Affordable Housing: The Nuts and Bolts of Housing Development

Single Family Development

Jenny Larson, Executive Director
jlarson@threeriverscap.org
507-316-0390
About Three Rivers

• Community Action Agency serving 4 counties in southeastern Minnesota

• Programs include Housing, Transportation, Energy, Family Services, Senior Services, and Early Childhood

• Community Housing Development Organization serving 20 counties

• Expertise across the Housing Continuum
Southeast Minnesota

- Mayo Clinic located in Rochester
  - Destination Medical Center – economic development initiative adding 35,000 jobs over 20 years
- Food processing, manufacturing, hospitality, and education are other top sectors in addition to health care
- 1.9% unemployment in SE MN, 2.8% statewide (Nov. 2018)
- Median rent: $1,245 (Rochester, Dec. 2018)
- Median HH income: $72,337 (Olmsted County, 2017)
- 497 homeless persons (SE MN PIT count, Jan. 2018)
Continuum of Housing
Three Rivers Community Action

Homeless Assistance
- Homeless Prevention
- Rapid Re-Housing
- Crisis Assistance
- Case Management
- Transitional Housing
- Coordinated Entry
- Continuum of Care Coordination
- Resource Referral

Rental
- Rental Assistance
- Energy Assistance
- Case Management
- Permanent Supportive Housing Coordination
- Continuum of Care Coordination
- Housing Development - new construction and preservation
- Weatherization
- Development Consulting
- Asset Management

Homeownership
- Financial Literacy
- Financial Empowerment Coaching
- Homebuyer Education
- Homeownership Counseling
- Downpayment Assistance
- Housing Development
- Energy Assistance
- Weatherization
- Owner-Occupied Rehabilitation
Housing Development Activity

794 units, $95.5 million

• Single Family Homes
  • 101 new single family homes
  • 50 homes preserved

• Rental Housing
  • 268 new rental units
  • 375 rental units preserved
How We Work

• Community-based approach
  • evaluate local needs
  • engage community partners
  • involve residents in planning process
  • develop local strategies
  • connect with state and local resources
  • implement community plans
  • develop housing projects

• Community is a partner in the process
• Services available to communities across southern Minnesota
• Assisting other non-profits build their development capacity
The Development Process

- Determine Local Housing Need
- Preliminary Development Concept/Site Selection
- Assemble Development Team
- Plan the Project
- Obtain Local Support
- Assemble Financing
- Construction
- Marketing
- Management & Operations
Financing Partners

• Local Government (tax increment financing, fee waivers, etc)
• Minnesota Housing Finance Agency
• Greater Minnesota Housing Fund
• MN Dept of Employment & Economic Development
• USDA Rural Development
• US Dept of Housing and Urban Development (HUD)
• Minnesota Housing Partnership
• Federal Home Loan Bank
• Employers
• Foundations
• Local Lenders
• Others
Single Family Housing Development

Key Considerations

• Goal: Creating homeownership opportunities for specific market, without losing money (maybe even making a little)

• Successful project requires resources for both the development AND for the end buyer

• Project must meet the need of the local market, use data not a hunch

• Consider both Value Gap and Affordability Gap in planning and executing the development
Single Family Housing Development Definitions

Value Gap

• Total Development Cost is **higher than** the final value of the home
• In some projects, not all funds can be captured in the sale price to the buyer, requiring infusion of grant funds to make up the difference

**Total Development Cost – Realistic Sale Price = Value Gap**

Notes:
Total Development Cost should include all project-related costs
Realistic Sale Price is based on appraised value in current market
### Value Gap - sample

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition</td>
<td>$93,500</td>
</tr>
<tr>
<td>Rehab Costs</td>
<td>$65,000</td>
</tr>
<tr>
<td>Developer Fee</td>
<td>$8,000</td>
</tr>
<tr>
<td>Marketing Fee</td>
<td>$6,000</td>
</tr>
<tr>
<td>Other Soft Costs</td>
<td>$4,000</td>
</tr>
<tr>
<td><strong>Total Development Cost</strong></td>
<td><strong>$176,500</strong></td>
</tr>
<tr>
<td>less Post-Rehab Value (sale price)</td>
<td>$(143,000)</td>
</tr>
<tr>
<td><strong>equals VALUE GAP</strong></td>
<td><strong>$33,500</strong></td>
</tr>
</tbody>
</table>

Sources of Value Gap could be federal, state, local, Federal Home Loan Bank, employers, banks, foundations, etc.

Sources are often layered.
Affordability Gap

- Target buyer cannot afford the payment on the sale price of the home.
- Gap financing loans lower the amount of the first mortgage, lowering the monthly payment.

\[
(Sale \text{ Price} + \text{Closing Costs}) - (\text{First Mortgage} + \text{Buyer’s Downpayment}) = \text{Affordability Gap}
\]
Affordability Gap

• Determine Sale Price + Closing Costs
• Determine What Buyer Can Afford -- Need-Based Calculation Based On:
  • Household Income
  • First Mortgage (interest rate, term)
  • Required Downpayment & Buyer Funds Available
  • Front Ratio (determined by first mortgage lender & by what your program will allow in qualifying buyers)
• Use Consistent Formula -- calculation spreadsheets are available
# Affordability Gap In Practice

<table>
<thead>
<tr>
<th></th>
<th>CRV Gap</th>
<th>GMHF Gap</th>
<th>Total Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyer 1</td>
<td>$15,000</td>
<td></td>
<td>$15,000</td>
</tr>
<tr>
<td>Buyer 2</td>
<td>$11,400</td>
<td></td>
<td>$11,400</td>
</tr>
<tr>
<td>Buyer 3</td>
<td></td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Buyer 4</td>
<td>$10,350</td>
<td></td>
<td>$10,350</td>
</tr>
<tr>
<td>Buyer 5</td>
<td></td>
<td>$3,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Buyer 6</td>
<td>$4,000</td>
<td>$10,000</td>
<td>$14,000</td>
</tr>
<tr>
<td>Buyer 7</td>
<td>$10,000</td>
<td>$12,000</td>
<td>$22,000</td>
</tr>
<tr>
<td>Buyer 8</td>
<td></td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Buyer 9</td>
<td>$20,000</td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td>Buyer 10</td>
<td>$4,730</td>
<td></td>
<td>$4,730</td>
</tr>
<tr>
<td>Buyer 11</td>
<td>$2,500</td>
<td>$10,000</td>
<td>$12,500</td>
</tr>
<tr>
<td>Buyer 12</td>
<td>$20,000</td>
<td>$10,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>Buyer 13</td>
<td>$1,259</td>
<td></td>
<td>$1,259</td>
</tr>
<tr>
<td>Buyer 14</td>
<td>$20,000</td>
<td>$10,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>Buyer 15</td>
<td>$7,000</td>
<td>$10,000</td>
<td>$17,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$126,239</strong></td>
<td><strong>$105,000</strong></td>
<td><strong>$231,239</strong></td>
</tr>
</tbody>
</table>

Average total gap = $15,416
15 households assisted
Only 3 used maximum gap

Maximum total gap = $30,000
If all buyers would have gotten maximum, only 7 or 8 buyers assisted

Need-based calculations allow twice as many households to be served
Single Family Housing Development
Project Examples

• New Construction
  • Individual Homes
  • Subdivision Development
• Acquisition-Rehab-Resale
  • Foreclosure Remediation
  • Contract for Deed pilot project
• Owner-Occupied Rehab
  • Neighborhood Revitalization
• Homebuyer Programs
  • Achieve Homeownership
Developing 1 New Home

Requirements:
- Lot
- Home Plans
- Contractor
- Construction Funding
- Sales Agent
- Buyer
- Financing for the Buyer
### Developing 1 New Home

<table>
<thead>
<tr>
<th></th>
<th>House 1</th>
<th>House 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lot Price (w/infrastructure)</td>
<td>$50,000 pay for lot from developer</td>
<td>$ - free lot from city</td>
</tr>
<tr>
<td>Architect/Home Plans</td>
<td>$10,000 cost of new plans</td>
<td>$5,000 pay to modify existing plans</td>
</tr>
<tr>
<td>Construction Cost</td>
<td>$180,000 1200 SF, $150/SF</td>
<td>$180,000 1200 SF, $150/SF</td>
</tr>
<tr>
<td>Legal/closing costs</td>
<td>$5,000 pay for attorney/closing fees</td>
<td>$2,500 receive in-kind donation from attorney</td>
</tr>
<tr>
<td>Construction Interest</td>
<td>$12,000 5% interest for 12 months</td>
<td>$3,700 2% interest for 12 months</td>
</tr>
<tr>
<td>Developer Fee</td>
<td>$15,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Marketing (Real Estate Agent)</td>
<td>$15,000 6% of sale price</td>
<td>$7,500 Agent lowers fee (3%) or staff sells house</td>
</tr>
<tr>
<td>Contingency</td>
<td>$18,000 10%</td>
<td>$18,000 10%</td>
</tr>
<tr>
<td><strong>TOTAL COST</strong></td>
<td><strong>$305,000</strong></td>
<td><strong>$231,700</strong></td>
</tr>
<tr>
<td>Market Value</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td><strong>Value Gap</strong></td>
<td><strong>$55,000</strong></td>
<td><strong>$(18,300) NO VALUE GAP</strong></td>
</tr>
</tbody>
</table>

- Costs for the same house can vary widely
- Plan the budget for every house
- Look for ways to reduce the costs, get commitments in advance
Developing 1 New Home

Strategies for Reducing Costs

• Find free or reduced-price lots
• Negotiate lower fees from professionals (architect, attorney, real estate agent)
• Look for low-interest construction loans
• Consider variety of home plans (smaller footprint, unfinished space, attached housing, etc)
• Seek funding sources - gap financing, construction financing
Developing a New Subdivision

Requirements:

- Land
- Zoning
- Survey/Engineering
- Infrastructure Plans
- Home Plans
- Contractor
- Sales Agent
## Developing a New Subdivision

<table>
<thead>
<tr>
<th>Number of Lots</th>
<th>Total Cost</th>
<th>Per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Total Lot Cost | $1,470,000 | $49,000 |

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
<th>Per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$300,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Engineering</td>
<td>$60,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>$990,000</td>
<td>$33,000</td>
</tr>
<tr>
<td>Contigency</td>
<td>$90,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Other soft costs</td>
<td>$30,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Architect/Home Plans</td>
<td>$105,000</td>
<td>$3,500</td>
</tr>
<tr>
<td>Construction Cost</td>
<td>$5,100,000</td>
<td>$170,000</td>
</tr>
<tr>
<td>Legal/closing costs</td>
<td>$90,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Construction Interest</td>
<td>$150,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Developer Fee</td>
<td>$450,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Marketing (Real Estate Agent)</td>
<td>$105,000</td>
<td>$3,500</td>
</tr>
<tr>
<td>Contingency</td>
<td>$510,000</td>
<td>$17,000</td>
</tr>
<tr>
<td>Total House Cost</td>
<td>$6,510,000</td>
<td>$217,000</td>
</tr>
</tbody>
</table>

| Total Development Cost        | $7,980,000 | $266,000 |
Strategies for Reducing Costs

- Seek infrastructure assistance from local government (i.e., tax increment financing)
- Vary size of lots, create a mix of housing opportunities
- Negotiate volume discounts from professionals (contractor, real estate agent, attorney, etc)
- Seek funding sources – gap financing, construction financing
Wazuweeta Woods, Pine Island MN

24 affordable rental apartments

21 detached single family homes

12 twinhomes
Homeownership Results

- 56% families with children
- 36% single women with children
- 4 Head Start Families
- 64% permanently affordable through First Homes Community Land Trust
Harvest Ridge, Plainview MN
Harvest Ridge, Plainview MN

- 12 acres
- 30 Single Family Homes and 20 Rental Townhomes
- Mix of Affordable and Market Rate
- City providing Tax Increment Financing
- Additional funding from First Homes, Minnesota Housing Finance Agency, Greater Minnesota Housing Fund
Acquisition-Rehab-Resale

• Buying homes, making needed repairs, selling them to target market
• Address specific needs in the market – foreclosure, neighborhood revitalization, blight removal, energy efficiency, etc.
• Each house is unique, need a good inspector to valuate prior to purchase
• Budget a higher contingency for unexpected repairs
• Typically requires both value gap and affordability gap
Foreclosure Remediation Project

- Track foreclosures
- Identify local and regional partners
- Develop local stabilization plans
- Seek funding resources
- Implement local plans
- Focus on energy savings, deferred maintenance and healthy improvements
- Keep homes affordable
- Educate future buyers
Foreclosure Stabilization

Items Addressed in Rehab

1. Energy Efficiency
   - Furnace
   - Insulation
   - Windows
   - Water Heater
   - Appliances
   - Lighting
   - Bath Fixtures
2. Deferred Maintenance
Items that are in disrepair or may need replacement within 5 years
- Roofing
- Siding
- Flooring
- Mechanical Systems
- Structural Damage
3. Health and Safety Concerns
   - Lead-Based Paint
   - Radon
   - Moisture & Mold
   - Electrical Systems
   - Smoke & CO Detectors
Foreclosure Stabilization
Items Addressed in Rehab

4. Functionality
   Making homes work for buyers
   • Kitchen updates
   • Bathroom updates
   • Bedrooms with proper egress
5. Exterior Improvements

- Stabilize property values in the neighborhood
- Encourage other neighborhood investment
- Show something positive happening in neighborhood
After
After
Before
After
Owner-Occupied Rehabilitation

• Programs to assist current homeowners with rehabilitation needs

• Establish criteria for assistance before program is launched
  • Geography
  • Income limits
  • Type of repairs
  • Type of assistance (loan or grant)
  • Owner match requirement
  • Contractor selection
  • Inspection requirements
Neighborhood Revitalization - Northfield

• Targeted area for maximum impact
• Owner-occupied rehabilitation
• 2:1 match of homeowner funds
• Focus on health, safety, energy savings & exteriors
• All homes receive energy audit, lead risk assessment & radon testing
Neighborhood Revitalization - Northfield

- 2:1 match of homeowner funds
  - $5,000 from the Northfield Housing & Redevelopment Authority
  - $5,000 from Minnesota Housing Finance Agency
  - $5,000 from homeowner’s own funds
    - Can include other programs that a homeowner qualifies for, including Weatherization, Rural Development, Minnesota Housing, Bank Loans, etc.

- Home is inspected
  - Energy Audit, Lead Risk Assessment, Radon Testing
  - Meet with homeowner to review wish list
  - Inspect for health, safety and energy needs
  - Review exterior improvement needs: paint, roof, landscaping, etc.

- Construction
  - Work is done by licensed contractor
  - Final work inspected before payment released
Role of Three Rivers Community Action in the Program

• Provides program staffing for administration, home inspections, and energy audits

• Provides capacity and housing expertise that the city doesn’t have

• HRA contracted with Three Rivers to administer the program, buyers are not paying for the administration

• Result of long history of collaboration on housing projects
Achieve Homeownership

- Comprehensive program to educate future homeowners
- Focus on underserved populations
- Homebuyer Education
  - 1,059 Households completed
  - 158 Classes
- Financial Literacy
  - 701 Participants completed
- Individual Counseling
  - 1,346 Participants
- Downpayment Assistance
  - 214 Buyers assisted
  - $2.3 Million disbursed
447 new homeowners (and counting...)
Ingredients for Successful Housing Development at Community Action

• Staff – Expertise and focus on housing development
• Risk Capital for upfront costs – funds you might lose
• Experienced staff and/or partners
• Committed Board
• Strong local collaboration
• Access to project financing
• Strong housing projects
Challenges for Community Action

• Housing markets can change

• Up-front costs require willingness to take risk
  • Site assessment & feasibility analysis
  • Site assembly
  • Staffing costs and professional fees
  • May not be recouped if the project financing does not come through

• Cost over-runs and unknowns are likely and can cut into your developer fees

• Ownership of rental requires asset management and planning for when markets change and units age
Benefits for Community Action

• Meets mission of providing affordable housing
  • Over 790 units developed
  • 564 rental units owned by Three Rivers or subsidiaries
  • Units target low- and moderate-income households, households of color and single parent households

• Generates Developer Fees – over $5 million received
• Rental projects generate on-going income – $190,000 generated last year
• Builds strong community relationships that lead to other initiatives and partnerships