

Developing Multifamily Housing With New Construction

PROGRAM
OPERATIONS



A Complete Overview of the Skills and Finances Needed
To Run a Successful Program

Launched in 1982 by Jim and Patty Rouse, The Enterprise Foundation is a national, nonprofit housing and community development organization dedicated to bringing lasting improvements to distressed communities.

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This book is part of the Enterprise Community Development Library, an invaluable reference collection for nonprofit organizations dedicated to revitalizing and reconnecting neighborhoods to mainstream America. One of many resources available through Enterprise, it offers industry-proven information in simple, easy-to-read formats. From planning to governance, fund raising to money management, and program operations to communications, the Community Development Library will help your organization succeed.

ADDITIONAL ENTERPRISE RESOURCES

The Enterprise Foundation provides nonprofit organizations with expert consultation and training as well as an extensive collection of print and online tools. For more information, please visit our Web site at www.enterprisefoundation.org.



About This Manual

What is multifamily housing developed with new construction?

Put simply, multifamily housing is a number of rental apartments concentrated at one site. But developing multifamily housing that low-income households can afford is not simple. Most affordable new construction programs usually include financing packages that rely heavily on equity raised through the Low-Income Housing Tax Credit (LIHTC) program, one of the more complicated funding mechanisms in the development

Developing Multifamily Housing With New Construction is designed for board members and staff of nonprofit community development organizations who are not experienced in managing a successful program for building new multifamily rental housing. This manual can make that process easier and clearer and should be used together with more detailed information and helpful documents available in The Enterprise Foundation's Developer Support System found on the Web at www.enterprisefoundation.org.

This manual touches briefly on aspects of the LIHTC program, particularly as LIHTC equity fits into the overall financing scheme of new construction multifamily development. However, the manual is not intended in any way as a full description of the LIHTC. It also includes information on such topics as:

- Risks and ways to minimize them
- Development process
- Staffing and consultants
- Capital requirements
- Development budgets and cash flows
- Community involvement

This manual is part of the *Program Operations* series within The Enterprise Foundation's Community Development Library™. The series provides detailed information on the housing-related programs used most by nonprofit organizations. Other manuals in the series include information on:

- Single-family acquisition and rehabilitation
- Single-family subdivision new construction
- Single-family housing for infill
- Multifamily rental housing through renovation
- Scattered-site rental housing
- Home improvement programs
- Supportive housing
- The HOME Investment Partnership Program

Table of Contents

Introduction	2
Strategic Risks	3
Development Process	5
Organizational Roles	9
Staffing and Consultants	10
Organizational Budgeting	13
Financing	18
Development Budget	21
Cash Flow	25
Operating Budget	28
Community Interaction	31
Internal Production Systems	32
Profitability	34

Introduction

The construction of new multifamily rental housing can substantially enhance the lives of low-income people in your community by offering them an increased number and variety of affordable housing options.

Many nonprofit organizations develop multifamily housing as part of a mission that might also include single-family housing, housing management, social services and other community development activities. Multifamily housing can complement these efforts as part of a comprehensive development strategy.

By constructing new multifamily rental housing, nonprofit organizations can fill a void that the private sector cannot. New, larger-scale development allows you to use and enhance many of your skills. It also garners great rewards both in the community's perception of your organization and in the development fees you can earn.

Multifamily housing development brings great risks to your organization — risks that are long term and will affect how your organization operates over the next 20 years or more. Building a competent team, understanding the risks and knowing your organization's limitations will help you to manage the risks.

BENEFITS OF BUILDING NEW MULTIFAMILY HOUSING

Creating a model for your community

Quality affordable rental housing may be your most immediate need. Depending on the financing, it's possible to make rental housing available to households with incomes as low as \$10,000 a year.

Increasing your housing production

The construction of new rental housing can also expand your development program. Although it's certainly possible to create quality rental housing through the rehabilitation of existing buildings, it is easier to increase the volume of new units by building from scratch. A couple of things contribute to this: The construction process is more standardized, and the financing (including both Low-Income Housing Tax Credit [LIHTC] equity and mortgage loans) is easier to obtain.

Generating income for your organization

A benefit associated with increased productivity is the opportunity for increased fees. In new construction using LIHTC equity, it's not unusual for an organization to earn \$5,000 to \$7,000 per unit in development fees. If your projects are in the 40- to 150-unit range (as is typical in many markets), even a single project can have a significant impact on your organization's budget.

Strategic Risks

If you use the LIHTC, you are committing your organization to 30 or more years (in most states) of participation in your project's development and operation. Unlike other shorter-term and less capital-intensive projects, a tax credit property must maintain affordable rents for at least 30 years or face major economic penalties. Even if your project does not use tax credits, you may find it difficult to get out from under a failing project with your organization intact.

Challenges involve:

- Securing sufficient operating capital
- Planning for long-term responsibilities
- Building or contracting for specialized skills in finance and asset management
- Understanding the broader housing market, both short and long term
- Managing a large development team of both staff and contractors
- Expanding political and community support

Major worries include:

- Incomplete market assessment — insufficient information on:
 - Consumers' needs
 - Consumers' ability to pay projected rents
 - Other projects, either existing or in development
 - Appropriate site
 - Required apartment size, configuration or amenities
- Insufficient working capital
- Politics of community opposition
- Inexperience

Keys to success are:

- Market sense
- Working capital
- Land
- Humility to know your limitations and get good help

Hiring and managing are critical — You may lack the staff capable of bringing a rental project to completion. There are actually two challenges here: contracting for the particular skills needed to build and manage the project and securing the finances needed to keep the project moving forward during the lengthy period from concept to lease-up.

There are complex laws and requirements — While offering financial advantages, the LIHTC involves you in arcane details of the federal tax code and your state's allocation and compliance processes. Their rules are exacting. This complexity can increase dramatically as you layer on the rules and requirements of other sources of financing. And remember, you will find yourself having to plan for and maintain compliance with all of these rules for the full life of the project. In addition, you have to manage the project at the same time.

There is a lot you will not know — You may find that you have to become familiar with a larger range of potential partners and contractors than with other community development business lines. With a single-family rehab program, for instance, you may rarely need the services of an architect or structural engineer. With multi-family new construction, these are essential members of your development team. You also will likely be using different contractors than on smaller-scale developments.

Then there is financing. You will have to engage partners, such as a tax credit syndicator or specialists in multifamily debt financing. If you have no experience in rental housing, you will discover that a skilled and responsible property manager is essential. Some nonprofits, lacking staff and financial resources, enter partnerships with other developers.

Politics always play a role — You may face new political challenges in increasing your scale of production, or perhaps in taking advantage of opportunities to move your affordable housing program into new communities and jurisdictions. Some communities oppose affordable housing. Government donors may seek to reduce your developer's fee. Other nonprofit community development organizations may consider your partnership with an experienced for-profit developer inappropriate or inconsistent with your mission.

Key limiting factors in this business include:

- The availability of suitable and affordable sites
- The availability of adequate development capital and operating subsidies
- Your organization's capacity to manage a complex business line involving a large development and operations team
- The complexity of managing federal tax credits

MINIMIZING THE RISKS

Keep accurate records — A tax credit project entails a legal partnership between a nonprofit organization — the general partner — and the tax credit investors — the limited partners. The nonprofit general partner is responsible for the ongoing delivery of tax credits to the investors. This requires:

- Ensuring that project costs eligible for tax credits, or "basis," and anticipated expenditures are calculated correctly
- Completing construction on time
- Leasing apartments to income-eligible tenants in a timely manner; at initial lease-up, the process needs to adhere to a "qualified occupancy" timeline
- Developing adequate operating budgets
- Maintaining full occupancy

Keep rents low and budget adequately for operating expenses — Anticipate minimum rent increases during the life of the financing. Do not project rent increases higher than 3 percent annually. The lower you can set your rents, the broader market you can reach. This also may give you more room to raise rents if expenses run high. Do not plan an operating budget without anticipating an increase in expenses of at least 4 percent per year. You can improve your forecasting by involving your property and asset management firm in your operating budget review.

Budget sufficient reserves — Long-term financial risk can be reduced by budgeting sufficient reserves. You should establish higher reserves than you believe necessary. Your financial partners will want this as well. Organizations such as the Institute for Real Estate Management (phone: 312.329.6000) or the Consortium for Housing Asset Management (phone: 410.964.1230 or 800.624.4298) can give you an idea of how to figure these numbers. Your property manager can also help. Investors often require operating reserves of six months' debt service and operating costs.

Assemble a capable development team — Multifamily rental projects require the coordinated activities of design, building, legal, property management and financing experts. Capable individuals who work well as a team increase the likelihood of long-term success.

Development Process

Multifamily rental housing development has six general phases. Each of these phases overlaps with others at various times during the project.

1. Concept and Site Identification
2. Feasibility Analysis
3. Financing
4. Construction
5. Lease-Up
6. Asset Management and Operations

For more detailed information about the development process, see The Enterprise Foundation’s Developer Support System at www.enterprisefoundation.org.

PHASE 1

CONCEPT AND SITE IDENTIFICATION

This is your organization’s vision for the proposed development. It usually includes a description of whom you want to serve, what services you intend to provide and where those services will be offered.

Concept example:

A mid-rise apartment building for 50 to 70 low-income senior citizens located on a bus line within our neighborhood linked to a number of on-site and nearby social services

Multifamily rental developments come in many different varieties. Tenancy can include permanent rental, lease/purchase (if a project uses tax credit equity, the lease period must be 15 years) or transitional housing for people moving from homelessness or in need of other short-term support. Building types can include garden apartments, townhouses, low-rise or high-rise apartment buildings or mixed-use commercial buildings.

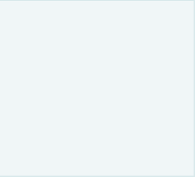
Sometimes the concept begins with a site, which can work if you serve a lot of different markets and can apply different concepts to an attractive site. Most nonprofits cannot do this because they are tied to a few specific consumer markets. Sites are most available in soft markets or in difficult-to-develop areas. These site limitations require that you be careful about what you build. Do sites that private developers have passed over meet a special need of your residents, such as proximity to a needed service? Will low rent levels help to ensure a market demand for your units?

Start with the market you want to serve. Where do prospective tenants want or need to live? What kind of housing do they want or need? What can they afford to pay? This analysis can be based on your understanding of your neighborhood and community rather than a formal market study.

There are several ways you can enhance your understanding of your market. First, look at the people you already serve. What are their incomes and family compositions? Where did they move from? What do they like about the housing you provide? What might they like better — different location, larger units, more amenities? You can gather this information through the collection of data at lease-up, through surveys or, less formally, through frequent conversations.

If you do not have much experience in providing rental housing, look to other agencies that may have contact with your potential market. Community service workers often know something about the type of housing their clients want or need. You can enlist their help in a more formal survey process as well.

Make use of your daily contacts. If you are targeting workers in the 30 to 50 percent of median income range, for example, talk to those you meet, such as retail clerks, bank tellers or social service case managers. Would they want to live where you are thinking of building?



If you have development partners, this is the time for a detailed letter of understanding or formal agreement to outline general goals, roles and responsibilities.

The conceptualizing period ends with identification of a site that can accommodate your vision. This can easily take six months. But if you do not have a site after a year, you may want to revisit your concept.

PHASE 2

FEASIBILITY ANALYSIS

A feasibility analysis will tell you if it is possible to build and operate your project at the identified location with the currently available resources. If not, the analysis should identify what further resources will be needed.

- Engage an architect to execute a preliminary design. Do not always trust his or her estimate on construction costs. An architect's strength is in design, not cost estimating.
- Hire an engineer or a builder to provide you with a reasonably accurate sense of costs. An engineer should also complete test borings to determine if the site can support the building or buildings that you want. Go over the construction schedule in detail with the builder or engineer. The construction schedule significantly affects the financial viability of your project.

- Retain a lawyer if you have questions regarding zoning.
- Consider hiring a development consultant to complete initial financial projections and to map out an appropriate development strategy, particularly if you are inexperienced or attempting to significantly increase your production level.
- Work with a property manager to help you estimate an operating budget and calculate an appropriate lease-up schedule.

The initial feasibility analysis ends when you have a development budget and operating pro forma. This can take three months if the team is in place. If it is a new team and everyone needs to be interviewed and screened, this process can take longer.

PHASE 3

FINANCING

With a site secured and a budget in place, you can apply for financing. It helps to think of financing needs in phases. Some funding sources may meet more than one need, but others will limit their support to one development phase only. Most organizations look to foundations or nonprofit lenders for earlier at-risk money and are able to secure commitments from conventional lenders and equity investors as the project passes additional development hurdles and obtains more elements of the total financing package. Financing phases, uses and sources are described briefly as follows:

Types of financing

Type of fund	Uses of funds	Sources of funds
Predevelopment	Architectural, engineering and consultant costs	Foundation grants; nonprofit housing fund loans; city program funds
Acquisition	Land costs; title and legal fees	Nonprofit housing fund loans; banks; city program funds; grants
Construction	Construction and architectural costs	Nonprofit housing fund loans; banks; city program funds; grants; LIHTC equity funds
Permanent	Repayment or conversion of acquisition, construction and predevelopment loans	Banks; city program funds; grants; LIHTC equity funds

The period from initial feasibility to commitment of all project financing can take from six months to 18 months or two years. Few professionals, such as architects or consultants, will work entirely at their own risk, so you will need to secure adequate predevelopment funding to complete project pro formas, architectural drawings and other items required to secure construction and permanent financing commitments.

The process of obtaining financing commitments from state and local sources will help to define the timing and priorities of the development process. Make sure your development team includes someone with an intimate knowledge of the requisites of funding sources.

As financing starts to gel:

- Architect should complete working drawings and get building permits.
- Builder should guarantee prices and completion date.
- Property manager should formally agree to the operating budget.
- Attorneys — and you — should finalize terms with equity investors and other development partners.

PHASE 4

CONSTRUCTION

Get moving, because winter is coming! Time is everything, because you are now paying interest on money borrowed for site acquisition and preparation and construction soft costs incurred. Your investors and the LIHTC issuer are looking at their watches, too. The contractor does the hard construction work, the development consultant is an extra set of eyes and ears, and the lender and you (the developer) try to keep small problems from blowing up.

Spend your contingency as frugally as possible. When your budgeted contingency is gone, additional cost overruns come from your developer fee. Depending on the nature of the project, construction will take nine to 12 months.

PHASE 5

LEASE-UP

Your property manager needs to have a marketing plan in place and begin marketing at least two months before the first unit is available. You may keep a waiting list even earlier, but know that such lists for rental housing grow “stale” quickly — potential tenants usually do not look for too long before settling on a new place. If you are doing a multiple-building development with staggered completion dates, lease-up will begin several months before construction is complete. You may be able to reach stabilization (breakeven) within a month or two after construction completion, but if you have a large project or the market is soft, it could easily take six months or longer.

Although it may be advisable to leave execution of the marketing plan primarily to your management agent — who is getting paid to do this work — make sure that the plan takes advantage of the strengths of your organization’s knowledge of and ability to reach your target market. Use the market information you gathered in deciding what to build to develop the plan that will reach your target. You may know:

- Where you expect your tenants to be living now
- Where they work
- What other associations they have

If you expect to draw your tenants from within the community where you are building, make sure your marketing materials are in local stores, libraries and other public places. Target neighborhood media with news about your project. If, as in many markets, consumers tend to move out along a radius from central portions of the city, you can use the same techniques in the neighborhoods between you and downtown.

Lower-wage employers are often happy to assist their workers in finding places to live near their jobs, because it reduces absenteeism and improves work force retention. Research the major nearby employers of people in your target income range.

If your development targets people at the entry-level wage, you may be able to reach them through employment training, counseling or other human service agencies. Trade schools may also be a likely source. Other nonemployment associations, such as churches, can be a very important addition to your marketing efforts.

The lease-up process itself should be carefully monitored. Analyze the hand-off system between your contractor and management agent, and make sure it is as efficient as possible. Make sure that the contractor's responsibilities for punch-out and cleanup are clear, but do not let the management agent hold things up over small details — he or she should be a problem solver.

Make sure that you and the management agent agree when leasing agents are to be on-site. With a project of 100 units or more, it is common for the leasing agent to be on-site 35 to 40 hours a week from the time the first units are available to show, including evening and weekend hours. To facilitate this, your contractor should have scheduled completion of the management office to precede or coincide with the completion of the first units.

PHASE 6

ASSET MANAGEMENT AND OPERATIONS

The nonprofit owner generally has long-term responsibility for operation of the project. The nature of this responsibility is best detailed in the Representation and Warranties section of the limited partnership agreement. The nonprofit is usually required to provide:

- Operating deficit guarantees
- Construction completion guarantees
- Replacement reserves

The nonprofit must ensure that the property remains leased, in good repair and financially solvent for 30 years or longer. The greatest risk outside your control is changing market conditions.

PIPELINE

Given that the total timeline on a project can easily reach three years, a pipeline requires that two more projects be under way for every project you hope to complete this year.

If your organization wants to do only one or two projects in the foreseeable future, it is recommended that you work with another more experienced organization as the primary developer.

If you are looking at multifamily new construction as a business line, then you should give some thought to where your next project will be (and how you will staff it) even as you are in the preconstruction phases of your first. Be aware of the two main external limitations to your production — the availability of good sites and limits on subsidies (largely public dollars). LIHTCs are in high demand by developers almost everywhere.

Organizational Roles

In multifamily development, nonprofit organizations can play one of three roles:

- Sponsor or co-developer
- Developer with strong technical consultants
- Developer with in-house expertise

ROLE 1

NONPROFIT AS A SPONSOR OR CO-DEVELOPER

This structure requires the least participation by the nonprofit. It leaves most of the real estate development work to another organization, either a for-profit or another nonprofit. The role of the nonprofit in this model includes:

- Defining community interests
- Working with governments to obtain subsidy
- Handling a specific job, such as marketing
- Protecting your own organizational interests

You will receive a modest sponsorship fee for your efforts.

A development partner can bring the following resources to the development effort:

- Cash and up-front development money
- Equity for land purchases
- A strong financial balance sheet
- Extensive multifamily development experience and experienced staff
- Reserve guarantees
- Strong ongoing relationships with architects, builders and engineers that ensure quality
- Back-office support to ensure compliance with all rules and deadlines

ROLE 2

NONPROFIT AS A DEVELOPER WITH STRONG TECHNICAL CONSULTANTS

In this development model, the nonprofit organization handles the following tasks:

- Serving as the sponsor
- Finding land
- Submitting or assisting in submitting all funding and subsidy applications
- Selecting all professionals for the project
- Handling all financing and cash flow needs

ROLE 3

NONPROFIT AS A DEVELOPER WITH IN-HOUSE EXPERTISE

In this model, the nonprofit organization must have strong technical knowledge and experience in tax, financing, legal and construction activities. The model also requires an organizational commitment to ongoing multifamily development to justify the high overhead costs associated with learning the business.

Your fee income will drop according to the amount of work you pass on to a partner. You will also have to give up substantial control of the development process. While you may learn from your ability to watch the process, you should consider what control you need to maintain in order to ensure that the project meets your goals. At a minimum, you probably need to maintain some control over the management agent and operating budget. Investors and other funding sources may be interested in having a more experienced or well-capitalized partner play the predominant role in the development.

Staffing and Consultants

As developer, in-house developer or even co-developer, the nonprofit will need experienced staff persons filling a variety of roles. What follows is a list of the roles, time allocations and required skills for an organization that produces 60 apartments annually through multifamily rehabilitation, acting as the developer. This list would be more extensive (adding legal, engineering and architectural expertise) if the nonprofit acted as in-house developer, and less extensive (subtracting accounting expertise and time allocations from the other positions) if the nonprofit acted as co-developer with an experienced developer.

Multifamily Development Staff for 60 Units Per Year

Position/Role	Fraction of FTE allotted to program	Critical Skills Required
Executive Director Cost: \$50,000–\$60,000	.20	Strategic sense of local politics, experienced negotiator, relationship builder, knowledge of housing development and finance
Project Manager Cost: \$30,000–\$40,000	1.00	Financial analysis, knowledge of financing programs and procedures, knowledge of construction, writing skills
Administrative Assistant	.50	Filing and record keeping, attention to detail
Controller	.25*	Experienced with LIHTC, knowledge of cost capitalization and reserves
Bookkeeper	.25*	Attention to detail, knowledge of reporting formats

* Development phase only. As the inventory of operating projects grows, additional staff must be added.

Note: Nonprofit organizations will generally have these other line items in their general operating budget: rent, utilities — \$10,000; phone — \$ 8,000; equipment rental (computers, copier, fax) — \$5,000; supplies (office, program, postage and delivery, printing) — \$10,000; consultants (auditors, public relations, fund raising) — \$25,000; travel and training — \$ 6,000; program expenses and staffing, if involved in social services or other programs — as budgeted.

FTE = Full-Time Equivalent

CONSULTANT ROLES

In multifamily new construction, it is typical to work with a great many consultants, including lawyers, accountants, architects and specialists in financing and structuring a deal. Sometimes the financing and deal structuring services are provided by organizations such as The Enterprise Foundation and The Enterprise Social Investment Corporation. The work involved in putting together a multifamily housing project is very detailed, and even the most experienced nonprofits use professional advice. A local nonprofit has many jobs. It is not reasonable to assume that staff can devote sufficient time to the intricacies of changing federal tax codes and other technical nuances of the development process.

Good consultants are:

1. Respected in your community or have regional or national reputations
2. Well capitalized and very experienced
3. Successful in their previous development efforts

The following consultants are typical:

Syndicators — If you use the LIHTC, you will need a syndicator, like The Enterprise Social Investment Corporation, to help you identify and work with potential project investors. When tax credits were plentiful and investors scarce, syndicators tended to be most responsive to investor needs. With tax credits more scarce, developers get more attention. A good syndicator or consultant knows both parties have to be satisfied for the deal to go forward.

Attorney — Your attorney must be skilled in partnership negotiations and knowledgeable of LIHTC. The critical question is, “Can he or she provide opinions acceptable to investors?” It is helpful if your attorney is also experienced in real estate and construction law. You should look for an attorney with a reputation for cost-effective service and consider establishing a fixed-price contract.

Architect/engineer — Your architect should be knowledgeable of multifamily development and the local code issues, cost-conscious, experienced in affordable housing development and willing to work as part of a team.

Builder — Your builder must have demonstrated experience in multifamily construction, preferably in fair-wage projects. Does the company have the capacity to continue work through delays in payment from city or state funding sources? Check references for the builder carefully, particularly from other nonprofits. Who are the company’s subcontractor and suppliers? You may want to talk with its bankers, subcontractors and vendors. Visit a current construction site. Is it clean? How many workers are on site?

Accountant — Your project accountant must have strong knowledge of LIHTC. The critical question is, “Can he or she provide opinions acceptable to investors on issues of cost certification, taxes and asset management?” You should make sure the consulting accounting firm can serve as an overall adviser to your organization on financial management issues. The accounting firm can also help you maximize your tax credit award and ensure the eligibility of costs for credits.

Property manager — Property management is critical to your success. Your property manager, who will be working with you every day for the next 15 years, must have a background in affordable housing, experience working with outside owners, and knowledge of LIHTC compliance issues. Do your philosophies of resident relations match? Can the company accommodate your on-site services and staff? Check references with other property owners. Visit other sites unannounced. See how you are treated and the condition of the site.

Caution: Avoid conflicts of interest

Board directors should not personally or professionally profit from the development activity. Do not use a law firm, engineer, builder or other professional from the board even if the services are pro bono. This changes the deal's dynamics and may hinder the staff's ability to negotiate in the best interests of the project and organization. This is particularly important with multifamily housing projects. The exception to this is a banking relationship. There are a limited number of banks involved in multifamily housing, and the banks typically have several layers of decision making, which reduces the direct involvement of your board member.

Organizational Budgeting

Retaining skilled staff is the major expense of operating a business line for developing multifamily projects using the LIHTC. Because there is an extended timeline to completion of the first project, the up-front costs before realizing any fees from the development can be substantial. Here is an annual expense budget for the development of a new project of approximately 100 units each year. Following it is a timeline for a single such development. Then, integrating the two, we show the amount an organization should expect to front in operational costs prior to earning fees, and how with a pipeline of projects (each beginning about one year apart) the business line can sustain its own operational costs after that initial period.

Program Operations Budget

Multifamily Development with Low-Income Housing Tax Credits (100 units per year)

Staff		
Executive director	.33 FTE @ \$60,000/FTE	\$ 20,000
Project manager	1.00 FTE @ \$35,000/FTE	35,000
Clerical assistant	.50 FTE @ \$20,000/FTE	10,000
Controller	.25 FTE @ \$35,000/FTE	9,000
Bookkeeper	.25 FTE @ \$25,000/FTE	6,000
Total Staff Salaries		<u>\$ 80,000</u>
Benefits @ 25%		\$ 20,000
General Overhead (prorated to program)		
Office space & utilities		\$ 4,000
Telephone		3,000
Equipment		2,000
Printing & supplies		4,000
Travel & training		2,000
Professional services		10,000
Total General Overhead		<u>\$ 25,000</u>
TOTAL OPERATIONAL COST		\$125,000

Timeline — Development Cost, Development Income

Development Phase	Duration	Development Income (Cost)	Source of Cost or Income
Concept & Site Identification	Six months	(\$10,000)	Site option
Feasibility	Three months	(\$15,000)	Preliminary drawings, soil tests, preliminary title
Financing	Nine months	(\$25,000)	Market study, appraisal, survey, environmental study, construction drawings
Construction	Nine months	\$50,000	Draw against construction loan for predevelopment expenses
Lease-Up	Three months	\$100,000	Portion of developer fee at construction completion or full occupancy
Operations	Ongoing	\$100,000	Balance of developer fee after project achieves breakeven; typically this will be three months after completion of lease-up

PIPELINE CASH FLOWS

The accompanying chart shows how operational expenses, fronted development expenses and operational income from development fees, as scheduled according to the timeline, interact in a production pipeline where projects are spaced one year apart.

Note that the organization reaches a maximum out-of-pocket investment of \$287,500 in the eighth quarter. It begins to receive fees from the development of its first project in the ninth quarter, just as it is beginning its third project. The organization still has not recovered its full investment by the end of the 14th quarter, after it has received fees for its second project and continues development of its third and fourth projects. It will break into the black in the 18th quarter with the completion of its third project, four and a half years from the beginning of its multifamily development business.

Factors that would decrease the organization's out-of-pocket investment and increase its return on that investment include:

- 1) stepping up the pace of development
- 2) negotiating an earlier payment of fees in the development process
- 3) persuading providers of professional services to wait for payment until construction financing closes
- 4) earning larger fees from development

Each of these factors is externally constrained, however. It is just as likely that development will proceed more slowly than projected here. Lenders and investors are often reluctant to fund the payment of fees prior to substantial completion of a development. Just like you, professionals such as architects want to be paid as quickly as possible, and the most economical firms may be unable to sustain themselves without payment. The scarcity of financing subsidy tends to limit fees.

It may also be possible to reduce cost in the first few quarters by delaying the addition of financial accounting staff. These staff members need to be in place during the financing phase, however.

**Development Pipeline Timeline (Over 3 1/2 Years or 14 Quarters) —
Multifamily Development with Low-Income Housing Tax Credits**

	Quarter 1 Start Concept – Project A	Quarter 2	Quarter 3 Start Feasibility – Project A	
USES OF FUNDS				
Program Operations	31,250	31,250	31,250	
Development Costs		10,000	15,000	
Total Uses	31,250	41,250	46,250	
SOURCES OF FUNDS				
Development Fees				
Financing Proceeds				
Total Sources	–	–	–	
Total Out of Pocket	31,250	72,500	118,750	

	Quarter 8 Start Financing – Project B	Quarter 9 Lease-Up – Project A Start Concept – Project C	Quarter 10 Operations – Project A Start Construction – Project B	
USES OF FUNDS				
Program Operations	31,250	31,250	31,250	
Development Costs	12,500	12,500	10,000	
Total Uses	43,750	43,750	41,250	
SOURCES OF FUNDS				
Development Fees		100,000	100,000	
Financing Proceeds			50,000	
Total Sources	–	100,000	150,000	
Total Out of Pocket	287,500	231,250	122,500	

	Quarter 4 Start Financing – Project A	Quarter 5 Start Concept – Project B	Quarter 6 Start Construction – Project A	Quarter 7 Start Feasibility – Project B
	31,250	31,250	31,250	31,250
	12,500	12,500	10,000	15,000
	43,750	43,750	41,250	46,250
			50,000	
	–	–	50,000	–
	162,500	206,250	197,500	243,750

	Quarter 11 Start Feasibility – Project C	Quarter 12 Start Financing – Project C	Quarter 13 Lease-Up – Project B Start Concept – Project D	Quarter 14 Operations – Project B Start Construction – Project C
	31,250	31,250	31,250	31,250
	15,000	12,500		10,000
	46,250	43,750	31,250	41,250
			100,000	100,000
	–	–	100,000	50,000
	168,750	212,500	143,750	150,000
				35,000

Financing

CAPITAL ISSUES

Now that you have reviewed the strategic, staffing and technical issues surrounding multifamily development, let's turn to the equally important capital requirements. Capital is needed at both the front end and back end of any multifamily project your nonprofit undertakes. It is important to understand capital demands and have a plan in place to meet them. This plan will change with each development effort. Your accounting staff should participate annually in these plans.

Operating capital

Do not expect to see any developer fees for two years from the start of a project, maybe three. During this time, however, you will need to pay staff and overhead costs. For a nonprofit, costs will start at a minimum of \$75,000 per project unless paid for by a co-development partner. Upgrading financial management does not need to happen until the second half of the feasibility analysis, but you will need to budget for new staff or upgraded systems. You may also be able to get grants to cover your expansion, but you may want to plan to build up cash reserves before going into multifamily development as a new business line.

TAX CREDIT FINANCING

The vast majority of affordable multifamily rental housing produced today uses the federal LIHTC to help with financing. You will find a more comprehensive description of this program in *Tax Credits for Low Income Housing* by Joseph Guggenheim, now in its 10th edition.

Meantime, here is a brief introduction. Established in 1986, the LIHTC program offers tax savings for investing in affordable rental housing. Investors achieve most of their expected return in the form of reduced federal tax liability. Nonprofit organizations receive investors' equity pay-ins, reducing the need for mortgage debt on projects and increasing their affordability.

How to qualify

To qualify for tax credits, a project must rent to tenants with incomes no greater than 60 percent of the area median income, adjusted for family size. Rents must be kept affordable to this market for at least 15 years. The tax credits are distributed to the project's owners during the first 10 years of this period.

Your state plays a role

Tax credits are allocated and regulated by state governments, typically housing finance agencies (HFAs). These state agencies may establish their own priorities or selection criteria for tax credits, which are in high demand. These often include preferences for rents below the maximum allowed under the program, geographical dispersion of projects, lower-cost projects and projects linked with social services or integrated into an overall community development plan. In some states nonprofits have scoring advantages under the selection criteria. In others, nonprofits complain that they are virtually shut out of the program.

Ownership structure

LIHTC investors are generally corporations that agree to invest a certain amount of money in a project in exchange for tax credits. These corporations usually become limited partners. The nonprofit developer frequently becomes the project's general partner and may own just .01 percent of the project.

In exchange for their money, investors may negotiate restrictions. They may, for example, demand approval of the property management agent and other outside contractors your nonprofit wishes to hire. They will certainly establish performance criteria for the operation of the project and demand financial guarantees. This can put considerable constraints on your nonprofit.

What is a limited partnership?

Limited partnerships are vehicles that allow investors to own most of a project (typically 99.99 percent), thus gaining the tax benefits of ownership but limiting their responsibility (and liability) for the project.

Key issues faced by nonprofits in negotiating with investors

- How much are investors willing to pay to enter the limited partnership?
- How much up-front money are investors willing to pay?
- What cash and guarantees are the nonprofit required to provide?
- How and when are cash reserve accounts to be funded?
- Under what terms can the general partner be forced out of the project?
- Under what terms can the nonprofit acquire the project at the end of the 15-year tax credit compliance period?

USING TAX-EXEMPT BONDS

In response to the increasing competition for 9 percent LIHTC allocations, many developers are turning to tax-exempt bond financing with and without the 4 percent LIHTC. The spread between taxable and tax-exempt bond financing varies depending on the bond market, but tax-exempt rates are always lower, making tax-exempt financing attractive to developers of low-income housing.

A brief introduction to tax-exempt bond financing follows. It is important to note that bond financing, like the LIHTC program, is a complicated process subject to Internal Revenue Service (IRS) regulations. It is also important to note that bonds have additional soft costs that can make bond financing prohibitively expensive. Bond transactions include a bond issuer, bond underwriter, bond counsel and usually some form of credit enhancement provided by a third-party source. Each of these additional entities carries a cost. As a result, most bond-financed housing consists of larger projects.

Tax-exempt bonds are divided between private activity bonds and public purpose bonds. Public purpose bonds are used to develop housing that will remain publicly owned. Private nonprofit and for-profit developers of multifamily housing commonly use two types of private activity bonds: exempt facility bonds and 501(c)(3) bonds.

Multifamily rental projects can qualify for exempt facility bonds if:

- 20 percent or more of the residential units are set aside for households with incomes at or below 50 percent of area median income; or 40 percent or more of the residential units are set aside for households with incomes at or below 60 percent of area median income.
- The minimum compliance period is the longer of 15 years or the term of the tax-exempt bond financing.

Multifamily rental projects can qualify for 501(c)(3) bonds if:

The primary beneficiary of the bond issue is a 501(c)(3) organization; for example, if a 501(c)(3) organization will own and operate the financed housing project for the benefit of low-income households.

One critical difference between exempt facility and 501(c)(3) bonds is volume cap: Exempt facility bonds fall under state private activity bond volume cap and 501(c)(3) bonds do not. In many states, competition for private activity bond allocations is substantial, with interests other than housing fighting for the same resource.

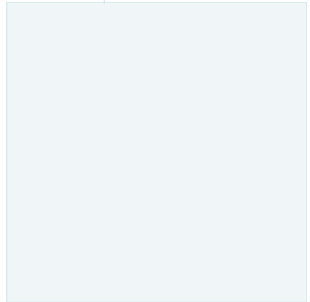
Another critical difference between exempt facility and 501(c)(3) bonds is eligibility for the 4 percent LIHTC. Projects financed through exempt facility bonds receive an as-of-right tax credit allocation; projects financed through 501(c)(3) bonds are ineligible for tax credits.

To qualify for the 4 percent LIHTC on all eligible units, the tax-exempt bond must exceed 50 percent of development costs, including land acquisition. To meet this test, many projects use tax-exempt bond financing in excess of 50 percent during construction and then take out a portion of the bond financing with lower interest rate debt for the permanent phase.

Bonds can be sold through private placements or public offerings. In a private placement, an investor buys the bonds directly from the issuer; in a public offering, the issuer sells the bonds to a bond underwriter that resells them to many investors. Public offerings require investment grade ratings from rating agencies like Moody's or Standard & Poor's to increase the marketability of the bonds and to keep interest rates low. Investment grade ratings usually require credit enhancement in the form of bond insurance, a bank letter of credit or some other form of third-party guarantee.

A tax-exempt financing project using the 4 percent LIHTC might have the following chronology:

1. Initial feasibility determination.
2. Development team selection — bond issuer, bond underwriter, credit enhancer, accountant, tax credit investor, in addition to the usual development team members.
3. Inducement resolution — bond issuer passes an inducement resolution to notify the public of its intention to issue tax-exempt bonds.
4. Private activity bond cap allocation — bond issuer receives a private activity bond cap allocation.
5. Credit enhancement commitment — the project secures a commitment from a credit enhancer like a bank or mortgage insurance company.
6. Tax Equality and Fiscal Responsibility Act hearing — the bond issuer holds a public meeting to hear public comments on the proposed issuance.
7. Tax credit application — the project, although entitled to the 4 percent LIHTC, needs to get a reservation or binding commitment from the LIHTC allocating agency.
8. Legal documents and final underwriting — all documents completed and bonds priced.
9. Bond closing.



Development Budget

You must have a development budget to show investors and officials that you have thought through and made provisions for all the necessary capital required to sustain your project through all development phases.

SAMPLE DEVELOPMENT BUDGET FOR 66 UNITS

Sources of Funds	Term	Rate	Amount	% of Total
1st Mortgage	30	8.00%	\$ 1,325,000	24%
2nd Mortgage	16	7.60%	660,000	12%
3rd Mortgage	16	6.50%	300,000	6%
Net Equity to Project			<u>3,192,567</u>	<u>58%</u>
Total Sources of Funds			\$ 5,477,567	100%

Uses of Funds	Per Unit	Total
Acquisition — Land	\$5,076	\$335,016
Acquisition — Building	0	0
Site Work	7,121	469,986
Construction Costs New	44,318	2,924,988
Construction Costs Rehab.	0	0
Contingency (10.0%)	5,663	373,758
Appliances	800	52,800
General Requirements	758	50,028
Contractor Overhead & Profit	4,432	292,512
Architect/Engineer	652	43,032
Developer Fee	6,167	407,022
Real Estate Taxes	152	10,032
Insurance During Construction	379	25,014
Environmental Study	45	2,970
Appraisal	76	5,016
Survey & Soil Tests	76	5,016
Title & Recording	288	19,008
Sponsor & Local Legal Costs	455	30,030
Fund/Partnership Legal	212	13,992
Accounting Review	8	528
Audit/Tax Return	23	1,518
Cost Certification	68	4,488
Market Study	38	2,508
Construction Loan Interest	1,786	117,876
Tax Credit Origination Fees	257	16,962
Loan Costs (Construction)	595	39,270
Loan Costs (Permanent)	201	13,266
Bridge Loan Fees	54	3,564
Consultant Fee	606	39,996
Soft Cost Contingency	152	10,032
Tax Credit Monitoring Fees	125	8,250
Lease-Up Reserve	106	6,996
Operating Reserve	2,121	139,986
Total Development Costs	<u>\$82,810</u>	<u>\$5,465,460</u>
Surplus (or Shortage)	<u>\$183</u>	<u>\$12,107</u>

EXPLANATION OF DEVELOPMENT BUDGET

The preceding budget shows typical source and use items for a project using the LIHTC. A brief explanation of each item appears below.

Sources of funds

1st Mortgage: This is usually, though not always, a commercial loan requiring monthly payments of principal and interest during the operating life of the project. The amount of the mortgage is limited by the value of the property and the net operating income of the project (income less operating expenses). In LIHTC projects, the latter is usually the more restrictive because of limitations in maximum rent. Since investors provide substantial equity to these projects, the loan-to-value ratio for the first mortgage is usually well within lender maximums.

2nd Mortgage, 3rd Mortgage, etc.: LIHTC projects often include grant or low-interest loan financing, including public funds managed or owned by state and local governments, as well as private funds. This “soft secondary” financing is commonly structured into the project as a loan in order to accommodate tax-related provisions of the LIHTC program. Repayment requirements may vary widely, ranging from payment of principal and interest, through whole or partial interest payments, to deferral of principal and interest payments for a number of years.

Grants: Sometimes soft secondary financing is structured into the project as a grant. This may reduce the amount of cost basis for calculation of the tax credit, however, and should generally be avoided.

Net Equity to Project: The amount investors agree to pay for their ownership share in the project (and their share of LIHTCs and other tax benefits), less any fees charged by the syndicator.

Uses of funds

Acquisition — Land and Building: These costs should be accounted separately, since land cannot be depreciated. In a new construction project, building acquisition will generally be zero, unless it is a mixed development including rehabilitation of existing structures as well as construction of new ones. Acquisition costs for buildings that will be demolished should be treated as part of the cost of land.

Site Work: On-site development costs such as running sewer lines may be treated as other construction costs. Off-site costs, however, such as the construction and improvement of streets, may not be included in the LIHTC basis.

Construction Costs: This includes the direct cost of building construction charged by the contractor. State agencies administering the LIHTC generally expect to see contractor profit and overhead broken out separately. General requirements, which include the contractor’s costs for such items as setting up an on-site office, should also be separated out.

Contingency: This is generally figured as a percentage — often 5 to 10 percent — of the entire construction contract, including the contractor’s profit, overhead, general requirements and site work. The contingency accounts for uncertainty in estimating costs at various stages of planning and development and can be adjusted downward as certainty increases (such as when a fixed-price contract for construction is signed).

Architect/Engineer, Environmental Study, Appraisal, Survey & Soil Tests, Title & Recording, Sponsor & Local Legal Costs, Fund/Partnership Legal, Accounting Review, Audit/Tax Return, Cost Certification, Market Study: These reflect the costs of contracts with various professionals essential to the completion of the development. Most of these costs are generally depreciable and may be included in the LIHTC basis. Some legal fees, however, may be treated as organizational costs (which cannot be depreciated and included in the basis). Other costs, including title and some legal costs, may be related more to acquisition than development and are also not depreciable. An annual audit and tax return for the partnership are treated as a cost of operation, rather than a cost of development, and are also not included in the LIHTC basis.

Developer Fee: Maximum developer fees are established by the state agencies administering the LIHTC. As noted earlier, portions of the fee that cannot be paid from financing sources are often structured as a loan from the developer. Such deferred fees must have a likelihood of actually being paid if they are to be included in the LIHTC basis.

Real Estate Taxes, Insurance During Construction, Construction Interest: These are the primary “holding costs” during development. They vary with the time of construction. Another common holding cost not shown is the cost of site security.

Tax Credit Origination Fees, Tax Credit Monitoring Fees: These are fees charged by the state agency administering the LIHTC program. All states charge fees related to applying for and securing LIHTCs; many states also charge an up-front fee to cover some of their costs of monitoring the project.

Construction Loan Costs, Permanent Loan Costs, Bridge Loan Fees: Fees charged by lenders for various loans on the project. Each is treated differently for depreciation and tax credit purposes. For an explanation of bridge, see the next page.

Consultant Fee: Developers may engage various types of consultants to assist them in the project. A general development consultant’s fees are treated as developer fees; fees charged for assistance with acquisition, or in obtaining a particular piece of financing, are accounted in the same way as acquisition costs or origination costs for that financing.

Soft Cost Contingency: Like a construction contingency, this item accounts for uncertainties in estimating costs during planning and development. As certainty increases, this item can be reduced.

Lease-Up Reserve and Operating Reserve: Accounts established from sources of financing to cover possible or likely shortfalls during the operation of the project. A lease-up reserve is intended to cover operating losses during the earliest phase of operations, while an operating reserve is meant to cover longer-term contingencies.

Cash Flow

Carefully estimate cash flow during construction. Will your financing sources keep pace with the demands of your contractor? Remember, some cash outlays are required prior to obtaining construction financing: options on the land, preliminary drawings, market study, some attorney's fees. These may run \$25,000 to \$50,000.

Construction will stop unless you pay your contractor on time or your contractor can bridge payment delays. This can be devastating since you will incur financial penalties for late completion of your project. Lagging payments can be a particular problem with public dollars. Is there a history of delays in public funding in your area?

Calculate your cash flow needs month by month. What is the largest cash drain you may experience during the project? Work to eliminate it. Your chief financial officer or comptroller should be involved in this planning process.

ALLEVIATING CASH FLOW PROBLEMS

The best sources for overcoming cash flow shortages are foundation or corporate grants, program-related investments from foundations and lines of credit from conventional or non-profit lenders.

Include discussions of cash flow in your negotiations with equity partners and lenders. Sometimes a lender may agree to bridge public money in a project that is committed but slow to advance. In some instances, you may be able to earn some fees at construction start or during construction. You may also be able to get an advance against your fees. An advance is unlikely, however, if you do not already have a history of consistent on-budget development.

SAMPLE CASH FLOW

Development Cash Flow

Sources	Prior to 1/1/98	Construc- tion Loan Closing 1/16/98	2/1/98	2/16/98	3/1/98	3/16/98	4/1/98
Equity (from general fund)	\$ 25,000						
First Mortgage (Construction)		\$ 15,750	\$ 19,500		\$ 23,000		\$ 45,500
First Mortgage (Permanent)							
State Grant					9,500		11,250
City Grant		15,000		\$ 9,500		\$ 11,250	
County Grant		25,000					
Centerville Foundation		50,000					
Church Contribution	10,000						
White Foundation	25,000	25,000					
TOTAL SOURCES	\$ 60,000	\$130,750	\$ 19,500	\$ 9,500	\$ 32,500	\$ 11,250	\$ 56,750
Uses							
Acquisition		\$ 25,000					
Architect/Engineer	\$ 10,000	10,000	\$ 1,000		\$ 1,000		\$ 1,000
Project Management							
Site Development			20,000				
New Construction			18,000		45,000		90,000
Contingency		49,000					
Furnishings							15,000
Legal & Accounting	2,000	10,000					
Loan Costs		5,138					
Utilities				\$ 500		\$ 500	
Interest					264		437
Operating Reserve							
Development Fee		10,000					
TOTAL USES	\$ 12,000	\$109,138	\$ 39,000	\$ 500	\$ 46,264	\$ 500	\$ 106,437
Available Cash	\$ 48,000	\$ 69,612	\$ 50,112	\$ 59,112	\$ 45,348	\$ 56,098	\$ 6,411
Construction Loan							
Principal Balance	0	15,750	35,250	35,250	58,250	58,250	103,750

	4/16/98	5/1/98	5/16/98	6/1/98	6/16/98	7/1/98	7/16/98	Cert. of Occupancy 8/1/98	Permanent Loan Closing 8/16/98	Total
	(\$10,000)				(\$15,000)				\$ 0	\$ 0
		\$ 45,500		\$ 45,500		\$ 45,500	\$ 23,500	\$ 0	(263,750)	0
									217,000	217,000
		22,500		22,500		22,500		22,500	11,750	122,500
	22,500		\$ 22,500		22,500		22,500	11,750	0	137,500
		25,000				50,000				100,000
								50,000		100,000
										10,000
								25,000		75,000
	\$ 12,500	\$ 93,000	\$ 22,500	\$ 68,000	\$ 7,500	\$ 118,000	\$ 46,000	\$ 109,250	(\$ 35,000)	\$762,000
										\$ 25,000
		\$ 1,000		\$ 1,000		\$ 1,000				26,000
	\$ 10,000							\$ 10,000		20,000
										20,000
		90,000		90,000		90,000	\$ 47,000			470,000
										49,000
							30,000			45,000
										12,000
									\$ 2,170	7,308
	500		\$ 500		\$ 500		500			3,000
		778		1,119		1,461		1,978	989	7,027
								42,300		42,300
									25,000	35,000
	\$ 10,500	\$ 91,778	\$ 500	\$ 92,119	\$ 500	\$ 92,461	\$ 77,500	\$ 54,278	\$ 28,159	\$ 761,634
	\$ 8,411	\$ 9,633	\$ 31,633	\$ 7,513	\$ 14,513	\$ 40,053	\$ 8,553	\$ 63,525	\$ 365	
	103,750	149,250	149,250	194,750	194,750	240,250	263,750	263,750	0	

Operating Budget

You must have an operating budget that demonstrates your ability to carry the project beyond development through at least six months of operation.

Development Operating Budget

OPERATING CASH FLOW

INCOME: 3% inflation factor

	1999	2000	2001	2002
	Year 1	Year 2	Year 3	Year 4
Gross Rental Income	\$202,020	\$353,246	\$363,843	\$374,759
Laundry Income	0	0	0	0
Less: Vacancy (@ 5% after stabilization)	30,303	17,662	18,192	18,738
Net Income	171,717	335,584	345,651	356,021
Additional Subsidy	0	0	0	0
Net Rental Income	\$171,717	\$335,584	\$345,651	\$356,021

EXPENSES: 5% inflation factor

Real Estate Taxes	\$22,750	\$22,750	\$23,888	\$25,082
Insurance	7,000	14,000	14,700	15,435
Utilities — Common Area	5,250	10,500	11,025	11,576
Water/Sewer	15,167	30,334	31,851	33,444
Maintenance/Repairs/Decorating	7,500	20,000	21,000	22,050
Administration	12,833	25,666	26,949	28,296
Management Fee (@ 6% of gross rents)	12,121	21,195	21,831	22,486
Audit & Tax Return	0	5,000	5,250	5,513
Asset Management	2,625	5,250	5,513	5,789
Other	0	5,000	5,250	5,513
Total Expenses	\$85,246	\$159,695	\$167,257	\$175,183
Net Operating Income	\$86,471	\$175,889	\$178,394	\$180,838

DEBT SERVICE

Principal	\$6,223	\$11,166	\$12,060	\$13,025
Interest	61,833	105,502	104,609	103,644
Total Payable	\$68,056	\$116,668	\$116,669	\$116,669

DEBT SERVICE COVERAGE RATIO:

Replacement/Equip. Reserve	1.16	1.39	1.41	1.43
	\$7,700	\$13,596	\$13,860	\$14,553

OPERATING CASH FLOW

Lease-Up Reserve	10,715	45,625	47,865	49,616
	7,000			

NET CASH FLOW

Incentive Management Fee	\$17,715	\$45,625	\$47,865	\$49,616
	0	0	0	0

RESERVES

Reserves Funded Through Equity Pay-Ins	\$80,000	\$20,000	\$20,000	\$20,000
Cumulative Operating Reserve	97,715	163,340	231,205	300,821
Interest Income	0	0	0	0

EXPLANATION OF OPERATING BUDGET

The project's operating budget (also known as a pro forma operating budget, or simply pro forma) projects, in numbers, the operating performance of the project. It consists of three main parts: operating income, operating expenses (which, when subtracted from operating income, result in net operating income, or NOI), and debt service and reserve payments (which, when subtracted from NOI, results in net cash flow). Four years of the operating budget are shown in the sample spreadsheet.

Operating income

Gross Rental Income: This is the income potential of the project, before deducting vacancy and nonpayment. It increases annually by the income inflation assumption listed in the spreadsheet.

Laundry Income: In projects with a coin laundry, the anticipated income is entered here. However, the cost of constructing a fee laundry (or other fee amenities, such as paid parking) may not be included in the basis for calculating the amount of LIHTCs the project will earn.

Vacancy: This is the percentage of rents that the project will not receive, because of either vacancy or nonpayment by tenants of occupied units. Typically, the percentage is higher in the first year of operation because of a lag between units coming online and tenants taking occupancy.

Additional Subsidy: Rental assistance payments not included in the base rent charged to tenants are shown here.

Net Rental Income: The total of rents and other income less the allowance for vacancy and nonpayment.

Operating expenses

The first column shows the actual anticipated expenses for that portion of the first calendar year that the project will be in operation. Expenses are increased each year thereafter according to the expense inflation assumptions listed in the spreadsheet.

Real Estate Taxes: Taxes vary widely between localities. They can, however, be estimated with a high degree of accuracy if you understand your locality's method of valuation and know the mathematical formula for calculating taxes based on valuation. This information can usually be obtained from your local county assessor's and treasurer's offices.

Insurance: The cost of property and liability insurance can also be accurately estimated based on the value of insurance. Your lender and investors will usually require minimum coverages. Find out what these are, and get a quote from your insurer as you put together your operating budget.

Utilities — Common Area: This includes the cost of lighting and heating unleased areas, such as hallways and parking lots. You should also include estimated costs of utilities in vacant apartments. In cases where the owner of the project is paying utilities other than water and sewer, these should be included in a separate line item.

Water/Sewer: In most communities, the owner pays for water and sewer service. These costs can be substantial, especially if the project includes water-using amenities, such as in-unit washers or hookups and dishwashers. Remember to estimate the cost of water for maintaining landscaping as well. An experienced property manager can be of help in figuring this line item.

Maintenance/Repairs/Decorating: This line item includes the costs of all repairs except for replacement of major capital items (such as roofs and furnaces), which is funded from the replacement reserve. Include in your estimate the cost of routine unit make-ready between tenants. Again, an experienced property manager can be of assistance in this estimate.

Administration: This item generally includes the cost of management staff and the direct expenses of your property manager on the project. Costs that can be passed through to the owner should be spelled out in detail in the property management agreement. This line item may also include contracted services, such as legal expenses.

Management Fee: Usually property managers are paid a percentage of collected rents, in addition to allowable pass-through expenses. Because LIHTC rents are often lower than market rents, this percentage may be higher for these types of projects. In some cases, owners and managers have negotiated per-unit fees rather than a percentage of rents. In either case, the payment should be based on actual payments (collected rents on occupied and paying units).

Audit & Tax Return: Tax credit partnerships must file an annual tax return. Investors generally require an annual audit, as well.

Asset Management: This fee may be paid either to the general partner or to a party designated by the limited-partner investors to pay for the extra costs of record-keeping and reporting to investors on the performance of an LIHTC project.

Debt service

This section shows the amount of principal and interest payment and, where appropriate, the amount of interest accrued for each loan listed in the Sources of Funds statement.

Debt Coverage Ratio: This shows, year by year, the projected ratio of NOI to the required debt service on the first mortgage loan. Lenders set minimum debt coverage ratios they expect to see in projections once the project has reached full occupancy, generally in the second calendar year of operations. The Debt Coverage Ratio shown in this example deducts required replacement reserve payments (see below) from the NOI before dividing by debt service.

Replacement/Equipment Reserve: Lenders and investors will require that the project make minimum contributions to a reserve for replacement of major capital items. This amount is based on the number of dwelling units; in this case the contribution is \$200 annually per dwelling unit.

Incentive Management Fee: The general partner and limited partners may negotiate payments to the general partner based on the amount of cash the project earns, as an incentive to the general partner.

Net Cash Flow: This is the amount remaining from operating income after all operating costs, debt service payments, replacement reserve contributions and incentive fees have been paid. Depending on the terms of the partnership agreement, this cash may be distributed to the partners in the project, left under the ownership of the limited partnership as a reserve fund, or both.

Reserves: This section projects the contributions to a capital reserve to fund operating deficits. In this case, contributions to the reserve include payment from the equity contributions of the limited partners (also shown in the Uses of Funds statement), net cash flow from the project and interest earned on the balance of the operating reserve account.

Community Interaction

During the development process, many constituencies will surface. The nonprofit real estate developer must pay very close attention to the needs or demands of these groups. Each is important, and all interact informally and are influenced by the comments of others. Many projects have been delayed or entirely derailed by community opposition, even projects sponsored by established, politically connected organizations.

WORK WITH YOUR NEIGHBORS

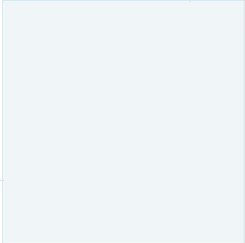
Remember that neighbors of your vacant land will be neighbors of your residents. Work with them throughout the development and initial occupancy phase. This will help your residents feel welcome in their new neighborhood. But remember that most people do not like change. Even replacing a hazardous auto graveyard with low-income apartments may cause complaints. Expect this and expect to make some design changes to respond to neighbors. Neighbors in a broader geographic area may be more supportive because they see removal of a blight or an increase in business opportunities.

AVOID OPPOSITION, IF POSSIBLE

A particular market constraint often affecting affordable housing producers is “NIMBY” (Not In My Back Yard). This can take the form of legal restrictions (numerous approvals required, relatively little land zoned for multi-family housing, high amenity requirements, flat-rate impact fees) or informal opposition. The approval process may be a basis for legal challenge, which most developers do not have the time and money to fight. If NIMBY is a continual constraint, you may have to organize with civil rights groups, other developers and the business community to seek political or judicial solutions. If this fails, look for projects in other neighborhoods or jurisdictions.

INVOLVE NEIGHBORS EARLY IN THE PROCESS

Regardless of whether you expect the development to cause major conflict, involve neighbors and supporters early in the process. Some NIMBY is a cover for racism, and it is helpful to have these neighbors expose their opinions early and loudly so the public can reject them. Take some friends to meetings with you. You will feel better with support in the audience. If you believe that your project will be controversial, seek help from your public donors and organizations with similar goals. Make a special effort to involve public officials, briefing them early and often. And do not forget informal community leaders, like the woman on the block who knows everybody.



Internal Production Systems

Within a team management system, goals, strategies and activities are reviewed and assigned informally. This system can work as an internal system or a system that includes consultants who are consistently part of your development team. Reports are necessary to monitor the asset management performance of your team after the development is finished and the property is occupied.

TEAM MANAGEMENT

A senior staff person leads the team. Team members may take different roles depending on skills, available time or a need to learn a particular activity. Activities that can be shared by the team members include:

- Finding deals
- Finding sites
- Working to ensure subsidy availability
- Developing community support
- Managing outside consultants

The team management system allows your projects to go forward during vacations, changes in personnel and personality conflicts.

REPORTING REQUIREMENTS

Occupancy — shows vacancies, how long units have been vacant, reasons for vacancies, waiting lists by bedroom size, tenant accounts receivable.

Budget to actual income and expenses — shows line item analysis by project and explains any substantive variations and steps to be taken to bring expenses in line with the budget.

Cash flow: projections and actual performance — compares performance to projections. Should show sources of funding and performance of each source of funds.

Cost certification — completed at the end of construction and lease-up by independent auditor.

Annual Allocation of Credits to Investors, Form 8609 — form provided to investors to show the actual tax credits distributed to a particular investor. Completed annually, often by the managing general partner or syndicator.

Annual tenant certification — evaluation of tenant income each year to demonstrate that the project is occupied by income-eligible residents. Must be maintained for review by several funding and monitoring agencies.

Annual audit — completed by an independent auditor; evaluates the accuracy of your financial statements.

FINANCIAL MANAGEMENT

Your partnership agreement will specify who is responsible for investor reporting, construction draws and reports for all funding sources. During construction the cash management of the project is time-consuming and critical.

In general, your organization needs an automated financial system with a job cost accounting module if you plan on developing more than one project at a time. As noted in the section on Staff and Consultants, your staff must understand:

- The distinction between capitalized costs and expenses
- How to set up and administer reserves

An outside accountant is part of your development team. You should make sure the accounting firm can serve as an advisor on financial management issues. The accounting firm can also help you maximize your tax credit award and ensure the eligibility of costs for credits.

ASSET MANAGEMENT

Your decision about serving as a sponsor or developer will affect the systems that you will need. If you have chosen to be a sponsor, your accountant can monitor compliance. Your accountant should check that annual audits are completed. The audit should be reviewed to determine the financial status of the project and its compliance with IRS requirements. If your organization is responsible for reporting performance to a public funding source, you should also verify that those reports are complete and submitted in a timely manner.

If you choose to serve as a developer, you will need to develop an asset management function within your organization. It is important to involve financial and property management staff at the earliest stages of the development process and throughout the construction and implementation stages. Early involvement helps to ensure an understanding of the competing financial issues as the project develops. How you manage assets defines your attitude as the owner and ensures that all the players (development, finance, property management) are working toward common goals.

PROPERTY MANAGEMENT

Your organization will need a strong property manager. This is a business line totally separate from development, requiring a distinctly different set of skills. A big word of caution: Unless you are already in the subsidized housing management business, start by hiring an experienced firm. Find out if good property management is available — either through an in-house business or by contract with an outside manager — long before your nonprofit ventures into rental development of any sort. You will not survive without it. Fortunately, in most markets, good property management firms for multifamily housing exist. In small cities and rural areas, this may be more problematic, and you should investigate whether there are firms in your region capable of and experienced in managing properties such as yours.

Profitability

Profits will generally come in the form of development fees. Expect little, if any, cash flow from an operating project. And unless you are an experienced and sophisticated property manager, do not expect to make a profit in property management.

Fee constraints come from the marketplace and public sector donors. Any increase in your fee results in an increase in rents. Remember, your tenants can only pay so much rent. Also, both your LIHTC issuing agency and your sources of soft second mortgage or grant financing may seek to limit your fees in order to limit their indirect subsidy of your organization.

Your financial partners may also restrict your ability to collect development fees quickly. This both improves their return by delaying expenses and gives them leverage to ensure that you continue to do your job.

PROFITS

You should earn \$5,000 to \$7,000 per unit in development fees if you are not sharing fees with another developer. The timing of the payment of fees is an item that is negotiated, but generally most of the fees will be paid by stabilization. (Stabilization is also called “operating breakeven.”) This fee should cover your organizational overhead costs but leaves little margin for error. As you expand production, some efficiencies will develop, but these may be offset by the cost of raising salaries to keep your best staff from joining other organizations or being recruited by for-profit firms.

EQUITY

Long term, if you do a very good job, you will probably see equity in the project itself after the investors exit in 15 years. At that time you will confront significant maintenance issues and long-term marketability questions of the real estate. But you may find that your project has value and that you are able to continue to operate the project affordably without major new public subsidy infusions.

Notes

Notes

THE ENTERPRISE FOUNDATION

The Foundation's mission is to see that all low-income people in the United States have access to fit and affordable housing and an opportunity to move out of poverty and into the mainstream of American life. To achieve that mission, we strive to:

- Build a national community revitalization movement.
- Demonstrate what is possible in low-income communities.
- Communicate and advocate what works in community development.

As the nation's leader in community development, Enterprise cultivates, collects and disseminates expertise and resources to help communities across America successfully improve the quality of life for low-income people.

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