

# Housing Washington 2015

# AFFORDABLE HOUSING 101



**BEACON**  
DEVELOPMENT  
GROUP

**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

## Affordable Housing 102

### 1. How do you make it pencil?

- Development sources & uses
- Operating pro forma

### 2. What's the process?

### 3. How does the future look?

# Our Experience

	Projects	Total Units	Total Value
<b>Completed</b>	72	3,391	\$524M
<b>Under Construction</b>	2	296	\$26M
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Project Types	
Family	45 projects
Agricultural Workers	24 projects
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Historic	8 projects
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Special Needs	26 projects
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## 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

# 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**
  - **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?

## Rents 2-Bedroom Units

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

# 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
  - **\$75M** for 2015-2017
- **CDBG Housing Enhancement** – for non-entitlement areas
- **2060 & 2063** – recording fees, state portion
- **Washington Families Fund** – homeless services

# How Is It Funded?

## 4. Federal

- **Housing & Urban Development**
  - **202/811** Capital/operating 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?

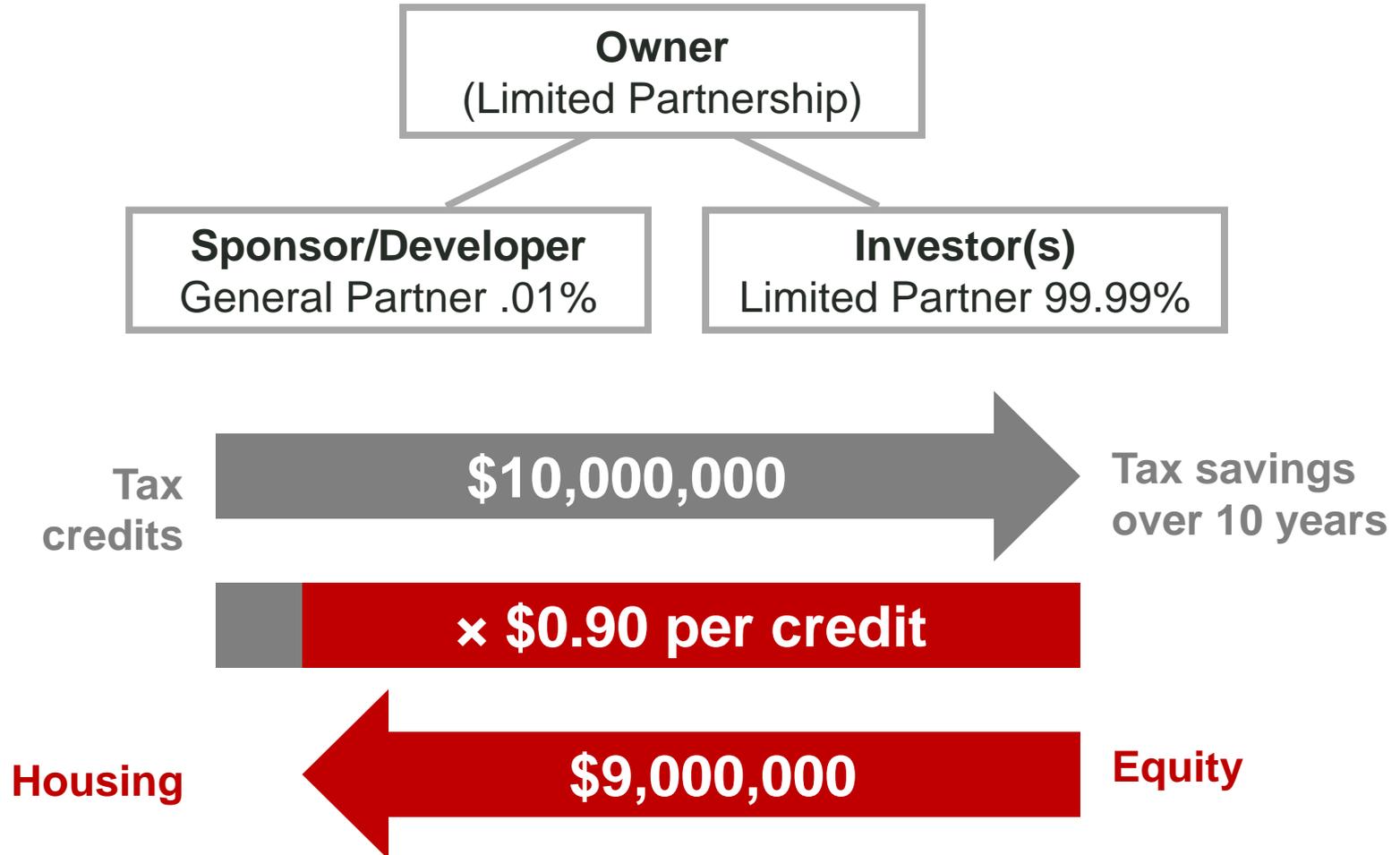
- Began with Tax Reform Act of 1986
- Section 42 of the Internal Revenue Code
- Federal tax incentive to encourage private investment
- Tax credits are now the primary vehicle for low-income rental housing construction and rehabilitation in the U.S.
- 2.4 Million units of housing since inception

# 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



# How Does It Pencil?

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**

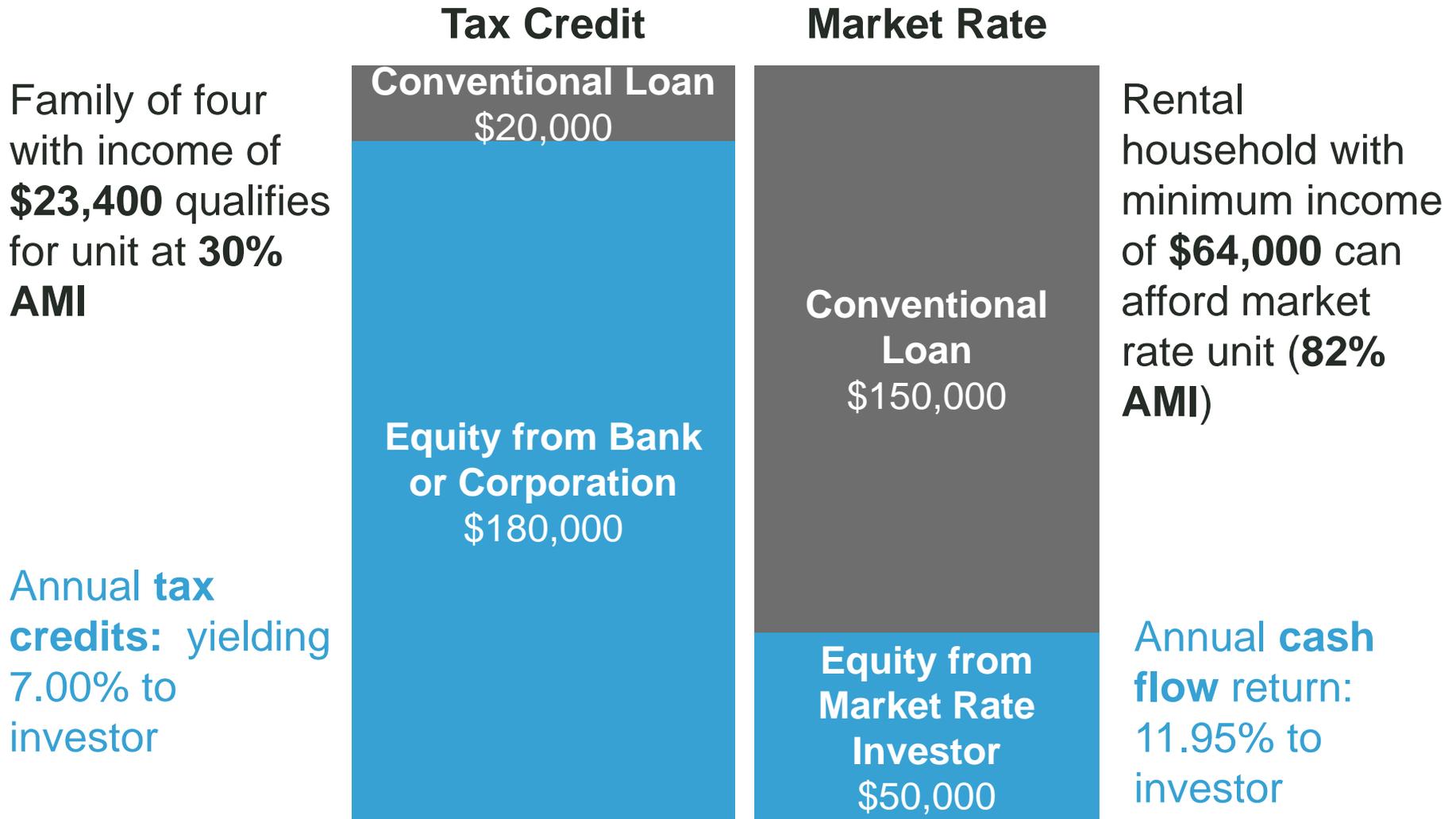
**\$6-\$7M LIHTC Equity**

**\$ City**

**\$ County**

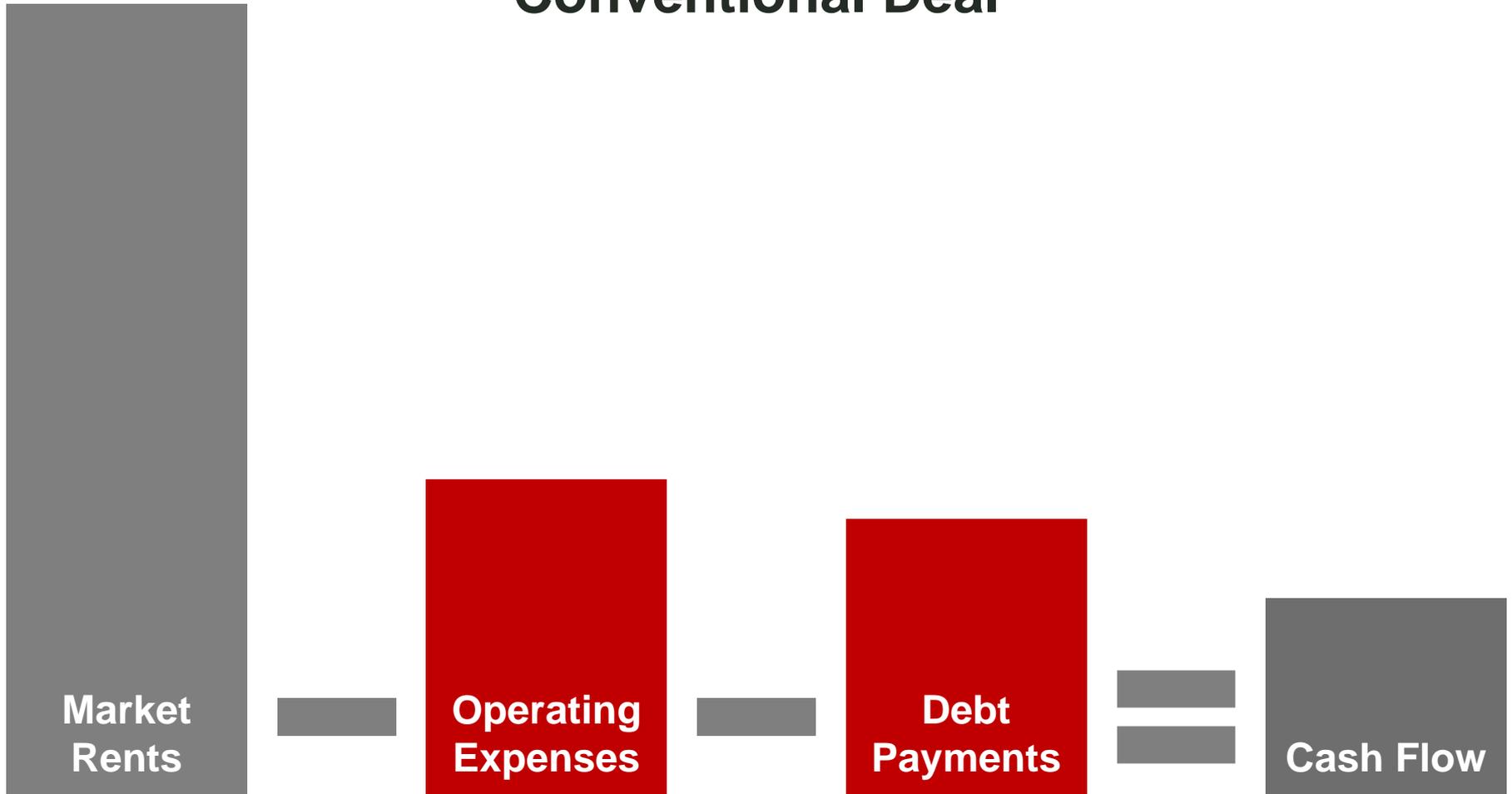
**\$ State**

# Comparison: \$200,000 cost per unit



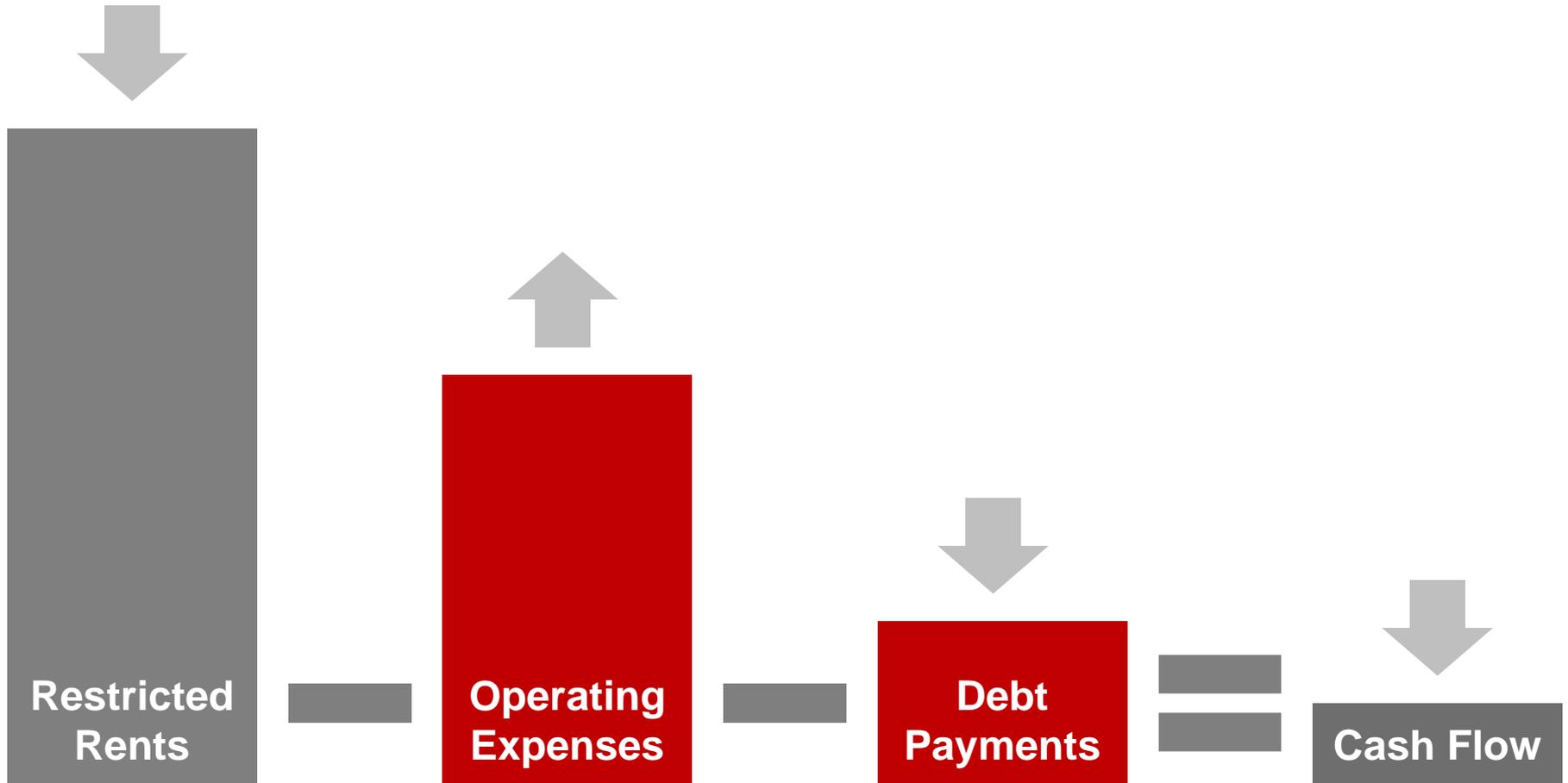
# Cash Flow Comparison

## Conventional Deal



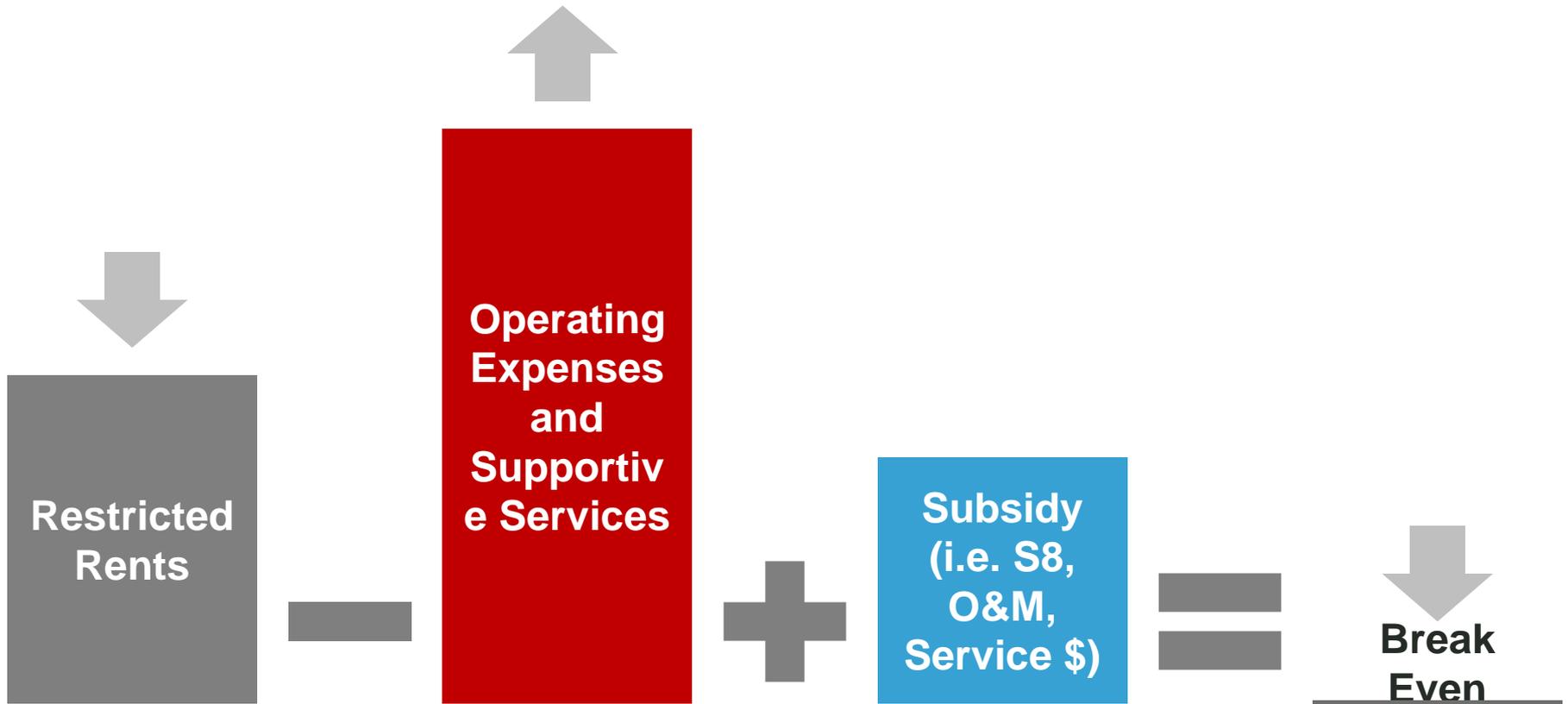
# Cash Flow Comparison

**50% - 60% Deal**



# Cash Flow Comparison

30% and below



# I. Project Definition & Feasibility



# 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?

## 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/vouchers

# II. Funding Applications



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# Funding Sources (Capital Stack)

## State Housing Trust Fund

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



# The Bar is Getting Higher



# The Bar is Getting Higher

## 1. Result of increased competition/decreased resources

### 1. Organizational Capacity

1. Financial statements – liquidity; asset strength
2. Performance – did you deliver: schedule & budget

### 2. Portfolio

1. Minding the shop – CNA's, reserve balances, occupancy
2. Focus on protecting past investments

### 3. Cost Control

1. Budget concerns at legislative level – pressure on agencies
2. WSHFC points



# 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
- Lease up to fully qualified households who meet all the income and lease guidelines and will be stable happy residents with your service levels

## 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?

## 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

# What Does the Future Hold?

5. Tax Credit market remains strong
6. Construction costs increasing in Puget  
Sound construction market, stable balance of  
state

# New Resources

## Required Future Resource Opportunities

**Medicare/Medicaid**

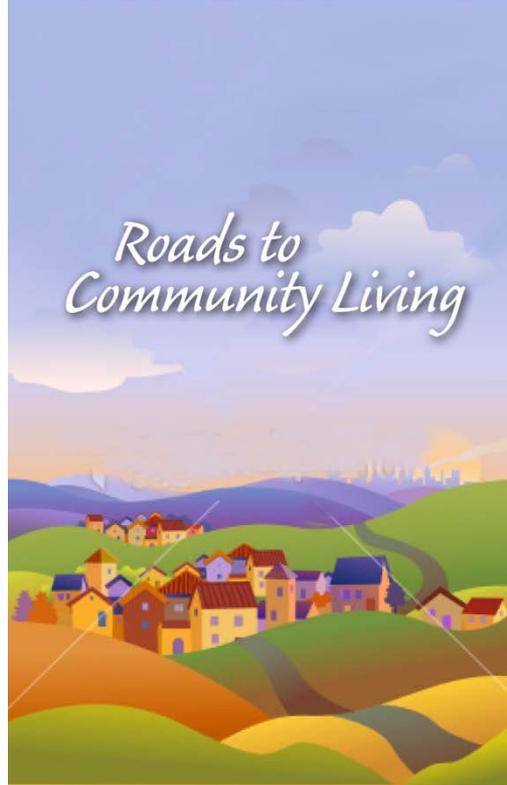
**Housing that reduces medical system expenses**

**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

# 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



**BEACON**

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<http://www.beacondevgroup.com>

Services for the lifecycle of your building

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# AFFORDABLE HOUSING 102



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# Our Experience

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# Recent Projects: Agnes Kehoe Place

*Before:*



**Client:** Spokane Housing Authority

**Type:** Historic Buildings

**50** units

**0% - 50% AMI**  
Homeless & disabled veterans



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# Recent Projects: Agnes Kehoe Place

*After:*



**Client:** Spokane Housing Authority

**Type:** Historic Buildings

**50** units

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# I. Project Definition & Feasibility



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# Outline of Cost Factors

- **Financing**
- **Site selection**
- **Design and Permitting(Density)**
- **Construction**
- **Operations**

# Financing Costs

- **Capital stack**
  - Multiple funding sources
- **Required deal structures (legal implications)**
- **Operations and reserves**
- **Application timing and processing**
- **Lack of asset appreciation**
- **Restrictive exit strategy – Ownership horizon**
- **Failure to perform of other funders**
- **Contingency requirements**

# 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

# Monthly Cash Flow

## Tax Credit

### Monthly Cash Flow

2BR rent	\$ 527
Expenses	(425)
Loan payments	(85)
<b>Total</b>	<b>\$ 17</b>

## Market Rate

### Monthly Cash Flow

\$ 1,600	2BR rent
(475)	Expenses (incl. property tax)
(627)	Loan payments
<b>\$ 498</b>	<b>Total</b>

# Sample 9% Project: 60 Units

<b>USES</b>	<b>Total Cost</b>	<b>Tax Credit Basis</b>
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	
	<b>11,597,200</b>	<b>10,478,200</b>

# 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%
<b>Total Sources</b>	<b>11,597,200</b>	<b>100%</b>
<b>Total Costs</b>	<b>11,597,200</b>	
Surplus (Shortage)	0	

# 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%
<b>Total Sources</b>	<b>11,597,200</b>	<b>100%</b>
<b>Total Costs</b>	<b>11,597,200</b>	
Surplus (Shortage)	0	

# II. Funding Applications



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## II. Funding Applications

- 1. Applications are required to: City, County, State, Finance Agency : Common application helps, but each has a different addendum/focus**
- 2. Will you get an award:**
  - Local capital subsidy, then State capital subsidy, then operating subsidies, then tax credits !!!
  - Current system, headed in direction of being population based, vets, etc. not project oriented, less predictable, timing uncertain
  - Challenge is to conserve \$ while trying to get to yes

# Funding Sources (Capital Stack)

**Tax credit equity**

**Sequence of Application Rounds**

**Application**

**Investor**

**Organizational formation**

**Due Diligence**

**Regulatory Agreement**

**LLC or LLP agreement**

**Compliance**



# The Competition is Getting Tougher



# V. Construction



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# III. Design and Permits



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# 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

# 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.**
- 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

# Operations Costs



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# Operations Costs

- **Operations impact on Development**
  - **Operational, replacement and investor guarantee reserves/section 8 reserves, etc capitalized upfront**
  - **For homeless/ELI projects, utilities included**
    - City light projections/proforma projections
    - Services necessary for stable building
  - **For all projects, Housing Authority utility allowances (or calculated substitute) deducted from rent**
  - **Not built for cash flow, all fees paid up front**
    - Utility fees, capacity charges
    - Developer fees
    - Legal fees to structure LPA exit/guarantees etc.



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## 2. Declining tax base and anti-tax sentiment

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- Increased need for housing
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# 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 urban construction markets, 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.**

# New Resources

## Required Future Resource Opportunities

**Medicare/Medicaid**

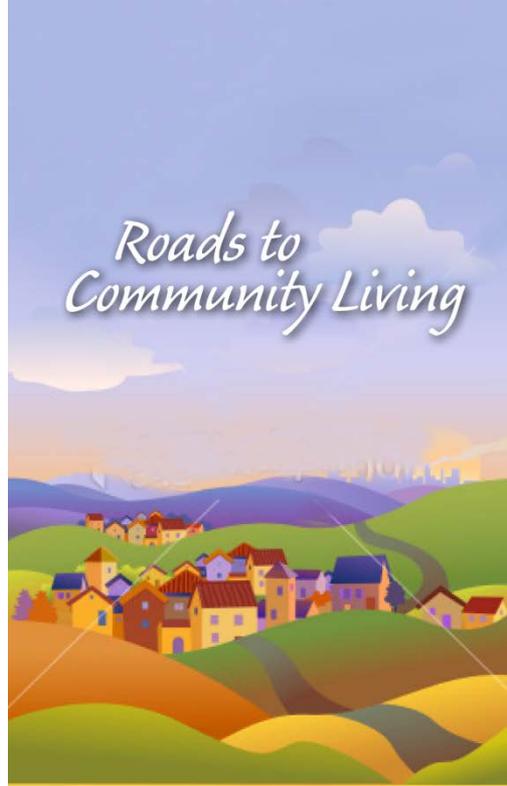
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- 2. Work with all the resources available.**
- 3. Be creative but make sure the fundamentals are sound.**
- 4. Public officials/funders need to understand how social goals add to the cost of affordable housing.**
- 5. Remember that real families and individuals will benefit from this work.**

# Additional Resources



<http://beacondevgroup.com>

Services for the lifecycle of your building