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community Action Partnership
AMERICA'S POVERTY FIGHTING NETWORK

TOOLKIT

MIXED USE / MIXED INCOME DEVELOPMENT

Affordable for sale, rental, commercial retail and office, community facilities, & mixed housing units

Disclaimer

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DON'T QUITE UNDERSTAND HOW TO ARRANGE THIS TABLE OF CONTENTS

MIXED USE / MIXED INCOME DEVELOPMENT

This guide is intended for use by community development practitioners considering development of mixed use and/or mixed income projects. Mixed use projects incorporate different real estate uses within one project. This mix may include affordable for sale, rental, commercial retail and office, and community facilities (such as child care, health care or space for community use). Mixed income refers to properties that include housing units targeted for above moderate income buyers and tenants.

MIXED USE:

Mixed use projects are more common in high density urban communities and are very popular as part of planned developments, especially around transit stations. Much of this development trend is driven by local communities and is being supported by both public and private sector funding sources. Some cities have zoned land in central city areas to be used for mixed use only.

These projects may vary in terms of the size and scope of the intended use; however your role will not change. You are the developer, owner and manager of the physical structure whether or not your organization or programs locate in the facility. Your organization will be responsible to ensure that debt payments are being made and the building or project operates reliably and successfully. You need to have the skills of a housing, commercial (retail and office), and community facility developer. To accomplish this multi task endeavor, we refer you to the five other real estate development guides. You will need to apply the detailed development skills for each portion of your project.

MIXED INCOME:

Mixed income projects have also become a priority for many communities seeking economic and social parity and balance in all communities. Mixed income projects are however more difficult to finance. Most grants, investment funds and loans are specially targeted to serve low and moderate income families and cannot be used for market or above market uses. Developers will need to obtain equity and debt from the same sources as for-profit developers building market rate housing.

Mixed Income projects inherently have more market rate risk (the same risk borne by for-profit developers competing in the open market). Instead of having waiting lists of eligible tenants seeking a subsidized rental unit or waiting to purchase an affordable housing unit, you are competing against every other rental or for sale project in the immediate region. In this arena, location, cost and amenities are key factors that determines viability. The ability to understand the housing market and your ability to penetrate your share of the market is essential.

GUIDE FORMAT:

This guide along with the other appropriate real estate guides 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 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 required to make a sound decision on whether or not to invest funds to take the project through an extensive development process. Much of the initial preliminary analysis describes a process that, once learned, could apply to most real estate development. By adding additional uses and/or incorporating market risks, your time, commitment and ability to manage multi–tasks will be tested.

In the second phase, we have outlined steps needed to complete a project. This 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 and amenities. Most of these added features do not generate income and need dedicated grant(s) or equity sources to be feasible. These added community benefits may incur additional development costs that you or your partners will need to consider.

For experienced developers, this guide (and the other referenced real estate guides) 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.

FINANCING:

Separation of Uses: Many of the funding sources will require you to either split single lots (subdivide the site) based on the different uses. Or in the case of single buildings, require the air rights be legally split and defined (much like condominium projects). This allows for a level of security for many lenders and investors who do not want to assume additional risks such as a default in the commercial retail portion of the project affecting financing for the housing

Commercial/industrial projects rely on the facility's (tenants) ability to generate the cash flow needed to service the project's debt. Sources of conventional financing are significantly less than sources for affordable housing development. New Markets Tax Credits are available for many of these projects but generate less equity (compared to the 4% and 9% Low Income Housing Tax Credits) so reliance on debt financing is higher and thus reliance on other local, state and federal grant sources is increased.

In affordable housing projects, the abundance of equity and grant sources allows projects to keep rents at below–market rates, creating high demand for these affordable units. Commercial/industrial projects do not have this advantage. With fewer subsidy sources, these commercial projects must survive on the strength of their tenants and (just as importantly), local and regional economic conditions.

Risks are higher, and it takes more creativity to structure financing. When structuring financing, we need to determine maximum debt based on market rents, vacancies, operating expenses, etc. We work backwards to determine the amount of equity needed. At this point any additional equity reduces the need for debt, creating a financing cushion that can be used to lower rents, subsidize other services, or generate income for your organization. This process must be completed for each proposed use.

If your project goal is to provide subsidized or below market rent, you will need more equity. This guide (along with the other appropriate real estate guides) includes some of the key sources of "equity" and other lower cost financing needed to create viable, successful ventures that will benefit both your organization and the community. Much of the local equity sources for different aspects of the mixed use project will come from either CDBG or Tax Increment Funds from the redevelopment agency, so they will be asked to provide substantial equity.

In many communities it is desirable to create commercial retail and office projects that support local business start-ups or incorporate new start-up social ventures. However, projects with tenants who have less experience cannot secure as much debt (their ability to make ongoing lease payments is not as reliable as more experienced seasoned tenants). This higher risk perceived by lenders results in smaller loans.

Risk is also increased when housing units are targeted as market rate. The added market risk results in less available debt and the greater need for more equity (grants).

SUMMARY:

Rental and for sale housing, commercial retail and office, and projects with community facilities (mixed use) are very complex but are continually being developed by nonprofit community development organizations. Your tenant (whether it is your organization, a business tenant, individual or family) must be able to reliably pay its share of the rent. As the owner, you are responsible to collect rental/lease income and make debt payments. The amount of debt that the project can reasonably afford determines the amount of "other equity" needed. The lower the level of debt, the lower the rents can be and the lower the leasing risk is to you (the developer).

Remember, you are the landlord! You must make sure that the tenants you select are successful and will make lease payments. You may wish to access local business technical assistance programs to support tenants and seek partnerships with local loan funds that can provide access to financing resources. It is important that your tenants have access to help and other financial resources.

The case for rental housing is similar, your tenants must be able to pay the scheduled rents whether or not they are affordable or at market.

Experience is very important in mixed use projects as it is very important in any one aspect of mixed uses. Partnerships with experienced developers are very important and in many cases required by public or private sector lenders and investors. Non-profit community development organizations can partner with for-profit developers and bring a significant amount of funding into projects. In addition to funding, organizations bring community support and ultimately will be the users or buyers who will define success for the project. These factors should be part of the negotiations in sharing the developer fees or cash/flow.

Development is a team effort. This guide describes the 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: This guide must be used with the applicable real estate development guides that separately focus on affordable housing rental and for sale, commercial retail and office, and community facilities. These individual subject guides will provide you with the information needed to develop each individual development component and each guide is organized similarly. The process outlined in the guides also will help you determine whether a certain use should be included in the project or to how much of the project should be dedicated to a specific use.
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 of 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 where 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 who 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 and 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 Notes: This section will provide 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.

This guide should be used (along with appropriate real estate guides) for the following types of projects:

1. Mixed Use projects that incorporate two or more of the real estate components: Affordable Housing (rental or for–sale), commercial (retail and office), and community facilities.
2. Mixed Income: Development of projects with rental or for sale units targeted to income categories above low and moderate.

First Phase: Initial Development Steps:

Please refer to the First Phase section of each appropriate real estate guide to assist in the initial steps and analysis needed to determine if you have a project worth investing your resources in. Remember, each use adds to the detailed analysis you will need to make for each real estate development type. This process will allow you to determine if each proposed uses are feasible, should be reduced, or eliminated.

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 you have committed some staff time and incurred very little expense. 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 in.

Financing Notes

Mixed Use and Mixed Income projects have very complex financing structures. For example, if you include affordable rental housing with commercial (retail and office) and a community facility you would at minimum require the following sources of funding:

AFFORDABLE HOUSING:

1. Low Income Housing Tax Credits (with equity from an investor)
2. HOME Funding
3. Affordable Housing Program Funds from FHLB
4. Conventional Loan (construction and permanent)
5. Local, state or other public sector support
6. Private sector grants

COMMERCIAL:

1. New Market Tax Credits (with equity from an investor)
2. Office of Community Services CED Grant
3. Economic Development Administration Grant
4. Conventional Loan (Likely from a different lender than the housing loan provider)
5. Local, state or other public sector support (Community Development Block Grant or Redevelopment Agency Funds)
6. Private sector grants

COMMUNITY FACILITY:

1. CDBG or RDA funds
2. Other Private Sector Grants
3. Conventional (construction and small permanent loan)

In this example you would have 15 sources of financing (possibly 17 if your permanent and construction lenders are different). You would likely have additional sources such as subordinate loans from a conventional lender, local government or the state. Your project may also need predevelopment financing that can come from various sources. The local CDBG or RDA funds might also be different even if from the same jurisdiction due to them coming from different departments with different objectives and goals.

It is very important to understand the timing and conditions of each funding source to ensure that such a complex closing will occur in a timely manner. Recently, some tax credit investors and financial institutions have developed specialized lending and investment programs that can provide both investments for both New Markets Tax Credits and Low Income Housing Investment Tax Credits or conventional financing for affordable housing and commercial.

Development Notes:

1. Most commercial retail and office projects compete for tenants in an open market: you are competing against others in your market area. This is the view that conventional lenders will use when they underwrite the size and terms of the loan they provide to the project. You will need to conduct a strong fundraising effort from both private and public sector sources to meet your equity requirements. Your project will also benefit by having the least amount of debt possible to reduce any risks of default.
2. Use real estate brokers experienced in larger commercial transactions.

3. Be aware that land costs will be restrained by local government sources which are typically limited by the appraised value.
4. Don't fixate on the first site or project you find or focus only on one project. In most cases you will find one possible project out of several that you investigate.
5. 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).
6. 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.
7. Keep your architect in check for cost purposes.
8. Keep lawyers in check for cost purposes. These fees will be very high. The project will pay for your attorney fees as well as for each lender or investors attorney fees.
9. Keep consultants in check for cost purposes.
10. Do not build for cash flow or developer fees, benefits to the community will always be greater than any financial returns you will generate.
11. The stronger the development team, the stronger the project and its ability to find solutions when problems arise.
12. Having business technical assistance and access to financing will enhance the success of your tenants and make a significant improvement in the project's long term viability and success. If there is excess cash flow generated by the project it would be beneficial to add this into the pro–forma (to cover your management expenses), versus using excess cash flow to pay back differed loans from the city.
13. If you do not have experience, consider partnering with someone with extensive experience and with someone you like. You will be with them for many years, working closely in stressful situations leading up to the closing of the financing and managing the units once they are occupied.
14. 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.
15. 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 commercial (retail/office) or industrial projects is not easy and requires a strong commitment from the organization and 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 once a decision is made to proceed.

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