

# **Real Estate Development**

## **Policy & Procedure Manual**

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## **I. The Four Stages of Real Estate Development**

**A. Predevelopment:** The predevelopment stage begins with the board's strategic decision to develop real estate, and ends with all the preliminary pieces in place to make the decision to buy or option a parcel or property. This may be targeted to a specific neighborhood, a group of neighborhoods, or a larger geographic area.

### **1. Community Needs Assessment**

Before the development team can begin the Visioning process, they must first have the basic sense of the community need and realistically-available resources. The sense of need comes from a community needs assessment. This term can be defined as the search conducted to form an educated and informed opinion of the current market and social/economic conditions.

There are key internal and external sources of information that must be gathered and analyzed. A question that must be asked is, "Will this project help to create or maintain a community of choice in this area?" Tapping into the project committee, made up of board members and area residents, will give some insight. Other staff members can be utilized as well. External sources, such as the Census, Assessors Office, Home Mortgage Disclosure Act database, US Department of Housing and Urban Development, and the US Department of Labor can provide information. In many communities, the local Planning Department or Master Plan can provide details addressing the need for housing and community development. Churches, other local housing service providers, and advisory committees and boards can provide additional information.

Capacity issues by the organization must also be addressed. If the agency is not equipped to handle a particular project, it would be wise to pass on the project if additional resources cannot be made available to make the plan viable.

The final source of information, which is extremely important, is the residents of the community themselves. Door knocking, surveying, interviewing are all techniques to make sure there will be buy-in at the beginning of the process. Asking community businesses as well as individuals will assist the development staff in making sure their Vision is accurately reflecting the needs and desires of the community's majority.

Several questions can be asked during this process:

Are the neighborhood trends sufficiently understandable and predictable to build confidence?

Are the patterns and standards of reinvestment widely understood and accepted?

How does the housing stock match up with the personal resources and needs of the residents?

How do the housing reinvestment patterns compare with those trends in other more stable neighborhoods?

What broader forces are shaping the community?

What are the discrete characteristics that influence the stability or instability of the neighborhood?

In neighborhoods where there are sub-markets identified, how do these sub-markets interact with each other?

## **2. Creating a Community of Choice**

The next step in the development process is to create the concept or vision of a project. The development team identifies a site and target population, and then visualizes the site as a viable and attractive place for the target population to live.

All projects start at this point, call Concept Development, which is the result of a vision by the development team and/or the project committee. Sometimes this vision grows from an opportunity presented from the outside, such as a municipality that approaches the agency about a problem property, a property owner looking to unload land or buildings that no longer fits their plans, a lender looking for a more viable steward to a property, etc. The agency's reputation in the community can assist in presenting these opportunities.

It is important to not react too quickly with respect to these offerings. Even a free parcel of property can be a liability to the agency. Instead, decide how an opportunity fits the community need that you've identified, and decide how that opportunity could best fit the mission and goals of your organization.

The development team must decide on what type of project they want to create. It could be homeownership, rental, mixed-use, rent-to-own, or commercial opportunities, or some combination of the above.

## **3. Test the Mission**

Once the project has been envisioned in broad terms, the development team must ask if this project will fit the agency's mission? Will it create affordable housing and impact community revitalization goals? Is there a way to generate income from this endeavor?

## **4. Site Identification and Evaluation**

Once a decision has been made based on the Community Needs Assessment, the next step is to identify and evaluate a site for the project. This task is complicated, time-consuming, and requires a

full team of professionals. The determination must be made that the site can be developed into something attractive, efficient, and economical.

The initial steps of identifying and evaluating a site are accomplished simultaneously, and the time involved may be as short as one hour or as long as several years, depending on issues that are presented. The development team must keep a file on "possible development sites" and check in periodically to the status of such.

In order to identify an appropriate site, the development team must compile the following information:

Ownership Verification  
Cost of Acquisition  
Physical Condition  
Maps and Photographs

## **5. First-Pass Feasibility**

The next step is to return to the office to perform a preliminary feasibility test. There are many software packages that can assist with this process. The information needed includes: proposed unit mix, the Area Median Family Income (family of four), a ballpark of development costs, and a ballpark of applicable interest rate on debt.

The added benefit of performing this task is that it will save time later on. Much of the data compiled is also necessary for grant applications. The items determined by this analysis include: ballpark development costs, outline of sources and uses, a timeline and cash flow review, determination of affordability, an operating budget, ballpark on capital reserve requirements, a 15-year preliminary pro forma, and a project summary report.

## **6. Due Diligence: Environmental Review**

A Phase I Environmental Review is required for all projects by the local regulatory authority, ultimately under the guidelines prepared by the Environmental Protection Agency (EPA). The purpose of Phase I is to determine whether there is a need to move forward with a full-blown Phase II review. This review is usually performed by an engineer. It consists of:

- A thorough description of the site with respect to the surrounding topography.
- A brief environmental history of the area and the site (former uses of the site).

- A description of any commercial, industrial, or mining activities within at least a quarter mile that may have an effect on the site's air, water, or soil quality.
- A detailed narrative of the site inspection.
- An examination of the state and local agencies' files to evaluate the site and adjoining properties with respect to regulatory compliance and any releases of oil, radioactivity, or other hazardous substances.
- A determination whether and why a Phase II audit should or should not be considered.

A Phase II Environmental Review is required for any hazard identified by a Phase I audit which poses a potential environmental danger to developing the site. The purpose of a Phase II is typically to quantify the presence or absence of an uncertain liability, e.g. asbestos, lead paint, a leaking underground storage tank, or the extent of an observed or suspected liability, e.g. soil or groundwater contamination.

Any abatement of hazardous or toxic materials identified by a Phase I or II audit will likely result as an additional cost of construction for a project's scope of work.

### **Due Diligence: Market Analysis and Comparable Rents**

Either a consultant or staff can perform this analysis, depending on capacity. This study consists of a survey of apparently eligible households in the proposed market area to determine if the proposed project meets the needs of the geographic location of the project.

The market study consultant can analyze available demographic data available, including the census and other public information sources. They may also do surveys or questionnaires of their own. They then compile the data necessary to support the owner's project or to determine that the project has an insufficient number of people in the target market to be successful. A market study is an objective, unbiased analysis of actual need, projected from various documented factors. A market study is aimed at proving the need or demand for a specific type of housing for a specific group in a specific market, or for proving that that need does not exist.

At the beginning of the market study should be a table of contents, the firm's statement of qualifications, and a certification of accuracy of the study being submitted. The context of the study should be clear. All mathematical calculations are to be expressed in actual

numbers, which may also be accompanied by percentages. Each table and/or section should identify the source of the data. A brief statement of the methodology used in the study should be included in the foreword and other sections when necessary for clarity. The more clearly the argument is articulated, the better its chance of being accepted by the lender.

In addition, a market study will contain the following information:

1. **Market Area**—The community where the project will be located and outlying areas that may be impacted by the project.
2. **Site**—A full description of the site to be developed, its position in the community, and its location with respect to residential support services.
3. **Demographic Characteristics**—Includes population, household age characteristics, household size characteristics, tenure, income, and the trends in these categories.
4. **Economic profile**—Includes employment trends, major employers, unemployment rate, and prospects for change in these elements.
5. A section on existing housing stock.
6. A section on existing rental housing.
7. Housing demand forecast.
8. Study recommendations.

For a for-sale project, the market study must address demand, sale price, and absorption rate (how quickly the units will sell.) For a rental project, the market study must look at comparable rents.

Either way, the market analysis must show:

1. What is the average rental or sale price by unit size (studios, 1, 2, 3, or 4 bedroom)?
2. Do the comparable rents and mortgages include utilities? Do they include other monthly charges (parking, cable TV, etc.)
3. How many people can afford to pay the proposed rent or mortgage, based on the HUD guidelines of a maximum of 30% of a family's adjusted gross income going to housing and utilities.
4. How many people in the targeted income bracket will be looking in studios, 1, 2, 3, or 4-bedroom units?
5. What other projects are in construction or pre-development in the neighborhood which might affect your target market?
6. What is the target population of these projects?
7. What is the vacancy rate among comparable multifamily units? Be sure that the study adjusts for the condition and age of the comparable properties (curb appeal) and the



- neighborhood environment (i.e. is there a highway, airport, or railroad track next to the property? Is it in a high-crime area?)
8. What amenities does your target population require? What amenities are offered by the competition? ? (Laundry, parking, cable TV, security, pool, etc.)
  9. What are the other housing options in the neighborhood? (Inexpensive condominiums, mutual housing, low-cost for-sale housing, trailer parks, etc.)
  10. Who is the target market and where can they be found?

During the process of collecting and analyzing this data, always remember to compare the concept to similar projects. If the concept is to build affordable senior housing, the rents, occupancy, and amenities of other affordable senior complexes nearby would provide the best information regarding the market. Pursuant to the analysis, if the rents are high and there are no vacancies and waiting lists, the market can easily absorb more apartments. If rents are low and vacancy is high, the project is likely to fail.

The local Community Development Office that receives Community Development Block Grant and/or HOME funding is required to have a document known as a Consolidated Plan (ConPlan). The ConPlan is a document containing the housing and community development needs of the community. The ConPlan typically has a Community Needs Analysis, the community's strategic plan, resources, and an action plan on "how to get the funding out on the street." The Community Needs Analysis must include the current physical condition of the neighborhood. This information is obtained by conducting a windshield or sidewalk survey. The current real estate market conditions are extremely important in the analysis of a neighborhood. A developer must have knowledge of who is moving in and who is moving out of a neighborhood, what are the current property values, and how are those values trending.

An important component of the ConPlan is the opportunity for the housing developer to play a role in the public hearings. The community is required to hold public hearings to accept oral or written comment on the needs of the community. This is the opportunity for the housing developer to describe the needs of the target population that has been identified. If the target population has not been identified, this planning process provides an opportunity to learn about the needs of the community, and to impact the direction of the Consolidated Plan.

There are other sources of information about the market besides the municipalities and market study firms. For example, local non-profit agencies or churches may have studied the community needs and

resources. Local advisory committees may have information as well. And local realtors or for-profit developers may have valuable market information. If you can develop these contacts, you can develop property more efficiently and effectively.

### **Due-Diligence: Planning and Zoning Investigation**

Zoning controls the character and use of land and buildings. It also controls the size of lots, types of structures allowed, building heights, setback requirements, open space requirements, and density. Many, but not all, rural towns and counties have adopted zoning ordinances. Some of those under heady development pressure are revising or adopting master development plans. These plans are intended to guide future changes in zoning and other laws that affect development; in an increasing number of states, zoning laws are required to comply with master plans, so a plan may provide invaluable information about future changes in relevant laws. Familiarity with zoning density and use restrictions is imperative for any developer, no matter what the proposed project might be, since what can be done with a site or building is constrained by the zoning classification it carries. The zoning classification will affect the construction or rehabilitation costs of the project as well, since fire rating requirements vary from class to class. The best source for information on planning and zoning issues are the county and city planning offices. An alternative source is the local building inspector. The project architect should be familiar with local planning and zoning regulations as well.

Both the architect and the developer must know how many units are allowed under current zoning when evaluating each site's development potential, and determining what specific costs might be entailed in development. Remember these costs must be incorporated into the project development pro forma.

A variance is an exception to current zoning laws. Variances are applied for by the developer and typically require the applicant to undergo a public hearing process. Similarly, a zoning change also requires any number of public hearings. Although a variance might seem at first blush to be easier to obtain than a zoning change, this is not necessarily true in practice. Some Boards of Zoning Appeals (BZA's) are extremely conservative and do not want to grant variances except in extreme circumstances, fearing that it may set a bad precedent. However, the planning board may support a zoning change if it is consistent with their ConPlan, and may actually help expedite the procedure. Either way, the housing developer should be aware of the timeframe involved. If there is any way to comply, that will greatly reduce the development time of a project.

There is certainly both an art and a science to obtaining a variance or zoning change. The science involves knowing the zoning and building code cold; knowing the costs of compliance, and knowing the track record and propensity of the local planning and zoning boards. The art involves knowing how to appeal to the various factions that may be either in favor or opposed to your variance or zoning change request. You must know how to appeal to these various factors—what are their interests, prejudices, and concerns. The housing developer should be prepared to argue their point both passionately and dispassionately, depending on the audience. He or she should be armed not only with the dry facts but also with a compelling story of filling a vital community need.

The housing developer must above all be a good judge of the odds. If the project hinges on a controversial variance or zoning change, he or she must be extremely conservative with expending predevelopment funds, time, or energy until this issue is decided. However, if the variance is minor and the odds are strong that it will be granted, waiting until the final gavel falls may cost months and months of valuable pre-development time.

### **Due-Diligence: Check Budget Figures**

Underwriting is the financial analysis of a real estate development project. Although a fair number of assumptions and educated guesses may be made in order to prepare the Quick and Dirty Housing Feasibility Study, now is the time to nail down those figures before serious capital funds are expended. These costs break down into seven major categories: Acquisition Costs, Soft Costs, Construction/Rehab Costs, Operating Costs, Working Capital Needs, Reserve Requirements, and the Developer's Fee.

**A. Acquisition.** The price of a property is negotiable until the signing of a contract. You may be able to reduce the asking price based on a number of factors—the results of the Environmental Phase I review, the condition of seller's title, the results of the market study, the results of an extensive planning and zoning investigation may show that the costs of the proposed project may be higher than originally estimated, the market is not as strong as expected, or the process of developing the property may be not be as easy as anticipated. All of these factors can influence the price of the property in your favor.

The other side of the coin may be that the seller's price goes up as more and more information surfaces regarding the property and the market. Playing one's cards close to one's vest is the best strategy if the results of the environmental audit, market study, or planning/zoning investigation are going well for you.

However, until the contract is signed, you need to maintain a positive relationship with the seller. If you bring them “doom and gloom” on a regular basis, they may decide to look for another buyer. The D.R.E.D. is the best source for advice on how to handle your relationship with the seller prior to acceptance of your offer.

There are four methods for determining the value of a property, but only two of them are reliable. The first reliable method is an appraisal by a licensed real estate appraiser. They will look at comparable local sales in the recent past, and make an arms-length assessment of the value of the property. The second reliable method, which is only applicable to an acquisition of rental property, is to look at the Net Operating Income (NOI) of the property. The NOI is gross potential rent minus vacancy loss minus collection loss minus operating expenses, not including debt service. The NOI is then divided by the local capitalization rate (the rate of return expected by a typical real estate investor in that particular market.) In hot markets, this rate can be as low as 4%; in very depressed markets, it can be as high as 14%. A local commercial banker can provide this value for you. For example, if the net operating income of a property is \$50,000 per year, and the local “cap” rate is 10%, the value of the property is  $\$50,000 / .10 = \$500,000$ . The third method, which is not very reliable, is to get a “best guess” by a local realtor. The fourth method is to check the assessed value of the property at the tax assessor’s office. However, this method can also be off by a wide margin.

- B. Soft Costs.** The soft costs, such as the fees charged by the architect, engineer, market study consultant, etc., need to be nailed down at this point. Now that the project is taking shape, you need to go down the list and verify your estimates. Although “Quick and Dirty” can provide you with some default guidelines, these should not be taken as gospel. Accurately estimating soft costs takes time and legwork, but is absolutely necessary for a successful project. Soft costs can eat you alive.
- C. Construction/Rehab costs.** Construction estimates are just that: estimates. You will not have a firm commitment to a price until you sign a contract with a builder. Even then, the costs will undoubtedly change as change-orders and unforeseen expenses arise. However, you can decrease the margin for error by refining the estimate with the contractor as more and more information is available to you. You can also get independent verification of cost information provided to you by a builder through a variety of sources—competing contractors, the architect or engineer, or your construction manager. Funders

and syndicators such as LISC, Enterprise, or Neighborhood Reinvestment can also help with cost analysis.

- D. Operating costs—utilities, insurance, taxes, management, maintenance, etc.** The basic operating costs of the project should be determined by Property Management (P.M.). P.M. will prepare an operating budget, if they intend to manage the property in-house. If not, the housing developer must work with the local property management provider on an accurate budget. The housing developer is responsible for obtaining back-up documentation of local utilities, taxes, and insurance expenses specific to that type of project. P.M. will calculate the maintenance, management, accounting, and other ongoing expenses based on comparable projects in their portfolio, and the special needs and uses of the proposed project.
- E. Working Capital.** The working capital budget is a line-by-line description of the expenses incurred by the project for the purposes of conducting Property Management. The working capital budget includes all funding of equipment and furnishings for the project, as well as initial marketing and carry-over of the utilities until the project is fully occupied. P.M. must complete this budget and inform the housing developer of the costs prior to site control. Note that many funding sources designate ranges of percentages for various line-item expenses. The funding sources must therefore be accounted for in preparation of both the operating budget and working capital budget.
- F. Project Reserves.** The housing developer must also determine the funding requirements for Project Reserves, both Capital and Operating. Capital reserves (or replacement reserves) is the amount of money necessary to sustainably replace “capitalized” building components (as opposed to “expensed components such as paint, carpet, and appliances). These Capital Reserves are generally determined by the funder, but generally run about 5% of gross potential rents. Operating reserves are cash needed to cover shortfalls in operating expenses caused by high vacancy or low collection rates. These generally run about 4%. However, these figures may be “capped” or “floored” by various funders. In fact, there may be contradictory requirements by various funders. For example, Funder A may require a minimum of 5% of gross potential rents go to capital reserves, while Funder B will not allow more than 4% of gross potential rents go to replacement reserves. Helping you finesse these requirements is one of the roles of the D.R.E.D..
- G. Developer’s Fee.** Ultimately, the real estate development teams’ paycheck comes from the developer’s fee. Again, the

size of the developer's fee may be determined by the primary funders. In general, it ranges from 5% to 15%. Setting your developer's fee too high may mean the project is financially unfeasible or unattractive to funders. Conversely, setting the fee too low may mean you work yourself out of a job, and worse, put the agency, in debt. How? The Developer's Fee is the last thing paid out, after all contingencies, overruns, and other problems have been resolved. It may be delayed for years by a funder. It will be the first thing a litigious party goes after in the case of a problem with the project. In general, if you don't pull a 10% developer's fee out of a project, you're not doing your job well enough. Why? Many costs of a project are not expensed into the project, such as the time the D.R.E.D. put into it, the time spent laying the groundwork for successful real estate development by senior staff, and the salary and expenses of the support staff which helped you get the project done. The agency cannot continue to develop real estate if it does not collect adequate developer's fees.

### **Due Diligence: Verify Potential Debt and Equity Sources.**

You have undoubtedly made some assumptions on the sources of grant, equity, and debt funding for this project. Prior to site control, it is advisable to "nail down" some of these sources.

- A. Establish Relationships with the Lender.** Lenders fall into three categories—construction, permanent, and secondary market. Construction, or interim financing, is the amount you will need to borrow prior to occupancy. This short-term (6 months to 2-year) money is going to be more expensive (higher points or interest rate) than your permanent financing, since the lender has increased risk that something may go wrong during construction, and must be compensated in advance for that risk. Permanent financing pays off the construction loan, and has a long (20-40 year) term. The third category may or may not be under your control. The bank may sell your mortgage on the secondary market. Or you may elect to use one of the non-profit intermediaries such as Neighborhood Housing Services of America or the Community Lending Corporation to buy out your permanent financing source. Most secondary market lenders want to wait until you have an established track record on the property.

While it may be advisable to have one lender supply both the construction and permanent financing, you may get a better deal by splitting the deal. Establish a relationship with several banks. Get a sense of the interest rates and terms they will be willing to commit to, and what information they will require before they make a funding commitment. Be aware of their

Community Reinvestment Act (CRA) status, and make the pitch that your project will positively affect that status. Let them know that, while you would prefer to work with their fine institution, you are shopping the deal. Never put your eggs in one banking basket. Do your homework, and provide them with accurate, detailed, and timely information with concise executive summaries at the front of any presentation. Above all, **DO NOT APPEAR DESPERATE!** Bankers smell fear, and close their checkbooks fast.

- B. Establish Relationships with the Syndicator.** If you are interested in either a low-income housing tax credit or a historic tax credit, you will need a syndicator. The Local Support Initiatives Corporation (L.I.S.C.), the Enterprise Foundation, and the National Development Council (N.D.C.) have excellent syndication arms that provide tax credits—L.I.S.C.’s National Equity Fund (N.E.F.) the Enterprise Social Investment Corporation (E.S.I.C.) and the NDC’s Investment Fund. They often help with predevelopment financing and technical assistance. Federal Historic Preservation Tax Credits may be used to rehabilitate commercial buildings placed in service before 1936, or to rehabilitate certified historic structures either listed or eligible to be listed on the Federal Register of Historic Places. These structures must then be rehabilitated in accordance with the standards set forth by the Secretary of the US Department of Interior. Local Initiatives Support Corporation (LISC) is a national intermediary organization that provides technical and financial assistance to local CDC’s in approximately two dozen selected cities and areas. Begun in 1980 under the auspices of the Ford Foundation and six large corporate sponsors, LISC leverages its assistance by channeling investments from the private and philanthropic sectors into local community revitalization activities. An example is the “Retail Initiative,” a recent program to spur the construction of inner-city retail shopping opportunities, particularly supermarket-anchored developments. LISC has also developed a secondary market organization, known as Local Initiatives Managed Assets Corporation (LIMAC) to purchase the community development loans originated by LISC and the CDCs with whom LISC works. The D.R.E.D. can point you in the right direction to find and develop a syndicator.
- C. Establish Relationships with other Federal Funders.** Now is the time to round up the usual suspects—the federal equity sources which can provide capital to your project, either directly or through a local pass-through. In general, find out what their funding priorities are. Attend their funding orientation sessions or interview their local representative on their programs, the

strings attached, their process, and timeframe. The rule of thumb—if you don't ask, you don't get. Nobody ever got a grant without applying for it. The cost? Somebody's got to do the paperwork. Sometimes forever.

1. Housing and Urban Development (HUD) Among the federal sources, there's HUD, of course, with their Community Development Block Grant program, designed to have a low- or moderate-income benefit, an urgent need, or a slum and blight reduction. With appropriations exceeding \$4.5 annually, the CDBG program is the Federal Government's single largest tool for supporting community development activities. The Entitlement program provides funds to larger cities and counties, which automatically receive annual CDBG funding. The States and Small Cities program is targeted to smaller cities and rural areas; each State receives an allocation of CDBG funds. Eligible activities include economic development projects, such as commercial lending and technical assistance, public services, infrastructure development, micro-enterprise development, and planning. This is the traditional "patching" money, and a vast network of consultants and planners spend a considerable amount of time developing applications and monitoring compliance with CDBG programs. There are, it's safe to say, a few strings attached.
2. Neighborhood Reinvestment Corporation is a public nonprofit organization chartered by Congress in 1978 to stimulate community revitalization. The corporation works through an independent national network of 200+ local nonprofit CDC's known as the NeighborWorks® network. Non-affiliated CDCs and others interested in the community development field may attend Neighborhood Reinvestment's National Training Institutes.
3. Affordable Housing Program
4. Other sources include the state finance authority, foundations, and HOME funds.
5. Non-traditional sources: Community Foundations, Social Purpose Enterprises, and Utility Companies

In general, the more funding sources you can stitch together to make the deal work, the lower the debt the project must carry. This translates into lower the rent or lower mortgage payments to the homeowner, and a greater likelihood of getting the full developer's fee you are entitled to. The caution is not to get into a situation



where you have contradictory requirements. The solution is to research the grant program thoroughly prior to submitting an application. But the initial phone call won't cost you much, and may literally be worth millions of dollars to the community in which you're working.

As part of the funding identification process, a table of restricted covenants should be put in place as well. This table will assist development staff in ascertaining the responsibilities tied to particular resources.

### **Due Diligence: Survey, Legal Description, and Title Check**

The survey is the registered map of the property. The Legal Description is the "meets and bounds", which is the narrative describing the survey.

"Beginning at a rod on the northernmost border of the property, heading east 100 feet, etc." If the seller has a recent survey, an examination of this document is appropriate at this point to ensure that the property lines as identified by the seller are the same as those he or she actually owns. The lender and funders will require an updated or re-certified survey prior to closing. In some markets, this may take months. In some cases, no survey has been done for generations. The survey must be done by a licensed surveyor, and will require either site control or permission of the owner. Most owners will give you permission to survey their site if they are serious about selling. Many will split the cost with a serious buyer.

A title company should be retained to perform a preliminary title search, which is an examination of public records, liens, and court decisions to disclose the current facts regarding ownership. This preliminary title information will help the developer/owner determine if clear title can be conveyed, reveal whether there are any encumbrances, or clouds on the title that would prevent title insurance from being issued.

## **7. Schematic Drawings**

At this point, it may be prudent to develop schematic drawings of the project, although this step may also be done after site control is established. The reason to do it prior to site control is to verify that the number of units can indeed be built according to the information gathered to date. The reason to wait is that most architects will charge something to prepare these drawings, and you may not want to risk the up-front expenditure of these funds if you believe there is a risk that you will not be able to nail the land-owner or property-owner down. There are four steps to developing schematic drawings.

- A. Preparation.** Working closely with the architect, the housing developer must translate his or her vision into drawings prepared by another. This involves communication, clarity, courage, and back-and-forth dialogue. Remember that architects often have large egos, and the manifestation of those egos is grandiose

buildings. It is your job as housing developer to keep that ego in check and still utilize the creative talents of your chosen architect. The minimum schematics would include a rough site plan, rough floor plans, and a rendering of the proposed building elevation.

- B. Property Management.** Whether it's done either in-house or contracted, property management should be involved in the design process from the start. They should look at the schematics with an eye toward security, maintenance, and marketability of the units.
- C. Review by Contractor/Construction Manager.** After the property manager has signed off on the schematics, they should be reviewed by the contractor and construction manager for reasonableness and cost.

**B. Development.** Development begins with site control, and ends with the property and financing closings.

### **1. Capital Needs Assessment**

*Sal, not sure how to word this section...can you improvise?*

### **2. Site Control**

Site Control is a significant step in the development process not only because it means that you have committed to the real estate in question, but also because you are now eligible to apply for a variety of grants and loans. You also have “standing” in matters of zoning, variances, and have certain rights to the property. Depending on which of the following options you choose to obtain site control, your rights as an owner have increased dramatically. Each of these legal contracts has particular characteristics that are suited to different needs of the buyer or seller.

**A. Option Agreements.** The safest, and arguably best course of action at this point is to option the property. Most non-profit and for-profit developers use an option to prevent the sale of a property to another party while extensive feasibility studies about the physical environment, legal and regulatory, socioeconomic, political, and financial aspects of the site and its development potential are undertaken. In an ideal situation, a developer obtains control of a good housing site for one month to a year for a nominal amount of money, called the option price. This is often not possible in areas where demand for property is high, and indeed, you may not be able to wait until this point to move forward with an option agreement. If the option price is low enough, and the risks of the project are low enough, the Project Committee may authorize the optioning of the property prior to the “due-diligence” period in order to tie it up long enough to go through the necessary steps.

An option agreement quite simply means that you have purchased, for the sum of at least a dollar, the right to purchase the land at your option. That dollar may be the extent of your commitment. But the owner makes a commitment to your agency to sell the property to you for a set price. It is a written contract between a seller and potential buyer in which the seller holds open an offer to sell property for a certain price for a stated period of time which is agreeable to both parties. Option agreements always have an expiration date, by which the buyer must exercise his right to buy the property or forfeit that right. Depending on the language of the contract, the option money may be applied toward the purchase, forfeited completely, forfeited in part, or fully refundable. This is a point of negotiation between the seller and potential buyer.

A purchase option may be recorded—placed in the public record—to notify other potential buyers that the property is tied up for a particular

length of time. This ensures that title to the property will not transfer during the option period.

- B. Lease Agreements.** Nonprofit institutions can often negotiate low or no-cost long-term leases with local government or with sympathetic sellers. The municipality or seller may simply not wish to sell, and you may wish to acquire rights to the property anyway. In that case, a long (99-year typical) lease may be the best option. In such a lease-hold agreement, the lessor (landlord) agrees to rent the property to the lessee (tenant) and agrees to allow that tenant to build or renovate the property as the lessee sees fit; to operate the property and make as much or as little from it as the lessee chooses. There are a myriad of lease arrangements. The lessee may be liable for the taxes, or not. The lessee may have the right to remove any lease-hold improvements (buildings, etc.) or not. The lessee may be required to remove any lease-hold improvements, or not. There may be an option agreement that kicks in at the end of the lease period.

Note, however, that a lease may compromise some potential funding sources, which have provisions specifically prohibiting them from funding projects in which the grantee does not have clear title. Consult your attorney for advice in this situation.

- C. Purchase Agreements.** By far the most common method of acquiring real property is to simply buy it using a purchase-and-sale agreement. A purchase contract is a fairly simple written agreement between a seller and buyer in which the buyer agrees to purchase the property within a specific period of time for a specified price. Consideration is given to the seller, making the contract binding. (Again, a dollar is the minimum legal consideration.) The buyer can only be released from the contract if certain contingencies specified in the contract cannot be met. Refund of the earnest money is tied solely to the inability of the buyer or seller to comply with the specified contingencies in the contract. The potential disadvantage of a purchase-and-sale agreement is in the contingencies set forth when the agreement is entered into, which may not include problems that arise subsequently.

Typical contingencies included in purchase contracts include:

- 1. Financing.** The terms of the financing in a purchase contract should specify the lender, the interest rate, the term of the loan, the points or fees to be paid. If the buyer cannot obtain financing under these terms, or is denied financing for any reason, the buyer is not obligated to execute the contract. Typically in a financing contingency, the earnest money is forfeited.
- 2. Physical Inspection.** This can include an environmental assessment of the land or building(s), a structural inspection of

buildings, or an engineering study. If the buyer is not satisfied with the condition of the property, the buyer is not obligated to execute the contract. There is usually a time constraint on the amount of time the buyer has to conduct the physical inspection, and a decision exercise the contingency or waive it, either proactively or passively. Typically, if a property “flunks” its physical inspection contingency, the earnest money is returned by the seller.

3. **Public Approvals.** If certain public approvals are absolutely essential in order to make the development of the property economically or practically feasible, these should be included as contingencies. These may include building permits, zoning changes, subdivision plat approval, water and sewer hookups, well and septic approvals, drainage issues, or hazardous, toxic, or annoying waste removal issues. It should be clearly specified whether it is the buyer or seller who will provide these approvals or remove these wastes, and the deadline by which they must be provided. Never underestimate the time it can take to get these approvals or clear up these sites!
4. **Condition of Title.** If the seller is unable to convey clear title, the buyer does not have to execute the contract. Title problems may include evidence that other people have interest in the real estate that must be cleared before it can be sold, (liens or mortgages) back taxes are owed, or other exceptions such as an unacceptable encroachment or easement appear on the preliminary title report. There is normally a specified deadline by which the seller can resolve these problems to the satisfaction of the buyer. Typically, if a title problem causes the deal to fall through, the earnest money is returned to the buyer.

**D. Donation.** Churches or other non-profit institutions may be willing to donate property for the public good. Sometimes, companies or individuals may be enticed to donate property to non-profit institutions in exchange for a tax write-off. The amount of the write-off is often slightly more generous than the amount that you might have been willing to pay. But be aware that the Internal Revenue Service is wise to this, and may seek an independent appraisal prior to allowing a tax write-off for real property.

### 3. Support Letters

Now it's time to nail down those connections you've been building throughout the predevelopment process. Funders will require letters of commitment in their files.

- A. Political.** Most funders look for broad-based, bi-partisan support for the project, locally, state-wide, and even nationally. Make use of those contacts you made. Having both Republicans and Democrats, from mayors, county executives, state legislators, congressmen, senators, and perhaps even presidential support for the project strengthens your chances of getting funded. It's best to send a sample support letter to the politician so they can copy the verbiage you want in the letter.
- B. Services.** If you are providing supportive services to the project, make sure you have a memorandum of understanding, or at least a commitment letter, from each of those service providers. These also include inter-agency services, such as a commitment from the Homeownership division to provide budget counseling or homeownership training; commitments from Employment and Training, etc.
- C. Community.** If possible, get letters of support from any marginally-interested community group in the vicinity of your project. For example, if any of your units are to be handicap-accessible, contact the local Independent Living Center (or local facsimile) and get their support for the project. Any local churches, non-profits, block clubs, neighborhood watch groups, police departments, probation departments—anyone you can think of who is a marginal stakeholder in having a successful, well-run housing project in the community. This also includes the local planning and zoning departments, and, if you are ahead of the game and have run the preliminary plans past the local building inspector, get them to say that they think the project as proposed will pass codes. Remember--make the phone call before sending the sample letter!
- D. Resident Interest List.** You may have done survey work during the market study, and this survey may have generated a list of people interested in your project. Include this list in your application!
- E. Waiting List.** Even better than a Resident Interest List is an actual waiting list—people who have signed up and been pre-qualified for your project.
- F. Pre-signed Leases.** Even better than a Resident Interest List or a Waiting List are pre-signed leases. It's unlikely you'll have many residential tenants willing to sign leases before groundbreaking, but you may find commercial tenants willing to pre-sign a lease if you have a commercial or mixed-use project.

#### 4. Final Planning and Zoning Board Approval

The groundwork you laid during the due diligence process should be bearing tangible fruit. You should be nailing down your Planning Board approvals, and any Zoning Board approvals that are necessary. This will usually require you to attend at least one public meeting, where you can expect to find somebody opposed to your project. Many a worthy project has been flushed at this critical juncture. Don't believe anything is a slam-dunk until you've gotten the paperwork! There are some rules of thumb to follow when making these key presentations.

- A. Prepare your presentation and practice your remarks.** Think about to whom you are talking, and what appeals to them, and what will turn them off. Address their concerns head-on. If you expect people to complain about the increased traffic or drainage issues, make sure your engineer has prepared a study. Above all, speak with clarity and energy about the need for this project, its revitalization component, its economic development multipliers, and any other local positive aspects you can think of to help sell this project. Use the same language you would use to explain to your own family members why you've been working so hard—bring some passion to the podium.
- B. Have your homework ready.** Blow-ups of site maps, site plans, floor plans, and proposed elevations help sell the project. People are visual, and need to be able to look at what you're selling them. Prepare handouts with plenty of copies for everyone who might attend. Have printed materials in the Planning and Zoning board members' hands well before the meeting. If there was ever a time to bury somebody with paperwork, it is now. Hand them a copy of the Needs Assessment, the Market Study, any commitment or support letters you may have in hand, etc. Make sure they understand who your agency is; include a copy of the Annual Report.
- C. Pack the house if you need to.** If you expect them to complain about the "tenancy" of your project (read: they don't want THOSE people in their neighborhood) have a fine upstanding potential tenant there to thwart their NIMBY (not-in-my-back-yard) argument. It's hard to complain about THOSE people when one of them is in the room! If you have strong community support, ask some of your supporters to show up at this critical juncture.
- D. Have your experts ready.** Your architect and/or engineer should accompany you to any key Planning or Zoning board meeting. They are your technical expert, and you may need them to think quickly on their feet if a compromise solution is proposed by a board member. Hopefully, you've selected architects and engineers who have a good reputation in the local community; who have come before these boards before with good results.

- E. Listen!** Nothing turns off a public board more than an argumentative bulldozer of an applicant. If someone has a concern, hear them out completely before starting your rebuttal. Use phrases like, “I hear your concern about . . . and we’ve anticipated those concerns by . . .” before launching on your defense.
- F. Know when to Hold Em and when to Fold Em.** A board is unlikely to reverse a ruling once they’ve voted on it. Know when to take it off the table for retooling. You may have misjudged the situation, and find a packed house full of hostile people lined up to speak against your project. It’s better to say, “We have heard a lot of voices who haven’t approached us before, expressing their concerns with this project as drawn. Clearly, we need to confer with these folks and make some necessary adjustments to our plan,” and temporarily withdraw the proposal than to get shot down forever there and then.

The other side of the coin is to know when you are holding the moral high ground. If the opposition is clearly NIMBY-based, (racist, age-ist, class-ist, or otherwise morally-bankrupt) then have the courage to call them on it. “If I’m hearing you correctly, you are saying that you are against providing safe and affordable housing for Senior Citizens. Is that your position?”

## **5. Grant Applications and Funder/Lender Review.**

You are now ready to proceed with applying for grant and loan funds. The groundwork you’ve already laid in preparing your submission to the Asset Management Committee, and all the other work you’ve done to date should be folded in to the funding applications. There are two extremes to funding applications—overkill and underkill. Both are deadly. Some grant applicants Xerox the file cabinet and mail a hundred-pound submission, and/or write volumes answering simple questions. This turns reviewers off, who must wade through mountains of paper at grant evaluation time. Give them a break. Other applicants curtly answer the questions on the application, without passion or elaboration, and include no attachments. This gives reviewers little or nothing to convince them you are a cut above the competition. Finding the fine line between these two is called Grantsmanship.

- A. Attend Funding Workshop Sessions.** The best way to scope out what is needed and what is overkill is to attend the grant funder’s workshops and ask the questions directly. “Do you want to see our blueprints and specifications, or will the schematics and draft specifications be better? Do you want the whole market study or just the summary?” Etc.

Almost all grants are scored based on published numeric criterion; lenders have similar criterion. Obtain this criterion and study it. Find out the “buzz” words that they’re looking for. If an organization is giving priority funding to “revitalization” then make sure that word appears prominently



and often in your narrative. If their focus is “affordable housing,” punctuate paragraphs with sentences explaining how a design or business decision you have made enables you to provide more affordable housing.

- B. Board Resolution to Apply for Funds.** Most funders and lenders require a board resolution to apply for funds as part of their application. The Project Committee go-ahead will probably not cut it. Make sure you’ve gotten a board resolution signed well ahead of the submission deadline.
- C. Submit prior to deadline for pre-review by funders and lenders.** Many funders will pre-review your application, at least for completeness, if not for content. If they will, find out when they’d like to see it, and get a draft in their hands well before that date. Some funders can’t or won’t do this officially, but might do it over coffee, if you’ve developed a good working relationship with them. A pre-review of your application greatly enhances your chance of getting maximum points. However, it’s best not to tip your hand to a lender with a half-baked plan. Make sure your ducks are in a row before pre-submitting an application.
- D. Have backups.** Few grantwriters bat a thousand. There’s nothing wrong with applying for more money than you need, and turning some of it down if you get funded by everybody. That’s far preferable to having your project tank because one out of several funders/lenders turned you down. Certainly, it’s easier to return money or to not accept an award than it is to ask for more money down the road.

Now you will have to wait, and wait, until they announce their awards. You may get phone calls asking for clarifications. There is no point bugging a funder or lender who hasn’t made a decision on your grant application until after their deadline for funding has passed. Then a polite phone call is all you can reasonably do to see if the process has been delayed.
- E. If once you fail, find out why.** If your application isn’t funded, schedule a meeting with the funder or lender to figure out reasons, and whether you’re in the right ballpark for a resubmission in the next funding round. Believe it or not, lenders and funders are human. They wish they could have funded your project, or lent you the money. If you approach them honestly and courteously, figure out what you could have done better, and then do the things they suggest, the odds are pretty good you will get funded the next time around.

## **6. Acceptance of Funding Awards**

Before accepting the award, you should be absolutely sure you know the implications and obligations of the funder or lender. They may make a conditional award, and you'd better make sure you're able to comply with them. They may make a conditional award, with conditions you can't live with. They may send you their "boilerplate" contract that has compliance and monitoring requirements that are too odious or expensive for your agency to accept. Their timeframe may be unrealistic.

A funding award must be accepted and closed before drawing any of the money. Usually, this requires something more than simply phoning and thanking them. They will need some signatures on some contracts. Consult with your legal counsel prior to signing any funding awards.

Refer to the Table of Restricted Covenants prepared during predevelopment to assure the requirements from various funding sources will not be in conflict with one another. Revise table as necessary.

## **7. Final Cost Estimates, Contractor Qualification, and Value Engineering**

During the waiting game for funding, you should optimistically move forward with finalizing your construction costs. If you wait until all the awards are in before moving on these, you'll be crunched and end up with higher prices than if you had taken the time during the funding cycle. There are two methods of getting firm prices for the construction or rehab—negotiated or bid.

- A. Negotiated.** The biggest advantage of a negotiated contract is utilizing the skill of the construction and/or development firm you've chosen. If they're on board early, or if they are part of a design/build/development firm, they can focus on the goal of getting the job done on time and to budget from the beginning. This saves a lot of time and professional fees designing, bidding, redesigning, and rebidding. However, the same characteristic that makes this model so powerful also creates its weakness. With all your eggs in one basket, if you make a bad team selection, you may be stuck with an incompetent or overbearing partner throughout the development process. You lose the system of checks and balances which allows the market to regulate the price of the construction.

The housing developer must define the product extremely well or there is a tendency for negotiated-bid contractors to substitute lower quality materials and methods to maintain their profit requirements. In some cases, these are acceptable substitutions that still achieve your goals. In other cases, they can be clearly unacceptable. The housing developer, architect, or construction manager must also have good skills in estimating costs in order to keep the contractor honest.

**B. Bid.** This is by far the most prevalent form of contracting, well understood by both the design and construction industry and by the finance and grant-making sectors. This model works best when there are a large number of contractors seeking work. When the bidding climate is the opposite, you may find that highly competitive bidding results in highly increased costs to the owner. In order to bid a job, you must go through the following steps:

**1. Match potential bidders to the job by a pre-qualification process.**

The contractor should be able to demonstrate not only experience with similar scope jobs, but also demonstrate the financial wherewithal to “float” the job from draw to draw. If a performance bond is required, the contractor must have good credit and a good track record in order to get a bond. If not, you should ask for a letter of credit for at least 1/3 the construction cost so the contractor can pay workers and suppliers steadily between draws.

**2. Prepare and forward bid documents.** Final drawings and complete specifications are required and should be made available to all eligible bidders. Often, a bid deposit is required for plans to separate the serious bidders from the casual “sniffers.” You should mandate that they fill out YOUR bid form, and include the necessary breakouts so that you can make informed decisions during the project management phase: separate line items by A.I.A. divisions, for example, will enable you to compare their electrical prices with other contractors. If one contractor bids \$4,000 for electrical work, and another bids \$40,000, you need to know why. If you let them submit a lump sum bid, you’ll have a devil of a time later on.

**3. Hold a Pre-Bid Conference.** You can decide whether to make this mandatory or optional, but a pre-bid conference, attended by your architect, engineer, and/or construction manager should be held where questions can be answered. It’s best to hold these conferences on site, if possible.

**4. Conduct Bid Review and Clarification.** No matter how hard you try, the contractors will bid “apples and oranges.” You must carefully review the bids and any alternates submitted by the contractors to make sure they’ve included everything, and included it only once. Remember that the lowest bid isn’t always the right bid. The European system, for example, always throws out both the highest and lowest bidder automatically. That’s not done in America, but you need to look very carefully at any “low-ball” bids.

**5. Select and Notify Contractors.** Once you’ve selected the “right” bid, notify both the winners and losers. They spent days on your bid; you owe them a phone call and the feedback on why they didn’t get the bid. There’s no reason not to share the other bids with the losing

contractors. On the other hand, there's no reason to share the losing bids with the winning contractor. If they find out they were too low, they'll be looking for corners to cut from day one. The more notice you can give the selected contractor, the more likely they'll start the job on time.

- 6. Approve Job Cost Breakdown.** You may need further job cost breakdowns in order to properly value-engineer the job. The time to ask for cost breakdowns is before the contract is signed, not after. You'll need to establish timelines for the construction and draw-downs. You'll need to know how much the contractor has allowed for each phase of the project before you can establish a good timeline and make accurate cash flow projections. For example, if they've only allowed \$50,000 for excavating and foundations, yet ask you for \$100,000 for completion of the foundations, you need that document in hand to make the case to only release \$50,000 less the retainage.

**C. Value Engineering.** Almost anybody can design something that you can't afford to build. The most effective groups know how to balance initial cost, life cycle costs, and operating expenses to create products that will last a long time without breaking the bank. In practice, value engineering is the presentation and analysis of construction material and practice options. For example, you may have specified 30-year shingles. The contractor says he can substitute 25-year shingles and save \$5,000 up-front. Value engineering is calculating the cost savings of the cheaper shingles, with the concurrent up-front \$5,000 principal and interest savings, and comparing those savings to the later cost of replacing that roof five years sooner. This involves applying an inflation rate to those shingles 25 years down the road, and comparing the bottom line for the project at the 30-year mark. You will probably be surprised to see how paying a little more for a more durable project actually saves you money in the long run; the faster the item wears out, the more money you'll save by doing it right in the first place. Replacing cheap faucets every two years will eat your maintenance department alive, and paying the water bills for all those leaky faucets should be part of the equation.

## **8. Property Management Plan and Preliminary Marketing**

You should develop a detailed property management plan with your selected property manager prior to awarding any construction bids. You probably had to submit a "Management Plan" as part of your funding applications. However, these are typically not much more than an identification of the likely property manager and their qualifications and experience, and a listing of services that they will provide, and are wholly inadequate for the ongoing management of a rental property. A real property management plan involves a thorough set of goals and guidelines for the following disciplines.

- A. Marketing and outreach.** How will you get the word out about your project to potential tenants? What techniques will you use, besides

newspaper advertising, to find eligible applicants? What local network of referrals can you tap into? Where would you distribute flyers? What kind of “free” publicity can you use to expand the potential market? The goals of marketing and outreach can be quantified by the number of applicants for units.

- B. Lease-up.** Who will do the intakes? What will be your criterion? Will you do credit checks? Criminal background checks? Reference checks? Home visits? How many person-hours will this take per applicant? Will you have the necessary staff on hand at crunch time? The goals of the leasing agent can be quantified by the occupancy rate and the number of families on the waiting list.
- C. Maintenance.** Even a new project will require maintenance. You can also expect heavy turnover during the first year of a new project, as many times tenants are “sold” on the dream of a brand-new unit but don’t necessarily like the reality of how you are going to run it. You may be too tough or too lenient, depending on their standards—they have no way of knowing until they try it. And turnover requires make-readies by maintenance staff. How many maintenance people will you need? What initial equipment and supplies will they need to do their job well? The goals of the maintenance staff can be quantified by turnaround time, the percentage of emergency calls handled within 24 hours, the number of non-emergency work orders completed within five days, and the number of preventive maintenance work orders completed monthly.
- D. Management.** Someone must collect the rent, evict the bad tenants, manage the maintenance staff, maintain the waiting list, oversee security, and pay the mortgage, taxes, utilities, vendors, and hired help. They also must set the initial and annual operating budgets. What are your collection policies? What is your inspection schedule? What controls will be used to keep the managers honest? The goals of property management can be quantified by turnover time, collection rate, and vacancy loss.
- E. Monitoring.** Affordable housing almost always comes with strings attached—monitoring requirements. Someone must fill out the monthly, quarterly, and annual monitoring paperwork, and distribute them appropriately. Typically, this includes annual income re-certifications. Who will do this monitoring? How many hours per month? Who will check on the monitors? The goals of monitoring can be quantified by percentage of monitoring deadlines reached.
- F. Accounting.** The monthly, quarterly, and annual property reports should include variance reports from budgets, and explanations of any variance above 5%.

**G. Preliminary Marketing.** Once you have finalized your Management Plan, it's not too early to begin preliminary marketing. Certainly, you will want to save the marketing "blitz" for later on, when you have a firmer move-in date, but you can begin getting the word out now. At the very least, you can prepare a job-site sign and plant some newspaper and television stories about your project. Although the funders may require you put up a sign listing giving them credit for giving you money, you may consider additional signage designed to catch the eye of potential tenants. You may want to consider building a model unit, which will need to be coordinated with the builder. You can begin spreading the word among the various referral agencies—the public housing authorities, homeless shelters, domestic violence shelters, church organizations, etc., who you have identified earlier on as potential sources for new applicants.

## **9. Resident Services Plan.**

A key ingredient to a successful rental property is the Resident Services Plan. As discussed earlier in Chapter 4, the overall goal of your rental project is to create a community of choice, and to become the landlord of choice in your community. There are three ways to accomplish this:

1. Strict screening and management processes that serve to eliminate illegal or disruptive activity and create a safe and pleasant environment for your tenants.
2. Excellent initial design and construction coupled with excellent ongoing property maintenance.
3. Resident Services above and beyond good maintenance and management.

The Resident Services Plan can include some or all items from the following menu of resident services, as well as the goals and policies that relate to them.

- A. Case Management
- B. Budget Counseling or Financial Literacy Training.
- C. Employment and Job Skills Training
- D. Access to Individual Development Accounts (I.D.A.'s) which match savings by residents one-to-one, two-to-one, or three-to-one, depending on the program.
- E. Resident Leadership Training
- F. Homeownership Training.
- G. On-site Day Care
- H. On-site Computer Labs, Tutoring Centers, Learning Centers, etc.
- I. Community Gardens
- J. Regular activities—outings, planting days, picnics, etc.

Your Resident Services Plan should not only include the menu options, but the goals, policies, and procedures for each element. The Resident Services Plan will also include the staffing, expenses, equipment, and space requirements for these activities, and a plan for providing the resources necessary to maintain these services.

Residents pay to live in your properties. If due to the agency's structure, funding, etc you are unable to provide quality of life at their homes, the agency must find and utilize funds to ensure that their needs for services are met.

## **10. Title Clearance, Partnership Agreements, and Closings.**

**A. Title Clearance.** Well before the closing, you should begin the title clearance process, to find and satisfy any outstanding liens, mortgages, or judgements against the property. However, you don't want to do your final title clearance until just before the closing, to ensure that a new lien or judgement doesn't crop up in the interim. You already did a preliminary title check during the predevelopment phase. Now you need to get clear title. This is almost always done by a Title Company. They will do a complete computer search and physical search of the county and state records. You may be required by a lender or funder to have a title insurance policy. However, this is redundant if you have clear title, and should be avoided if possible.

**B. Partnership Agreements.** You may have a partnership involved in this project, especially if it's a tax credit deal in which you are the general partner or co-general partner and there is a limited partner holding 99% of the original equity. If so, you must finalize the partnership agreement prior to closing. The partnership agreement must:

1. Describe the project
2. Declare the partnership interest (ownership split.)
3. Describe the Capital Contributions from each partner
4. Summarize the Compensation to the Sponsor and the Affiliates
5. Define the Credit Adjustments
6. Describe the Operating Benefits
7. Describe the Process for Disposition (Sales proceeds, Purchase of the limited partner's interest, Right of first refusal, Sale or refinancing splits)
8. General Partner's Obligations including guarantees and reserve requirements.
9. Opinion of Counsel
10. Description of who will pay legal costs and fees
11. Additional requirements, if any.

Consult your legal counsel for assistance in preparation of the partnership agreement.

**C. Closings.** Once you have clear title and a signed partnership agreement, you can proceed to Closing(s). You must close separately with every funding source prior to signing any construction contracts, and you can now close with the seller of the property. If you've gone through all of the steps outlined above, your closings should be easy. That said, few closings go smoothly. There is always a flurry at the end: faxing or messengering documents, etc. The housing developer should attend all closings if possible, to ensure that nothing slips through the cracks at the last minute. Obviously, your legal counsel will attend any and all closings as well.



**C. Construction Management.** Construction Management begins with the letting of contracts and ends with the Certificate of Occupancy.

### **1. Letting of Contracts**

Now that you have closed on your funding source, you can officially award the prime contract and any subcontracts for construction or rehabilitation. It is required that you use the Master Construction Contract, which will have as attachments the amended (final) plans and specifications. An attorney is typically not required to execute a construction contract. It is vital, however, that the housing developer and the project manager, if there is one, be completely conversant in the contract. Because the contractor will be.

### **2. Relocation**

You are ready to begin any relocation of tenants, if required. If there is HUD money involved in your project, you will have had to file a Relocation Plan with them during the funding process. Relocation is a tricky and expensive business. It is generally preferable to get the seller to do any relocation prior to taking title to the property. If this isn't possible, you will have to go through the following steps.

- A. Notification 90 days prior to relocation of any tenant.
- B. Provision at the developer's expense for new temporary housing of equal or better size and equal or better quality to the existing housing, with comparable access to transportation, shopping, etc.
- C. Provision at the developer's expense for moving expenses.
- D. Provision at the developer's expense for hooking up utilities

### **3. Pre-Construction Meeting**

Prior to the notice to proceed, you should hold a pre-construction meeting. Until you as project manager are satisfied with the results of the pre-construction meeting, you should not issue a Notice to Proceed. The contract will still be in force, but the pressure is on the contractor to work with you on the details covered by the pre-construction meeting.

A pre-construction meeting should include the contractor, project manager, architect, engineer, and construction manager, as well as any funder who will be taking an active role in approving payment requests.

A pre-construction meeting should cover the following topics:

- A. Clarification of chain-of-command and routing of paperwork, including shop drawings, catalogs, samples, project reports, scheduling reports, test reports, maintenance instructions, etc.
- B. Duties of owner, contractor, architect, construction manager, and monitor. A brief review of the general conditions and how the contract is intended to work.

- C. Submittal of insurance certificates, clarification of requirements and method of verifying ongoing coverages.
- D. Final submittals of shop drawings, engineering data, operation and maintenance manuals, tests and inspections, including required items, procedures, number of copies and distribution.
- E. Agreement on schedule of values and progress payment schedule, including retainage, payment for materials on hand and material stored off-site, payroll records that must be submitted with requisitions, etc.
- F. Submittal of list of subcontractors and prime vendors. This is critical so that you will be able to determine whether the releases of liens provided by the contractor are inclusive.
- G. Clarification of any employment practices such as prevailing wage, minority/women-owned business requirements, union labor, etc.
- H. Clarification of temporary utilities and charges.
- I. Scheduling. Job progress scheduling requirements, including frequency of updating, scheduling of submission.
- J. Clarification of methods for change-orders, interpretations of contract documents, etc.
- K. Clarification of security methods.
- L. Designation of parking areas.
- M. Designation of storage areas.
- N. Submittal of any required permits and clarification of inspection schedules.
- O. Clarification of right-of-way, site restrictions, special cautions regarding adjacent property, protections required such as trees, etc.
- P. Clarification of testing policies and procedures.
- Q. Clarification of overtime policies and procedures.
- R. Clarification of cleanup policies and procedures.
- S. Clarification of responsibilities for owner-furnished equipment and furnishings.
- T. Clarification of roles and responsibilities for record documents such as As-built drawings, manuals, warranty documents, etc.
- U. Clarification of roles and responsibilities regarding public relations, statements to media, restrictions on construction operations, construction sign requirements.
- V. Clarification of any separate contracts and the impacts on the work of the project.

#### **4. Notice to Proceed/Groundbreaking.**

At the end of the pre-construction meeting, assuming the parties are still amenable, you can issue the Notice to Proceed. At this point, you can also hold your official ground-breaking ceremony, complete with golden shovels. Invite everybody who wrote a letter of support, especially the politicians and community leaders, as well as all the funders. Make sure the contractor, architect, and administrative staff are invited as well.

Spend a little money, provide a little refreshment, and **MAKE SURE THE MEDIA IS THERE!**

One word to the wise: make sure somebody goes out with a pick and loosens up some of the soil first. There's nothing more embarrassing than watching a bunch of bigwigs and hotshots in suits trying to ram a shovel into compacted or frozen soil while the cameras are rolling and the voters are tittering.

## **5. Construction Management.**

The long hard dusty noisy aggravating road from actual groundbreaking to Certificate of Occupancy has begun. Enjoy the afterglow of the groundbreaking ceremony as long as you can. If the architect, contractor, monitor, project manager, and construction manager are still talking to each other by the end of the project, it will be an unqualified success. But take note of the following statistic from the National Association of Home Builders. Seventy-five percent of all projects over a million dollars have at least one lawsuit attached to it by the time it's all said and done. Granted, this may be a Small Claim by a subcontractor or vendor against the contractor, but the statistics are very clear—when big money is at stake, the lawyers aren't likely to be very far behind.

How do you avoid lawsuits? Easy! Don't do anything! Stay in bed with the covers over your head. A better question is, if you want to get something build, how do you avoid losing a lawsuit? The four P's: policies, procedures, process, and paper trail. It all begins with the Job Log.

**A. Job Log.** The job log should include every significant event that happens on a jobsite on a daily basis. It might not seem that way at the beginning. "Day one, contractor dropped off sawhorses, left. Day two, no sign of contractor." Don't fall into the trap of letting the log slide and only updating it periodically from memory. A construction log should include how many of the general contractor's workers were on the job, what subcontractors were on site, what material deliveries were made, what was accomplished by the end of the day, what inspections were made, what correspondence passed through your hands, and what the weather was. The weather? Yes! When the contractor pours concrete on a below-freezing day, and you've noted the temperature every other day of the week, when you're in court noting that you objected to their methods of protecting the concrete from freezing, the temperature you wrote down will have some validity. Details, details, details are critical in keeping a job log, because if your log shows that you noticed everything, then it's a valid document. If it only notes where you argued with the contractor, it then becomes an invalid and in-admissable opinion.

**B. Schedule Update.** Schedule a weekly formal meeting with the contractor, the main point of which is to formally update the schedule. Record how you feel about the schedule. How are the contractors performing? Are they on schedule, ahead of schedule, or behind schedule? Remember that replacing a contractor in the middle of a project can create a major problem with respect to scheduling and budget. It is almost always better to work through a scheduling problem than to replace the contractor. Remember how difficult their job is—they are constantly beset by weather problems, labor problems, material problems, and subcontractor problems. The estimator undoubtedly missed something, which the contractor must make up for, not only in terms of materials and labor, but also in time. Remember also that everything takes longer than you want it to. That's not an excuse, but it is reality. A good construction manager will stay on top of the project and make adjustments to size of work crew and perhaps the order of construction in order to make up time.

**C. Inspections.** Everybody inspects the contractor's work—the architect, the building inspector, the project monitor, and the sidewalk superintendents. But as the owner's representative, it's ultimately your opinion that counts. Keep your mouth shut during inspections as much as possible, and limit your questions to the task at hand. For example, refrain from spending time debating wallpaper during the footing inspection. Prior to inspecting, refresh your memory by looking at the plans and reading the applicable part of the specifications. You should be able to quote them chapter and verse to the contractor during your daily walk-through. Make a habit of carrying a tape measure, an accurate 4' level, and a flashlight on all inspections. This lets the contractor know you mean business. Also know when close enough is close enough. A 10' wall that's 1/8" out of plumb does not need to be corrected. Have a camera handy, and photograph representational typical work, especially that which will be covered. Carefully photograph anything that you do not intend to accept. Another handy item for inspecting finish work is a 200-watt light bulb with cord. Walk around, plug that baby in, and imperfections will leap out at you.

If you do not know the following terminology and methodology cold, get out the book and learn BEFORE the step happens.

- Overall: verify safe work practices. Verify appropriate storage and protection of materials.
- Excavation: Verify notification of Underground Facilities Protection Organization (UFPO) and that all underground utilities have been marked prior to allowing any excavation

work to proceed. Verify measurements, do not allow refilling of any excavation. Protection from flooding and freezing.

- Underground utilities and drainage: verify materials, verify inspections, verify backfill methods, verify protection of exposed ends.
- Grading and landscaping: verify materials, level, installation of driveway or walkway substrate and finish materials, appropriate protection of plantings, proper seed and mulch mix, watering.
- Concrete: verify measurements, check forming, test slump, verify mix, verify anchorage for other work, check width and edge condition at joints, attachments, finish, cracks, spalls, staining, verify protection from freezing or rapid drying.
- Masonry: verify measurements, layout, plumb and level, coursing, bond, headers, reinforcements, dowels, weeps, ties, flashings, anchorage for other work, protection from freezing or rapid drying.
- Waterproofing/dampproofing—preparation of substrate, application technique, seal, verify materials.
- Framing: Verify measurements, layout, plumb and level, materials, bracing, anchorage for other work, gluing and nailing patterns, partition types, stud spacing, gauges and doublers, verification of temporary protection such as Tyvek, plastic, or tar paper.
- Stairs: verify materials, rise and run, clearances, fasteners, adhesives, temporary protection, quality of finish work.
- Roofing: verify materials, fasteners, nailing patterns, seaming, flashing, gravel stops, temperature.
- Insulation: verify materials, integrity of vapor barrier, temporary protection.
- Siding, soffits, and fascia: verify materials, fasteners and fastening patterns, trims, seals, coursing, quality of finish work.
- Gutters and downspouts: verify materials, positive drainage, seals, anchors.
- Windows and Doors: verify materials, plumb and level, anchorage, layout, flashing, sealing, labels and seals, glazing materials, setting blocks and shims, protection or storage of hardware and/or screens, adjustment, operation, sealing of exposed edges (including bottoms of doors and window sash).
- Drywall and plaster—fire ratings, types of beads, fasteners, tape and joint compound.
- Suspended ceilings—coordination with mechanical and electrical equipment and fixtures, level, quality of finish work.
- Paint and finishes: verify materials and finish, proper priming, and number of coats, temperature.

- Flooring: verify materials, fasteners, preparation of substrate, protection.
- Trim: verify materials, fasteners, quality of jointwork, temporary protection.
- Millwork and cabinetry: verify materials, installation methods, plumb and level, quality of finish work, temporary protection.
- Equipment and appliances: verify materials, installation, adjustment, code issues.
- Elevator equipment and rails: locations and clearances.
- Electrical rough-in: verify materials, locations, clearances, alignment of electrical devices, coordination with other work, code issues.
- Electrical finish work and equipment: verify materials, finishes, locations, access, and code issues.
- Plumbing/sprinkler rough-in: verify materials, locations, clearances, code issues, coordination with other work, access to cleanouts and shut-offs.
- Plumbing/sprinkler finish work and equipment: verify materials, location, color, trim, code issues.
- HVAC rough-in: verify materials, locations, clearances, coordination with other work, finishes and protection of exposed equipment, protection, and access.
- HVAC finish work and equipment: verify materials, locations, clearances, alignment, coordination with other work, protection of exposed equipment, access, balancing.

It is critical that you maintain chain-of-command with subcontractors. Never address a problem with a subcontractor. Deal directly with the contractor and/or architect. Once you instruct a subcontractor, you have shifted a major liability burden onto yourself, as well as having subverted the chain-of-command. You can ask questions of subs, but never EVER give them instructions directly. Likewise, the architect or owner's representative who observes a questionable condition at the site should call it to the attention of the contractor, but should be clear that, under AIA Document A201, it is the contractor's responsibility to decide whether to correct the condition and how to correct it. For example, an owner's representative observing a scaffolding without a proper railing should point it out to the contractor but should not specify the kind of guard rail to use or how it is to be installed.

Only the owner has the right to stop all or portion of the work on the project. This must be done by written order from the owner or the owner's legal agent. Unless the architect has such legal power, (which they do not have under the standard owner/architect agreement) the architect does not have the right to stop work on the project.

#### **D. Progress Meetings, Progress Payments, and Retainage.**

The frequency of progress meetings is decided by the project manager, or by the architect. The contractor can ask for a progress meeting if they want a progress payment. The purpose of these meetings is to discuss schedules, costs, change-orders, problems, and unacceptable work. The contractor is required to provide access to the work and if requested by the architect or project manager must uncover work that has been covered up contrary to the architect or project manager's request. The architect or project manager has the right to request additional inspections and/or testing and has the right to reject nonconforming work. The contractor has the obligation to promptly correct such work.

It should also be noted that the owner has the right to accept nonconforming work, and, if appropriate, to adjust the contract accordingly. Typically, progress meetings are held on site, and these problems can be addressed directly.

The architect and/or project manager is required to monitor the progress of the contractor's work relative to the established schedule, and to make status reports to the owner. Whenever the contractor or subcontractors fall seriously short of the established schedule, the owner's representative should request a revised plan to re-establish the schedule. This revision may entail overtime work, additional workers, replacement of the contractor, or joint venture contracting at the subcontractor level. This is usually an unpopular solution to the contractor, since it means bringing in a subcontractor to work, at the contractor's expense, with the offending subcontractor in order to make up the lost time.

Typically, if the contractor requests a progress payment, they must submit an A.I.A. G702 (Summary Page) and an A.I.A. G703 (Application and Certification for Payment) to the architect and project manager at least a week prior to the meeting to give them a chance to review the documents. They detail the amount for each portion of the construction project, the amount the contractor believes they have completed, and the amount they are requesting. The determination of whether or not the contractor's estimate of the percentage finished is not an exact science. The question you should ask yourself is simple: if the contractor walked off the job today, could I find a contractor to complete the work for the amount that is left? If a progress payment is accepted, the architect and project manager must sign off on it.

If a contractor submits a payment request for \$100,000, under most construction agreements they will only be paid \$90,000. The other 10% is called "retainage"—the amount of money held by the owner to ensure that the contractor fulfills the contract. Retainage is a critical element to a successful construction project. At some point, it can become more cost-effective for a contractor to walk away from a job than to complete it,

especially if there is no performance bond or provision for liquidated damages. Think of it this way. If the job doesn't go particularly well, the contractor may have spent \$90,000 out-of-pocket to get 90% done on a \$100,000 job. If he's been paid \$90,000 to get 90% done, then he's likely to have to spend another \$10,000 out-of-pocket in order to get paid \$10,000. There's no profit in it. He's better off walking away, and working somewhere else where he has a fresh chance to make a profit. However, if he's only been paid \$81,000 (\$90,000 minus ten percent retainage), then he stands to receive \$19,000 to do \$10,000 worth of work. He thus has incentive to finish up, even if he doesn't make any profit. He can't afford to walk off the job and leave \$9,000 on the table. If he does, that \$9,000 is going to come in awfully handy to pay the next contractor to come in and complete the work.

Retainage should only be paid after the Certificate of Occupancy has been issued and the punch list has been satisfied.

#### **E. Davis-Bacon Reporting.**

If the job is under Davis-Bacon wage guidelines (prevailing rate) the contractor must prove that he is paying prevailing wages to all workers in his employment, and certifies that any employees of his subcontractors are also being paid prevailing wage. Davis-Bacon is typical under Community Development Block Grant (CDBG). The CDBG funder has the responsibility of verifying that the workers are indeed receiving a prevailing wage under their classification. This means asking them, out of the hearing of their foreman or supervisor, how much they are being paid, and comparing that to the wage classification the contractor has declared for them. It is also incumbent upon the CDBG administrator to verify that laborers (lower wage classification) are not performing finish carpentry work (higher classification), for example, or that carpenters are not driving heavy equipment (even higher classification). In practice, this is nearly impossible for anyone except the project manager to verify, since CDBG administrators do not visit jobsites regularly. Generally, however, big contractors are used to prevailing wage guidelines and file the paperwork properly. Still, spot checks are recommended.

#### **F. Change-Orders.**

If a change to the original plans or specifications is necessary, an AIA G709 (Proposal Request) asking the contractor for a proposal to complete a certain task. Once the contractor submits a price for the proposed change, the architect fills out an AIA G714 (Change-order) directing the contractor to proceed with the change. If the contractor requests a change to address a problem or specification that isn't in the plans, they fill out an AIA G701 (Change-order). However, the architect is not required to accept a G701 if they feel the contractor should have either foreseen the problem, caused the problem themselves, or if they believe that the plans and specifications are sufficiently clear that the change-order is unnecessary. This is where the third-party (tie-breaker) intervention of a project manager is especially important. Contractors sometimes bid a job below costs and try to make up



their profit in change-orders. Architects seldom admit that their plans and specifications weren't perfect. In a good working situation, a good project manager can act as judge. However, be very clear that the project manager does not have the power to BE a judge, and G701's are the most often-litigated element of a construction project. An AIA G710 Architect's Supplemental Instructions is sometimes filled out by the architect to clarify something in the plans or specifications.

Once a change-order is signed, the payment for that change-order should be added to the next appropriate progress payment once the work is completed. It is entirely unfair to add change-orders to the retainage, since the contractor must pay for the work, and 90% of the time, the change-orders are the fault of either the architect or the owner. However, it is entirely appropriate to take retainage on any change-order. For example, if a change-order is for \$1,000 to add a wall, the contractor should be paid \$900 upon completion of that wall at the next progress payment.

### **G. Contingency Management.**

Most construction contracts have a contingency, since construction is by nature an inexact science. However, it is critical that you not allow a contractor to manage your contingency. If the contractor bids \$100,000 for a job, the owner should have between 5-10% in reserve for a contingency to cover change-orders. But DO NOT allow the contractor to include a contingency in his contract. If the contingency is not used, it will simply go into their profit line. Change-orders should be paid out of the contingency and the contingency balance should be tracked. Don't fall prey to the idea, however, that you have to spend your contingency during construction. If things go smoothly, there will always be appropriate places to spend that money—additional landscaping, amenities, etc. Or simply use it to pay down the principle on the mortgage!

### **H. Lien Releases**

Construction liens in most states are called Mechanic's liens. These are recorded with the County Clerk and prevent the transfer, sale, or mortgaging of the property until the lien is satisfied. They are placed on a property when the contractor, subcontractor, material provider, or design professional is worried about getting paid. At each progress payment, you should be provided with a Lien Release (or Lien Waiver) by any subcontractor or vendor who has supplied labor or materials to the job during that time period. This protects the owner against claims, founded or unfounded, that subcontractors or vendors have not been paid by the contractor. DO NOT APPROVE A PROGRESS PAYMENT WITHOUT A RELEASE OF LIEN! You may find yourself unable to close on your permanent financing because of a small lien by the plumber, or at least having to escrow the amount of the lien. It is the contractor's obligation to pay the subs and suppliers. If they are paying them, they will provide the lien waivers. If the contractor says they're having difficulty getting a lien release, that is not your problem. Simply

approve what you have lien releases to cover, and hang onto the money until the contractor and his subs and suppliers have reached agreement.

### **I. Cost Versus Budget**

As project manager, it is your job to track costs versus budget for the owner. While all the paperwork required for payment requests and change-orders effectively tracks the construction costs, the other costs (utilities, architect's fees, etc.) must be tracked. It is very important keeping a good handle on how the money is being spent, and how quickly compared to the original cash flow projections. There is little point in waiting until the end of the project to fill this in, except to help inform you for the next job. Doing it as an ongoing discipline will enable you to fix problems before they become insurmountable. The simplest method is to use the Cash Flow sheet from the Quick and Dirty Housing Feasibility Analyzer. It will automatically calculate the overrun as you enter the data.

### **J. Punch Lists**

A punch list is the list of incomplete or unsatisfactory items identified by the architect, monitor, owner, and/or project manager. As the project nears completion, the project manager must prepare a punch list so that the contractor knows what remains to be fixed before getting final payment. Be detailed and critical during the first inspection to avoid adding things to the punch list every time you walk into the building. While editing of the punch list does happen, after the fourth or fifth edit you start to look incompetent. On the other hand, in fairness to the contractor, you should make them aware of problems with work performed by significant subcontractors before these subs are off the job completely. Most punch list items should therefore be handled as part of the weekly progress meetings. The final punch list should be just that: every complaint you have. Once the contractor has satisfied that list, coming up with new items signals to the contractor that you are simply delaying final payment.

### **K. Certificate of Substantial Completion**

The AIA G704 Certificate of Substantial Completion establishes the date at which the clock starts ticking on warranty items. It also establishes the time allowed for completion of other items. When an architect deems that the project is substantially complete, he can recommend adjustment of retainage, if it is provided in the contract. When the Certificate of Substantial Completion is filled out and signed by the architect and owner's representative, however, you are obligated to pay the contractor the full amount of the contract plus change orders, less retainage. Failure to do so can result in a lawsuit.

### **L. Certificate of Occupancy (C.O.)**

A Certificate of Occupancy is issued by the local building inspector, and is required before any new or relocated tenants can occupy the building. This does not necessarily mean that the project is complete. For example, in some places and by BOCA code you do not need floor covering for a C.O.,

and significant exterior work such as gutters, landscaping, lighting, security, etc, do not need to be functional. It just means that it is safe enough for occupancy. This certification should not be taken as an approval to pay the contractor.

**D. Asset Management.** Asset Management begins with the Certificate of Occupancy and is ongoing until the property is abandoned or sold. Asset Management is the acquisition, administration and disposition of properties in order to fulfill the goals of the owner.

### **1. Construction Close-Out**

You might ask why this wasn't included in the development phase section of this manual. After all, the project manager brought us this far. The answer is simple. Construction close-out includes the warranty and call-back phase, and the delivery of as-built drawings to the owner. This needs to be closely coordinated between the project manager, property manager, and the asset manager. Much of the onus is on the contractor, since the final retainage will not be released until the Close-Out phase is complete.

The Project Close-Out Process calls for the contractor to:

- Request architect's inspection for substantial completion, if that has not yet been done.
- Provide a list of incomplete items, stating the reason why each of the items is incomplete. The monetary value of each item should be stipulated.
- Notify the owner relative to any changes in insurance coverage requirements.
- Submit all general and special warranties, maintenance contracts, and required operating instructions.
- Obtain the certificate of occupancy and similar releases that permit the owner's full and unrestricted use.
- Submit record documents. The contractor is required to maintain at the site a copy of all drawings, specifications, addenda, etc., with all changes made during construction recorded, called "As-Built" drawings and specifications. The final versions of these documents, incorporating all contract changes, are submitted to the architect and owner.
- Deliver replacement and maintenance stock of material if this is specified as part of the work.
- Complete the keying schedule, delivering it to the owner with properly tagged master, submaster, and room and special keys. Make final changes to lock cylinders and plan for shifting the responsibility for security to the owner.
- Instruct the owner in the operation and maintenance of all systems and equipment.
- Thoroughly clean all areas of construction debris

- Restore all damaged finishes
- Submit all required guarantees, certificates of inspections, and bonds. It is customary to require the contractor to sign a written guarantee at the completion of the work that covers all items requiring guarantees under the specifications and to distribute copies to both owner and architect.

It is highly advisable that the contractor, local property manager, and the maintenance supervisor get a tour of the building with the as-built drawings in hand. During this inspection, all access panels, shut-offs, clean-outs, etc., should be carefully checked. The property manager and maintenance supervisor should be sure that they have key replacement data in hand—paint colors, flooring numbers, etc.

Once the full retainage has been paid, the property manager and/or asset manager will still be in contact with the contractor as problems inevitably crop up which fall into the warranty category, as opposed to maintenance issues. It should be noted that there is very little incentive for the contractor to return and do warranty work. Therefore, if satisfaction is not achieved promptly with a phone call, it's best to begin laying a paper trail by sending written requests by registered mail, with specific deadlines, with copies prominently sent to the local attorney. Registered mail tends to get a contractor's attention.

## **2. Lease-up**

While marketing and leasing should have been ongoing well prior to this step, the pressure is really on now that the contractors have pulled off the job, especially in tax credit deals. Before the final equity funds are released, and with it the developer's fees, the project must hit 95% occupancy.

## **3. Monitoring**

The monitoring you do will be determined by the funding source. It is critical that understand the monitoring requirements are well understood by the property management staff, and that the system and personnel are in place to re-certify tenants, assemble the necessary documentation and data, and send that documentation to the right place at the right time. It should be a routine task, with sufficient planning so that "scrambling" is unnecessary.

#### **4. Asset Management**

The Property Manager Reports to the Asset Manager, and the Asset Manager reports the Executive Director and a committee of the Board. The property manager should have clear goals and targets for the property; the asset manager should ensure that those goals and targets are being met. The property manager is responsible for the appearance, function, and profitability of the buildings, as well as the level of customer satisfaction with the program. The asset manager is responsible for verifying that the reports from the property manager are accurate. In small organizations, the Executive Director must act as the Asset Manager, but it's difficult for one person to be both the property and the asset manager. The Asset Manager should work closely with the Executive Director and the Board, and must prepare concise and accurate reports for them on a regular basis. The budget versus actual reporting, the capital needs program, and the use of reserves, and the ongoing decision to keep or sell properties are the responsibilities of asset managers, but these decisions should not be theirs alone. Neighborhood considerations, partnership issues, and other factors which the board understands influence these decisions.

The key to good asset management is good reporting. Using quantitative reporting methods, property management reports can be used to gauge staff performance and to pick up early trends in key performance areas. Historic and internal measurements provide useful tools for reviewing historic performance, and as a method of comparing property and company performance against local and industry standards. It allows staff to know how they are doing, not only against their own internal goals, but against the industry in general.

Another major benefit of indicator reporting is to provide summary information to the Project Committee, the Board of Directors, funding, and regulatory partners. The reporting needs of the property management department and oversight entities are often quite different. Internal staff reports often contain very detailed information that is needed by the manager for staff evaluation and comparison, while Board reports require clear and accurate summary information and trend data. Good indicator reports determine what small amounts of summary information best provide a broad and accurate picture of agency operations. Certain detailed information can be helpful as well to Board members, such as which sites are performing and which are lagging. However, in developing Indicator Reports, managers should ask themselves the question, "If I have my board's attention for 15 minutes, what information do I need to make sure they get?" Well-prepared summary information can lead interested board members to ask other questions and seek detail in areas of concern or interest.

Management indicator reports should include at a minimum the following:

- Occupancy Rate
- Turnover Rate
- Vacant Unit Turnaround Time
- Rent Collection

- HQS Inspections and Quality Control on HQS Inspections
- Emergency and Other Work Order Completion Percentages
- Budget vs. Actual Performance
- Cash Flow

Other items which are helpful and are worth including under some circumstances include:

- Rent recertification status (how many recertifications are due and completed)
- Quality control on workorders, inspections.
- Waiting List Information
- Cash Reports
- Accounts Payable
- Management performance on specific goals such as resident services.

What are the elements of a strong asset management system?

- ✓ **Commitment to Asset Management.** Recognizing the value of asset management is often the first step towards financial stability in a rental portfolio. Property management should be checked by the asset manager, and the asset manager should be checked by the executive staff or board. A Building Needs Assessment for each property should be made and maintained. The Asset Manager must be managing short-term and planning long-term. Knowing how the portfolio is performing, versus expectations, and keeping track of those trends, is a key ingredient to a well-run program.
- ✓ **Good Reporting.** Easy to understand, accurate, comprehensive, and timely reports should be available for annual audits. The board committee overseeing the property and asset management program should be able to quickly check key indicators on a monthly or quarterly basis to see how the program is going. The audit should verify that rents are being collected and deposited, security deposits are being paid, income verifications are being done and filed, and vendor, debt service, tax, and utility payments are being made regularly. When big dollars fly fast, someone needs to track their flight methodically. Two-signatory check-writing systems, accredited auditing, and periodic program reviews are necessary to ensure that taxpayer dollars and borrowed funds are properly spent.
- ✓ **Needs Assessments and Maintenance Schedules.** Knowing when the roof is due to be replaced, when the boiler is scheduled to fail, and how long the appliances are projected to last are critical information which the asset manager must have to run their program. A building needs assessment shows when major work will be needed, and how much it will cost. It should be compared regularly to available reserves. Being able to plan for replacement prior to failure is vital. Having a system for staying on top of regular maintenance is another crucial piece of good asset and property management.
- ✓ **Linked Reporting Systems.** There are a lot of numbers in rental management, and a myriad of reports. The “back-office” functions of a

successful property management system are the keystones. Having linked systems which track move-in/move out data, collections, arrears, utility costs, and overhead costs, and which compare actual expenditures to budget projections regularly is the mark of an excellent property management program.

- ✓ **Commitment to Quality Property Management.** Good intentions aren't enough. A quality property management system includes marketing, selection, collection, eviction, budgeting, reporting, maintenance, and overall management. For affordable or subsidized housing projects, this expands to include funder compliance, income verification, and more complex reporting requirements.
- ✓ **Aggressive Marketing and Leasing Techniques.** Knowing the market conditions at the time the property is built or acquired is part of the work of the development team. But staying on top of changes in that market is the job of the property management department. Informed and aggressive marketing techniques often spell the difference between high and low vacancy in a building: they generate the pool of potential tenants. Good screening techniques ensure that those tenants have good credit histories and good landlord references. For example, Troy Rehabilitation and Improvement Program (TRIP) has reduced both its vacancy and turnaround in the last year by more aggressive tenant screening and increased satisfaction to its existing tenants. In other words, they evicted the old troublemakers and screened out new troublemakers. Their existing tenants are happier because they don't have to live amidst troublemakers, and the reputation of TRIP's properties has improved. They streamlined their operations, underwent a series of assessments, consultations, and peer-to-peer mentoring, and their bottom line got dramatically better. Once at 30%, TRIP's vacancy has been cut to single digits, trending toward full occupancy.
- ✓ **Low Turnover, Low Vacancy, High Collection Rate, Fast Turnaround.** There are many indicators for a good property management operation, but among the easiest to quantify are: turnover rate (should be 15% or less), the vacancy rate (should be less than 5%) the collection rate (should be 100% of subsidized rent and 95% of all rent) and turnaround time (should be 15 business days or less from move-out to move-in). Having this information at the ready, and being able to analyze it properly, is vital to an efficient program. There are tactics for attacking each of these problems individually. For example, vacancy is often due to poor waiting list management, poor marketing, lack of maintenance to the property, or poor safety and security.
- ✓ **Long Term Strategic Planning.** All too often, non-profits develop properties and then immediately sell them. While this tactic has some benefits (public funds revolve, private sector investments increase), it also has some drawbacks. The primary flaw in refusing to hold onto rental properties is that the non-profit loses control, and doesn't enjoy the potential financial benefits of a good property. Let's face it: landlords often get rich. Why let profits and equity from low- and moderate-income families end up in some landlord's pocket when the non-profit can recycle them back into the community?

- ✓ **Focus on Resident Services, Resident Leadership and Resident Self-Sufficiency:** Non-profit landlords can offer resident services far above what private landlords are able or willing to provide, such as Individual Development Accounts, job training, day care opportunities, and homeownership counseling. As a direct result, these properties will be more competitive in the marketplace. One of the challenges we see facing the NeighborWorks® organizations is a limited capacity to manage and fund these services, provide training and services to strengthen leadership development and service systems, and fund these services out of the operating funds of the properties through deeper equity investments in properties.



## **II. Internal Operations – Roles and Responsibilities**

Depending on the size and structure of the organization, the following departments will vary. For purposes of this manual, overall responsibilities for each department are being addressed, even though they may be delegated to more than one person. Sample job descriptions are attached.

### **A. Real Estate Development Staff**

The real estate development team designs, manages, and implements strategies that address the organizational goals for real estate development and asset management established by the board of directors.

Staff should identify areas for reinvestment, identify properties for acquisition, investigate potential properties and/or land for acquisition, handle negotiation of these acquisitions, perform financial feasibility analysis, prepare funding requests for acquisition and development, act as a liaison to property management, and act as project manager for any development projects. They must be able to negotiate contracts with architects, contractors, and other consultants and coordinate their efforts.

The development team must oversee project-related community outreach and education. Resident services plans must be established and implemented.

A key responsibility for the development team is packaging the appropriate financial resources needed for each project. These resources need to be properly monitored and adjusted as necessary during all phases of the project. A pipeline of new development projects needs to be maintained. Communication with the board of directors, project committee members, the executive director, and accounting staff are crucial to managing the development process. Cash flow needs for each project need to be clearly defined and updated regularly by the development staff. Any reports generated on actual expenses need to be reconciled back to the general ledger activity submitted by the accounting staff.

Completed projects must be monitored for performance. Trends need to be evaluated and reported to the project committee and the board of directors. Capital needs assessment, maintenance schedules, collection rates, turnover, and vacancy rates all need to be quantified as part of a long-term strategic plan for each project.

## **B. Accounting Staff**

The accounting team has significant responsibility for real estate development project reporting. A general ledger needs to be established to identify the budget and expenditures from the pre-development phase through the completion of the project. The accounting staff will monitor available funds for payment of expenses and will prepare invoices to sources as needed. Adjustments to the budget based on data from the real estate development team will be reflected in the reporting.

While the accounting staff does not have primary responsibility for cash flow needs for each project, they shall maintain sufficient capital and operating reserves for new or potential acquisitions in the budget of agency, based on recommendations from the board of directors. Any deficiencies in cash flow on existing projects need to be reported immediately to the development staff for appropriate action.

The accounting team will reconcile any inter-company accounts with redeveloped properties no less than semi-annually, based on the reports submitted from the property management team. They will assist the development team in reconciling internally generated reports back to the general ledger.

The accounting staff will retain copies of the development services agreements for each project. A schedule of developer fees receivable will be maintained. The agency's budget for developer fee income will reflect anticipated cash receipts during the fiscal year, based on the development team's projections.

## **C. Executive Director**

The Executive Director will work with the internal staff to ensure a smooth process for development, keeping in line with the organizational mission. He/she will report updates to the board of directors and give guidance to the real estate development and accounting teams. He/she will assist in the procurement of adequate capital needs for development projects.

## **D. Property Management Staff**

The property management staff will be responsible for marketing and rent-up of the agency's real estate portfolio. They will provide the day to day operational support and provide timely reports to the asset manager for review. They will ensure that appropriate measures are taken to abide by

the restrictive covenants placed on each property by various funding sources.

#### **E. Auditing Firm**

The auditing firm hired by the agency will provide independent analysis of each project's financial information. They will verify costs, funding sources including loans, grants, and investments in projects, test internal controls, and value development fee income.

#### **F. Board of Directors**

The Board of Directors function is to provide direction to the agency through strategic planning methods. They also have a fiduciary responsibility to ensure proper use of the organization's funds. The board may assign a committee to oversee and provide direction on development projects. This committee could be made up of area residents, experts in the field, and other stakeholders in the community. The Board can also set aside funds to be used on future development projects, known as Board-Designated Funds. These funds would be restricted, needing board approval for usage.

### **III. Risk Management – Internal Controls**

During the predevelopment phase, and each phase after, the agency should identify, measure, monitor, and manage business risks. A plan should be established to avoid unforeseen events that could threaten the agency's viability. Key indicators and ratios should be developed by management to track and measure regularly the performance of each project during the various stages of development. Management should determine the acceptable range for each indicator, outside of which would indicate excessive risk exposure. Management also determines the frequency with which each indicator should be monitored and analyzed. Following a procedure manual, like this one, will also assist in mitigating risks. The effectiveness of current policies and procedures should be tested to determine if they are having the desired outcome and whether the agency is adequately managing its risks.

#### **A. General Ledger**

##### **1. Account Setup**

The general ledger system used for development accounting should be consistent between projects. Costs from predevelopment to post-closing and rent up phase all need to be captured appropriately. The more detailed the ledger, the easier it is for the real estate team to understand and manage the project. For projects at multiple sites, mixed usage, and those requiring different levels of funding, it would be best to capture all costs separately to accurately determine the financial picture of each area. If costs come in for the overall project, they can be allocated based on a formula generated by the development team. (Example: by % of total units, by % of projected total costs, by % of acquisition cost, etc.)

The categories for development accounting are generally broken up in the following manner:

##### **Assets:**

- Cash
- Reserves
- Building
- Land
- Equipment
- Security Deposits
- Construction\*

##### **Liabilities:**

- Accounts Payable
- Security Deposits Payable
- Interest Payable
- Due to Related Organizations
- Construction Loans
- Other Loans

Capital:  
Equity from Investors  
Equity from Related Org  
Operating Revenue & Expenses\*\*

\*Construction tends to have the most detailed accounts for project reporting – see attachment for an example.

\*\*Operating costs may occur when an occupied building is purchased by the agency. Otherwise, these costs would be captured after development by the property management staff.

## **2. Reporting**

The timeliness and accuracy of financial reporting is crucial for the development team to make appropriate decisions during the phases of development. Any discrepancies to data presented needs to be followed up and recorded promptly.

## **3. Files**

Project files must be maintained to allow access of pertinent information by various staff members. Accounting staff should maintain accounts payable files, bank statements, loan documentation, financial reports, contract/loan billing requests, development services agreements, and audits. Development staff should maintain insurance information, closing documents, contractor information, funding applications, asset management reports, and any other documents related to the development or holdings of the agency's real estate portfolio.

## **B. Cash Flow Needs**

### **1. During Predevelopment**

Due to the inherent risks associated with developing real estate, the agency should maintain a balance of funds to be used to seek out new project possibilities. Costs are incurred from the beginning of predevelopment, and may not be repaid by other sources, especially if the project does not come to fruition. Therefore, funding needs to be identified at the onset of each endeavor.

### **2. During Construction**

Any cost overruns from a project should be documented by the real estate development staff, with recommendations on how they will be recouped. Delays in construction from various factors can also have a significant impact, and should be monitored appropriately.

### **3. During Rent-Up**

Once the project has gone into rent-up phase, it should be generating enough income to support its operational needs. There could be situations however, that this is not the case. Adequate reserves

should mitigate any risks to the agency, but if this is not the case, the agency may need to find additional resources, especially if rent increases are not possible.

### **C. Communication Log**

In order to establish strong control systems for real estate development projects, the real estate team and accounting team should meet regularly to review information on projects in various stages of development. Reporting should be reviewed, projections for the next steps for each project should be discussed, and any issues flagged by either party should be explained for clearer understanding. Depending on the number of projects being managed, and the complexity of each, these meetings should be scheduled every two weeks or, at a minimum, once a month.

Any significant results of the communication log should be reported to the executive director and/or the board of directors. This process incorporates a continual “feedback loop” from and back to the board and senior managers to ensure they receive the information they need, that the information is accurate, and that it is consistent with the risk parameters set by the agency.

### **D. Cost Overrun Plan**

As part of a strategic risk management process for development, contingency plans beyond the scope of the project budget should be established for the agency. This plan is the responsibility of the Real Estate Development Director, Operations Director, and the Executive Director and should be reported to the Board of Directors.

### **E. Budgeted Fee Income Analysis**

For purposes of creating an annual budget for the agency, the development and accounting teams must determine what projects will be producing fee income for each fiscal year. The total amount budgeted in fee income should be identified, with the timing of cash receipts, based on the development services agreement. These amounts should be further analyzed to evaluate risks for each project. The weight each project is given on risk will determine the end result of what is budgeted as income for the agency. Additionally, while income should be maximized for all projects, some of the developer fee should be reserved for future project needs. This can be determined by the board of directors at the time of receipt, based on the organization’s overall financial health, cash flow projections, and other factors.

Beyond developer fee income, the agency shall also budget for resident service fees for each project. These fees are paid out of the operations of the project and offset the costs of providing supportive services.

#### **IV. Attachments**

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## Sample Chart of Account Structure

FF-ACCT-TP-LL

FF = Fund

ACCT = Account

TP = Type (Development or Operating Exp)

LL = Location (If more than one)

### Assets:

Development Cash  
Operating Reserve  
Replacement Reserve  
Initial Rent Up Reserve  
Marketing Reserve  
Insurance Reserve  
Real Estate Tax Reserve  
Tax Credit Monitoring Fee  
Working Capital Reserve  
Operating Savings Account  
Security Deposit Account  
Tenant Receivable  
Subsidy Receivable  
Prepaid Insurance  
Prepaid Taxes  
Building  
Land  
Equipment  
Loan Fees  
Construction  
Demolition  
Construction Contingency  
Architect Design  
Architect Inspection  
Engineering Fees  
Construction Loan Origination Fees  
Construction Interest  
Insurance  
Construction Bond Fee  
Lender's Counsel  
Development Fee Payable  
Permit Fees  
Acquisition Loan Interest  
Permanent Loan Origination Fee  
Permanent Loan Credit Enhancement  
Tax Credit Fees  
Title Insurance and Recording  
Transfer Taxes  
Bond Premium

### Assets (Cont'):

Lender's Counsel  
Soft Cost Contingency  
Appraisal  
Market Study  
Soft Cost Contingency  
Environmental Study  
Site Survey  
Relocation Costs  
Legal Fees  
Accounting Fees  
Development Overhead and Profit  
Consultant Fee  
Syndication Legal  
Syndication Accounting  
Syndication Fees  
Syndication Consultant  
Bridge Loan Origination Fees  
Bridge Loan Interest  
Investor Servicing (Capital)  
Holding Costs

### Liabilities:

Accounts Payable  
Due to General Partner  
Security Deposits Payable  
Security Deposits Accrued Interest  
Real Estate Taxes  
HOME Funds  
CDBG Funds  
Other Funds/Loans  
Construction Line of Credit

### Capital:

Tax Credit Equity  
General Partner Equity  
Retained Earnings



## **Sample Chart of Account Structure (Cont')**

### Revenues:

Rental Income  
Subsidy  
Vacancy  
Laundry  
Late Fees  
Other Fee  
Interest Income

### Expenses (Cont'):

Depreciation  
Amortization  
State Taxes

### Expenses:

Management Fees  
Resident Leadership Fees  
Accounting/Auditing  
Legal  
Advertising/Marketing  
Office  
Subscriptions  
Telephone  
Travel  
Bad Debt  
Other Administrative  
Electricity  
Heat  
Water  
Sewer  
Security  
Salaries & Wages  
Administrative Payroll  
Maintenance Payroll  
Payroll Taxes  
Employee Benefits  
Cleaning & Supplies  
Cleaning Payroll  
Repairs & Maintenance  
Safety Inspections  
Grounds Maintenance  
Exterminating  
Trash Removal  
Extraordinary Repairs  
Rehab Costs  
Real Estate Taxes  
Property Insurance  
Worker's Compensation  
Mortgage Interest  
Interest

