

Finding Peace in the CDC Development Process
The Lessons of the Siochain Rental Rehabilitation Project

By

Mark R. Ellerbrook

B.A. Political Science/Environmental Studies
Middlebury College, 1995

SUBMITTED TO THE DEPARTMENT OF URBAN STUDIES AND PLANNING AND THE
CENTER FOR REAL ESTATE IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREES OF

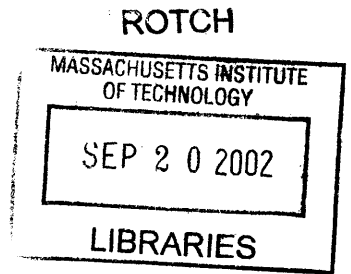
MASTER IN CITY PLANNING

AND

MASTER OF SCIENCE IN REAL ESTATE DEVELOPMENT

AT THE
MASSACHUSETTS INSTITUTE OF TECHNOLOGY

SEPTEMBER 2002



© 2002 Mark R. Ellerbrook.
All rights reserved.

The author hereby grants to MIT permission to reproduce and to distribute publicly paper and electronic
copies of this thesis document in whole or in part

Signature of Author _____
Department of Urban Studies and Planning
July 12, 2002

Certified by _____
Karl f. Seidman
Senior Lecturer
Thesis Advisor

Accepted by _____
Dennis Frenchman
Chair, MCP Program

Accepted by _____
William C. Wheaton
Chairman, Interdepartmental Degree
Program in Real Estate Development

TABLE OF CONTENTS

Abstract.....	Pg. 3
Chapter 1: Introduction.....	Pg. 4
Part I: NOAH and Siochain	
Chapter 2: The Neighborhood of Affordable Housing.....	Pg. 6
Chapter 3: Siochain Rental Rehabilitation Project.....	Pg. 19
Part II: Development Ideals and Practice	
Chapter 4: Ideal Practice.....	Pg. 36
Chapter 5: Case Studies.....	Pg. 51
Part III: The Future	
Chapter 6: Recommendations.....	Pg. 64
Chapter 7: Conclusion and Future Study.....	Pg. 74
Bibliography.....	Pg. 76

Finding Peace in the CDC Development Process
The Lessons of the Siochain Rental Rehabilitation Project

By

Mark R. Ellerbrook

Submitted to the Department of Urban Studies and Planning and the
Center of Real Estate on July 12, 2002 in partial fulfillment of the requirements
for the degrees of Master in City Planning and Master of
Science in Real Estate Development

ABSTRACT

This thesis presents an analysis of the Siochain Rental Rehabilitation Project to identify areas of concern for the development procedures of the Neighborhood of Affordable Housing (NOAH), a Community Development Corporation (CDC). Development practices in acquisition, financing, budget, construction, and the use of the CDC development team were evaluated and specific processes within each area identified as contributing to the overall marginal success of the Siochain project.

Case studies were then created outlining the development practices of three Boston-area CDCs: the Jamaica Plain Neighborhood Development Corporation, Urban Edge, and Codman Square Neighborhood Development Corporation. Best practices from these CDCs in each of the areas of concern were profiled, leading to a set of recommendations for the improvement of affordable housing development practices at NOAH.

Thesis Advisor: Karl F. Seidman

Title: Senior Lecturer

CHAPTER 1

INTRODUCTION

Viewed through the acute lens of hindsight, the property on the corner of Meridian Street and Princeton Street may have been better left alone. After all, shrouded beneath the withering façade were structural problems that would haunt the construction budget. In the ironically named Licelot Hair Salon was a harbinger of oncoming persistent tenant issues. And the location, on the edge of the frenetic economic center of East Boston could have in some way portended the complexity of the project financing. But these signs were imperceptible at the project's inception.

This was, after all, a Neighborhood of Affordable Housing (NOAH) project. Over the previous 10 years, the NOAH had been supremely successful in creating affordable housing opportunities on the narrow streets and warrens of East Boston. As the organization grew, NOAH's development staff sought out increasingly complex affordable housing projects that would serve as the foundation for a diverse and experienced real estate development department. The three story building at the corner of Princeton and Meridian was part of a project that would form the cornerstone of this foundation. However, instead of solidifying the experience of NOAH's real estate development department, the project laid bare development practices that were effective but narrowly applied.

The Siochain Rental Rehabilitation Project derives its name from the Gaelic word for peace. However, the development process used to create the project was anything but serene. Over the course of the project, NOAH and its development staff faced a variety of issues, from structural concerns that impacted both the construction and tenant relocation budgets to spiraling construction loan interest payments. As the project progressed, it became clear to everyone involved that the development practices that served NOAH so well through its first 13 years were not suitable for complex development projects carried out in a rapidly changing real estate environment.

This thesis is the result of a request from Phil Giffie, NOAH Executive Director, to analyze the Siochain Rental Rehabilitation Project and determine what mistakes were made. Community Development Corporations (CDCs), such as NOAH, rely heavily on overhead and development fees from their affordable housing projects to help support their less profitable endeavors, such as community organizing. From a project that was budgeted to generate \$200,000 in income for NOAH, Siochain produced less than \$40,000. A small CDC such as NOAH cannot carry out many projects such as Siochain and hope to survive.

However, this thesis does not focus solely on what NOAH did wrong. It also seeks to set NOAH on a path towards future development success. Towards this end, Mr. Giffie also requested that the development practices of successful Boston-area CDCs be explored. Interviews with development staff at Jamaica Plain Neighborhood Development Corporation, Urban Edge, and Codman Square Neighborhood Development Corporation, led to the identification of best practices in areas such as acquisition, financing, and the CDC development team. These best practices were then used in turn to create a set of recommendations for NOAH to use to improve their affordable housing development process.

Real estate development is a risky endeavor. Any experienced developer can point to a bad project in their past. Affordable housing development holds even more pitfalls because of weak market incentives and narrow margins. However, the key to continued development success is learning from the mistakes of completed projects. Hopefully, with the analysis and suggestions outlined in this thesis, NOAH will be able to make the necessary adjustments to its real estate development practices and ensure the creation of many more units of affordable housing in East Boston.

Part I: NOAH and Siochain

CHAPTER 2

NEIGHBORHOOD OF AFFORDABLE HOUSING

NOAH's development practices are a result of the general CDC development environment and NOAH's specific history, neighborhood, and capacity. To understand the successes and failures of a specific NOAH project, it is therefore necessary to explore both the external and internal factors influencing NOAH's real estate development projects.

This chapter will:

- Explain the role of the CDC in affordable housing development;
- Identify the risks associated with CDC projects;
- Discuss the organizational and development history of NOAH; and
- Identify NOAH's development strengths and weaknesses.

This discussion will not only build the foundation for exploring the intricacies of the Siochain project, but will also facilitate the use of lessons learned by drawing commonalities between NOAH and other CDCs.

The Role and Operations of CDCs

NOAH is one of more than a dozen CDCx operating in the City of Boston. While each is focused on the development needs of a specific community, the majority of these organizations share a set of common traits that form the foundation for carrying out affordable housing projects, including organizational mission, productivity objectives, and nonprofit economics.

Mission: The Local Initiatives Support Corporation (LISC) defines CDCs as “locally controlled nonprofit organizations that reinforce the economic and social foundation of neighborhoods, towns, and villages building their way out of years of disinvestments and

decay.”¹ CDCs are needed in these struggling communities because the history of disinvestment weakened the market forces that drive economic growth and housing development. As a result, traditional for-profit entrepreneurs are hesitant to invest in a community with marginal economic conditions. CDCs seek to counteract the cycle of decaying local economy and urban blight by focusing local resources on community-specific needs such as affordable housing, micro-lending, and environmental programs.

That CDCs are needed indicates increased development risk, as traditional developers shun potential projects because of increased risks and marginal returns. However, unlike for profit companies that expect increased returns for increased level of risks, the nature of affordable housing development in these marginal neighborhoods does not reward increased risk with increased profits. In general, CDC-led affordable housing projects are not profitable because CDCs rent or sell their units below the market rate. By definition, the sale of first-time home buyer properties or cash flow from rental units is not sufficient to offset development costs. As a result, most projects draw on some type of development subsidy. The subsidy could come directly from a grant, from linkage funds from other development projects, or from tax credits purchased by investors. The need for subsidy also may result in limited funds to cover cost overruns. As a result, effective budget and operating pro forma analysis is crucial to the success of the project. Property acquisitions must be carefully evaluated to ensure that unseen site and structural issues do not upset projected costs. Finally, market demand, operating costs and sales price for the units must be accurately forecast to ensure the necessary source of funds.

CDCs are not driven solely by their mission to develop affordable housing. As part of a community of organizations striving to improve marginal urban areas, CDCs have a responsibility to hold up their successes as signs of progress. For CDCs, the most visible manifestation of their impact is the affordable housing units they develop. CDC development projects are so important to fomenting and maintaining political and financial support for affordable housing projects that annual production goals are established and unit completion is carefully monitored. These production numbers are

¹ “What is a CDC”, Local Initiatives Support Corporation Web Site, www.liscnet.org, 4/13/02

then used by politicians and housing activists to gain continued financial support for affordable housing activities.

In addition to the marketing benefits of successful affordable housing projects, CDCs that are particularly successful are held up as positive agents for urban revitalization. City and state development entities often turn to CDCs to carry out a large portion of their affordable housing agenda. Those that are successful are used to highlight the positive impact of urban development policies. NOAH is one of these organizations. Throughout its 15 year history, NOAH received numerous awards for affordable housing development which the organization has been able to leverage into grant funds to support future projects. It becomes clear that the importance of a successful record of housing development serves as a boon to both the affordable housing field in general, as well as to specific CDCs.

A final factor pushing CDCs to take on development projects is economics. Although CDCs are not for-profit developers, they still depend on revenues from development projects to provide income for the organization. This cash flow comes from the overhead and developer fees that CDCs are allowed to charge for carrying out affordable housing projects. These fees are included in the development budget and may be either set by the CDC as a matter of policy or more often set by the city or state housing agency at a certain percentage of the total budget in return for development subsidies.

The developer fees created by affordable housing projects are a key source of operating funds for CDCs. In fact, for many community development organizations, they represent the single largest source of money to support the organization's activities. CDCs are not simply non-profit real estate developers. They offer a wide variety of services, including community organizing, micro-lending, and workforce development. However, the majority of these other service areas are not self sustaining, relying on grants and other sources of funds for support. Real estate development activities often serve as the

financial lifeblood for these activities, as they generate excess cash flows that can support the entire organization. Figure 2-1 shows the operating budget for NOAH for 2001.²

	R.E. Develop.	Home Services	Housing Counsel	Comm. Organ.	Property Man.	Fund- raising	G&A	Total
Rev.	\$590,005	\$381,827	\$40,000	\$216,025	\$149,433	\$153,000	\$235,220	\$1,765,510
Exp.	\$262,531	\$381,597	\$39,874	\$214,758	\$146,604	\$152,561	\$459,500	\$1,657,425
Net Inc.	\$327,474	\$230	\$126	\$1,267	\$2,829	\$439	-\$224,280	\$108,085

As can be seen, the Real Estate Development Department was budgeted to generate a net income of over \$325,000. Without the developer fees created from affordable housing development activities, NOAH would be much more dependent on grants to support its crucial non-development activities, such as community organizing and administrative costs.

Therefore, beyond the influence of a CDC's mission or the overall importance of affordable housing within the city or state, CDCs must take on development projects simply to survive. CDC leadership must constantly seek out affordable housing opportunities within their communities to ensure that the organization will continue to offer a wide range of community development services. While the demand for developer fees guarantees that CDCs will continue to develop affordable housing projects, it also carries the risk that they will be forced to take on increasingly marginal projects.

This discussion demonstrates the complexities of CDC-led development and the forces driving CDCs to seek out new projects. It becomes clear that CDCs are involved in a crucial but risky endeavor. While the affordable housing services they provide stabilize marginal neighborhoods, the physical environment, political climate, and financial demands of non-profit community development often threaten the survival of many CDCs by combining to adding external pressures to an already risky development

² NOAH FY01 Budget, June 19, 2000.

process. These risks are a reality for many CDCs, including NOAH. However, beyond these general concerns, a CDC's development approach will also be dictated by a set of more specific factors, including the physical and political characteristics of their constituent neighborhood, as well as the organizational capacity of the CDC.

NOAH and the East Boston Development Environment

In order to explore the Siochain Rental Rehabilitation Project in depth it is necessary to explore both the history of NOAH and its service community, East Boston.

The Neighborhood of Affordable Housing was founded in 1987 to serve the housing and community development needs of East Boston. Initially solely focused on the development of rental housing, over the years NOAH evolved into a full service community development entity. Today, NOAH develops both affordable rental and homeownership projects, manages affordable rental units, provides low interest loans to first-time homebuyers, and leads community organizing activities. While occasionally at odds with older residents, NOAH is now an integral and respected member of the East Boston community.

Established in the 1830s as a residential and commercial center focused on maritime uses, East Boston has developed a rich cultural history as immigrants to the region settled in the community because of its affordable housing and economic opportunities. This continues today as East Boston's newest set of immigrants from Latin America and Asia settles in to create a diverse and vibrant urban community. However, moderate income residents of East Boston face a housing crisis. In general, there are low vacancy rates in rental and limited inventory in for sale properties. Low income households in the community spend well over the 33% of income standard (routinely between 40% and 50%) on housing costs and have virtually no home ownership opportunities in the East Boston market.³

³ East Boston Master Plan, Boston Redevelopment Authority, April 2000, pg. 17.

The need for affordable housing is clear. However, development of affordable housing in East Boston faces a number of limitations. According to the East Boston Master Plan:

these limitations include issues relating to cost, regulations, transportation, and community involvement. One specific factor is the high cost of (re)development relative to real estate prices in East Boston (especially including land costs, waterside infrastructure costs, parking costs, and landside development premiums). Another economic issue is the high cost of converting/redeveloping existing uses to more productive uses. There are regulatory limitations, conditions for certain uses of the waterfront (especially non-water dependent) and there is limited land available for new development.⁴

These limitations translate into increased development costs for NOAH. Rapid economic growth in the late 1990's greatly impacted NOAH's development capacity. First, rapid growth in the Boston region placed a premium on land and property available for housing development. As a result, property acquisition costs increased. Acquisition costs for the two Siochain buildings were \$23,500 per unit in 1998. Two years later, when NOAH acquired a three unit building for a homeownership project, costs had risen to over \$50,000 per unit.⁵ Second, the construction boom also spurred a rise in construction costs. In the original Siochain budget, per square foot costs for the project were \$95. By 2001, construction costs on NOAH's two newest homeownership costs were approaching \$150 per square foot.⁶ Because NOAH rents and sells its units at affordable prices, it is both difficult and undesirable for NOAH to offset its costs by increasing prices. Therefore, it must either increase the subsidy used for the project or scale back the project budget by removing contingencies and other budget protections, leading to a riskier project.

⁴ East Boston Master Plan, Boston Redevelopment Authority, April 2000, pg. 14.

⁵ "Project Budgets", Siochain I, May 2000, 227 Princeton, February 2001.

⁶ "Project Budgets", Siochain I, May 2000, Lexington-Putnam, June 2001.

Beyond increased land costs due to limited developable land, the built environment of East Boston presents another hurdle for effective affordable housing development; property size. East Boston is among the densest communities in the Boston region, with few open parcels of land available for development. In addition, with the predominance of row houses in the neighborhood, parcels are small, typically in the range of 1500 SF. The lack of open land coupled with

the small parcel size makes land acquisition for large affordable housing development extremely difficult. With the high land prices, carrying costs for such a development strategy are also prohibitively high. As a result, NOAH must focus on developments on existing parcels or property.

Exhibit 2-2 and 2-3 compare parcels in East Boston with the Upham's Corner area, a community served by several other Boston-area

CDCs. As can be clearly seen, parcels in East Boston are noticeably smaller than in other areas of the City. This reality of the built environment forces NOAH to take on small-

**Exhibit 2-2
East Boston**



**Exhibit 2-3
Upham's Corner**



scale affordable housing projects. As a result NOAH is unable to take advantage of the economies of scale that accrue to larger development projects. This translates into increased development costs for NOAH.

A constraining physical environment, in tandem with the general factors affecting CDC-led projects discussed earlier, combines to make affordable housing development difficult and risky in East Boston. In fact, according to the Master Plan, feasibility of low priced ownership and rental apartments in the East Boston community is only positive if subsidized.⁷ As a result, managers at NOAH focused their development efforts on specific types of projects that provided the necessary subsidy, ensuring both completion and collection of developer fees.

NOAH's Past Development Work

Throughout its history, NOAH focused on the development of both rental and homeownership projects. However, as the economics surrounding affordable housing development changed in the mid to late 1990s, NOAH's development approach evolved as well, impacting how projects were evaluated and carried out. Therefore, understanding the evolution of the organization's development approach is crucial to exploring the successes and failures of the Siochain project.

NOAH commenced development operations in July, 1987. The first project was a Low Income Housing Tax Credit-financed rehabilitation known as Trinity House. As the organization's first development project, NOAH retained Trinity Financial, a development firm specializing in residential and commercial projects, as the project manager. The use of experienced developers as mentors is a common development practice used by nonprofit developers. According to a study by Abt Associates on nonprofit housing costs and funding

Often the less skilled nonprofit could utilize its working relationship with the mentor to build its own expertise and capacity to undertake projects

independently in the future. In other instances, however, the nonprofit cede[s] much of the development decision-making to the expert. With this approach, the quality of learning experience for the less skilled nonprofit would not be so high, and therefore the organization would remain more dependent on the expert for future efforts.⁸

However, while NOAH successfully completed the project, the organization fell into the mentor trap outlined in the Abt study, gaining little in capacity because of the active role of Trinity Financial.

Following the completion of Trinity House, NOAH carried out a variety of rental housing development projects from 1989 to 1991. These projects required moderate rehabilitation work and were completed efficiently and on budget. However, following completion it became apparent that several of the projects required additional work. Towards this end, NOAH wrapped the projects into a subsidiary entity, Shalom Properties, and attained a grant and subsidy funds from the State to rehabilitate several of the units, which were completed in 1996. NOAH gained valuable experience through the Shalom development and became intimately familiar with the rehabilitation needs of East Boston properties.

In 1995, the City of Boston, in conjunction with Boston Community Loan Fund (BCLF), the Local Initiatives Support Corporation, and seven Boston area CDCs, including NOAH, began the Boston One to Four Family Program. According to BCLF:

One to Four Family Program, is a powerful public/private partnership that provides loans to community development corporations (CDCs) to rehabilitate one to four family buildings in strategically targeted areas for first-time homeownership. The program enables the renovation of abandoned houses of one to four units that are too expensive for a single household to restore and too small to interest most developers.

⁷ East Boston Master Plan, Boston Redevelopment Authority, April 2000, pg. 17.

⁸ "Nonprofit Housing: Costs and Funding, Final Report", Abt Associates, Inc., November 1993, pg. 3-30-31.

As originally conceived, the Boston One to Four Program rehabilitated multi-unit houses that would be purchased by a single owner. The owner would live in one of the units and rent out the remaining units to help defray the cost of the mortgage. Deed restrictions required that the rent be affordable and that any resale of the property also be at an affordable rate.

Because the predominate residential structure in East Boston is row houses, the One to Four Family program suited NOAH's development environment and objectives. The program was easy to use, requiring a simplified proposal that was submitted to LISC and BCLF. These intermediaries then negotiated with the necessary City and State agencies to ensure funding. Under the program, each unit could receive up to \$80,000 of subsidy (in year 2000). The remainder of the project funds resulted from the sale of the units. The only requirement was that the total project budget remain under the "Total Development Cost" (TDC) cap set by the State at \$150,000 per unit (in 2000). With low acquisition costs in the mid to late 1990's, NOAH was able to remain under the TDC cap and develop over 50 units of housing. Even as acquisition and construction costs began to rise in 1999 and 2000, grant funds from Fannie Mae enabled NOAH to defray increasing costs and continue developing affordable housing units with the One to Four Program.

Financially, the One to Four Program proved lucrative as well. Under the program, NOAH received a standard overhead and developer fee of roughly \$14,000 per unit. These funds were relatively assured because of the cushion provided by the TDC and the ability to use sales proceeds to cover cost overruns. By 2000, NOAH had used the One to Four Program to create over 40 units of housing and generated hundreds of thousands of dollars in development fees for the organization.

Organizational Capacity and Development Practices

Following its founding, NOAH carried out its original affordable housing projects with limited resources. Phil Giffie, the executive director, led the first rental projects as the

organization gained a foothold in the development community of East Boston. However, as NOAH grew and became more sophisticated in its development approach, its organizational capacity also expanded. Recognizing that affordable housing development in East Boston would be concentrated on small properties, NOAH hired staff with small property development experience. The first director of real estate had significant experience in developing single family residences. Additional staff with complimentary experience joined the organization, leading to a team able to efficiently use the One to Four Program to create affordable housing.

As the real estate development department grew increasingly familiar with the East Boston development environment and the requirements of the One to Four Program, a set of development practices emerged. First, NOAH increasingly began to acquire properties for development prior to formalizing the project development strategy with potential lenders. A potential property for development through the One to Four Program would first be acquired. NOAH development staff would then begin the process of enrolling the property in the program, feeling assured at the property's acceptance. This strategy was partially necessitated by the strong housing market and the difficulty in acquiring properties. In addition, with Boston experiencing a severe housing shortage in the late 90s and in 2000 and the One to Four Program a popular development vehicle within City and State agencies, NOAH felt secure in receiving project approval after acquisition.

The One to Four Program also shaped development budget decision making. The subsidy from the program was fixed at \$80,000 a unit. In addition, NOAH's lending department was able to determine the sales price for the units through calculating the amount potential purchasers were able to borrow. As a result, the total sources for the project were fixed. Throughout the late 1990s and into 2000, project sources more than covered project uses. In addition, NOAH had access to grant funds from the Fannie Mae Foundation that could be applied to any One to Four project to cover additional costs. As a result, NOAH staff were able to quickly generate project budgets, assured that adjustments could be made to specific line items during development as actual costs required. While this process facilitated development, it also contributed to a relaxed

approach to project budgeting, possibly leading to potential problems when development costs began to rise.

As demand and costs for housing continued to grow in the Boston housing market, NOAH altered the traditional One to Four project. Where originally the program created housing with a single owner and up to three renters, NOAH began to pursue a development strategy where the entire development would be a condominium. Each unit in a four unit building would have a single owner, with a condo fee covering the costs of the common areas. This arrangement allowed NOAH to increase the number of first-time homebuyers while also generating increased sales proceeds, since four condominium units could sell for a higher price than a single homeowner unit with three rental units. In this way, NOAH was able to modify the One to Four Program to fit the constraints of the East Boston housing market.

Conclusion

NOAH's years of development experience created a skill set for affordable housing development, tailored to the needs of the community. According to current and past project managers, NOAH's development strengths include:

- Extensive experience in small homeownership projects;
- Entrepreneurial and innovative development approach; and
- City, State, and financial intermediary support.

While effective, these skills were limited by the physical environment of East Boston and by the financial realities of affordable housing development. In addition, the organization's intent focus on the One to Four Program may also have weakened its understanding of broader real estate development tools. According to staff, these weaknesses specifically included:

- Limited development opportunities due to lack of land;
- Lack of Low Income Housing Tax Credit Experience; and
- Inexperienced property management staff.

It is with these strengths and weaknesses that NOAH approached the Siochain Rental Rehabilitation project. They would play a pivotal role in both the projects significant successes as well as its various shortcomings.

CHAPTER 3

SIOCHAIN RENTAL REHABILITATION PROJECT

On July 25, 2002, NOAH staff members, along with the Mayor of the City of Boston, held a ribbon cutting for the Siochain Affordable Housing project. Located in East Boston, Siochain provides 12 units of affordable rental housing. The project also included two ground floor commercial units, occupied by a beauty salon and a local chapter of Alcoholics Anonymous. In addition to the creation of affordable housing and commercial units, the Siochain project also redeveloped a large, corner property that contributed to blight in the heart of the East Boston commercial district. This benefited the entire East Boston community, particularly the Central Square neighborhood, while simultaneously provided positive publicity for NOAH.

The Siochain Rental Rehabilitation Project

Historically, NOAH's development strategy included both homeownership projects and rental housing. While the Board of Directors believed in the importance of this dual approach, it continued to stress the importance of rental housing. Affordable homeownership and condominium projects in East Boston had led in the past to non-resident owners and dilapidated properties. Consequently, as NOAH's real estate strategy increasingly used homeownership projects to meet production objectives, the Board felt it was important that NOAH continue to create rental housing.¹

In 1999, NOAH was in the process of completing the Eutaw Meridian rental housing project. Consequently, project managers and the Board were interested in seeking out a new rental housing opportunity to balance NOAH's One to Four Program homeownership developments. Supporting the Board's desire to see a new rental housing project was NOAH's 100% success rate on past projects. In addition, NOAH enjoyed considerable support from the City, State, and financial intermediaries, such as LISC. These translated into a willingness to take risks to complete rental housing. The question was simply how to finance the project.

¹ Interview, David Fernandes, April 29, 2002.

The Siochain Properties Limited Partnership was originally created to carry out a 25 unit, scattered site development financed both with HOME funds and affordable housing tax credits. As proposed, the Siochain project was only partially financed through low income housing tax credits. As can be seen in Exhibit 3-1, the project sources also included HOME funds from both the Boston Department of Neighborhood Development (DND) and the State's

Source	Total
Equity: NOAH	\$646
Equity: Tax Credit	\$1,077,800
DND HOME	\$330,000
DHCD HOME	\$330,000
Permanent Loan	\$285,255
TOTAL	\$2,023,671

Department of Housing and Community Development (DHCD).² Under funding provisions, projects of over 12 units that receive HOME funds activate Davis Bacon regulations. These regulations stipulate that projects must pay the “prevailing wage” for construction work and also must use individuals licensed for each specific trade rather than using an worker able to do a variety of tasks, such as carpentry and masonry.

While not opposed to paying fair wages for construction workers, both NOAH and the project contractor believed that using a different set of workers for each trade would be substantially more expensive than taking advantage of a discrete set of highly skilled carpenters who could carry out a variety of tasks.³ In fact, this concern was proven in presenting the project to city and State officials who expressed concern about the project’s overall development costs. As a result, NOAH decided to divide the Siochain Partnership into two projects, Siochain I with 12 units, and Siochain II with 10 units. Only Siochain I included tax credit financing. The Siochain I project is the sole focus of this document.

Acquisition

Acquisition represents the first important phase of the Siochain project. As a first step in the acquisition process, NOAH entered into negotiation with Boston Community Capital (BCC) for a permanent line of credit. BCC is a community development financial intermediary dedicated to the preservation and development of communities where low-income individuals and families

² Siochain I Budget, 5/17/2001.

³ Interview, David J. Fernandes, 4/29/02.

live. Through their Boston Community Loan Fund, BCC is an important member of the One to Four Housing Program and a long supporter of NOAH and its operations in East Boston.

NOAH and BCC set up a standard line of credit for acquisition purposes. Under the terms of the agreement, the line of credit was for \$1 million (later increased to \$1.3 million) at a 7% interest rate. It is important to note that the line of credit originated for acquisition purposes only. This would eventually lead to problems in the future as NOAH used the line of credit to carry out construction activities.

NOAH's original development plan envisioned the acquisition of 25 units for development using low income housing tax credits. However, the economics of the project required that it be reduced to twelve units. Even with fewer units, the built environment of East Boston necessitated that multiple buildings be purchased, as few large structures suitable for housing exist in the community. Eventually, NOAH purchased two buildings in the Central Square area of East Boston. Following is a discussion of each property, including building condition, occupation status, and costs.

100-104 Saratoga Street: The Saratoga Street building contained five residential units and one commercial unit. The building was in a state of disrepair. No units at the Saratoga building were occupied at the time of purchase and information suggested the building had been abandoned since at least 1989. Peace Properties, a wholly owned subsidiary of NOAH, purchased the building in September 1997 for \$68,100.⁴ Title to the property was later transferred to Siochain Properties for the purpose of carrying out the development. When redeveloped, the commercial unit would be converted to housing and the building would contain a total of six residential units.

273-283 Meridian Street: The Meridian Street building served as the anchor for the project. Located on the corner of Meridian and Princeton Streets in the Central Square area the building was severely run down and contributed to urban blight in this vibrant commercial area of East Boston. The building held two active ground floor commercial units, a beauty salon and an Alcoholics Anonymous meeting room, as well as five occupied residential units. Peace

⁴ HUD Uniform Settlement Statement, Peace Properties, 9/11/97

Properties purchased the building in June 1998 for \$215,000.⁵ Title was then transferred to Siochain Properties in 1999. Upon completion of the project, the building would house the two commercial establishments and six residential units.

According to the original budget submitted by NOAH to the State for funding, acquisition costs totaled \$282,000. Exhibit 3-2 outlines the allocation of these costs between the land and the buildings.⁶ For the 12 residential and two commercial units, this equals a per unit cost of \$20,142.

	Residential	Commercial	Total
Land	\$62,509	\$7,491	\$70,000
Building	\$179,723	\$32,277	\$212,000
Total	\$242,232	\$39,768	\$282,000

These costs represent the direct acquisition expenditures for the project. However, it would be misleading not to include relocation expenses in the total acquisition costs.

Any project using federal funds must comply with the Uniform Relocation Act. Under the Act, the developer is required to pay to move any existing tenants to new units and pay any difference in rent for the duration of the project. As previously discussed, the Meridian Street building had four existing residential tenants and two commercial tenants. According to the Tenant Relocation Plan prepared by NOAH in 1998:

The Project will not permanently displace any tenants. However, the four residential tenants will be temporarily relocated during construction. NOAH will find suitable housing for these families in the completed Saratoga building, in other NOAH buildings, or on the private market. These tenants will be reimbursed for reasonable moving costs to the temporary unit and back to the Meridian building, as well as any difference in rent while in the temporary unit.

⁵ HUD Uniform Settlement Statement, Peace Properties, 6/30/99

⁶ Budget, Siochain I Rental Rehabilitation Project, May 2000.

The Project will work around the two commercial tenants and not require any temporary or permanent relocation from them.⁷

According to a memorandum from the NOAH project manager to the Director of Real Estate Development regarding the application of the Uniform Relocation Act to the commercial tenants:

We are not allowed to provide temporary relocation assistance to businesses or non-profits. It appears that if we have to relocate a business or non-profit organization, it should be relocated permanently and treated as displaced. **Luckily, we don't plan to force either the beauty salon or AA to relocate during construction.**⁸

Under the provisions of the Uniform Relocation Act and using the Tenant Relocation Plan as a guide, NOAH budgeted \$13,696 for temporary tenant location.

NOAH completed acquisition in 1999. While the organization carried out discussions with the city and State regarding the Siochain project before the acquisition period began, at the close of acquisition activities, NOAH still needed to apply to the State for approval for tax credit financing.

Financing

As previously discussed, NOAH planned on financing the Siochain project through the use of Low Income Housing Tax Credits. This financing scheme was developed in part due to what management perceived to be a lack of other financing options for affordable rental housing. In addition, NOAH received encouragement from DHCD to seek tax credits for the project out of the Department's desire for "production" tax credit projects.

Low Income Housing Tax Credits are divided in their allocation. A portion go to support housing preservation activities in a state and a portion go to the production of affordable housing.

⁷ Tenant Relocation Plan, NOAH, 1998.

⁸ "Memorandum: Relocation Training", December 10, 1998.

In 1999, the majority of preservation tax credits were allocated to the Mission Main HOPE VI project. This meant that the remaining tax credits had to be used for production of affordable housing. Although only two new units would be created under the Siochain project, substantial rehabilitation activities of the type planned for under the project also qualify as production activities.

Exhibit 3-3 outlines the planned sources for the Siochain project. Over half the funds needed for completion of the project would be drawn from tax credits. Rather than using a tax credit syndicator to provide the necessary investor equity, NOAH entered into a partnership agreement with Citizen’s Bank of Massachusetts, with Siochain Properties, Inc. as the general partner and Citizens as the limited partner.

Source	Total
Equity: NOAH	\$646
Equity: Tax Credit	\$1,077,800
DND HOME	\$330,000
DHCD HOME	\$330,000
Permanent Loan	\$285,255
TOTAL	\$2,023,671

The belief at the time was that entering into an agreement directly with the tax credit investor would be less expensive than operating through a financial intermediary such as a tax credit syndicator.⁹

Additional sources of funding included HOME funds from both the City (Department of Neighborhood Development) and the State (Department of Housing and Community Development), as well as a permanent loan from Boston Community Capital. In addition, NOAH would use the BCC line of credit as a construction loan, to be paid off with a permanent loan at the closing of the project.

The total development budget for the Siochain project was just over \$2 million. Exhibit 3-4 outlines the costs for acquisition, construction, selected soft costs, and developer overhead and

	Total
Acquisition	\$282,000
Direct Construction	\$1,222,900
Construction Contingency	\$60,450
Subtotal: Construction	\$1,283,350
Subtotal: Soft Costs	\$235,135
Developer Overhead	\$111,593
Developer Fee	\$111,593
Total Development Costs	\$2,023,671

⁹ Interview, Paula Herringlyton, 5/9/2002.

fees. According to the budget, acquisition represented 14%. Construction equaled 61% with a 5% construction contingency for a construction total of 64%. Total soft costs equaled 11% of the budget with a similar 11% for the developer fee and overhead.

Because of the eventual impact of soft costs on the Siochain project, it is important to explore projected soft cost expenditures in greater depth. Exhibit 3-5 breaks soft costs into specific categories and also shows them as a percentage of the total development costs. The categories outlined do not represent all soft cost line items. However, these are the soft cost line items that experienced the greatest cost overruns. Specific line items, such as

	Cost	% of Total
Architecture	\$51,958	2.6%
Owner's Legal	\$2,075	0.1%
Lender's Legal	\$18,200	0.9%
Partnership Legal	\$15,000	0.7%
Accounting	\$12,500	0.6%
Relocation	\$10,483	0.5%
Const. Loan Interest	\$42,929	2.1%
Soft Cost Cont.	\$2,500	0.1%
Other Soft Costs	\$79,490	3.9%
Total	\$235,135	11.6%

Title that are not broken out are grouped into the category "Other Soft Costs". The information outlined in Exhibit 3-8 will prove useful when comparing these pro forma values with the actual development costs. It is also important to note that developer fee and overhead were equal to the total expected expenditure for soft costs. The budget clearly depicts NOAH's expectation of realizing a large developer fee and overhead on the project.

With the completion of the financing scheme, project budget, and schedule, NOAH was in a position to apply to the State for tax credit financing. Following NOAH's first application for funding, NOAH received notice that it had been rejected. Considering the level of support that NOAH had received from DHCD and the organization's 100% past project success rate, the rejection of the proposal by the State was very surprising. In retrospect, project managers stated that they subsequently learned that almost all tax credit projects are rejected on their first application.¹⁰ This is due to the back log of applications and the need to accept projects that are on their second (or third) application. However, the fact that NOAH was unprepared for the possibility of being rejected is a harbinger of their lack of experience in dealing with the complexities of a tax credit project.

¹⁰ Interview, David Fernandes, 4/29/2002.

Upon second application, the Siochain Rental Rehabilitation Project was accepted for tax credit financing in October 1999. Subsequently, on November 9, 1999, NOAH officially incorporated the Siochain Limited Partnership for the purpose of carrying out the project. The properties, which had been acquired by Peace Properties, NOAH's umbrella development entity, were then transferred to the Siochain Partnership. With the transfer, the Siochain project was officially underway.

As part of the application process, NOAH provided a schedule for both project completion and the use of funds. The development schedule for the Siochain project was 12 months. Therefore, with a November 1999 start date, the project was to be complete by October 2000. Under the flow of funds plan, shown in Exhibit 3-6, NOAH planned to use the BCC line of credit as the major form of funding for project construction.¹¹

Sources	Total	Closing	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Const. Loan	\$1,300,000	\$243,415	\$245,576	\$291,818	\$244,408	\$274,783
Equity: Cash	\$646	\$646	\$0	\$0	\$0	\$0
Equity: Tax Credit	\$1,077,800	\$0	\$0	\$0	\$0	\$1,077,800
Subordinate Debt	\$660,000	\$119,562	\$109,774	\$134,254	\$110,314	\$186,098
Permanent Debt	\$285,225	\$0	\$0	\$102,619	\$0	\$182,606
Subtotal	\$3,323,671	\$363,623	\$355,350	\$528,691	\$354,722	\$1,721,287
Repay Const. Loan	-\$1,300,000	\$0	\$0	\$0	\$0	-\$1,300,000
Total Sources	\$2,023,671	\$363,623	\$355,350	\$528,691	\$354,722	\$421,287

These funds would be augmented by use of the subordinated debt (DND and DHCD HOME funds). Funds from the equity investor would not be used until the end, primarily for repaying the construction loan. This arrangement coincides with the partnership agreement that NOAH signed with Citizens, which clearly states in Schedule B, "Schedule of Capital Contribution Installments" that NOAH will receive the first equity installment of \$913,515 no earlier than completion of construction.¹²

¹¹ Derived from Siochain Budget, May 17, 2001.

¹² "Amended and Restated Certificate of Limited Partnership of Siochain Properties Limited Partnership", March 1, 2001.

The scheduled flow of funds gives cause for concern. First, the BCC line of credit carries an interest rate of 7%, while the interest rate of the subordinate debt is effectively zero and the limited partner equity carries no interest charges. By relying heavily on the line of credit early on for project financing, NOAH established an expensive financing scheme. In addition, under more traditional tax credit projects, limited partner syndicates provide their capital early in the project. This not only provides a large source of inexpensive cash, reducing carrying costs, but also invests the limited partners in the success of the project. The fact that Citizen's structured their participation in such a way to provide funds at the end both increased the development costs of the project and also reduced their incentive to ensure that the project was carried out efficiently and on schedule.

On the eve of the project, the seeds for development difficulties were sown. NOAH had created an expensive financing arrangement and also appeared inexperienced in the intricacies of tax credit projects.

NOAH's Concerns

NOAH was not without their own concerns for the Siochain project. Through its numerous past rehabilitation projects, NOAH built a relationship with several local East Boston contractors. With an organizational mission to promote community and economic development in the neighborhood, NOAH wanted to use an East Boston contractor. There was concern that NOAH's past contractors, whose primary experience was on small, one to four unit buildings, would not have adequate resources to carry out a scattered site, 14-unit building. However, with a vigorous construction environment in 1999, and particularly with the impact of the Central Artery, Third Harbor Tunnel project (Big Dig), NOAH's interest in retaining an East Boston contractor became a necessary reality. NOAH selected Boston Metropolitan Construction to carry out project construction. NOAH worked with the company on numerous projects in the past and felt that the benefits of an East Boston contractor, their understanding of NOAH's needs and expectations, and their availability outweighed their concerns regarding capacity.

Beyond the ability of the contractor, NOAH was also concerned about the general state of the two properties. The Saratoga Street building, although seriously deteriorated, had the advantage of also being vacant. Consequently, NOAH project managers felt confident that this portion of the project could be carried out on schedule and on budget. However, the occupied status of the Meridian Street building concerned the NOAH project managers. While NOAH always planned on needed to relocate residential tenants, they did not want to relocate the two commercial tenants. Because of the questionable structural integrity of the building, David Fernandes, former Director of Real Estate Development for NOAH, expressed doubt about maintaining the tenants in the building. However, he received assurances from Boston Metropolitan Construction that the project could be carried out without needing to relocate the commercial tenants.¹³

Project Construction

In June, 2001, NOAH held the official ribbon cutting for the Siochain project. However, behind the happiness for the completion of what everyone involved would agree was an arduous project, were more mixed and cloudy emotions about the projects success.

At completion, the total development cost of the Siochain project was \$2.4 million. This is roughly 20% over the original budget. More importantly to NOAH, of the \$223,000 the organization planned on earning in developer fee and overhead, it received only \$73,024, roughly one-third of the planned funds. All of this was developer overhead. NOAH did not collect any funds as developer fee. In addition, NOAH completed the project a full eight months behind schedule.¹⁴ While many development projects are completed behind schedule and over budget, the magnitude of these overruns for the Siochain project hints at problems larger than simple development miscalculations. What were these issues? What impact did they have on the project? How can they be avoided on future projects? The first step in answering these questions is found in conversations with past and current NOAH project managers.

¹³ David Fernandes, Interview, 4/29/2002.

¹⁴ Note: As of June 27, 2002, NOAH continues to pay interest on its construction loan.

In interviews with the two past real estate directors, the current project manager, and the executive director, all four cited NOAH's lack of experience with tax credit projects as the major factor contributing to the problems with the Siochain project. Secondary concerns centered on relocation expenses, acquisition, and construction costs. However, it was the complexities of using Low Income Housing Tax Credits, and the delays it caused, that created the largest barrier to success for the project.

According to Paula Herrington, Director of Real Estate for NOAH at the beginning of the Siochain Project, tax credit financing was the inevitable outcome of the Board of Director's decision to develop a rental housing project. Her opinion, echoed by all other individuals associated with the project, is that Low Income Housing Tax Credits are the only way to carry out affordable rental housing.¹⁵ Although the City and State continue to experiment with various pilot projects for rental housing, none were available at the time. As a result, NOAH decided prior to acquisition that tax credits would be used for the Siochain project and was then forced to learn about the program while simultaneously carrying out the project.

It is important to note that project managers at NOAH felt confident in their ability to carry out the project successfully. David Fernandes, Director of Real Estate from 1999-2001, pointed out that NOAH's 100% success rate in project development contributed to both the management's confidence in their ability and the funder's belief that NOAH could successfully complete the project.¹⁶ However, although NOAH completed a tax credit project in the early 1990's, the majority of it was carried out by consultants, leaving NOAH little capacity or institutional memory from the experience. Consequently, according to Phil Giffie, NOAH Executive Director, no preliminary planning or budgetary adjustments were made from the way NOAH traditionally carried out their home ownership projects.¹⁷

Low income housing tax credits are extremely complex. In his book, "Developing Affordable Housing," author Bennet Hecht admonishes nonprofit developers to take care when considering tax credits.

¹⁵ Interview, Paula Herrington, 5/9/2002.

¹⁶ Interview, David Fernandes, 4/29/2002.

¹⁷ Interview, Phil Giffie, 4/17/2002

Nonprofit developers should be aware that this program is extremely complicated and rife with land mines for those uninitiated in this type of financing. Early in the development process, sponsors who are seriously considering a tax credit project should retain tax counsel experienced in the low-income housing tax credit.¹⁸

This statement alludes to both the legal complexities of tax credit financing and the importance of early preparation and project planning. Both of these issues played an important role in the Siochain project.

The legal issues surrounding the use of low income housing tax credits are substantially more intricate and involved than those associated with NOAH’s more traditional home ownership project. However, the original budget for the project suggests that project managers were unaware of the legal gauntlet they faced. In the first project budget submitted to the State in May 1999, NOAH only projected \$2,800 in syndication legal fees.¹⁹ Joe Bamberg, the current NOAH project manager, believes this figure was taken directly from NOAH’s legal costs on past homeownership development projects.²⁰ Following conversations with the City and State, the syndication legal fees were adjusted and are shown in the Modified Original Budget in Exhibit 3-7. However, even with upward adjustment to the legal fees, the final legal costs were almost three times the amount originally budgeted.

	Original Budget	Final Costs	\$ Change	% Change
Owner’s Legal	\$2,075	\$8,287	\$6,212	400%
Lender’s Legal	\$6,200	\$21,004	\$14,804	338%
Syndication Legal	\$15,000	\$37,137	\$22,137	248%
TOTAL	\$23,275	\$66,428	\$43,153	285%

¹⁸ Hecht, Bennet L., *Developing Affordable Housing: A Practical Guide for Nonprofit Organizations*, Second Edition, John Wiley & Sons, Inc., New York, 1999, pg. 221.

¹⁹ “Siochain Rental Rehabilitation Project: Application for Low Income Housing Tax Credits”, May 12, 1999.

²⁰ Interview, Joe Bamberg, 5/14/2002.

Beyond the cost overrun in legal fees, the use of tax credits also presented problems in the form of the equity partner. In general, the equity in a low income housing tax credit project is provided by a tax credit syndicator. Equity funds are provided by investors to the syndicator, who in turn provides the funds to the project. The syndicator also typically plays an important oversight role in the project. For their services, the syndicator charges a fee as well as passes legal and other costs on to the project sponsor. For the Siochain project, managers decided to use a single investor, Citizen's Bank. According to Paula Herrington, NOAH felt that syndication costs would be lower if only a single investor was involved.²¹ However, as previously discussed, syndication costs were substantially higher than originally planned.

Part of not realizing the expected reduced syndication costs by using a sole corporate investor can be blamed on NOAH's inexperience with tax credit investors. There are three ways of receiving equity for Low Income Housing Tax Credits; public offerings, private placements, and sole corporate investors. While each investor purchases tax credits at a discount, the level of discount varies, with public offerings delivering the highest value for each dollar of tax credit and sole corporate investors offering the lowest. While it is true that public offerings have the highest syndication costs and sole investors the lowest, when factored into the higher offered price, all three types of investor offer roughly the same final price per tax credit dollar.²² (Note: This is discussed in greater detail in Chapter 4.) This reality reveals one of the major issues with NOAH's rationale for using Citizen's Bank as a sole corporate investor.

In addition, over the course of the project, it became clear that Citizen's was as inexperienced in the nuances of tax credit projects as NOAH. This inexperience negatively impacted the project in two important ways. First, due to their inexperience, Citizen's did not play the vigilant oversight role of a typical tax credit syndicator. While originally considered an asset by NOAH because of the flexibility it allowed, the hands-off approach of Citizen's ultimately proved costly in the form of project delays and the accompanying increase in construction loan interest payments. Second, Citizen's approached equity financing in a very conservative manner. Typically, tax credit investors provide a portion of their equity early in the project. This not only

²¹ Interview, David Fernandes, 4/29/2002.

²² Stevens, H., and T. Tracy, A Developer's Guide to the Low Income Housing Tax Credit, 3rd Edition, National Council of State Housing Agencies, Washington, D.C., 1994, pg. 7

assists the project sponsor by supplying low cost funds but it also provides an incentive for the syndicator to actively participate in the management of the project. In the case of Siochain, Citizen's arranged the financing in such a way that it wouldn't provide the tax credit equity until the buildings were complete. This conservative strategy protected Citizen's equity investment but actually hurt the project by forcing NOAH to use more expensive funds.

The cost of the equity financing arrangement to the project is demonstrated in an analysis of the actual flow of funds for the project. NOAH originally budgeted \$43,000 for construction loan interest. However, in part by relying entirely on the construction loan as a source of funds, by the completion of the project NOAH had paid over \$146,000 in loan interest.²³ (Note: A portion of the loan interest payment is due to project delays and not the use of funds). This payment approach is in line with how NOAH carried out past homeownership projects. However, unlike past project, the tax credit financing provided a source of funds with no loan interest. In the majority of tax credit projects, investor equity is used as one of the first sources of project funds.²⁴ If NOAH had been able to reach an agreement with Citizen's to invest their money at the inception of the project, NOAH could have put off using the construction loan until ten months into the project. This could have saved up to \$41,000 in interest payments, depending on how the flow of funds was structured. NOAH's decision to use a tax credit investor that was unwilling to invest early represented a direct cost to the project.

Although the use of tax credits and the associated financing and legal fees created the majority of the problems on the Siochain project, other issues related to construction, tenant relocation, and the NOAH development team also negatively impacted the project. As previously discussed, the two buildings purchased for the Siochain project were in a state of serious disrepair and required complete rehabilitation. The original budget for the project included \$1.28 million in hard costs. By the end of the project, construction costs increased by \$248,000 to \$1.53 million. In per square foot costs, this translates into \$92 at Saratoga and \$117 at Meridian. These costs, particularly for the Meridian Street building, are substantially higher than previous construction

²³ Note: As of June 27, 2002, NOAH continues to pay interest on its construction loan.

²⁴ Interview, Joe Bamberg, 5/14/2002.

costs for NOAH. Part of this can be explained by rising construction costs. But according to David Fernandes, a large portion is due to the poor condition of the Meridian Street building.²⁵

Traditionally, gut rehabilitation projects demand exploratory demolition prior to a final construction cost in order to discover any hidden structural issues. For the Saratoga Street building, pre-construction demolition was allowable because the building was vacant. However, the Meridian Street building had both residential and commercial tenants at the time of construction estimate. Even after the residential tenants left the building, the contractor was unable to carry out extensive pre-construction demolition because the commercial units were to remain occupied. As a result, the original hard cost estimate was simply a best guess by the contractor. Eventually, only after the commercial tenants were forced to relocate (see below), did the true structural problems of the Meridian Street building become apparent, with costs and schedule rising accordingly. Under the original schedule, the Siochain project was to be completed in November 2000. However, the project was not closed out until May 2001. Over this six-month period, construction loan interest continued to accumulate, costing NOAH over \$36,000.

As previously discussed, the Meridian Street building was completely occupied. Under the Uniform Relocation Assistance and Real Property Acquisitions Policy Act, NOAH had to either pay to move tenants to new permanent residences or temporarily relocate them for the duration of the project. With assurances provided by the contractor, project managers did not plan to move the commercial tenants. As a result, project managers planned for eight months of relocation expenses, as outlined in Exhibit 3-8.

However, as construction progressed, it became increasingly apparent that the commercial tenants would need to be moved in order to address structural issues within the building. Further exacerbating the expense, as the project fell behind schedule, tenants remained in their relocated units at NOAH's expense for a longer

Total Relocation Costs	
Temporary Rent	\$8,880
Moving & Utilities	\$6,000
Contingency	\$1,250
TOTAL	\$16,130

²⁵ Interview, David Fernandes, 4/29/2002.

period of time. By the completion of the project, relocation expenses for the Siochain project totaled \$32,600, over twice the amount budgeted.

In retrospect, Mr. Fernandes has pondered the option of demolishing the whole building. This could have saved on construction costs by providing an accurate estimate and solving the structural issues. It also could have shortened the project duration, lowering construction loan interest and tenant relocation expenses. However, if the original building was demolished, the new structure would be forced to have set backs, off -street parking, and a lower density because of zoning provisions. This would have lowered both the project subsidy and the developer fee and overhead for NOAH. It also would have damaged the built environment of the Meridian Street commercial district.²⁶

Paula Herrington suggested one other area that contributed to the problems of the Siochain I project: coordination. One of the requirements for receiving the equity funds from Citizen's was tenant lease up.²⁷ According to Ms. Herrington, NOAH's property management was inefficient in finding the necessary tenants for the building. This contributed to delays in project completion, further exacerbating the construction loan interest issue within the project.

Conclusion

The Siochain project raised a variety of concerns regarding NOAH's development practices. While these factors were specifically discussed with respect to the Siochain project, they could be generalized and used to develop best practices for the CDC sector. Restated, the issues include:

1. Acquisition

- How can CDC's acquire properties while not over-committing to a project prior to financing?
- How can tenant relocation be budgeted and managed in an efficient manner?
- How should acquisition cost be determined?

2. Financing

²⁶ Interview, David Fernandes, 4/29/2002.

²⁷ "Amended and Restated Certificate of Limited Partnership of Siochain Properties Limited Partnership", March 1, 2001.

- What are the options for financing affordable rental housing?
- Can low income housing tax credits be used on smaller scale projects?
- Can legal fees be decreased through an innovative structure?
- How can an effective partnership be created for tax credit financing?

3. Budgeting

- What is the proper way to create development budgets for rental housing projects?

4. Development Team

- How should the various departments within a CDC participate in developing and carrying out a project?

5. Construction

- How can construction costs be controlled?
- How should construction budgets be created?

The fourth chapter will explore these issue areas in a literature review of ideal practice while the fifth chapter outlines the best practices of three Boston-area CDCs. In the sixth chapter, a set of specific recommendations are made for NOAH in adopting a more effective development approach. In addition, these recommendations are applied to the Siochain project, in an attempt to gauge their impact.

Part II: Development Ideals and Practice

CHAPTER 4

IDEAL PRACTICES

The objective of Part II of this thesis is to outline ideal development techniques for the creation of affordable housing, as well as explore alternative practices for housing development in the Boston region. Through literature review, Chapter Four identifies general development practices, or “ideal practices”, for the creation of affordable housing. Specifically, these ideal practices are drawn from current research and practical guides, including:

- CDC-specific development practices;
- Low Income Housing Tax Credit use and management;
- Construction cost control; and
- Legal options for site control.

Chapter Five focuses specifically on the Boston CDC arena, profiling the development practices of three local CDCs. Through this discussion of both ideal methods and refined practice, various options for affordable housing development will be identified that could be applied by both NOAH and other CDCs considering new projects.

Introduction

The development of real estate, in general, and affordable housing specifically, involves the process of applying standard techniques and practices to unique properties. There is no “standard” development. Each existing building or vacant lot holds a singular set of circumstance that must be effectively managed to guarantee a successful project.

However, to these site-specific factors are applied a set of development practices that serve as the framework for the development process. These practices range from arranging pre-development financing to obtaining certificates of occupancy. Each plays an important role in completing affordable housing projects on schedule and on budget.

In applying these standard practices, CDCs must also be aware of the specific conditions of their target communities. For example, in acquiring property, it may not be possible to negotiate the usual purchaser protections into the purchase and sale agreement because of competition for the selected parcel. However, where practical, these development techniques should be utilized to both protect the developer and ensure the quality of the end product. Therefore, it is important to outline the standard development practices so that CDCs can then tailor them to the specific requirements of their community and project.

Practice Identification

Just as real estate development projects take a variety of forms, there is also a broad array of standard development practices. Some are general in their application while others are tailored to a specific set of conditions, such as environmental contamination. However, for the purposes of this discussion, development practices will be drawn from the issue areas raised in the discussion of the Siochain project in the previous chapter. There are two reasons for this approach. First, by outlining ideal practices that correspond to the issue on the Siochain project, it will facilitate a comparison between the Siochain development approach and more general development principles, ultimately leading to the adoption of improved practices for NOAH. Second, drawing the practices out of an existing CDC-led development project will facilitate the application of lessons learned to other CDCs in the Boston area.

In the previous chapter, the issue areas listed below were identified as contributing to the problems associated with NOAH's Siochain project.

- Project Feasibility
- Acquisition and Site Control
- Financing
- Budget and Construction
- Development Team

Ideal practices for each of these issue areas are outlined below.

Project Feasibility

Determination of project feasibility is the first step in any real estate development project. Project costs are balanced against future rental income, sales proceeds, or other income sources to determine if a project can be carried out successfully. As project feasibility represents a cost that may not be recouped if a project is determined to be infeasible, there is a temptation to carry out a cursory project feasibility analysis. This attraction is particularly high for nonprofit developers such as CDCs that operate on small development budgets. According to Bennett Hecht, former Vice President at The Enterprise Foundation, “given the high level of risk inherent in the feasibility process, many nonprofits are not prepared to invest that much money in a building evaluation at the stage when there is little certainty that the project will go forward.”¹ However, as the Siochain project demonstrates, superficial project analysis can lead to subsequent problems in acquisition, financing, and construction.

In carrying out the feasibility study, the development project manager needs to consider both the costs of the project (the “uses” of funds) and the income (the “sources”). Total development costs (TDCs) include hard costs, including the purchase price and construction expenses, and soft costs which include all other development costs, such as financing charges and architecture fees.

Acquisition Price

Determination of the acquisition price is possibly the most important step in the feasibility evaluation. Construction costs and soft costs can be negotiated during the project. But purchase price is fixed from the outset. Consequently, nonprofit developers should strongly consider using appraisals, or at least input from brokers, when determining purchase price. With affordable housing programs that have established financing costs and fee structures, it is attractive to derive the purchase price as a residual of other costs. However, “backing into” the purchase price does not give an accurate

¹ Hecht, Bennett L., Developing Affordable Housing: A Practical Guide for Nonprofit Organizations; Second Edition, 1999, pg. 40.

value of the land, but rather the acquisition price the project can afford. It may not take into account parcel specific issues, such as environmental contamination that, if not uncovered through appraisal or other due diligence, will not be reflected in the residual purchase price.

Construction Cost

In order to gain a solid estimation of construction costs, CDC project managers should attain a professional opinion. Ideally, this would include an architect, engineer, contractor, and various sub-contractors for their specific services. However, for budget-conscious nonprofit developers, collecting bids from the various development professionals involved in an affordable housing project may be prohibitively expensive. Consequently, they may be able to use an estimation provided by an experienced general contractor or construction manager, who may provide their service at little or no cost, other than consideration for carrying out the work. While it is tempting to use local construction per square foot costs for construction cost estimation, as each site is unique, these costs may be only marginally relevant to the work envisioned.

Soft Costs

While soft costs are the least expensive component of the TDC, they still represent a considerable expense to the project. In addition, as with purchase price, the temptation exists simply to derive soft costs as the project budget allows. However, this can lead to underestimation of costs. As a result, project managers should attempt to determine soft costs through conversations with architects, lawyers, appraisers, and other individuals involved in the soft cost side of the TDC. Soft costs are often estimated based on a percentage of hard costs; 5% for architecture, for example. However, it is also helpful to attain specific line-item figures in an effort to create a soft cost budget that will not vacillate with increasing construction costs.

Financing

Finally, an estimation of the financing is important in determining the final project feasibility. Only if financing, in combination with operating income or sales proceeds,

covers the TDC will the project indeed be feasible. Please refer to the finance section below for an in depth discussion of this subject.

For CDCs considering the rehabilitation of existing properties, it is important to note that the project feasibility process is site specific. General construction figures or financing packages will not necessarily be applicable to a specific row house or contaminated parcel. In addition, structural issues or environmental contamination may not have been fully evaluated because of lack of access to the site. Consequently, for the project feasibility process to be carried out completely, CDCs generally need some form of site control to provide both access to the property and the time to carry out an effective analysis.

Acquisition and Site Control

Property acquisition represents the first major risk associated with any real estate development project. The type of building or vacant parcel acquired will dictate the type of development that will ultimately be placed on the site. Even though the preliminary project budget is complete, and the target acquisition price is identified, there is no guarantee that the final cost will coincide with the budgeted figure or that unforeseen development costs will not occur. For CDCs considering an affordable housing project, property acquisition is particularly important as the type of project (housing) is pre-determined, and the affordable nature of the development limits financing arrangements. In general, CDCs will not be able to change the design program or increase rent or sales prices because the original project envisioned for the newly acquired property is more expensive or more complex. As a result, CDCs should enter the acquisition process with a clear vision of both the necessary steps and their objectives for site control and purchase price. Important considerations within the acquisition phase of the development include method of site control, purchase price, and tenant relocation.

Site Control

The form of site control used for the property is important as it provides significant protection to often cash-poor nonprofit developers. By the time a CDC is considering

site control and purchase, it has completed the feasibility phase of the project and has incurred the associated expenses. A thorough feasibility analysis could cost \$10,000 or more in both staff time and costs from contractors, architects, and others.² Consequently, in negotiating site control, CDCs want to make certain that provisions will provide recourse if the seller reneges on the purchase. In addition, certain site control vehicles may allow a CDC to back out of their commitment to purchase the property if site specific issues, such as structural concerns or environmental contamination make the proposed project untenable. Consequently, because of the need to protect their investment and provide flexibility for dealing with unknown site conditions, CDCs should use a site control strategy with the greatest level of flexibility possible.

Two general types of agreements are used for gaining site control: purchase and sale agreements and option agreements. Both are written documents that grant legal rights to both seller and buyer. The purchase and sale agreement states the purchase price, participants, and various deposits and other arrangements. Of particular importance to a CDC is access to the property. Otherwise, the purchaser will not be able to inspect the building for structural, environmental, or other issues. An option agreement is similar to a purchase and sale agreement, but grants the purchaser a set period of time to decide whether or not to purchase the property for an agreed price. For this option, the purchaser agrees to a deposit, or option price, that will be forfeited if the purchaser decides not to acquire the property. While this method of site control is more expensive, especially if the developer decides not to purchase the property, it also allows for an increased level of flexibility by giving the developer time to carry out an in depth analysis of the property.

In addition to the protection and responsibilities contained within each type of agreement, each may also be modified by specific contingencies. Contingencies may be included for such items as acceptable appraisal, lack of environmental contamination, or approval by a structural engineer. Failure to meet the contingencies would void the purchase or option agreement and allow the CDC or other nonprofit developer to renege on the agreement.

² Hecht, Bennett L., pg. 29.

In the case of the option, the developer would lose the deposit agreed to under the option agreement.

As with all concepts discussed in this chapter, it is important to note that these site control practices are development ideals. In competitive real estate markets, such as Boston's in the late 1990s, sellers are in a superior position to buyers and are often able to dictate their terms. Under such conditions, truly flexible site control may be difficult to arrange. However, it is important to understand the site control options and attempt to incorporate purchaser protection and flexibility where possible.

Tenant Relocation

One final acquisition related expense is tenant relocation. A project involving existing tenants may be subject to the Uniform Tenant Relocation Act if Federal or state funds are used. Under the act, the sponsor is responsible for relocation and rent expenses for displaced tenants. While this does represent an expense to the project, it is typically small, around 1%.³ However, as previously discussed in Chapter 3, relocation expenses for the Siochain project were substantially higher, closer to 3%. According to the Abt Associates study on nonprofit housing costs, one of the keys to controlling relocation expenses is phasing the project in such a way to allow the majority of tenants to remain in the building, albeit in different units.⁴ Not only does this cut back on direct relocation expense but also decreases the amount of time needed to place tenants in the building at the completion of the project, saving construction loan interest payments and increasing cash flow.

Financing

Financing Rental Housing

The selection of a financing scheme for an affordable housing project is one of the most important steps in the development process. Financing serves the direct purpose of covering deficits in the project budget not covered by developer equity or unit sales

³ "Nonprofit Housing: Costs and Funding, Final Report", Abt Associates, Inc., November 1993, pg. 5-4-5-5.

prices. However, as the Siochain project demonstrated, the impact of a financing approach can extend beyond providing capital to an affordable housing development. If used incorrectly or poorly managed, a financing scheme that originally allowed a project to be feasible can actually lead to the financial ruin of an affordable housing development by increasing financing charges and delaying completion.

There exist a broad variety of financing options for general real estate development projects. Banks, financial intermediaries, real estate investment trusts, and private investors are all willing to provide capital to development projects that promise solid future cash flow and high returns on debt and equity. However, affordable housing projects are not the typical real estate development project. As discussed in Chapter Two, affordable housing projects generally have a funding gap that needs to be filled with some form of subsidy. However, with the current political climate within the affordable housing field favoring homeownership, many of these subsidy sources are not available for affordable rental projects.

The options available for affordable rental housing are few. The financing options are slimmer still when the target population for a project includes tenants at or below 60% of median household income. With a lower income, the rent that tenants will be able to pay will also be less, creating a smaller cash flow from the project and resulting in a diminished ability to financing the project. In fact, with the exception of project based Section 8 certificates, both Lizbeth Heyer, senior project manager at Jamaica Plain Neighborhood Development Corporation and Lisa Davis, Director of Development at Codman Square Neighborhood Development Corporation commented that Low Income Housing Tax Credits are the primary way of creating affordable rental housing for deeply discounted rents.⁵

⁴ Hecht, pg. 5-5.

⁵ Interviews, Lizbeth Heyer, JPND, 6/5/2002, and 6/7/2002

Tax Credits and Technical Assistance

The Low Income Housing Tax Credit is “now the largest production and incentive program funded by the federal government for new construction and rehabilitation of low income housing.”⁶ However, it is also an expensive and highly technical program that can be difficult to use effectively. According to Bennet Hecht, Vice President of the Enterprise Foundation, “Nonprofit developers should be aware that this program is extremely complicated and rife with land mines for those uninitiated in this type of financing.”⁷ NOAH ran into many of these costly pitfalls as they tried to navigate the arcane regulations of the Low Income Housing Tax Credit Program. The solution, suggested both in literature review and interview with Boston area practitioners, is to use experienced consultants, attorneys, and financial intermediaries.

Drawing on the experience and expertise of development professionals is an integral step in increasing the capacity of CDCs to carry out affordable housing development. This is particularly true in the case of effectively using the Low Income Housing tax Credit. The impact of a development mentor can be dramatic. According to a 1993 Abt Associates Study:

A result of the availability of this expertise was that even the most novice nonprofit developer could pursue a highly sophisticated, state-of-the-art financing approach to its project. For example, the involvement of The Community Builders as development consultant for the Langham Court Cooperative [in Boston] allowed its nonprofit sponsor, Four Corners Development Corporation, to undertake as its ‘first’ effort this 84-unit project with \$4.275 million in Tax Credit syndication proceeds from private investors, along with city and state subsidies, plus involving more than \$17 million in out-of-pocket costs.⁸

⁶ Stevens, H., and T. Tracy, *A Developer’s Guide to the Low Income Housing Tax Credit*, 3rd Edition, National Council of State Housing Agencies, Washington, D.C., 1994, pg. xvii.

⁷ Hecht, B., pg. 221.

⁸ “Nonprofit Housing: Costs and Funding, Final Report”, Abt Associates, Inc., November 1993, pg. 3-30.

All three of the Boston-area CDCs profiled in the next chapter use development consultants on difficult projects. However, while the involvement of the mentor is an integral component of project success, it is also important that there is a transfer of knowledge from the mentor organization to the novice CDC. Otherwise, the CDC is resigned to continual reliance on development consultants or set up for potential problems on future Low Income Housing Tax Credit projects that they try to manage themselves.

The Tax Credit Investor

Another important issue in using Low Income Housing Tax Credits is the development of an effective partnership with the equity investor. In selecting a tax credit investor it is necessary to consider both the price offered for each dollar of tax credit as well as the expertise of the investor. In the Siochain project, NOAH focused only on price, and in fact, may have incorrectly evaluated this as well.

CDCs and other tax credit developers have three ways to market their tax credits: public offerings, private placements, and sole corporate investors. Each of these offers a different discounted price per tax credit dollar, cost of syndication, and ultimate dollar value to the project, as summarized in Exhibit 4-1.⁹

While the public offering generates the highest equity price per dollar of tax credit, it also has the highest syndication costs. The converse is true with the sole

Exhibit 4-1 Tax Credit Values			
	Price Per Tax Credit Dollar	Syndication Expenses	Effective Value Of Tax Credit \$
Public Offering	\$0.606	27.4%	\$0.44
Private Placement < 35 Investors	\$0.5405	18.6%	\$0.44
Sole Corporate Investor	\$0.4878	9.8%	\$0.44

corporate investor, which offers the lowest price per tax credit dollar but also the lowest

⁹ Stevens, H., and T. Tracy, pg. 6.

tax credit expenses. NOAH's assumption that using Citizen's Bank as a sole corporate investor would decrease syndication expenses was correct. However, what they did not consider is that they also received a lower value for each tax credit dollar. What the above analysis demonstrates is that the tradeoff between price per dollar of tax credit and syndication costs may result in similar project equity regardless of type of investor. To budget for higher tax credit returns based on lower syndication costs is risky, if not simply incorrect.

Beyond the price and costs associated with the tax credit investor selected, it is also important to consider the experience of the equity investor. According to the Abt study, tax credit syndicators can offer valuable expertise to CDC developers, especially those not experienced in the use of tax credits.¹⁰ Joe Bamberg, former NOAH project manager, echoed the importance of the tax credit investor, stating that experienced investors become active participants in the project and provide an inexpensive source of funds by investing their equity at the beginning of project construction.¹¹ NOAH's selection of Citizen's Bank did not meet this objective because of both their lack of experience and unwillingness to provide the tax credit funds early in the project.

A final point on the use of Low Income Housing Tax Credits is project size. Even with development consultants and experienced tax credit syndicators involved in the project to avoid unexpected costs, Low Income Housing Tax Credit projects are expensive. Legal fees and carrying costs are proportionately higher than for other projects because of the complexity and time needed to complete tax credit projects. As a result, there is a common belief that tax credit projects need to be of a minimum size in order to take advantage of economies of scale. While there is no established minimum number of units, Paula Herrington, former director of development for NOAH now believes that tax credit projects should be at least 35 units.¹² Other CDC development professionals cited a number around 40-45 units.¹³

¹⁰ Stevens, H., and T. Tracy, pg. 3-29.

¹¹ Interview, Joe Bamberg, 5/14/2002.

¹² Interview, Paula Herrington, 5/9/2002.

¹³ Interviews, Lizbeth Heyer, JPNDC, 6/5/2002, and Lisa Davis, Codman Square NDC, 6/7/2002.

Budget and Construction

Effective control of development costs is among the most important steps in creating a successful project. As previously discussed, housing development serves two purposes for CDCs: fulfilling the organizational mission of the organization by improving the lives of residents in the target community; and realizing development fees from real estate activities to financially support all activities of CDCs. Consequently, under budgeting and failure to control development costs have the potential to seriously damage the effectiveness and future of CDCs.

One of the primary methods to control development costs is through effective project budgeting. While budgets for hard costs can be controlled, in part, through the type of contract used, correctly budgeting soft costs draws heavily on experience. Development consultants, public entities, and local associations may be able to provide regional estimates of soft cost items such as architecture and legal fees to inexperienced nonprofit developers. Over time, these consultants can be phased out as development staff becomes attuned to the local development market.

A second key cost control is the effective use of construction contracts. The selection and management of the construction contract can help control costs by increasing construction cost transparency, providing incentives to the contractor, and creating cost caps. The two primary types of construction contracts available for affordable housing projects are fixed price and cost-plus-fee or negotiated bid contracts.¹⁴

Fixed price contracts are the most common and also the most widely accepted by public funders, such as the City of Boston. Under the fixed price contract, several contractors bid on design and specification documents provided by the sponsor. Certain funders will require a specific number of bids to ensure both a fair and lowest price. The sponsor then selects the contractor based on the bids submitted. The fixed price contract places a large

¹⁴ Collier, K., Managing Construction: The Contractual Viewpoint, Delmar Publishers, Inc., 1994, pg. 88.

portion of the development responsibility on the contractor to deliver on his bid price. However, if incomplete design documents are used, or the scope of the project changes, change orders will be required, shifting some of the financial responsibility back on the developer. For projects where design is not complete or there are unknown factors that could influence the scope of the project, such as the structural issues on the Siochain project, the fixed-price contract may not provide enough flexibility to control costs.¹⁵

Under a cost-plus-fee or negotiated contract, the sponsor agrees to cover all construction costs and pay the general contractor a set fee for profit and overhead. The advantage of this approach is that the payment structure and contract can be established early in the development process, prior to the completion of drawings and specifications. It is also useful for projects where all site conditions are not known prior to construction, such as in a occupied building. A third advantage is that it allows for the process of value engineering, as the contractor is involved in the final development of design documents. Finally, the cost-plus-fee contract saves development time, as the early phases of construction can begin before completion of the design documents. Cost-plus-fee contracts are best used when there is a positive and close relationship between project sponsor and contractor, as the contract dictates a high level of openness and honesty regarding subcontractor costs. However, according to Bennett Hecht:

The advantages of this option must exceed the disadvantages because it is becoming increasingly popular among developers of large, phased, or complex projects. Bringing a project on line early generates revenues and reduces market risks and financing costs. Refining the plans and specifications for later phases of the project while early construction gets under way saves time ad money.¹⁶

One additional twist to the cost-plus-fee contract is the use of a guaranteed maximum price. Under this scheme, in addition to providing his fee structure during the bidding,

¹⁵ Collier, pg. 88.

¹⁶ Hecht, B., pg. 486.

the contractor also supplies a maximum price. The contractor is forced to cover any and all costs above the established maximum price. This provision transfers a portion of the cost risk that the developer accepted through the cost plus contract back on the contractor.

A final important contract tool that can help control costs is the use of incentives. Under both the fixed price and cost-plus-fee contracts, there is the potential to share budgeted hard cost contingencies. Construction contingencies are simply a pool of funds that are set aside to cover any unforeseen hard cost expenses that arise during construction. Prudent budgeting requires that they be included in the overall hard costs of the projects. Typically, they are derived as a percentage of hard costs. They range between five and ten percent and may be required by funders to ensure adequate capital reserves to ensure completion.¹⁷ While contingencies are established to cover unforeseen expenses, there are cases where not all the set aside amount is used. The fact that contingencies may not be used during a project may cause some developers to conclude that a construction contingency should be reduced or eliminated altogether. However, this not only risks cost overruns if there are construction problems but also reduces the potential for cost controlling incentive to the contractor. By establishing in the contract that the extra contingency will be shared between sponsor and contractor, there is an alignment of interests between the two parties to complete the project under budget.

Development Team

Best practices in the creation and use of the CDC development team became a focus of the interviews with Boston-area CDCs and, as a result, are discussed exclusively in the case study section below.

¹⁷ Hecht, pg. 44.

Conclusion

This chapter outlined a number of the ideal practices used by nonprofit developers throughout the country. While no developer adheres to all of these methods, they provide a solid foundation for evaluating an organization's development approach. The next chapter explores the development practices of three Boston-area CDCs. This discussion provides insight into how local nonprofit developers are modifying development practices to fit the specific demands of their service areas.

CHAPTER 5

CASE STUDIES

It is important to explore ideal development practices as they are discussed in development theory. This can lead to both improved practices within a CDC as well as opportunities for improving upon current methods to create new paradigms. However, it is equally important to understand how affordable housing development is carried out within the unique environment of the Boston region. In this environment, it is possible that the ideal development practices previously discussed may not be applicable. Therefore, it is the development practices of other CDCs, operating under many of the same constraints as NOAH, that will be most useful to improving development methods at the NOAH.

Case Study Selection

In selecting other Boston-area CDCs for case studies, it is important to identify organizations that are similar to NOAH in size and scope. However, it is equally important to explore the development practices of large, skilled CDCs in an effort to glean insight from their experience. Towards this end, the case study portion of this chapter profiles three CDCs. Two are large, well established CDCs with over 20 years of affordable housing development experience, while one is smaller and on a similar scale as NOAH. Each case study provides background information on the CDC, and then discusses insights from each CDC's development approach in four areas: acquisition, financing, budgeting and construction, and the development team.

Jamaica Plain Neighborhood Development Corporation

Established in 1977, the Jamaica Plain Neighborhood Development Corporation (JPNDC) strives to carry out community development projects that benefit low-income neighborhood residents. Since its founding, JPNDC has created over 600 jobs and over 300 units of affordable housing. Programs include affordable housing development, community organizing, job creation, and small business development.¹ Lizbeth Heyer,

¹ JPNDC Web Site, www.jpndc.org, 6/5/2002.

Senior Project Manager, provided information on JPNDC's affordable housing development practices.²

Acquisition

Acquisition Strategy

JPNDC uses two different approaches for acquiring properties. The first is the general purchase and sale agreement. While Ms. Heyer stated that riders and contingencies should be added to the purchase and sale agreement to protect the buyer where possible, she added that a key component to effectively using the P & S is active community participation. If community residents are involved and support a proposed project, they are an effective way of pressuring the seller to work with the CDC. This is also true when acquiring an occupied property, such as in the Siochain project. Tenants, empowered by the CDC community organizing department, can not only persuade the owner to negotiate with the CDC but can also serve as an effective method of providing more time for negotiation, as they lobby the seller on behalf of the CDC. This additional time can be useful for the CDC to arrange financing or other components of the development process.

The second approach to acquisition is the "financing" approach, using financing schemes, such as the Community Economic Development Assistance Corporation (CEDAC) acquisition loan program. Under this and similar programs, CEDAC provides quick acquisition funds for the purchase of vacant property. The loan is secured by the resale value of the land and provides a rare opportunity to use loan funds for land purchase, as traditional banks are usually unwilling to lend against land value alone. The CEDAC loan is good for two years and allows the CDC time to put together a financing strategy for affordable housing development.

Acquisition Price

JPNDC frequently derives acquisition price as a residual after all other project costs are budgeted. Ms. Heyer noted that it is important to realize that CDCs rarely, if ever, realize

² Interview, Lizbeth Heyer, Senior Project Manager, JPNDC, 6/5/2002.

their full fee, and the loss often comes through acquisition. She also again pointed out that the community can be of great assistance when negotiating acquisition price. An active and well organized community can become a liability to a seller and can pressure the seller into “moral” site control, lowering the selling price.

Tenant Relocation

Tenant relocation cost are of a concern and whenever possible JPNDC tries to avoid acquiring occupied properties that require substantial rehabilitation. When taking on a project that involves tenant relocation, JPNDC uses two strategies. The first is to explore “creative contracting” solutions with various contractors. When interviewing contractors for the job, JPNDC requests options for maintaining residents in the building during construction. JPNDC recently selected a contractor for one project specifically because they were the only one whose bid did not include the relocation of the existing tenants. The second strategy is using a relocation specialist. While the specialist is an expense to the project, their experience in negotiating rents with landlords, arranging for relocation, and handling utility allowances may be the difference in keeping relocation costs on or under budget.

Financing

Rental Financing Options

On the issue of financing affordable rental housing, JPNDC does not have a lot of options, in part because of the current emphasis on home ownership. The City of Boston does have a pool of project-based Section 8 certificates that could be used for a rental development, the majority of Section 8 certificates are “mobile”, which cannot be used for financing. Otherwise, the primary option was Low Income Housing Tax Credits. While JPNDC has only used the 9% tax credit, there are 4% credits, which could be used to finance a project. While the 4% credits hold the advantage of having a rolling application process, there is concern regarding whether they could provide the level of equity needed to make an affordable rental project feasible. Regardless of whether 4% or 9% tax credits were used, it is imperative to have the tax credit equity invested early in the project because there are no carrying costs associated with the tax credit funds.

Legal Fees

JPNDC uses two strategies to handle legal fees. The first is that if additional lenders are involved in a tax credit project, their legal fees can be reduced if they would agree to do a participating loan to the project. Under the participating loan, each lender would provide their funds under the same lending agreement. This would mean that only one lawyer would be needed for the additional lenders, rather than a separate lawyer for each lender. Second, JPNDC uses the legal services of the Hale and Dorr Legal Service Center. The Legal Service Center, where Harvard law students gain experience during law school, offers their services to organizations such as JPNDC at a discounted rate. JPNDC is using the Legal Service Center on a current tax credit project, and while the legal insight is not as rapid as it would be for a top flight law firm, it is also substantially less expensive. Ms. Heyer added that because the law firm of Hale and Dorr provides the Legal Service Center, JPNDC can access practicing lawyers if needed.

Budgeting and Construction

Controlling construction costs is always an issue and JPNDC effectively used a negotiated construction contract to curtail cost overruns. Under a negotiated contract, the project is put out to bid very early in the design phase, with only preliminary drawings complete. Bids are evaluated based on the general price, as well as on the fee structure the contractor requests. Once a contractor is selected, he becomes an active participant in the design process. This allows for the contractor to suggest cost saving design and rehabilitation decisions during the final phase of the design process. It also gives the contractor an increased sense of ownership, which provides an incentive for the contractor to provide top quality work and keep the project to its budget. The final price is negotiated based on the fee structure established in the original bid at the completion of design process. The negotiation includes evaluation by both the CDC and the contractor of sub-contractor prices to arrive at a final, agreed upon construction cost. This negotiated contract approach allowed JPNDC to save half of its hard cost contingency on a 60 unit project.

CDC Development Team

In alignment with JPNDC's strong belief in community participation, the community organizing staff plays an integral role in the development process. In fact, many of the real estate staff at JPNDC are former community organizers. The majority of JPNDC's development projects have their inception with the residents of the community or individuals living near a potential project site. As a result, all proposed developments have project advisory committees. These are made up primarily of community members and also include both a JPNDC project manager and community organizer. The project manager and community organizer meet at least every other week to discuss community issues related to the project. To the greatest extent possible, JPNDC tries to grant the community members as much control over the project as possible but makes the advisory committee aware of the possible limits to its control for legal reasons. This method is effective because JPNDC turns to the community early in the project, typically before project design. This allows the community to gain a stake in the process and also gives JPNDC the support of the community for the purposes of site acquisition and city approvals.

Urban Edge

Established in 1974, Urban Edge is the oldest and largest of the three community development corporations profiled. With a large service area, Urban Edge's development focus overlaps with that of JPNDC, as well as several CDCs working in the Roxbury neighborhood. Over its 28 year history, Urban Edge developed or preserved nearly 900 units of housing and currently manages over 1200 units. Urban Edge's real estate development department not only creates affordable housing but also provides assistance for home purchases and renovations and produces commercial properties. Urban Edge addresses community organizing and youth programming needs in addition to its property management and development activities.³

³ Urban Edge Web Site, www.urbanedge.org, 6/7/2002.

Acquisition

Acquisition Strategy

According to Mossik Hacobian, Executive Director of Urban Edge, it is very difficult for CDCs to acquire properties without over committing to a specific project.⁴ Prior to the rapid increase in Boston property values in the late 1990s it was possible for Urban Edge to reach purchase and sale agreements with extended option periods. However, today, few sellers are willing to wait for a CDC to complete feasibility or arrange financing. Mr. Hacobian stated that the key to acquisition is “convincing the seller that you are the best option.” Once a strong relationship is established between buyer and seller, Urban Edge then uses its relationship not only create a framework for establishing a final price but also to provide opportunities for access to the site or additional time to arrange financing.

Acquisition Price

In budgeting for acquisition, Mr. Hacobian noted that it is important to include interest payments for holding the property in the line item for acquisition. For example, Urban Edge purchased a property that was appraised for \$1.3 million for \$1.1 million and was able to arrange financing for an additional \$200,000. These additional funds were used to cover the interest payments on the project for the two year holding period. Additionally, construction loan interest payments were budgeted under the soft costs line item. As a result, acquisition costs for the project were budgeted at \$1.3 million

Financing

Rental Financing Options

Financing rental housing remains a challenge and there are few options other than Low Income Housing Tax Credits. While Mr. Hacobian could recall one twelve unit tax credit project other than Siochain, he stated that such a small project is untenable because of the various transaction costs associated with tax credits. The smallest Tax Credit project completed by Urban Edge is 35 units. However, the credits were used for refinancing rather than development. In developing an equity partnership for the purchase of the tax

⁴ Interview, Mossik Hacobian, Executive Direction, Urban Edge, 6/7/2002.

credits, Urban Edge has used private placements. However, this is not Urban Edge's usual approach to marketing tax credits and Mr. Hacobian stated that such an approach typically requires confidence on the part of the investor and experience on the part of the CDC. Otherwise, Urban Edge has used a syndicator for the majority of their projects.

Budgeting and Construction

Urban Edge relies heavily on its 28 years of experience when carrying out project feasibility analysis and budget. Years of experience, combined with the over 1200 units of affordable housing under management, provide the development staff with a wealth of information when proposing and analyzing new affordable housing projects.

For Urban Edge, the key to controlling construction costs is effective project management. More important than contracts or contingencies, Mr. Hacobian feels that carrying out projects quickly and efficiently is the most guaranteed method for keeping projects on budget and on schedule. With regard to contracting, Urban Edge is experienced in the use of the cost-plus-fee form of contracting. This is similar to the method used by JPNDC in which project costs are clearly identified prior to negotiating the project fee for the contractor. While Urban Edge has also used guaranteed maximum price contracts, project managers at Urban Edge feel that they are best used with contractors that are experienced and trusted by the CDC.

Development Team

The Urban Edge development strategy is tied to three important relationships in the development of affordable housing: the development relationship, the property management relationship, and the organizing relationship. Although each is a separate department within the organization, each has a role to play in the development process. The development role is the most straight forward and has already been discussed. Property management holds an important stake in the development process, particularly for rental housing, because of their role in managing the project when it is complete. Urban Edge involves property managers early in the design and specification of a project. Property managers and maintenance staff are familiar with the systems used in a specific

project they can efficiently deal with problems that arise during the management phase of the project. If maintenance staff or property managers are unable to routinely fix problems within an Urban Edge-owned rental project, the problem represents a direct cost to the organization in the form of decreased cash flow, because of higher maintenance fees..

As with JPNDC, community organizing plays an important role in the development of affordable housing for Urban Edge. Mr. Hacobian stated that “development is the best vocabulary for community organizing.” It provides a focal point for community outreach and a strong source of support for the CDC. Urban Edge presents potential projects to community members once properties have been acquired and invites neighbors and residents to participate in project development. However, Urban Edge does not draw as heavily on community organizing as JPNDC does for generating real estate development projects. The key for Urban Edge is to make certain that community organizing is sustainable and not dependent on the success of affordable housing development for its purpose and resources.

Codman Square Neighborhood Development Corporation

The Codman Square Neighborhood Development Corporation (Codman Square) serves the Dorchester neighborhood in southeast Boston. Founded in 1981, Codman Square seeks to stabilize the neighborhood while improving the lives of the residents of its service area. It carries out comprehensive initiatives including community planning, housing and commercial real estate development, and economic development.⁵ Lisa Davis, Director of Development, provided information on Codman Square affordable housing development practices.⁶

⁵ Pioneer Institute, Center for Urban Entrepreneurship, http://www.pioneerinstitute.org/pdf/dir_csndc.pdf, 6/12/2002.

⁶ Interview, Lisa Davis, Director of Development, Codman Square Neighborhood Development Corporation, 6/7/2002.

Acquisition

Acquisition Strategy

Codman Square NDC uses two principles in its acquisition strategy. The first is that Codman Square will only acquire one large scale project at a time. While Codman Square NDC is similar to both Urban Edge and JPNDC in that it has access to both vacant land and existing properties that can be developed as large, rental projects, there are two reasons for the single project acquisition strategy. First, Codman Square's development pipeline is smaller than the other two CDCs profiled. This smaller pipeline results in fewer dollars in the overall development department budget for new projects, limiting the amount of capital available for large scale acquisitions. Second, Codman Square is experiencing rising pre-development costs, with decreasing access to pre-development funds. As a result, there is typically only enough pre-development money available for a single large project.

The second acquisition strategy used at Codman Square focuses on the relationship between project financing and acquisition. Codman Square will not take possession of a property until they have financing firmly in place. With public financing rounds taking 18 months or more, it can be difficult to get sellers to commit. One result is that Codman Square ends up with what Ms. Davis qualified as the "worst" properties. However, even with the obstacles presented by the long financing timeframe, Codman Square tends to use basic purchase and sale agreements to acquire properties. It will often take a "special" seller or site to use the purchase and sale agreement for Codman Square to gain site control. In addition, Codman Square is able to use extended agreements because they are willing to funnel more money to the seller over time. Codman Square includes these option payments in the acquisition budget and also noted that as these payments add up over time, the CDC becomes increasingly committed to the project.

Tenant Relocation

Similar to JPNDC and Urban Edge, Codman Square hires relocation consultants. While Codman Square staff could carry out the tenant relocation activities, the relocation

consultants understand the regulations and have the contacts and experience necessary to carry out the tasks at the lowest cost.

Financing

Rental Financing Options

For Codman Square, Low Income Housing Tax Credits are really the only option for financing rental housing. In addition, Ms. Davis believes between 40 and 50 units is the ideal size for a tax credit project, with projects smaller than 40 units unable to cover the various project expenses. Codman Square typically uses syndicators for their tax credit projects. In addition, Codman Square always uses tax credit funds first, as they are substantially cheaper than a typical construction loan and also keep the syndicator involved in the project and interested in completing the project on time.

Legal Fees

With regards to the legal fees associated with tax credit financing, Ms. Davis echoed Liz Heyer's comments at JPNDC by stating that Codman Square is able to receive a large portion of their legal fees at reduced rates or for free.

Budget and Construction

Properly budgeting project costs and then controlling construction to meet these budgeted figures is difficult. Codman Square will often use development consultants or information available from organizations such as the Massachusetts Association of CDCs (MACDC) to obtain general project costs. However, the City and State are increasingly shifting the costs to CDCs through development cost caps. While CDCs will create initial numbers that meet the cost limits set by the public entities, during the project, the under budgeting becomes apparent. CDCs are then forced to go back to the city and state later to ask for additional funds. Ms. Davis stated that not only is this inefficient, but it also threatens the credibility of the CDCs when they go to present future project plans and budgets.

Development Team

In general, Codman Square follows a development team model similar to that of Urban Edge. On the majority of projects, Codman Square generates the general framework for a project, explores financing and creates budgets, and then turns to local residents for input. While there is an effort to have the community involved in the development projects, local residents don't generate projects the same way as they do at JPNDC through community organizing. There may be an exception to this general rule in the future. Codman Square is currently beginning a neighborhood planning process for the Norfolk Triangle area of Dorchester. The objective is to develop resident leadership. One outcome of this planning process could be the identification by neighborhood residents of parcels and properties they would like to target for development. These would then be projects that Codman Square would consider for development. In this way, community organizing would, in fact, be directly contributing to development activities.

Beyond the role of Codman Square's community organizers, property managers are also intimately involved in the real estate development process. This occurs in three primary ways. First, property managers are involved very early in planning and arranging for tenant selection for projects slated for completion. This decreases the closing period for the project and decreases financing expenses. Second, property managers are involved in the design process from the beginning, to address any design issues that could impact the management or operating expense of the building. Finally, past property management teams debrief with development staff to garner information on the functionality of buildings to improve future projects. In addition, the heads of both property management and community organizing serve on Codman Square's Development Committee, ensuring participation by all departments within the organization.

Conclusion

In an effort to distill the lessons learned from the CDC case studies, the best practices offered by the staff of JPNDC, Urban Edge, and Codman Square Neighborhood

Development Corporation are summarized on the following page, as well as their potential impact on the Siochain project.

These case studies profile the development practices of three successful and effective Boston-area CDCs. While informative, they must be coupled with specific recommendations if they are to be useful to NOAH and other CDCs striving to improve their affordable housing development skills. These recommendations are the focus of Chapter VI.

**Exhibit 5-1
Summary of Best Practices and Impact on Siochain Project**

Development Area	Development Practice	Summary	Potential Impact on Siochain Project
Acquisition (Site Control)	Purchase and Sale	Strategic use of purchase and sale agreement in connection with community organizing.	Provide contingencies for structural assessment and arrangement of financing, providing accurate assessment of construction and financing costs.
	Acquisition Financing	Use low-interest acquisition financing to hold properties until development can occur.	Allow for longer predevelopment period, leading to more thorough analysis of property structural issues and financing costs.
	Community Organizing	Employ community and tenant support to pressure sellers into negotiating with a CDC.	No direct impact on Siochain project.
	Committed Financing	Extend the acquisition process through option payments until all project financing is assured.	Provide additional time for accurate assessment of project financial and construction requirements, improving cost control
Acquisition (Price)	Residual Value	Derive acquisition price as a residual, following a thorough analysis of project costs, cash flow, and site conditions.	Improve understanding of property conditions, allowing for decrease in acquisition price to reflect structural concerns
Acquisition (Relocation)	Consultant	Hire a relocation consultant.	Control direct relocation expenses and create development plan to decrease need for tenant relocation.
Financing (Rental Projects)	Minimum Number of Units	Identify the minimum number of units needed to achieve economies of scale to cover syndication and legal costs	Create accurate financial assessment of project, allowing for educated decision regarding feasibility of 12 unit tax credit project.
Financing (Legal Fees)	Syndication	Evaluate equity investor both for price offered per tax credit dollar and experience in tax credit investment	Accurately evaluate Citizen's experience, leading to selection of different tax credit investor. Shorten project duration, decreasing construction interest.
	Discounted Fees	Seek out discounted (or pro bono) legal fees from either established law firms or lawyers in training.	Decrease project legal fees, allowing NOAH to realize larger portion of the projected developer fee.
Budget and Construction	Contract Type	Explore various contract types, such as cost-plus-fee for a structure that aligns contractor and developer interests.	Create incentive between Siochain contractor and NOAH to decrease costs and development time, creating savings on construction loan interest.
CDC Development Team	Broad Skill Set	Take advantage of the broad skill set of a CDC to develop assist with acquisition and create accurate project budgets.	Improve coordination with property management, shortening project rent-up and overall project time, decreasing construction loan interest.

Part III: The Future

CHAPTER 6

RECOMMENDATIONS

Analyzing past projects and CDC best practices is a purely academic exercise unless organizations are able to use the information to foment positive change leading to improved development practices. Towards this end, this chapter focuses on discrete changes managers at NOAH can make to improve their affordable housing development activities in East Boston. Following a discussion of NOAH's organizational capacity, recommendations for organizational change will be broken down into the four areas used in the previous chapter: acquisition, financing, budget and construction, and CDC development team. A final section will focus on additional recommendations to assist NOAH's future affordable housing practices.

Organizational Capacity

When considering operational changes for an organization, it is important to first analyze the status of the organization. Highly technical alterations to development practices will not be feasible if the staff lacks the capacity to incorporate them into day to day activities. Today, board members and staff of the Neighborhood of Affordable Housing can point to 15 years of successful community building in East Boston. However, as NOAH looks to the future, both internal and external factors will determine if the organization is able to adopt new practices and policies that will allow it to continue to operate as an effective affordable housing developer into the future.

As previously discussed, NOAH is organized into several program areas, including real estate development, community organizing, property management, and lending. Each of these departments will play an important role in determining the future effectiveness of NOAH in developing affordable housing.

Real Estate Development

Of these program areas, real estate development serves as the lead department for development activities. Over the years, the real estate department fluctuated in size, ranging from one to four employees. At its largest in the late 1990s when NOAH skillfully used the Boston One to Four Program to create homeownership units, the department employed a Director of Real Estate, along with two Project Managers and one or two Development Interns. As acquisition prices increased and development cost caps restricted development, the department began to downsize in 2000, first losing Project Managers and then the Director of Development. As the department contracted, NOAH increasingly relied on development consultants, further marginalizing real estate employees.¹ By the summer of 2002, the real estate department operated with only one part time staff member, with the Executive Director actively recruiting for a new Director of Development.

As NOAH looks to rebuild its real estate development department, the Executive Director and the board face both opportunities and constraints. With all current development projects due to close by the end of Summer 2002, the organization has a unique opportunity to redefine the role of the real estate development department. In addition, the new Director of Real Estate will be able to put new and effective development practices into place, strengthening NOAH's future affordable housing activities. However, future housing developments at NOAH also faces potential threats. The primary concern is that affordable housing development is carried out almost exclusively by the real estate development department. There is little input from the other departments, even though they act as the lenders, operators, and marketers of NOAH-developed properties. Additional areas of concern include continuing marginalization of staff due to the use of development consultants, difficulty in hiring experienced housing development staff, and integration of real estate development activities with those of other NOAH departments.

¹ Staff Interviews, Spring 2002.

Other NOAH Departments

Although the real estate development department plays the primary role in the development of affordable housing, the community organizing, lending, and property management departments are also potential partners. Staff in all three departments are strongly committed to their departmental mission. The lending department is skilled at securing favorable mortgages for low income, first time homebuyers and is the most active and interested participant in development activities among the three departments. While property management is the largest department within the organization, it is a reluctant participant in property development, a situation that should be rectified if NOAH hopes to continue in the development of rental housing. Finally, the community organizing department has no role in affordable housing development. Focused on organizing area residents around environmental issues such as harbor planning and school yard improvement, the organizing staff hold the potential to support NOAH's affordable housing activities through nurturing community support, organizing tenants, and identifying future projects through community outreach events.

With an understanding of NOAH's organizational strengths and weaknesses, it is possible to make specific recommendations for improving NOAH's affordable housing development practices.

Acquisition

As NOAH looks to expand its development pipeline, property acquisition is the first hurdle. The past acquisition strategy of quickly acquiring property to then develop under the One to Four Program is both increasingly unfeasible as the program is hampered by development cost caps, as well as highly risky as acquisition costs rise and the quality of available property falls. While the approach may work for inexpensive, undeveloped land, NOAH should also consider other acquisition strategies.

The majority of real estate acquisitions are carried out through a simple purchase and sale agreement. While almost all of NOAH's past purchases involved such an agreement, development staff could become more strategic in the use of the document. Presently,

NOAH simply negotiates a final price as quickly as possible. While this approach helps to ensure that NOAH gains site control over targeted properties, it also does not provide development staff with lead time to create a development scheme or secure the necessary financing. As a result, NOAH will often own a property before fully realizing how the property is to be developed. However, if NOAH incorporated options and deposits into the negotiations of the purchase and sale agreement, it could keep the seller motivated over a longer period of time, allowing for improved feasibility analysis. Under this approach, as the two parties carry out the negotiation process, the CDC provides additional financial incentive to the seller in the form of option payment and incentives. This provides assurances to the seller that the CDC is a motivated buyer while extending the purchase period. Both the JPNDC and Codman Square use this approach.

An additional tactic for property acquisition draws on the skills of the community organizing staff of a CDC to generate community support for affordable housing development projects. JPNDC uses this approach extensively and it allowed the organization to gain control of several large properties in their service area. Under this approach, grassroots organizing both within the community and among the tenants of specific targeted parcels places pressure on property owners to either improve their properties or sell them. This strategy also works well in conjunction with a community planning process. Through the process, community members identify properties they are interested in improving or redeveloping. The advantage of using the community planning process is that the community is already organized and positioned to take action.

NOAH is uniquely positioned to use this strategy in East Boston. The community organizing department is currently focused on organizing the Chelsea Creek Action Group (CCAG). CCAG focuses on the Chelsea Creek waterfront in both Chelsea and East Boston. Residents have participated in several charrettes to identify a vision for the area as well as specific problem parcels. If through the community organizing efforts, NOAH is able to foment community interest in the acquisition of parcels, it will not only be able to expand its development pipeline but have a strong hand in bargaining with the owner over favorable terms. This will provide NOAH with the time and support to both

negotiate a suitable price and identify a financing strategy, protecting the organization from the dangers of early acquisition experienced in the Siochain project.

Budgeting and Finance

The literature review and best practice interviews discussed in the previous chapter revealed the importance of experience in properly developing project budgets and carrying out complex financing schemes. For inexperienced organizations or CDCs considering a new development or financing approach, outside assistance can prove instrumental in ensuring the successful completion of the project. Although NOAH has been creating affordable housing for over 15 years in East Boston, it is a relatively inexperienced nonprofit developer. As NOAH became increasingly dependent on the One to Four Housing Program and staff left the organization, the depth of NOAH's development experience diminished. As a result, NOAH may be less experienced in housing development today than it was several years ago.

In its report to the Department of Housing and Urban Development, Abt Associates states "often the less skilled nonprofit could utilize its working relationship with [a] mentor to build its own expertise and capacity to undertake projects independently in the future."² A mentor could take the form of another, more experienced CDC or a development consultant. All three of the CDCs interviewed stated that one of the development best practices they follow is the use of development consultants for determining the costs of specific budget line items, such as relocation expenses or per square foot construction costs.

In reality, NOAH is beginning to both build development partnerships and incorporate consultants into development projects to assist in the developing and financing of more complex projects. However, while the involvement of development consultants in a project may be invaluable, it is important that their use be managed strategically. A concerted effort must be made to transfer knowledge to the permanent development staff. Otherwise, the organizational development capacity does not grow and the dependence

² Nonprofit Housing: Costs and Funding, Volume I, Abt Associates, Washington, D.C., 1993, pg. 3-29.

on expensive consultants increases. In addition, the use of development consultants can marginalize existing development staff, as the need for a consultant implies a lack of skill on the part of the staff. Both of these issues can be rectified by including real estate development staff in the process of selecting and meeting with development consultants. This will not only assist in the transfer of knowledge from consultant to employee but will also keep staff members involved in all facets of development.

Construction

As NOAH turns to various methods for controlling development costs, the use of contracting tools holds great potential because of the organization's strong relationship with Boston Metropolitan Construction. Contract tools such as the cost-plus-fee format require a high degree of trust between contractor and developer. According to Noah Maslan, project manager for Urban Edge, cost plus and guaranteed maximum price contracts work best when there is both a positive relationship and a history of success between the sponsor and general contractor.³ Boston Metropolitan and NOAH have teamed up to carry out nearly a dozen affordable housing projects in East Boston. Giorgio DiCostanzo, project manager for Boston Metropolitan, is committed to working with NOAH and believes in the organization's commitment to affordable housing. NOAH has already attempted to use their positive relationship with Boston Metropolitan Construction to control costs by using a guaranteed maximum price contract on their most recent 1-4 Housing condominium project. NOAH could further these cost controlling efforts by working with Boston Metropolitan Construction to use a cost-plus-fee contract and cost sharing incentives. In fact, Mossik Hacobian of Urban Edge directly mentioned NOAH's relationship with Boston Metropolitan as a potential source for cost savings.

Development Team

Property management staff have an important role in CDCs, both as operator of rental housing and as an experienced partner. In the case of rental buildings, NOAH property management staff is often the client of the real estate department. But in operating rental

³ Interview, Noah Maslan, Urban Edge, 6/7/2002.

buildings, the property management department gains important insight into how buildings should be developed to operate more efficiently. This information should be shared with the real estate development staff. In addition, by including them in the development team, the property management staff would be able to suggest designs and specifications that have worked well in the past, while removing those that proved either expensive to maintain or difficult to use. Not only does this improve the final product but would save the NOAH money in future maintenance charges. This process should be formalized, with project review by property management staff becoming a permanent step in the development process.

The role of community organizers has already been discussed under the section on acquisition.

Finally, NOAH lenders and housing search staff should be an integral component of the NOAH development process, placing tenants that allow the completed building to operate and allow the permanent mortgage to close. The longer it takes to rent all the units, the more construction loan interest will accrue and the less operating income will be generated. Therefore, including these staff members in the development process early and keeping them informed will provide an easy transition from construction to operation, cutting back on costs and insuring development fees and cash flow for NOAH.

Beyond these department-specific recommendations, there is also an organizational step that NOAH could take that would improve affordable housing development. This is the creation of project teams. Similar to JPNDC, each real estate development project would have a project team that includes a community organizer and a real estate project manager. Depending on the complexity of the projects, a representative from property management could also be included. The purpose of the team two fold. First, the project team will coordinate community input and property development, creating a building that meets both the needs of the community and NOAH's real estate development objectives. Second, similar to the development committee, the project team increases participation

among all NOAH staff in real estate development activities, increasing organizational capacity and morale.

Business Approach

Beyond the recommendations outlined in the above development areas, the best practice research revealed two additional suggestions from the interviews with the project managers and executive directors. The first relates to the developer fees associated with carrying out affordable housing projects. According to Lizbeth Heyer at JPND, CDCs never receive their full fee.⁴ While this is a difficult reality to accept because of the importance of development fees in supporting the CDC operating budget, it is also possible to budget for this reality if it is accepted prior to carrying out the project. Because they are mission driven, many CDCs would still carry out affordable housing projects even if they didn't receive the full development fee. However, if the organizational budget relies on receiving full fees that then are not collected, it becomes both a source of frustration between the real estate department and the CDC administrators and a financial hurdle. This was the case in the Siochain project where NOAH only received a small portion of the fee. Ms. Heyer suggested that lowering expectations regarding developer fees can go a long way finding success in affordable housing projects.

The final recommendation centers on the business strategy for CDCs. Mossik Hacobian stated that when Urban Edge was smaller than NOAH is today, he had the goal of always working on at least one large-scale project.⁵ He feels this is necessary for both sustaining a CDC and increasing its capacity for carrying out complex affordable housing projects. He added that the key to this strategy is involving an experienced partner in these early efforts. This is corroborated by other sources, as previously discussed. In fact, NOAH is currently considering several large projects, including the redevelopment of an old warehouse on the East Boston waterfront, the HOPE VI redevelopment of Maverick Gardens, and new construction on a one-acre parcel of land in Eagle Hill. While NOAH

⁴ Interview, Lizbeth Heyer, JPND, 6/5/2002.

⁵ Interview, Mossic Hacobian, Urban Edge, 6/7/2002.

is undertaking the warehouse project alone, the HOPE VI project fits the model outlined by Mr. Hacobian by including experienced organizations such as The Community Builders that could pass development expertise on to NOAH.⁶ In addition, NOAH is in the preliminary project design phase of the Eagle Hill project. The one-acre parcel holds the potential for 12-15 units of affordable housing. As NOAH begins to create a development plan for the site, it has the opportunity to include consultants and other development professionals that could increase NOAH's development skills. The key to realizing the benefits of the strategy lies in NOAH's ability to both create a significant role for itself in the project and also ensure that the knowledge of the more experienced developers involved is translated into capacity for the organization.

Strategic Plan

Beyond the recommendations outlined above that address process oriented improvement for NOAH's affordable housing development practices, the organization also must address a set of strategic barriers. East Boston is a challenging development environment because of the community's small parcel size, lack of vacant land, and high acquisition price. Even if NOAH had completed all the steps in the Siochain project correctly, it still would have faced high transaction costs because traditional affordable rental housing financing tools such as Low Income Housing Tax Credits that demand a large number of units to cover the increased financing costs. Consequently, as NOAH prepares itself for future development activities, it should create a development committee.

The development committee would serve a dual purpose by both evaluating potential affordable housing projects and charting the NOAH's strategic approach to real estate development. The committee would be staffed by three groups of individuals: NOAH staff, board members, and external representatives. From the staff, the committee would include a representative from the real estate, property management, and community organizing departments, as well as Phil Giffie, Executive Director. One or two board members with affordable housing skills or interest should be included, as well as one or two representatives from outside NOAH who have specific finance or development

⁶ In late June 2002, NOAH was informed that its team was not awarded the HOPE VI renovation.

experience. This committee would meet regularly to discuss current and future issues facing NOAH's development practices

Among the subjects addressed by the committee, the first is the evaluation of current and future projects. The development committee will be able to draw on the wide experience of its members to critically assess the feasibility of proposed projects and the operations of current projects. The committee will serve as a resource to the development staff for questions during the development process, helping to avoid the missteps that occurred on the Siochain project.

The second charge of the development committee is strategic planning. NOAH's affordable housing development practices are evolving. It can no longer rely on simple projects as it did in the past to meet the goals of its mission and ensure income. Vacant land is in short supply in East Boston and the Siochain project demonstrated that a traditional tax credit project is difficult to complete successfully. Drawing on the expertise of staff members, board representatives, and external participants, the development committee could begin to consider new development approaches that would serve NOAH's real estate needs in the future. Whether the committee proposes modifications to the Low Income Housing Tax Credit program to the State or embarks on an acquisition strategy that draws on the skills of the community organizing department, it will be able to lead NOAH into the evolving real estate environment of East Boston.

Conclusion

The Neighborhood of Affordable Housing faces a variety of challenges in improving its affordable housing development practices. The recommendations outlined in this chapter are designed not only to initiate this process but also to create an improved ethic of collaboration within the organization. Armed with a new development approach and a new sense of purpose, NOAH will continue to serve the housing and community development needs of East Boston into the future.

CHAPTER 7

CONCLUSION & RECOMMENDATIONS FOR FUTURE STUDY

As developers of affordable housing, charged with rehabilitating substandard buildings and neglected parcels in marginalized neighborhoods, it is inevitable that community development corporations will face development challenges. The Siochain Rental Rehabilitation Project serves as an example of these difficulties. To overcome these obstacles, CDCs and other nonprofit developers need to be willing, as NOAH was, to evaluate past projects to determine how to improve their development practices for the future. Although painful, this is the only way a CDC can ensure that it is evolving to meet the dynamic political and economic forces impacting affordable housing development.

NOAH will continue its work to improve the East Boston community. Hopefully, with the analysis and recommendations provided in this thesis, it will be able to grow in capacity to bring about this change.

In addition to the analysis of the Siochain Rental Rehabilitation Project and the identification of Boston-specific development practices, this thesis also identified several areas for future study specific to affordable housing. These are discussed below.

- **Legal Fees** – CDCs and other nonprofit developers use a variety of methods for controlling legal costs. One possible area of research is the creation of a single legal arrangement between the City of Boston and the State of Massachusetts that streamlines the legal requirements for affordable housing development. This arrangement could be patterned after the One Stop Application used by the City and State for development applications.

- **Tax Credit Financing: Size** – Conversations with various affordable housing developers regarding the use of Low Income Housing Tax Credits suggests that there is a minimum number of units required to balance the legal and syndication costs of

tax credits. Determination of the “ideal” project size or identification of the factors that directly influence tax credit project expense would be useful as affordable housing developers increasingly rely on this program for the creation of rental housing.

- **Tax Credit Financing: A New Model** – Low Income Housing Tax Credits are not suited for all neighborhoods. The small parcel size in East Boston discourages the use of tax credits because of the high transactions costs. However, tax credits remain the primary financing source for affordable rental housing. This means that entire neighborhoods, both in Boston and around the country, are severely limited in their ability to provide affordable housing options to their residents. Research should be carried out to explore new applications for Low Income Housing Tax Credits. For example, can they be pooled across several projects in either one or several neighborhoods? Could the city or state create and administer such a tax credit pool? Research into the evolution of the Low Income Housing Tax Credit program would facilitate its use by a broader group of developers and assure its utility into the future.
- **Construction Contracts** – Anecdotal evidence from interviews used to create the three CDC case studies indicates that nonprofit developers use a variety of methods for controlling construction costs. An analysis of these methods and a guide for their application could assist nonprofit developers in creating a construction arrangement that meets the fiscal and time restraints of a specific project.

As the Siochain project demonstrates, affordable housing development is not a static enterprise. Development practices that are effective for a specific type of structure or real estate market may prove to be inefficient or expensive under a different set of circumstances. Only through reflective practice, experimentation, and analysis of emergent issues will CDCs and other nonprofit developers be able to continue to deliver the real assets that our urban environment requires.

BIBLIOGRAPHY

Books

Collier, K., Managing Construction: The Contractual Viewpoint, Delmar Publishers, Inc., 1994.

DeGiovanni, F., R. Ream, and L. Phare, Bank-Ability: A Practical guide to Real Estate Financing for Nonprofit Developers, 2nd Edition, New York, 1996.

Hecht, Bennet L., Developing Affordable Housing: A Practical Guide for Nonprofit Organizations, Second Edition, John Wiley & Sons, Inc., New York, 1999.

“Nonprofit Housing: Costs and Funding, Final Report”, Abt Associates, Inc., November 1993.

Stevens, H., and T. Tracy, A Developer’s Guide to the Low Income Housing Tax Credit, 3rd Edition, National Council of State Housing Agencies, Washington, D.C., 1994.

Interviews

Bamberg, Joe, Former Project Manger, NOAH, 5/14/2002.

Davis, Lisa, Director of Real Estate Development, Codman Square Neighborhood Development Corporation, 6/7/2002.

Fernandes, NOAH, Former Director of Real Estate, 4/29/2002.

Giffie, Phil, Executive Director, NOAH, 4/17/2002.

Heyer, Lizbeth, Senior Project Manager, Jamaica Plain Neighborhood Development Corporation, 6/5/2002.

Hacobian, Mossik, Executive Director, Urban Edge, 6/7/2002.

Herrington, Paula, Former Director of Real Estate, NOAH, 5/9/2002.

Maslan, Noah, Project Manager, Urban Edge, 6/7/2002.

NOAH Documents

“Amended and Restated Certificate of Limited Partnership of Siochain Properties Limited Partnership”, March 1, 2001.

HUD Uniform Settlement Statement, Peace Properties, 9/11/97.

HUD Uniform Settlement Statement, Peace Properties, 6/30/99.

NOAH FY01 Budget, June 19, 2000.

“NOAH Memorandum: Relocation Training”, December 10, 1998.

“Project Budget”, 227 Princeton, February 2001.

“Project Budget”, Lexington-Putnam, June 2001.

“Project Budget:, Siochain I, May 2000.

“Project Budget”, Siochain I, May 17, 2001.

“Siochain Rental Rehabilitation Project: Application for Low Income Housing Tax Credits”, May 12, 1999.

“Siochain Tenant Relocation Plan”, NOAH, 1998.

Public Documents

East Boston Master Plan, Boston Redevelopment Authority, April 2000.

Web Pages

Jamaica Plain Neighborhood Development Corporation Web Site, www.jpndc.org, 6/5/2002.

Local Initiatives Support Corporation Web Site, www.liscnet.org, 4/13/2002.

Pioneer Institute, Center for Urban Entrepreneurship, http://www.pioneerinstitute.org/pdf/dir_csndc.pdf, 6/12/2002.

Urban Edge Web Site, www.urbanedge.org, 6/7/2002.