The Affordable Housing Development Process

This guide offers an introductory overview of the affordable housing development process for organizations or agencies inexperienced in the new construction and/or preservation of existing affordable housing. HUD Grantees should use this guide as a training tool with their partners interested in exploring development or preservation in partnership with faith-based organizations. HUD Grantees should consider sharing this guide with audiences who are new to affordable housing development to inform them of the basic process, players, and effort required to build new construction or acquire and rehabilitate existing affordable housing. This guide focuses on the stages of a traditional development effort, the roles of key development team members, and the major issues and questions a faith or community-based organization who is new to affordable housing will face.

Faith-based organizations can be both excited and cautious about how to support the development of affordable housing in their community. Building their knowledge builds their capacity to be a leader of the effort at the project level, leading to more successful, community-driven development projects. HUD's **Primer on Increasing the Supply of New Affordable Housing** and the **HUD Grantee Guide to Working with Faith-Based Organizations on Affordable Housing Development** can be used to further expand knowledge in addition to this overview.

Additionally, seeking trusted, targeted advice early on can be the single most important step in positioning faith-based organizations to be an active catalyst for a development or preservation project. To achieve that level of engagement, it is important for HUD Grantees to support the faith-based organization to drive as much decision making as possible by providing informational resources like these guides and transparency into the affordable housing development process.

An overview

Affordable housing development and preservation is often a complicated and challenging process that typically takes 3-5 years depending on a project's parameters and resulting complexity. Other aspects of a project can lengthen its timeline and cost, including site challenges, financing source requirements, and whether the neighboring community is supportive of the proposed development.

A successful project requires a team of stakeholders – organizations and individuals with specialized expertise from different disciplines and professions – to work closely together within defined roles. To best tackle ever-changing real estate markets and funding and political environments, many faith and community-based organizations, nonprofits, and housing developers decide to enter into a formal partnership with another organization to give them an advantage in achieving their affordable housing goals. These organizations may include HUD Grantee Agencies such as Public Housing Authorities (PHAs) or nonprofits. For example, while one organization might have the necessary track record, initial financial capital, and demonstrated experience developing similar projects, a partner might bring a potential development site, vital neighborhood perspective, and necessary relationships within the community. As with any real estate project, developing affordable housing involves considerable financial risk that may be too much for one organization to bear alone. Different entities can provide these assets in different combinations, depending on the partners you have available in your market.

In general, no single organization has all the expertise in-house to develop and operate an affordable housing project. A strong and capable development team, which may be anchored by a partnership between two or more organizations, is the project's greatest asset for successfully navigating the inherent challenges.

How does an affordable housing project *typically* start?

Affordable housing projects can start in various ways, and project origins typically fall into one of three categories:

Need & vision

Stakeholders identify an affordable housing need or issue that they would like to address through the creation of affordable housing. In this case, the faith-based organization first identifies the need and then creates the vision and strategy for addressing that need before they have identified a project site.

Project site

An affordable housing project can arise from the availability of a potential development site. The local jurisdiction, including, the Public Housing Authority, may have identified a suitable site for affordable housing development, or the site owner is interested in pursuing an affordable housing development on their underutilized property.

Funding opportunity

A project can start when a governmental agency (such as the HUD Grantee) announces the availability of funding for affordable housing. To utilize the funding opportunity, a developer would look for an eligible site to propose for development.

Organizational commitment

Regardless of how a project starts, embarking on the development of affordable housing takes a considerable amount of planning and resources – both in time and in money. To move forward in a concerted and timely manner, an organization interested in development and preservation should demonstrate:

- A capacity to learn and listen;
- A clear understanding of why the organization is interested in being the catalyst for an affordable housing project;
- Some willingness to take risk;
- Ability and willingness to use political capital to advance a project;
- Perseverance — the ability to hang in there until the best path is clear;
- A clear decision-making process within the organization; and
- Broad organizational support and commitment to pursue the project.

Without these attributes, a project concept can languish for years before the first shovel of dirt is moved. The fundamental question an organization must ask itself is: "How will this development project help us pursue our mission?" Mission represents the motivation that facilitates movement forward. This can be a difficult question to answer and require some tough conversations within the organization. For faith-based organizations that have not been focused on providing affordable housing, immersion into the experience can represent a dramatic (and sometimes traumatic) change in the basic character of the organization.

On the other hand, an organization might want to broaden its mission, particularly given the national affordable housing crisis. Affordable housing provides a critical resource to the community and makes a lasting physical improvement to a property and the surrounding neighborhood. Ultimately what's most important is that each faith-based organization makes a deliberate decision on how to move ahead based on its unique capabilities and circumstances.

Aspects of affordable housing development and preservation to consider before committing to develop include:

- It can be an all-consuming undertaking for some staff or members of the organization.
- Development fees are seldom sufficient to cover all the real costs (including the imputed costs of staff and the opportunity costs this represents) over the entire lifecycle of a project.
- The organization's leaders must be willing to invest staff and board time, money, and political capital over several years to ensure the success of the project.

Also, once the development is built, the rental housing needs to be managed (directly or indirectly) for the rest of its useful life: 30, 40, 50+ years. This requires substantial time, energy, and financial resources of the entity responsible for managing the property that otherwise might be focused on other organizational priorities. Homeowners likewise will need to be responsible for managing their covenants that continue for the life of the loans as long as they remain affordable upon resale and other terms.

Development team member roles

There is no single required role for a faith-based organization that initiates an affordable housing project to play in the project's development. Faith-based organizations can play any of five major project roles:

THE OWNER	The owner has long-term legal responsibility and control of the project. The owner has a long-term interest in seeing the project completed and is responsible for making critical decisions that drive the process. Even if another entity is developing the project, the owner must be fully engaged in the development process to ensure its long-term interests are addressed.
THE DEVELOPER	The developer plays the lead role as a backbone in bringing a project from idea to occupancy. The developer is responsible for all project development tasks and the overall management of the project development process. Some development teams consist of two organizations serving as co-developers or joint venture partners, but often one organization is the lead developer.
THE COMMUNITY ENGAGER	The community engager ensures the development incorporates the voice and interests of the local community. They are often a public leadership voice in making the development happen, advocating to drive the development forward with the other various stakeholders.

THE PROPERTY / ASSET MANAGER

The property manager is responsible for day-to-day operations of the project once completed. The management of the property is vital to its ongoing success. Managing a project is a complex endeavor that involves skill and familiarity with legal and funder requirements. The asset manager, often different than the project manager, acts as a financial manager for the asset (completed development), making sure that the project's occupancy level remains high, and the project performs well financially meeting its various obligations to the several investors and stakeholders. The asset manager is also responsible for compliance and reports to funders on behalf of the owner.

THE SERVICE PROVIDER

The service provider develops and manages any services programs offered to the residents. If the project is going to provide housing for tenants with special needs, a service provider partner should be on board early to plan for adequate and effective tenant services.

All five distinct roles are critical to project success. In some cases, an organization may assume one or more of these roles and then partner with other nonprofit and for-profit organizations to fulfill other necessary roles.

Additional professionals representing the owner and/or developer may join the development team to complete specific project tasks or to contribute during specific project phases:

ATTORNEY

An attorney must be available to provide legal services related to real estate or project financing and organizational issues (e.g., creating a new corporation to own and manage the real estate). Depending on the different organizations involved and scale of the project, one project may require multiple attorneys.

ARCHITECT

The architect works with the development team to determine the feasibility of specific sites, create preliminary and final designs and drawings, develop construction specifications, assist with preliminary cost estimates, secure local site and design approvals, and monitor construction.

FINANCIAL CONSULTANT

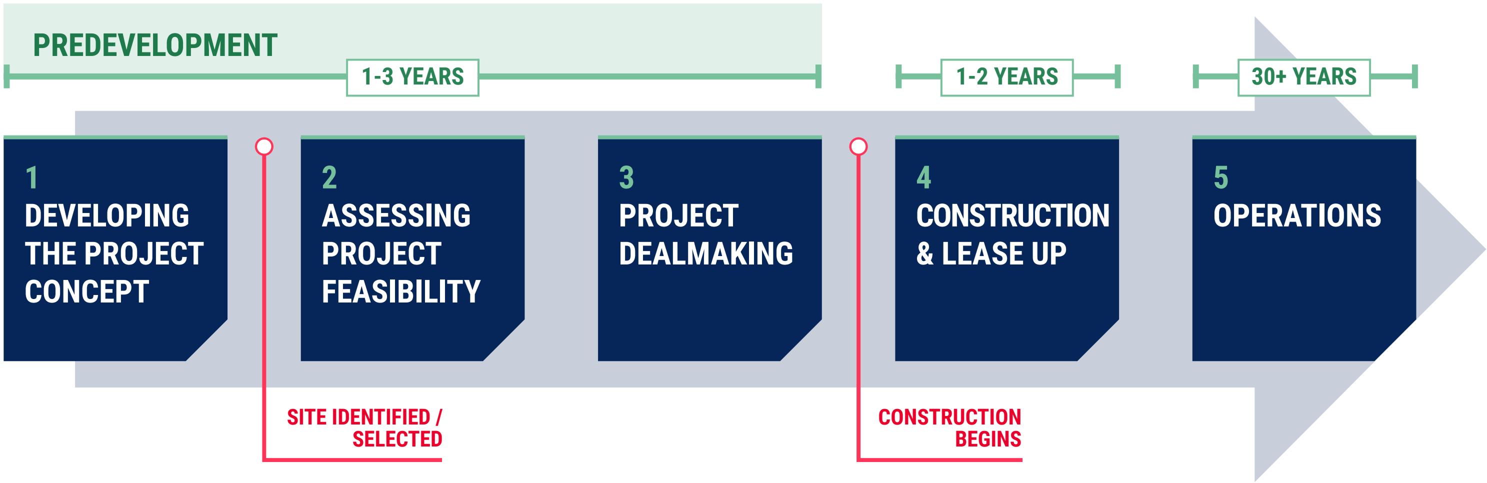
The project financial consultant has deep knowledge of the funding sources typically used to finance affordable housing projects, which vary state by state. They advise the development team on identifying the best financial strategies for achieving project goals, obtaining funding from a large array of competitive programs, and ensuring that the project is well structured to perform financially over time.

GENERAL CONTRACTOR

The general contractor is responsible for the actual construction or rehabilitation of the housing. Most housing developers hire an outside firm through a competitive process after the architect completes the plans and building specifications. Sometimes a contractor is selected early in the process and is a member of the development team from the beginning.

The affordable housing development process

Once a project begins and an organization has internal support to move forward, the affordable housing development process generally consists of five distinct phases as shown below. The term "predevelopment" is used to refer to the period prior to the start of construction, which can last three to five years. This process applies whether the development is new construction or preservation of existing affordable rental housing or homeownership. The actual number of years within the ranges given depend on the type of development, size of development, amount and requirements of available funding resources, and local support for the project.



The affordable housing development process is linear, moving from one stage to the next, sequentially. However, projects can hit roadblocks that require the development team to go back to the previous phase for additional discussions, planning or to conduct predevelopment studies/analysis to move forward again. In some cases, roadblocks can take years and multiple cycles through the different development phases to overcome. For example, changes in entitlement requirements may send a development team back to the concept phase. Sometimes a roadblock can be insurmountable despite the team's efforts to move the project forward. While some unexpected roadblocks are unavoidable, one of the most important reasons to have experienced partners involved is to avoid as many common roadblocks as possible.

The HUD Grantee can play an important role at this stage. If the HUD Grantee has strong relationships with people experienced in the development process, is able to coordinate with other local agencies engaged in defining the requirements for development, or is working directly with developers, this knowledge could be utilized to provide assistance and advice to the faith-based organization to help guide them through the development process.

Generally, as the development team moves through the development process, it invests more time and money into the project, making it important to uncover potential barriers to the deal as early as possible. Furthermore, the farther the team gets into the development process and the project components become more fixed, the more difficult it can be to make necessary changes. The time the development team invests upfront planning for potential delays pays off as the development process progresses. At that point it can use that upfront planning to troubleshoot and resolve both anticipated and unanticipated issues more efficiently.

1 DEVELOPING THE PROJECT CONCEPT

The **Project Concept** phase covers the starting point of the project until the site is identified and eventually secured, if the developer does not already own or control the site. Determining basic feasibility at this point can reduce cost and frustration if the intended plan does not meet zoning restrictions, funding requirements, or partner capacity. This phase of the project can take one to two years, and tasks and activities during this period include:

- **Setting the goals** — for example, deciding who will live there;
- **Conducting a zoning analysis to understand the development or rehabilitation potential of the project site and the number of housing units the site can accommodate. This work might also involve working with the HUD Grantee and related jurisdictions to understand if the project is possible and supported;**
- **Identifying site challenges in addition to zoning;**
- **Assessing organizational capacity; and**
- **Identifying and assigning roles and responsibilities for the development team.**

PROJECT CONCEPT PHASE
HOW DO WE PAY FOR IT?

- Grants
- Loans
- Fundraising

2 ASSESSING PROJECT FEASIBILITY

Once the project concept is conceived, the next phase involves transforming the concept into a feasible proposal for an affordable housing project. A feasible proposal includes having site control, assembling a strong development team, and conducting a feasibility analysis on the project site, including identifying a realistic financing plan, with positive results. This Project Feasibility phase is also known as the "due diligence" period when the development team conducts a variety of analyses, studies, and investigations to ensure that the site is developable and can deliver the proposed project. The key components of project feasibility include:

- **Appraisal:** a professionally prepared report that establishes a market value for a property required to secure project financing. The initial appraisal will guide value expectations. Future appraisals required by lenders and investors will govern access to resources for building as well as the land.
- **Zoning analysis:** an analysis of the existing zoning laws and regulations applicable to the project site, which determines whether the planned development is allowable. Key criteria a zoning analysis should cover are land use, density (units per acre, or floor area ratio), parking, building height(s), and setbacks (front, rear and side yards). HUD Grantees can provide relevant information on existing zoning requirements.

- **Environmental analyses:** an analysis of prior uses of the site, adjacent sites, information about proximate underground storage tanks and the results of a site reconnaissance conducted by an environmental engineer. This information is gathered to determine if a site should be tested for the presence of hazardous materials in the soil or the groundwater. Existing buildings should be tested for termites, asbestos, lead based paint and mold. Note: NEPA (National Environmental Policy Act) reviews can take up to six months, and individual state environmental requirements may add additional complexity and time for review.
- **Initial predevelopment funding:** While the cost of each due diligence predevelopment items is usually modest, identifying early, low-risk funds that do not have to be paid back is a crucial part of this phase. The use of federal dollars such as CDBG or HOME may require review of "other federal requirements" such as historic preservation, flood insurance, and planning for the preservation of Indigenous artifacts. Philanthropic resources or CDFI financing are typically better sources of funding for this phase.
- **Tenant relocation of occupied property:** In the case of existing affordable housing occupied by tenants, engaging and planning for resident relocation during construction and logistics for returning to the project will be an important aspect of predevelopment.

- **Community support:** a critical component to ensure project success. It is important to accurately gauge the level of support the surrounding community has for a project and to identify the required public approvals. The project team should implement a comprehensive community outreach strategy as early as possible to test assumptions and get early feedback on how much the surrounding community may challenge the development. The HUD Grantee may be able to provide support here, depending upon their existing relationship with the community.
- **Financial feasibility analysis:** a preliminary financial analysis that consists of projecting development expenses (uses) and identifying likely funding sources to cover these expenses (sources). Key questions that determine financial feasibility include: How much will the project cost to develop? Will the rents support the operations of the property? Will the rents support the servicing of permanent debt? What funding sources are available for the project given that rents are not likely to cover either the construction or operations of the property on their own?

PROJECT FEASIBILITY / PREDEVELOPMENT PHASE
HOW DO WE PAY FOR IT?

- Soft loans or recoverable grants (local governments or CDFIs)
- Short-term bridge loans (private banks, CDFIs)
- Grants
- Internal financing – Lines of credit
- Fundraising

3 PROJECT DEALMAKING

Once the development team has a feasible proposal for an affordable housing project, the project is now ready to "structure the deal." The dealmaking phase encompasses the time from the applying and securing of financial commitments to the closing of the construction financing and the beginning of construction. Project development activities during this time involve:

- ☐ working with the architect to develop and finalize the project design;
- ☐ getting all the necessary community approvals and project entitlements, such as zoning changes, conditional use permits, density bonuses, and parking requirement waivers;
- ☐ securing and closing the project financing; and
- ☐ other tasks required to start construction.

As previously mentioned, project phases are not always strictly linear, and sometimes project feasibility and dealmaking activities happen at the same time. The first three phases together typically last two to there years, depending on project complexity and circumstances.

Deal structuring involves combining stakeholders' varied interests and requirements into one cohesive and viable housing project. During this phase, various pieces of the predevelopment process must come together: localities must approve the more specific architectural plans, funders must agree to provide all needed funding, and the development team must continue to test and re-test the site analyses and financial projections to ensure project feasibility and minimize risk. If the team is successful in meeting these necessary thresholds, the project is ready to close on construction financing and break ground.

The dealmaking phase can be extremely challenging. This phase is often when projects fail, and/or unanticipated sacrifices may be required. During this time, opposition to the project from neighbors and the broader community can surface. It is important early on to learn strategies for addressing the concerns of - and ultimately overcoming - project opposition. Engaging the community early (concept phase) will often reduce concerns and prepare the development team for the work needed to achieve the many local approvals. At the same time, however, at this point in the overall process, the project has likely received a considerable investment of time, energy, and resources from the development team, government staff, elected officials, future tenants, and other supporters in the community. These project stakeholders are focused on and invested in making the project a reality and often provide critical support to assist with addressing potential barriers.

4 CONSTRUCTION & LEASE UP

The project enters the **Construction and Lease Up** phase once the architect has designed the project and completed the construction documents; the development team has obtained all necessary community approvals and the building permit; and the developer has negotiated and signed the construction contract with the general contractor and worked with funders to close the construction loans. The construction period lasts on average two years but can be shorter (or longer) depending on project type, size, and complexity. It begins with the start of construction and ends with completed and occupied units and the closing of permanent (take out) project financing.

Construction is an exciting time when the physical structure of the development finally begins to emerge. All the work and planning invested up to this point starts to manifest as the housing project takes shape for everyone to see. Construction, however, is arguably the riskiest phase of the project. At this phase, it is important to have a strong development team in place with experience managing the understood risks that are generally avoidable with diligent management and oversight of the project. Each organization makes a choice upfront in the development process about how much involvement they want to have during construction and how they will manage or delegate responsibilities/risk.

As construction begins or soon after, the property manager takes the lead on finalizing the plan for marketing the units (or moving existing tenants back in the case of preservation projects), and the service provider (if applicable) prepares to launch the services program. Depending on the type of development, number of units, and tenant population to be served, the property manager begins marketing available units as per funding guidelines and screening applicants for income and other eligibility requirements. The property manager will ensure compliance with federal fair housing laws when marketing the units.

These laws exist to ensure that all eligible prospective tenants have equal access to the housing regardless of race, religion, ethnic background or national origin, sex, familial status (such as having children under age 18), physical or mental disability, or other protected class as identified by state or local laws. During this period, the developer is focused on closing the permanent financing to repay the construction loans.

CONSTRUCTION PHASE

HOW DO WE PAY FOR IT?

- Investor equity
- Bank loans
- Developer cash
- Soft loans or recoverable grants – local government
- Grants – local government

5 OPERATIONS

Once construction is complete, the local jurisdiction will issue the certificate of occupancy to confirm the property is safely built and ready for eligible tenants. A faith-based organization's involvement during this phase of the project depends on the roles and responsibilities assumed at the onset of the development process. Most likely, however, a professional property management company is hired to manage the day-to-day operations of the project, including leasing up tenants, providing for maintenance and upkeep, collecting rents, handling tenant turnover, and ensuring the property is run well and within budget. During operations, an asset manager ensures that the project is performing well and complies with funder requirements on an ongoing basis. The asset manager is also responsible for conducting any long-term planning to ensure that reserves are built up to cover capital improvements required in years 5, 10, 20 when building materials and systems need upgrading or replacement. In most cases, the developer/owner has agreed to continue to provide housing over the future life of the property to qualified residents. Ensuring this continued tenant access and compliance is as important as planning how to maintain the physical condition of the property. Some organizations choose to involve residents to different degrees in the project operations or plan for amenities and/or to provide ongoing services on site.

Conclusion

The affordable housing development process is challenging for even the most experienced development team. Just as it can be difficult to determine a project concept that addresses the goals of various stakeholders, it is also challenging for developers to maintain enough momentum to advance an affordable housing project over a three- to five-year period through an inherently risky and time-consuming process. Organizations interested in developing affordable housing for the first time face unique challenges as a new developer. However, with adequate technical assistance and appropriate partnerships (roles HUD Grantees can play), an organization committed to creating additional affordable housing in its community can successfully develop a high-impact affordable housing project with long-lasting results.