

## Handout 2-1

### THE HOUSING DEVELOPMENT PROCESS

There are fundamental similarities in the housing finance and development process that cut across all types of housing whether that housing is market rate, affordable housing for the general population or permanent supportive housing.

The development process falls into four basic phases; it begins with conceptualizing the housing development and moves through to building occupancy. Like any planning process, the steps may not be carried out in the exact sequence provided below, but all of the steps are necessary for the successful development of the housing. For example, for a mission-driven non-profit organization, the starting point is often the identification of a housing crisis faced by a particular population group and the passion to ameliorate that crisis. For a for-profit developer it would be the identification of a profitable market. In each case, the end product is occupied housing units.

The following are the four basic phases in the residential rental real estate development process (sales housing would be similar, except instead of renting the units they would be sold and there would be limited or no on-going management responsibility):

1. **Concept:** In this stage the housing developer determines the basic parameters of the proposed housing development. The details of the concept will change over time as the details and realities of the project come together. The key activities during this phase are:
  - Defining the project, including the purpose of the housing, the type of housing (single family, apartments, high rise, etc), potential locations, approximate scale of the project and target population (families, elderly, special needs)
  - Selecting the members of the development team, which typically includes: architect, lawyer, engineer, development consultant, builder, construction manager and service provider if the project is serving a special needs population
  - Selecting and evaluating the site
  - Developing an understanding of the housing market and the community
  - Identifying and procuring predevelopment funds

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**2. Predevelopment:** During this stage, the developer undertakes the specific tasks necessary to be ready to begin the actual housing construction including:

- Conducting a market study or analysis of the housing needs in the community of choice
- Obtaining site control (in the form of an “Option to Buy” or “Agreement of Sale”) in order to secure the site while its appropriateness and feasibility are being evaluated
- Conducting environmental studies on the site
- Identifying financing sources
- Preparing preliminary architectural designs/cost analysis
- Determining feasibility including environmental considerations, zoning, and cost
- Identifying and obtaining financing sources, whether they be grants, loans, philanthropic donations, or in-kind services or materials (which could include the site)
- Finalizing architectural plans and bid documents
- Closing/settling on financing
- Acquiring the site
- Developing a management plan, including the identification of a management entity, making certain that there will be adequate income to operate the project and assuring that it will maintain its value over time
- Obtaining governmental approvals to proceed with construction of the project
- Soliciting and reviewing construction bids

**3. Construction:** The housing is built and all financial and operational planning are completed during this phase. Specifics include:

- Awarding construction contracts. Generally the housing developer will hire a general contractor who will, in turn, hire subcontractors in each trade
- Obtaining building and other permits to obtain permission to proceed with construction.

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- Preparing the site and actually building the housing. Non-profit sponsors often have a special “ground-breaking” ceremony to celebrate the completion of the planning stages and thank their funders
- Managing the construction. Oversight of the contractor may be conducted by the architect, a separate construction manager, or a member of the sponsoring agency who has this expertise
- Initiating marketing and lease-up to assure that there will be occupants and a source of operating income as soon as possible after the completion of construction.
- Identifying management and support staff so that they can begin work just prior to occupancy.
- Completing construction and obtaining a certificate of occupancy
- Holding a “ribbon cutting” ceremony to celebrate the actualization of what had been a concept and a dream

**4. Operations:** Once the housing is in place and the occupants have moved in, the sponsor begins the long-term management and operations of their housing. If it is targeted to a special needs population, the coordination or provision of supportive services also begins. Specific steps include:

- Closing on permanent financing. If the construction costs were covered in full or in part through short-term financing, the long-term mortgage needs to be put in place
- Occupying the units
- Maintaining and managing the housing, including making repairs, providing seasonal maintenance like snow removal and lawn care, janitorial services, rent collection, and enforcing lease compliance
- Providing services as appropriate to the population

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### FINANCING THE DEVELOPMENT AND OPERATIONS OF REAL ESTATE

Obtaining the appropriate amount and type of financing is key to the development and on-going operations of any housing. It is critical to identify all funding needs at the start of a project so there are no delays or shortfalls as you move along the development process through to occupancy. The majority of public and private financing is from state and local sources. Therefore, in order to assure compliance with funding sources as well as building and zoning regulations, it is important to have the active involvement of housing development experts throughout the planning and financing process.

The necessary types of financing fall into four categories that are closely linked to the stages of the development process as follows:

- **Predevelopment Financing:** As described above, predevelopment is the planning stage of the housing development process. It includes all of those activities that must be completed before construction can begin. These expenses typically relate to: architectural and engineering studies, attorneys' fees, consultant services, appraisals, title reports, initial site control, environmental studies, market studies, zoning variances, and feasibility analyses.
- **Construction/Development Financing:** This is the actual acquisition and construction or rehabilitation of the housing. Financing is needed to purchase the site and for the general contractor and all trades, including electrical, plumbing, masonry, roofing, and heating and ventilation. Often a developer will obtain short-term financing just for the actual construction period, making periodic payments as the construction progresses. This is then replaced with long-term permanent financing that is secured by the property. Development financing for affordable housing is typically a combination of the developer/sponsor's equity, public and private loans and grants.
- **Building Operations Financing:** Once construction is completed and the units are occupied, funds are needed to operate the building(s). This includes such costs as: maintenance and repairs, utilities, exterminating, lawn care, and snow removal. These costs are generally covered through rental income, however, if the housing is targeted to people with lower incomes, there will need to be extra funding available to cover the difference between rental income and the actual cost of operating the housing. This difference is generally covered through rental subsidies and/or through operating reserves (dedicated source of funds to cover possible operating deficits).
- **Program and Services Financing:** Housing that is developed for a specialized population, will need to have program support and services available to its residents. Some of these costs may be covered through rental income, and some through appropriate third-party reimbursement or the public system.

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### RELATIONSHIP OF HOUSING CHARACTERISTICS TO FINANCING CONSIDERATIONS

As described above, there are four sets of costs that cumulatively determine the cost of developing and operating the housing. The extent to which these costs are met through investor equity, grants, monetary or in-kind donations as opposed to loans, affects the final monthly costs to the housing sponsor and to the households. While equity, grants, and donations do not have to be repaid, most loans have monthly amortization or payments and become part of the on-going operating expenses. The inclusion of these monthly repayments or debt service increases the monthly expenses of operating the housing, generally far in excess of rents that are affordable to low- and moderate-income households.

The following is a simplified rental property operating pro forma (budget): housing development.

**Rental Income:**

12 units @ \$500/month	\$6,000/month
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**Expenses:**

Real Estate Operations (utilities, taxes, maintenance, etc)	\$4,500/month
Debt Service	\$1,500/month
Total Expenses:	\$6,000/month

In this example, the rental income is adequate to cover the cost of operating the real estate and the debt incurred. However, the rents shown are higher than an individual whose income is SSI can afford. According to HUD standards, a household should spend no more than 30% of its income on housing. In order to make the housing affordable to an individual whose income is SSI, there would need to be a reduction in the debt and/or a rental subsidy.

The following illustrates the change in the pro forma if there is a rental subsidy:

**Rental Income:**

12 units	
Resident Payment	
30% of SSI @ \$187/month	\$2,244/month
Rental Subsidy @ \$313/month	\$3,756/month
Total Income	\$6,000/month

**Expenses:**

Real Estate Operations (utilities, taxes, maintenance, etc)	\$4,500/month
Debt Service	\$1,500/month
Total Expenses:	\$6,000/month

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The following illustrates the change in the pro forma if there is no debt – the rental subsidy can be reduced:

### **Rental Income:**

12 units	
Resident Payment	
30% of SSI @ \$187/month	\$2,244/month
Rental Subsidy @ \$188/month	\$2,256/month
Total Income	\$4,500/month

### **Expenses:**

Real Estate Operations	\$4,500/month
(utilities, taxes, maintenance, etc)	
Total Expenses:	\$4,500/month

The key to long-term financial feasibility, therefore, becomes the infusion of grants, donations, subsidies and loans that minimize on-going operating expenses. The major financing techniques used to accomplish this are:

- 1- Grants, non-repayable loans or donations that reduce or eliminate the need for loans that need to be repaid
- 2- Deferred loans that do not need to be repaid until sale or refinance of the property
- 3- No/low interest loans that reduce the monthly debt service or repayment
- 4- Tax credits to investors for providing equity to a project
- 5- Rental subsidy that provides a monthly subsidy to cover operating expenses
- 6- Tax abatements that reduce operating costs