

Housing Washington 2013

Affordable Housing 101 +

Paul Purcell
President, Beacon Development Group



Session Outline

1. What is affordable housing?

- How is it defined?
- Who does it serve?
- Who provides it and why?

2. How is it funded?

- Local, state, federal
- Capital and operating

3. How do you make it pencil?

- Development sources & uses
- Operating pro forma

4. What's the process?

5. How does the future look?

Our Experience

	Projects	Total Units	Total Value
Completed	65	2,663	\$409M
Under Construction	7	667	\$96M
Fully Funded	4	385	\$44M
In Development	6	465	\$74M
Total	82	4,180	\$623M

	# Projects
Family	19
Farmworker	24
Green/Sustainable/LEED	6
Historic	9
Senior	12
Special Needs/Homeless	27

National Awards

Traugott Terrace, Seattle

First LEED Certified Affordable Housing Project, 2003

Tepeyac Haven, Pasco

First Affordable LEED for Homes Gold, 2007

New Wilson Hotel, Anacortes

- NAHRO Community Revitalization Award of Excellence
- State of Washington Historic Preservation Project of the Year

Oakland Building, Bellingham

NAHRO Historic Rehab Award of Excellence



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GROUP**

Current Projects: Walla Walla Farmworker

Before:



Client: Walla Walla Housing Authority

Type: Farm worker

60 replacement units

30% and **50%** AMI



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Current Projects: Walla Walla Farmworker

After:



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Type: Farmworker

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30% and **50%** AMI



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Recent Projects: Agnes Kehoe

Before:



Client: Spokane Housing Authority

Type: Historic Rehab

50 units

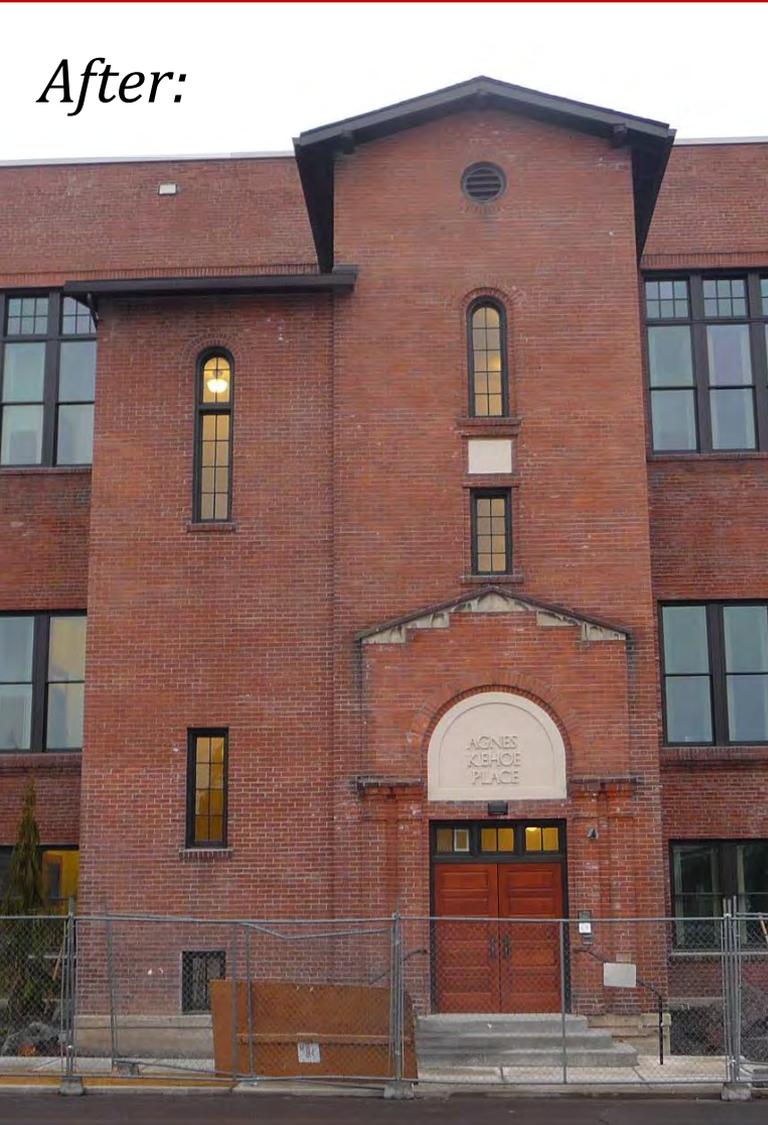
0% - 50% AMI
Homeless & disabled veterans



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Recent Projects: Agnes Kehoe

After:



Client: Spokane Housing Authority

Type: Historic Rehab

50 units

0% - 50% AMI
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What is Affordable Housing?

1. Residents pay at most 30% of their income in housing costs

- Rental Housing Cost = **Rent + Utilities**
- Ownership Housing Cost = **Principal + Interest + Taxes + Insurance**

2. Includes a wide range of housing types

- **Shelter** – night to night or permanent beds
- **Special Needs** – homeless, disabled, etc
- **Veterans**
- **Farm worker**
- **Working “poor”**
- **Workforce**
- **Ownership** – Single Family, Townhouse, Condo

3. Percentages – Area Median Income (census data)

- 0 – 30% = **Extremely Low** Income
- 30 – 50% = **Very Low** Income
- 50 – 80% = **Low** Income (60% is maximum for tax credits)
- 80 – 120% = **Moderate** Income

What is Affordable RENTAL Housing?

Median Incomes 3-Person Households, 2012

	30% AMI	50% AMI	60% AMI
Yakima	\$15,510	\$25,850	\$31,020
Spokane	\$17,280	\$28,800	\$34,560
King	\$23,760	\$39,600	\$47,520

What is Affordable RENTAL Housing?

Rents

2-Bedroom Units, 2012

	30% AMI	50% AMI	60% AMI
Yakima	\$15,510 \$387	\$25,850 \$646	\$31,020 \$775
Spokane	\$17,280 \$432	\$28,800 \$720	\$34,560 \$864
King	\$23,760 \$594	\$39,600 \$990	\$47,520 \$1,188

How Is It Funded?

1. What is affordable housing?

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How Is It Funded?

1. Local, State and Federal Resources

- **Capital Side** – subsidize cost of **construction and development**
- **Operating Side** – subsidize **operations, maintenance, and services**

2. Local – City & County

- Entitlement Cities & Counties – pass-through of **CDBG and HOME** funds
- Local **property tax levies**
 - City of Seattle, City of Bellingham,
 - King County Veterans and Human Services Levy
- **2060 & 2063** for services – recording fees
- **Regional consortia** – ARCH
- **General funds**
- **Philanthropy**

How Is It Funded?

3. State

- **Housing Trust Fund**
 - **\$200M** in the 2007 – 2009 budget
 - **\$130M** in the 2009 – 2011 budget (100 + 30)
 - **\$50M** in the 2011 – 2013 budget
 - **\$67M** in Supplemental budget in 2012
 - **\$51M** for 2013 – 2015 biennium
 - Committed for 2 years/4 target groups
 - Approximately \$34M 2013 and \$17M 2014
- **CDBG Housing Enhancement** – for non-entitlement parts of the state
- **2060 & 2063** – recording fees, state portion
- **Washington Families Fund** – homeless services

How Is It Funded?

4. Federal

- **Housing & Urban Development**
 - **202/811** Capital programs
 - **HOME & CDBG**
 - **McKinney** for homeless services
 - **Public Housing Authorities**
 - **Section 8** Vouchers, **VASH** vouchers
 - **FHA** – federally guaranteed loans
 - **National Trust Fund** -unfunded
- **US Dept of Agriculture – Rural Development programs**

How Is It Funded?

And last but not least...

Which Federal Agency runs the nation's largest housing production program?



What is the Low-Income Housing Tax Credit?



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What is the Low-Income Housing Tax Credit?

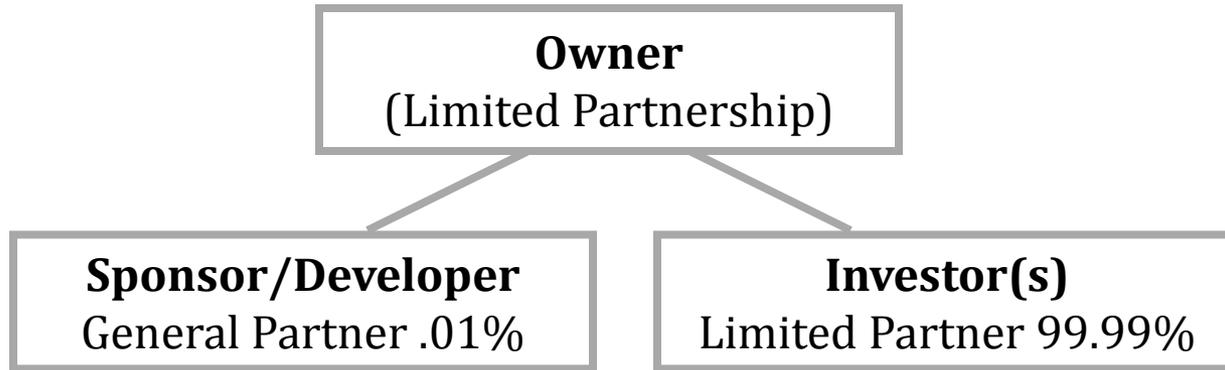
- **Began with Tax Reform Act of 1986**
- **Section 42 of the Internal Revenue Code**
- **Federal tax incentive to encourage private investment**
- **Tax credits are now the primary vehicle for low-income rental housing construction and rehabilitation in the U.S.**
- **2.4 Million units of housing since inception**

What is the Low-Income Housing Tax Credit?

- **Dollar for dollar reduction in federal tax liability**
- **10 year credit period; 15 year recapture period; 15+ exit**
- **Investors purchase the tax credits by providing equity for the construction or rehab of housing**
- **9% (competitive) vs. 4% (automatic)**
- **Money comes from CRA investors (banks) and economic investors (insurance companies, Google, Verizon)**
- **Money is equity, not debt, returns are from benefits, not cash**
- **Syndicators vs. Direct Investors**

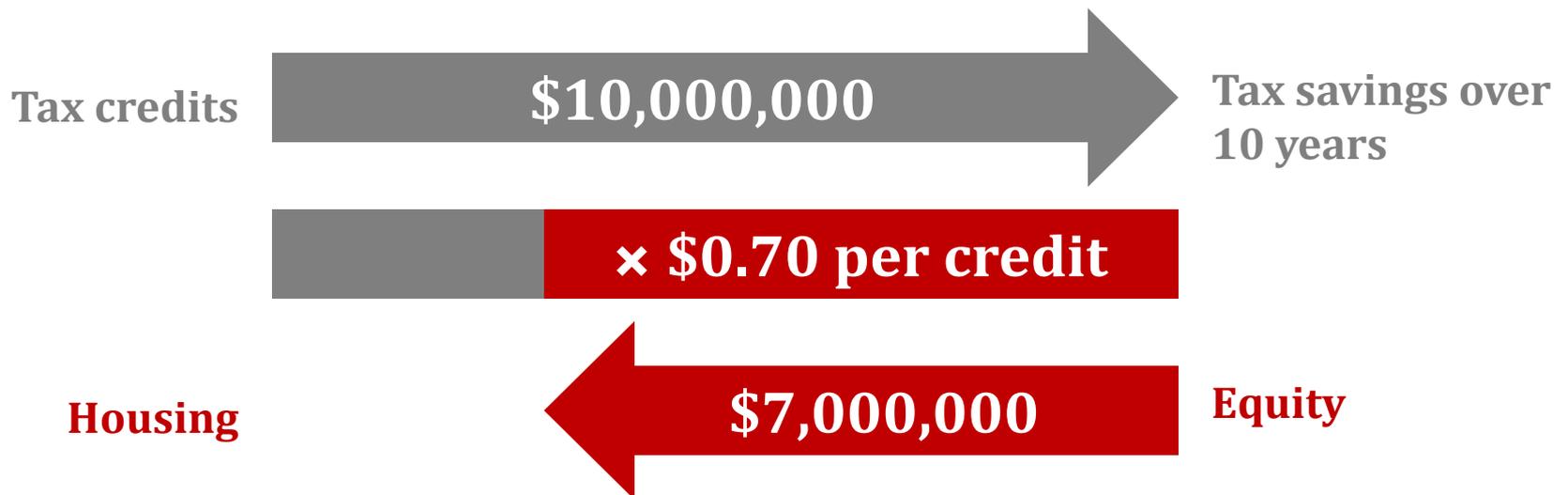
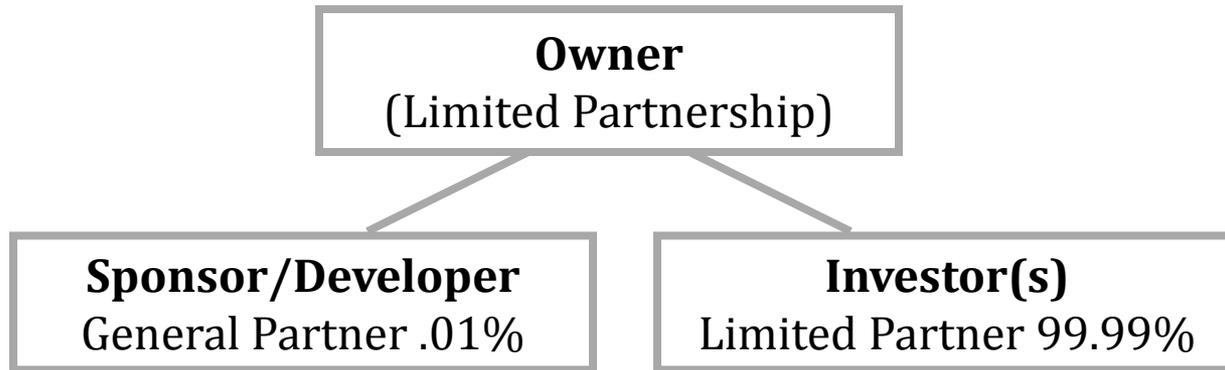
Credit to Equity

Example : \$1,000,000 in Credit



Credit to Equity

Example : \$1,000,000 in Credit



How Does It Pencil?

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How Does It Pencil?

In other words....

Why can't affordable housing work without all these subsidy programs?

Development Side

1. Conventional Real Estate Development:

- Total Project Cost = **Debt + Owner Equity**
- Debt paid by **rental income**
- Equity re-captured by Owner through **cash flow, appreciation, and sale** of asset

2. Affordable Real Estate Development

- Reduced rents mean **little or no debt**
- Non-Profits: **no Owner equity or re-sale** of assets
- Investor equity based on sale of tax credits
- Gap funding from public sources for the difference

Financing Comparison

Conventional Deal

\$2M Owner Equity

\$8M Bank Debt

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Financing Comparison

Affordable Deal

**\$0
Owner
Equity**

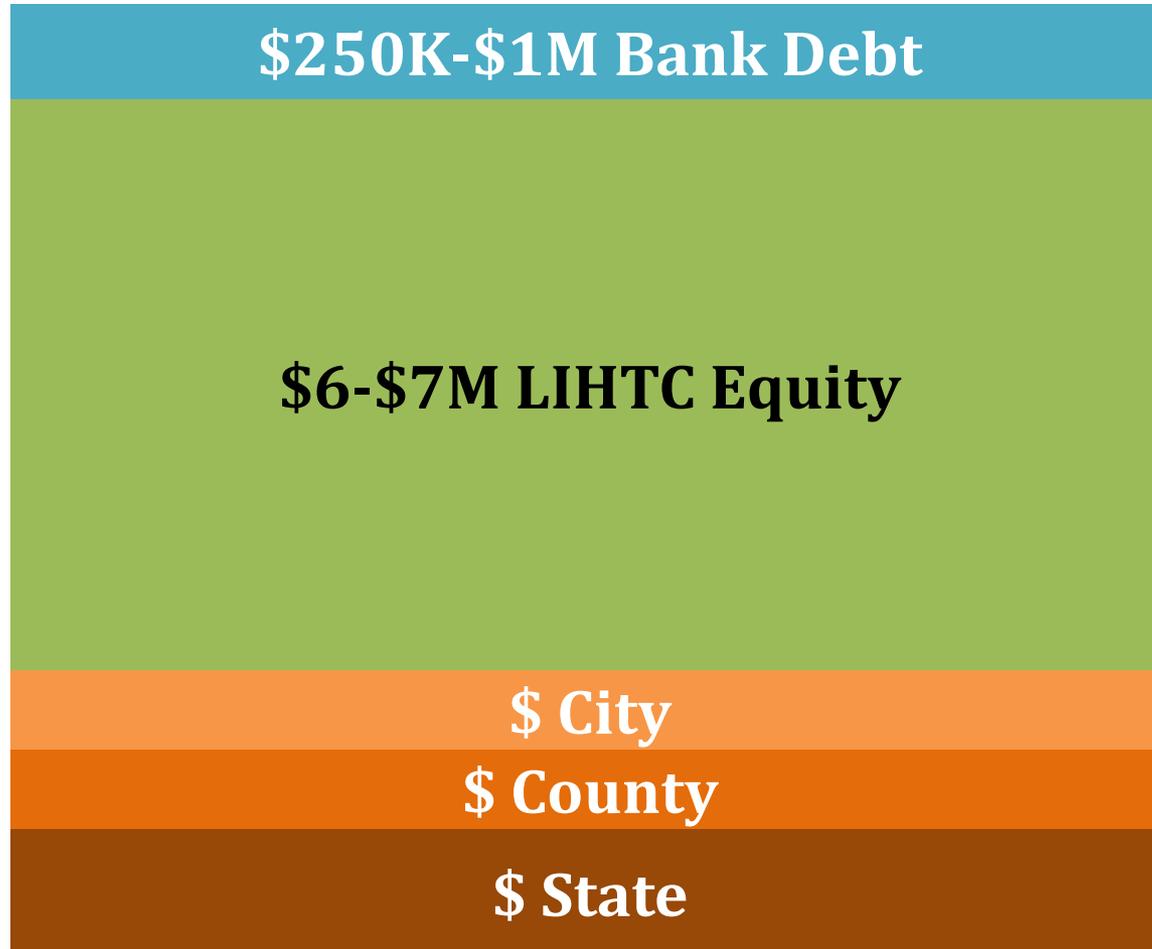
\$250K-\$1M Bank Debt

\$\$\$ GAP

Financing Comparison

Affordable Deal

\$0
Owner
Equity



How Does It Pencil?

Operating Side

1. Conventional Real Estate Development

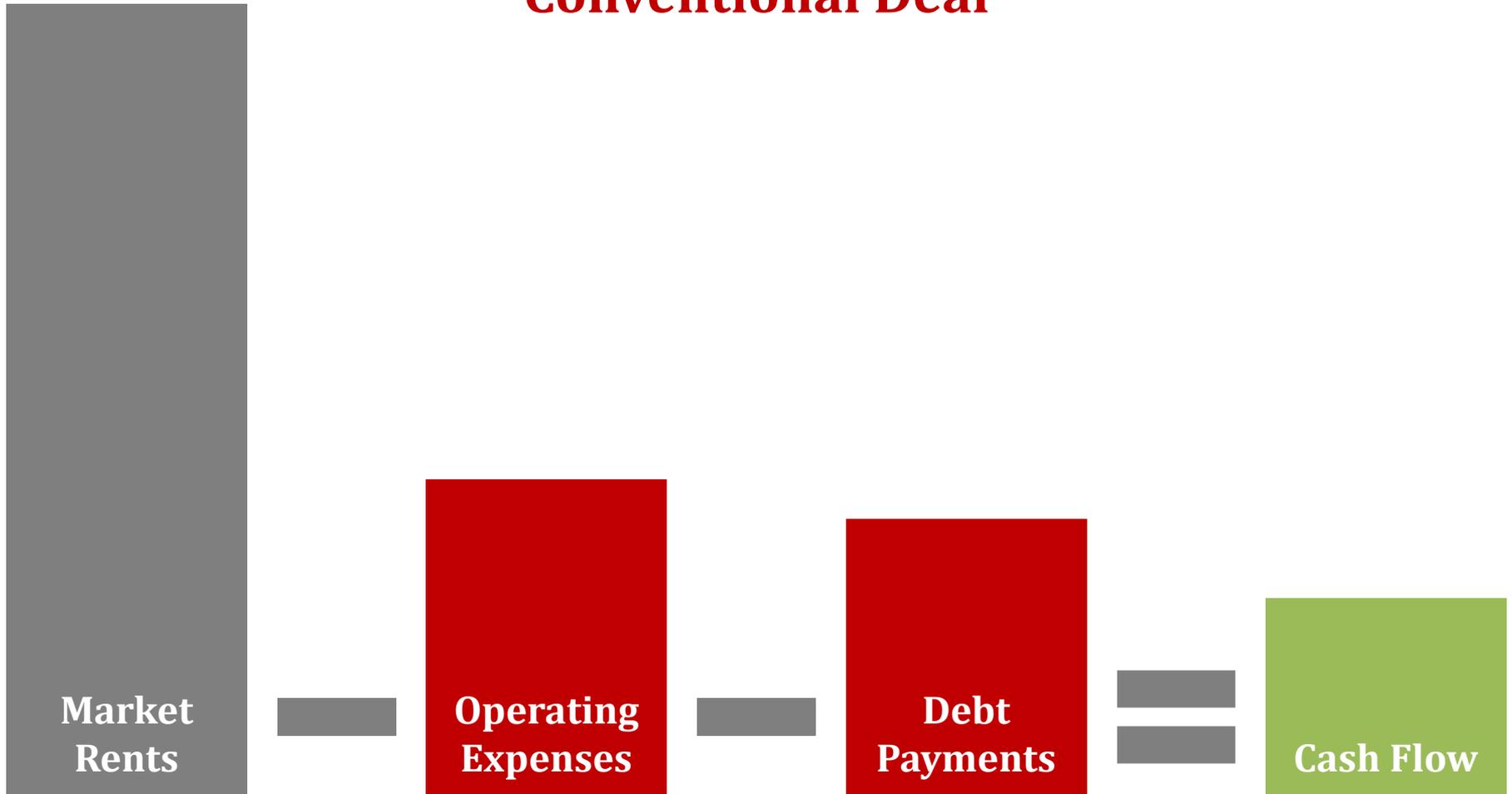
- **Market Rents - Operating Expenses = Net Operating Income** which drives debt
- Net Cash Flow goes to Owner as Return on Investment

2. Affordable Real Estate Development

- **Reduced Rents** based on income targeting
- **Operating Expenses same or higher** based on population being served
- Projects serving 50% - 60% AMI may be able to break even or support a small amount of debt
- Projects serving 30% and below can't break even, so need operating subsidies

Cash Flow Comparison

Conventional Deal



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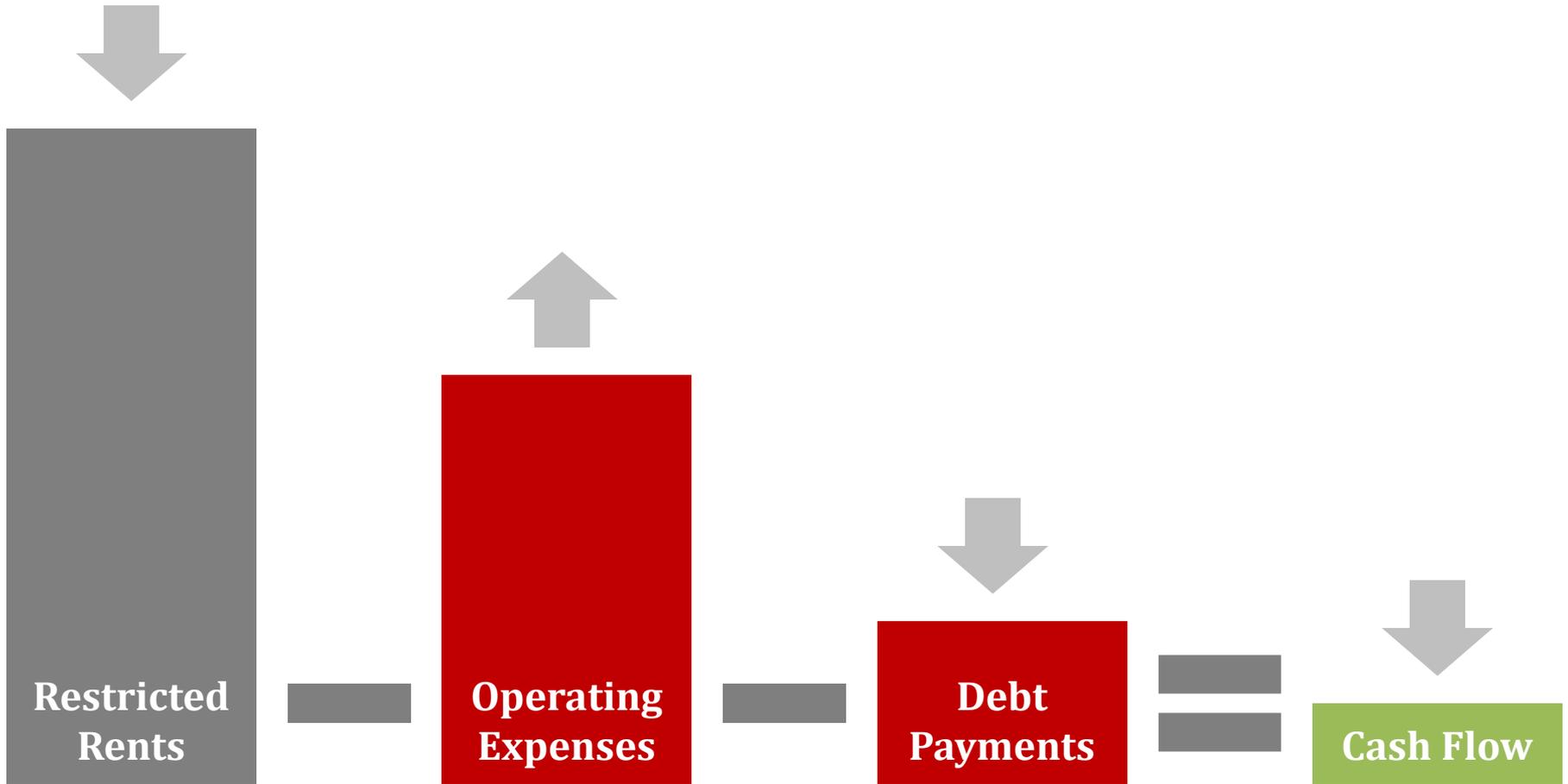
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Cash Flow Comparison

50% - 60% Deal



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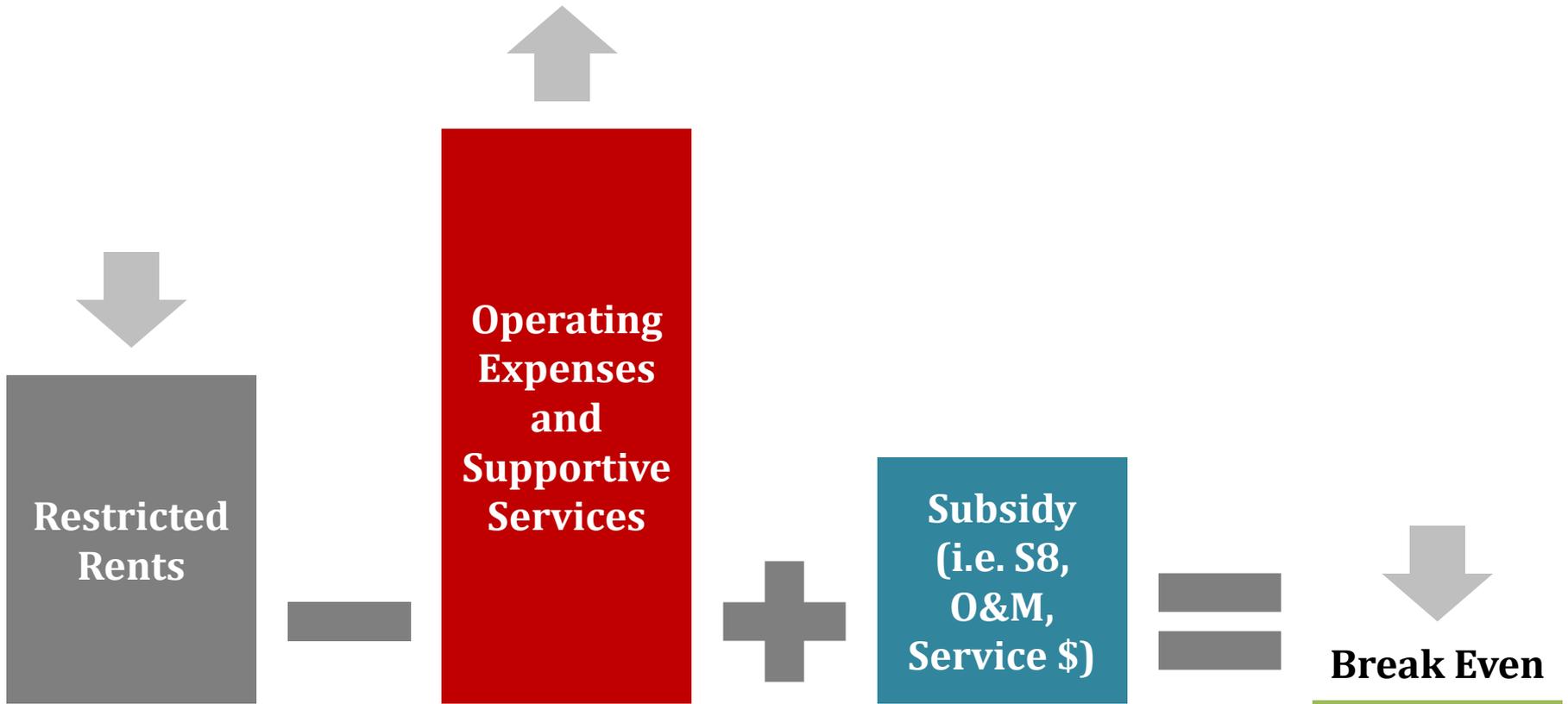
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Cash Flow Comparison

30% and below



Sample 9% Project: 60 Units

USES	Total Cost	Tax Credit Basis
Land & Related Cost	306,000	
Construction Contract	7,760,000	7,640,000
Construction Contingency	776,000	776,000
Furnishings	50,000	50,000
Architect and Engineer	577,000	577,000
Surveys & Construction Testing	41,500	41,500
Permits & Impact Fees	245,200	245,200
LIHTC Fees	117,000	
Construction Loan Fees & Expenses	60,000	60,000
Construction Loan Interest	291,000	135,000
Perm Loan Legal & Closing	13,500	13,500
Perm Financing Fees & Expenses	39,000	
Insurance, Accounting, Lease-Up	90,000	40,000
Developer Fee-Sponsor	950,000	900,000
Reserves	196,000	
Syndication Costs	85,000	
	11,597,200	10,478,200

Sample 9% Project: 60 Units

9% LIHTC Calculation

Eligible Basis		10,478,200
Calculated Credit Amount	x applicable % (9%)	943,038
Adjusted Credit Amount	x 130%	1,225,949
Maximum Credit per WSHFC	59 units x 19,181 / unit	1,131,679
Total Credit	x 10 years	11,316,790
Investor Share of Credit	x 99.99%	11,315,658
Price per Credit		\$ 0.90
Total Equity to Project		10,184,093

Sample 9% Project: 60 Units

Funding Sources

LIHTC Equity	10,184,093	88%
State HTF	1,000,000	9%
Local Funding	100,000	1%
Deferred Developer Fee	313,107	3%
Private Debt	-	0%
Total Sources	11,597,200	100%
Total Costs	11,597,200	
Surplus (Shortage)	0	

Sample 9% Project: 60 Units

9% LIHTC Calculation

Eligible Basis		10,478,200
Calculated Credit Amount	x applicable % (7.3)	764,908
Adjusted Credit Amount	X (100%)	764,908
Maximum Credit per WSHFC	59 units x 15,124/ unit	892,316
Total Credit	x 10 years	8,923,160
Investor Share of Credit	x 99.99%	8,922,267
Price per Credit		\$ 0.90
Total Equity to Project		8,030,041

Sample 9% Project: 60 Units

Funding Sources

LIHTC Equity	8,030,041	69%
State HTF	2,500,000	22%
Local Funding	500,000	4%
Deferred Developer Fee	567,159	5%
Private Debt	-	0%
Total Sources	11,597,200	100%
Total Costs	11,597,200	
Surplus (Shortage)	0	

Sample 9% Project: 60 Units

Operating Pro Forma: Gross Income

					Yr 1	Yr 2	Yr 3
	Units	Max Rent Tax Credit	Utility Allowance	Net Rents	Inflation:	2.5%	
2BR - 30% AMI	12	387	71	316	45,504	46,642	47,808
2BR - 50% AMI	18	645	71	574	123,984	127,084	130,261
3BR - 30% AMI	10	447	92	355	42,600	43,665	44,757
3BR - 50% AMI	14	745	92	653	109,704	112,447	115,258
4BR - 30% AMI	2	498	115	383	9,192	9,422	9,657
4BR - 50% AMI	4	831	115	716	34,368	35,227	36,108
Gross Rents	60				365,352	374,486	383,848
Rental/Op. Subsidy	-	0			-	-	-
Laundry or Other	3,000	50			3,000	3,075	3,152
Vacancy	7%	(430)			(25,785)	(26,429)	(27,090)
EFFECTIVE GROSS INCOME					342,567	351,132	359,910

Sample 9% Project: 60 Units

Operating Pro Forma: Net Income and Cash Flow

	Yr 1	Yr 2	Yr 3
Operating Expenses			
Utilities & Garbage	118,000	122,130	126,405
Grounds & Maintenance	53,800	55,683	57,632
Replacement Reserve	21,000	21,735	22,496
Management Off-site	35,000	36,225	37,493
Management On-site	40,000	41,400	42,849
Other Operating Services	45,700	47,300	48,955
	15,000	15,000	15,000
Total Op Expenses	328,500	339,473	350,829
(\$5,475)			
NET OPERATING INCOME	14,067	11,659	9,081
Debt Service	0	0	0
Cash Flow (before payment of partnership fees)	14,067	11,659	9,081

What's the Process?

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I. Project Definition & Feasibility



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I. Project Definition & Feasibility

1. Who are you going to serve?

- What's the market? (i.e. the need)
- What makes you the right provider?
- Impact of prioritizing populations?

2. Due Diligence

- Survey, Phase I, title report, design studies

I. Project Definition & Feasibility

3. What are the costs?

- Site Acquisition
- Construction/A&E
- Financing & Soft Costs
- Replacement & Operating Reserves

4. What are the likely development and operating sources?

- Local subsidy and support
- Tax credits: Are you competitive? What's the equity calculation?
- Rent levels

II. Funding Applications



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II. Funding Applications

1. Applications are required to: City, County, State, WSHFC : Common application helps, but each has a different addendum/focus

2. Will you get an award:

Prior system, if you had

- Local capital subsidy, then State capital subsidy, then operating subsidies, then tax credits !!!
- Current system, headed in direction of being population based, not project oriented, less predictable, timing uncertain
- Challenge is to conserve \$ while trying to get to yes

Funding Sources (Capital Stack)

State Housing Trust Fund

- Application
- Note
- Deed of trust
- Loan agreement and assignment for security purposes
- Regulatory agreement
- Covenant
- Subordination agreement
- Compliance



Funding Sources (Capital Stack)

Tax Credit Equity

- Application
- Investor
- Organizational formation
- Due Diligence
- Regulatory Agreement
- LLC or LLP agreement
- Compliance



III. Design and Permits



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MUNICAS VILLAGE PLACE

23 Ave

III. Design and Permits

- 1. Design a functional, bullet-proof building that can be built at rock-bottom construction costs**
- 2. Meet all funding requirements**
 - Green/Sustainable
 - Prevailing Wages and Labor Standards
 - Program space
 - Lender preferences
 - Historic, Neighborhood, or other constraints
 - Other??
- 3. Line up permits with closing of all subsidies and the tax credit partnership**

IV. Closing



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IV. Closing

- 1. Meet the requirements of 3 – 5 different lenders simultaneously**
- 2. Get 3 – 5 different attorneys to agree on anything**
- 3. Priority Agreement**
 - Who's on First? What's on Second?
- 4. Manage guarantees (if possible)**
 - So that Sponsor isn't completely exposed to recapture and repayment obligations to Investor or Construction Lender

V. Construction



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V. Construction

1. Find a contractor you can trust

- But one that's hungry and willing to do high-quality work for as little overhead & profit as possible
- Can build a responsible budget 18 months ahead in current environment

2. Find a contractor who can navigate all the subsidy requirements:

- Green Requirements
- Prevailing wage and other labor standards
- Hire Section 3 and WMBE firms
- Meet apprentice program requirements

3. Meet tax credit and investor delivery deadlines

- Despite weather and unforeseen site conditions

Construction Issues

- Wage requirements
- Social Goals
 - Apprentice programs, Section 3 hiring, WMBE
 - Compliance and Reporting
- Greening the portfolio
- Building for operational savings
- Quality of building systems, security/HVAC
- Bidding/negotiating/need of contractor to manage all of the social goals and requirements – hassle factor
- Payment schedule for draws/retention/investor payments
- No attention to time value of Money, delays, furloughs

VI. Lease-Up & Management

1. Lease-Up

- Deliver units according to the schedule you set with the investor 12 – 18 months earlier so you don't lose equity
- Push early lease-up of units to achieve upward adjusters
- In the midst of the frenzy, lease up to fully qualified households who meet all the income and lease guidelines and will be stable happy residents

2. Management

- Then starts the hard part – operating a financially and socially stable housing community for the long term
- Next Class: Affordable Housing Management 101

What Does the Future Hold?

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What Does the Future Hold?

1. Flat or declining resources in near term

- State budget
- Federal budget and federal role in housing in general
- Health of cities/Urban cores vs. suburban and rural
- Priority of housing vs. education and health care

2. Declining tax base and anti-tax sentiment

- Fewer dollars for services
- Lower support/increasing competition for organizational dollars

3. Fraying safety net

- Increased need for housing
- Increased needs for those already in housing

4. Unemployment, underemployment and Foreclosures

New Resources

Required Future Resource Opportunities

Medicare/Medicaid

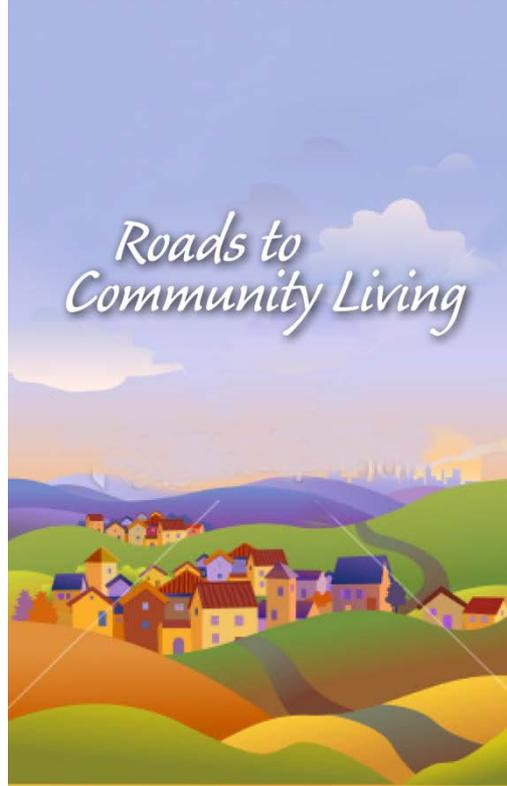
Housing that reduces medical system expenses

Programs that reduce incarceration expenses

Housing resources which improve educational performance/ attendance

Programs which demonstrate savings to cities and counties for emergency services/detox

Energy saving programs which translate into leveraged resources



*Roads to
Community Living*

**Helping People Living
in Nursing Homes Return
to Their Community**

Washington State Department of Social and Health Services
Aging and Disability Services Administration

What Does the Future Hold?

5. Tax Credit market remains strong

- Rebound from 2008 capital crash
- Investor returns in the 5.5% - 7.5% range, which means pricing in the high 80's to mid and upper 90's.
- Guarantee and reserves – pull back from crisis levels; still far-reaching
- Higher Debt Service Coverage (i.e. 1.20+ compared to 1.10 – 1.15)
- More scrutiny of sponsor balance sheet, liquidity, portfolio

6. Construction costs increasing in Puget Sound construction market, stable balance of state

What Does the Future Hold?

- 1. Market rents rising and low vacancy in some markets**
 - Strong operations for new and existing affordable housing
- 2. ...but also means increased demand**
 - More households needing and not finding affordable units
- 3. Incomes likely to remain flat**
 - Rents (tied to AMI) will remain flat or drop, HUD rents decreased for 2013, making it hard to keep up with increasing operating expenses.
- 4. Fewer funded projects**
 - Pressure on sponsors that rely on developer fees
- 5. Expiring HUD projects will need to be preserved in order not to lose ground.**

Parting Thoughts

- 1. Very difficult to do this work alone. Find partners with experience who can help get the deal done.**
- 2. Work with all the resources available.**
- 3. Be creative but make sure the fundamentals are sound.**
- 4. Do not work the numbers until the deal works. Work the deal until the numbers work.**
- 5. Remember that real families and individuals will benefit from this work.**



Additional Resources



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<http://beaconddevgroup.com>

Services for the lifecycle of your building