lease up and manage the project. In many cases the lenders have specific requirements. If your organization is interested in building this capacity (especially if you are providing additional services such as after school programs, senior nutrition, health and family care or youth programs), you may want to work with an experienced provider while gaining the experience.

14. Syndication: The process of syndication began in Sep 9 (when you determine the ownership structure). You can locate a syndicator (investor who purchased the tax credits) using the following steps.

    a. Tax Credit Investor Solicitation: The (tax credit) investor market changes based on economic conditions and the appetite of lenders. Demand from lenders and financial institutions are partially based on their desire to meet Community Reinvestment Act (CRA) requirements. Purchase of tax credits has proven to be a very safe method of meeting CRA investment requirements. Lenders are incented to invest in certain low and moderate income communities that are part of their service areas. This has driven up the market demand for tax credits (they will pay a higher price for tax credits). Check with any lender and they will know which investors are active in any region.

       Besides financial institutions, insurance companies, utilities and some larger corporations are active in the tax credit market. There are also syndicators that purchase credits on behalf of corporate investors.

    b. Negotiate Terms (Pricing, Amount, Pay in Schedule and Other Requirements): These items and the terms thereof are very important to your project. Two years ago the purchase price of credits ranged from 80 cents for a dollar worth of credit to over one dollar per credit. Post economic crash has dropped pricing down to as low as 67 cents, with very few investors in the market. In some high CRA demand areas, the pricing is back up to the 90 cent plus range. The pay in schedule is important because the investor does not accrue value in the credits until the project completes construction. However, equity is needed during construction (it is the cheapest source of funds during construction versus a conventional construction loan that charges interest over the period of the financing).

    c. Finalizing Ownership Structure: Once terms are agreed, the attorneys will finalize the limited partnership. This document will outline the conditions of the equity investment, how the partners need to perform and how they could be removed or replaced.

   d. Execution of Partnership Agreement: The actual execution usually occurs at the close of the construction loan.

15. Construction Loan Closing

   a. Fulfill Other Funding Conditions

      i. Escrow Account/Instructions: The escrow instructions are critical and include all of the documents, exhibits and approvals that must be presented before closing and recording of the documents. Escrow also manages the funding process (from lenders, investors and other grant sources) and payments to participating parties and consultants.

      ii. Other: Signed construction contracts, approved drawings, permit approvals and funded reserves.

   b. Documentation: All of the loan documents, funding agreements, inter–creditor agreements, partnership agreements and deeds are drafted by respective attorneys and reviewed by you and your attorney. Note: The permanent loan provider will provide a commitment to fund based on meeting conditions related to construction completion and lease up. The take out (or permanent loan provider) will require specific documentation. In some cases the construction lender will also be the permanent loan provider. There is a strong desire to close the construction loan since the interest rate on a construction loan is higher than the rate on the permanent loan.

   c. Negotiations: Representatives of every source of debt and equity participates in negotiations while closing the financing. You (the project), bear the cost of all attorney fees. It is essential to manage your attorney to ensure their fees are not being generated by insignificant negotiations. Business decisions should be the center of negotiations.

   d. Execution: Signing by all parties and subsequent recording of documents.

16. Start Construction: Construction cannot begin until the documents are signed and approval to proceed is given. In some cases, demolition and site preparation might be approved under a separate contract and funded outside of the construction financing.

17. Construction Period Management

   a. Monthly Draws

      i. Inspections: There are usually monthly meetings with all participating entities (various lenders, architect, contractor, building inspector, and the owner). Your participation might be through a hired construction manager who has experience in all aspects of construction. All parties should agree on the percentage of completion and how it matches the completion schedule. Your construction manager will help ensure that costs and change orders are justified.

      ii. Architect Sign Off: See above

      iii. Change Orders/Clarifications: Your construction manager is important in managing change orders and approving clarifications (between contractor and architect). All parties must agree on any change order.

      iv. Draw Request: As part of the inspection meeting, the draw request is reviewed. Construction progress is agreed upon, bills reviewed and change orders examined and approved (signed by all parties).

      v. Lien/Lien Releases: Upon completion of work by various trades and suppliers, lien releases are issued, signed and forwarded for recordation.

      vi. Payments: Per the loan agreement, funds are released by the construction lender and participating lenders (city and/or state sources) to the construction account managed by your organization. You will subsequently transfer funds to the contractor. The agreement also defines the turn–around period for funding by both the bank and by you to the contractor.

   b. Pre Leasing: Each funding source (including the tax credits) has restrictions on family income and family size.

Potential tenants must be pre–qualified. In most cases, there will be greater demand than there are units, resulting in the need for a drawing or "lottery". Many of the sources also have strict requirements on how and where the pre leasing is advertised.

c. Construction Completion: Tax credits require that a project must be placed into service by a specified date or the credits will no longer have value. Additionally the equity investor has estimated their equity investment into the project based on what the placed–in service date is (the partnership agreement will include monetary "penalties" if days are missed.

d. Architect Sign Off: Final completion sign off

e. Building Inspection Sign Off: Completion and issuance of the Certificate of Occupancy is by the city building inspector.

18. Leasing/Move In: The management company will coordinate move in with the lottery winners. They would have also reviewed each tenant's financial status to determine if they meet the income guidelines for low or moderate income individuals and families.

19. Project Stabilization (Construction Lender): The construction lender will be repaid by the permanent lender upon meeting certain agreed upon leasing goals (project lease up stabilization). The terms of the lease up are requirements of the permanent lender, per your loan agreement. In most cases the interest rate for the construction loan is higher than that of the term loan, so it is beneficial to meet the lease up requirement as soon as possible.

20. Tax Credit Requirements

    a. Filing of 8609 (Meet Tax Credit Requirements): This is an Internal Revenue Service document

21. Conversion/Closing of Permanent Financing: Stabilization is the main trigger for the conversion however there are a number of items that are outlined in the permanent loan agreement (clear title, occupancy certification, approval of participating lenders, etc.)

Financing

MULTI-USE AFFORDABLE RENTAL HOUSING – NEW CONSTRUCTION

FINANCING

1. 9% Low Income Housing Tax Credits (LIHTC):
   a. These are tax credits that are federally allocated to States. There is an annual per capita allocation.
   b. Each state has its own allocation plan that may emphasize certain types of affordable housing development or certain locations.
   c. In some states the credits are very competitive and extensive criteria and requirements have been added.
   d. LIHTCs Allocations are made to the project
   e. The credit's useful life is 15 years
   f. Investors (usually institutional investors such as banks, insurance companies, utilities and syndicated pools) purchase the credits from the project.
   g. Investors purchase credits in return for reduction of tax liability used over a 10 year period. The investor uses the tax credits to offset income over a 10 year period.
   h. Investors participate as limited partners through the 15 year compliance period. During the compliance period the investor will actively remain in the partnership and the project must meet all of its affordability requirements. The investor is subject to significant recapture penalties during this period.
   i. The limited partner is usually 99.99% of the partnership, while you are the .01% general partner.
   j. There is up to a 30% boost in the value of the credits in hard to develop areas (Example: In California, 90% of the state is considered hard to develop).
   k. Many states offer accompanying state tax credits that are also sold to investors
   l. Rents are restricted for a minimum of 20% of the units being affordable at 50% of median rents (median income for families in the Standard Metropolitan Statistical Area (SMSA)), or 40% of units affordable at 60% of median. Typically 100% of the units are restricted (to achieve maximum benefits).
   m. Example:
      i. Development Costs are $10 million
      ii. Land is $1 million
      iii. The eligible basis is about $8.5 million (most of the hard costs)
      iv. For hard to develop sites, this basis is multiplied by 30% and the total is $11,050,000.
      v. The Department of Treasury will daily determine the applicable rate for the credits. If it is 9%, the credits useful life period is 10 years so the value of the credits is $9,945,000.
      vi. The investor will offer a price for the credits. If sold for .70 per credit the total equity would be $6,961,500. (Note: if the credits sold at $1.00, there would be $9,945,000 in equity, a difference of over $2.98 million! Prior to the financial collapse, credits sold for more than $1.00).
2. Conventional Debt:
   a. Loan term must exceed 15 year tax compliance period, usually amortized over 30 years with a 1.15 Debt Service Coverage Ratio (DSCR).
   b. Since loans are based on DSCR the permanent loan amount will not cover the remaining financing need, thus the need for other local funding and tax credit equity.
3. Gap:
   a. Residual receipt loans provided by government sources (local and state funds)
   b. Direct grants and foundation support
   c. Terms usually about 55 year terms at 3%, along with rental restrictions
   d. Possible gap loans are available if there is cash flow available from Community Development Financial Institutions (CDFIs).
4. 9% Low Income Housing Tax Credits:
   a. Tax credit equity usually will need to be at least $1 million

b. Transaction costs are very high
c. Many states require extensive development experience
d. Compliance is very important (15 year period) so experienced property management is a critical component.
e. Depending on location, there might be significant demand for credits, especially if the project is in a CRA assessment area of major financial institutions.
f. At the end of the 15 year credit compliance period the project converts to the nonprofit sponsor. In some cases there are some tax consequences

5. Predevelopment:
    a. Hard to get unless you have a strong balance sheet or have an extensive successful track record
    b. Local government is your best source
    c. Intermediary sources such as Local Initiatives Support Corporation, Enterprise or the Low Income Investment Funds are cheap but may take some time to approve
    d. Syndicator/Investor may partner with you to cover costs if you have a strong relationship with them
    e. Commercial Bank lines of credit. Many institutions offer lines using investment funds in the form of equity equivalent loans. These are based on organizational financial strength.

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COMMUNITY ECONOMIC DEVELOPMENT — REAL ESTATE SERIES

Development Notes



MULTI-USE AFFORDABLE RENTAL HOUSING — NEW CONSTRUCTION

DEVELOPMENT NOTES

1. Use real estate brokers experienced in larger commercial transactions.
2. Be aware that land costs will be restrained by local government sources which are typically limited by the appraised value.
3. Don't fixate on the first site or project you find or focus only on one project. In most instances you will find one possible project out of several that you investigate.
4. Negotiate ongoing fees with local gap lenders (with residual receipt financing), to ensure that excess cash flow does not go to repay the gap loan (instead of going to management fees or project services).
5. Make sure there is cushion in the development budget. You will never have too much money, and expect the most unexpected reasons for cost over–runs. It is difficult to go back to equity and grant sources for more funds.
6. Keep architect in check for cost purposes.
7. Keep lawyers in check for cost purposes.
8. Keep consultants in check for cost purposes.
9. Do not build for cash flow or developer fees, benefits to the community will always be greater than any financial returns you will generate.
10. The stronger the development team, the stronger the project and its ability to find solutions when problems arise.
11. Having services and programs for the residents will make a significant improvement in the projects long term viability and success. Other family or community services may be added to support tenant needs but these costs and services are usually outside of the project financing structure. If there is excess cash flow generated by the project it would be beneficial to add this into the pro–forma, versus using excess cash flow to pay back differed loans from the city.
12. If you do not have experience, consider partnering with someone with extensive experience and with someone you like. You will be with them for 15 years or more, working closely in stressful situations leading up to the closing of the financing and managing the units once they are occupied.
13. Make sure you have staff designated to be the point person or "quarterback" for the project. He/she will be responsible for communicating with staff and management and with all of the project development team members. They must be responsible and have the ability to multi–task assignments.
14. Negotiate hard with your investor. If you do not have this skill, use a consultant. Total purchase amount, terms, dates/time of equity payments and exit terms are all negotiable.

Final Note

Development of multi unit projects is not easy and requires a strong commitment from the organization and the members of the development team. The goal can be accomplished with the support of the community, local government and interested financial institutions. It is most important to have staff dedicated to the project and if they do not have the expertise, locate resources to support and guide the effort.

This document is intended to be a guide that outlines some of the key issues and identifies possible solutions and steps. It is not intended to be your source since every project has its own issues, concerns and peculiarities and its own unique solutions. The document is not intended to encourage any organization into project development but only to lay out some of the key steps and issues once the decision is made to proceed.

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