

Real Estate Development

Policy & Procedure Controls

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ATTACHMENT: REAL ESTATE POLICY MANUAL (DRAFT)	

ABSTRACT

Developing real estate is a complex undertaking. Many non-profit agencies that develop affordable housing find the process to be, at times, overwhelming. There are many factors to be considered and each project is different from any others that have been completed before it. Many risks are assumed by the non-profit in this business. Because there are decisions to be made by managers throughout the development process, a policy and procedure manual will assist the team in recognizing each other's roles and provide a guideline for effective risk management and minimize financial impacts to the agency, and ultimately to the residents.

SUMMARY

Target Community:

The target community that benefits from this project is a group of statewide non-profit housing agencies in New Hampshire: Affordable Housing Education & Development (AHEAD), Cheshire Housing Trust (CHT), Concord Area Trust for Community Housing (CATCH), Laconia Area Community Land Trust (LACLT), Manchester Neighborhood Housing Services (MNHS), Neighborhood Housing Services of Greater Nashua (NHSGN), and The Housing Partnership (THP).

Problem Statement:

Establishing communication through a development policies and procedures manual will prevent CDC agencies from losing fee income used to fund operations, avoid cash flow issues, and increase capacity to sustain vital programs. Without proper controls and communication, development of affordable housing suffers from a lack of adequate accounting practices, loss of shared information needed to make important decisions to contain costs, and a higher risk of project delays or possible failure due to diminished resources.

Goal Statement:

Internal controls will be established and monitored at MNHS to improve communication and reporting for new projects. Statewide partners will become more active in working together to create synergy between the real estate development and accounting staff. Statewide partners will also be involved in editing the manual to address their needs.

Current Conditions of Target Community:

None of the seven statewide partner agencies currently have a written document to guide their development process. Until this past year, the accounting staff had met as a group to discuss issues of importance, but the development staff had not met in the same manner, or with the accounting staff to talk about issues they have in common. Many agencies have been frustrated with the lack of a procedure to follow. They feel that often times, managers are making decisions without clear communication to others that are impacted by those decisions. Most agencies have a difficult time in getting the development and accounting team's reporting to reconcile, which adds to the level of frustration. They all are concerned about how to pay for predevelopment costs on new projects and how to handle the risks associated with housing development

Desired Conditions of Target Community:

By implementing a development policies and procedures manual, staff will be able to streamline their processes, increase efficiencies, and make decisions with a better understanding of the implications to the agency. The statewide group will act as a resource to assist each agency in implementing and improving their processes. This project will build capacity of the statewide agencies involved in housing development.

Project Objective:

By April 2003, I will have a draft manual for development policies and procedures. I will distribute it to all of the statewide partners for feedback.

Major Outputs for successful completion:

- Discussion results from focus group meetings

- Discrepancies of data between real estate and accounting department reporting
- Existing Real Estate Development Manuals
- Discussion results from the perspective of the auditing firm for affordable housing agencies
- Documented risk assessment of prior MNHS projects
- Feedback from distribution of draft manual to update and make necessary changes or adjustments

Major Outputs achieved:

- Discussion results from focus group meetings
- Discrepancies of data between real estate and accounting department reporting
- Existing Real Estate Development Manuals

Major Outputs partially achieved:

- Discussion results from the perspective of the auditing firm for affordable housing agencies
- Documented risk assessment of prior MNHS projects

Major Outputs, no tasks have been initiated:

- Feedback from distribution of draft manual to update and make necessary changes or adjustments

Conclusion/Recommendations:

The goals and objectives for this project have not changed, however some of the details of what to include in the manual have been enhanced from the discussions held

with the statewide partners. We have also recognized that the manual, in and of its self, will not solve the issues faced in developing affordable housing. Effective communication between departments that results in minimizing cost impacts and provides a clearer understanding of the situation will positively affect the organization's ability to manage risk. If the statewide partners had met sooner than June 2002, we may have been able to get a draft manual together and have the feedback necessary to implement the full document. It has also been challenging to get the statewide partners to follow up on items they are working on. There was a missed opportunity for me to be involved with the statewide partners in December 2002, as someone else organized the group meeting for a date that I could not attend, due to my school schedule.

I would give the following advice to someone doing a similar project for CED: getting things done will always take longer than you initially anticipate, and don't get discouraged if participants are not as eager to do the work as you are.

Definition of the Problem

Poor internal controls over real estate development can adversely impact all other programs within the agency, due to the high cost and exposure involved with large projects. These controls include managing funding resources appropriately, providing accurate reporting on project costs, assigning risk to each project and budgeting accordingly, communicating problems as they happen during the development process, and quantifying those problems to actual dollar impacts. The lack of clearly defined development policies poses risks to CDC's in regards to managing their projects. These risks can be financial as well as credibility with potential funders. Ultimately, if the project suffers due to poor financing structures or miscommunicated costs, the tenants of the project will feel the impact along with the CDC through delays in construction. The effect of this risk in terms of dollars can vary widely with each project.

One risk is during the predevelopment stage. Predevelopment costs are those costs incurred from seeking out new development projects. They can include feasibility studies, legal fees, and environmental review. They are also comprised of costs incurred after acquisition, but prior to construction. Items that need to be factored in are utilities, maintenance, site cleanup, etc.. Even more costs can be incurred if the property purchased was occupied, as management responsibilities begin from day one of ownership. Predevelopment costs, also known as "soft costs" averaged \$4,145 per unit from three redeveloped projects from MNHS. Factoring into the costs of predevelopment is the timing between acquisition to construction. The longer the holding period, the higher the risk and potential exposure will be. Sometimes getting a project into construction takes multiple years of funding resources. All costs of a project need to be

covered with designated resources, including predevelopment costs. Sometimes these resources are pulled from the agency's operating cash when no other sources are available. If they are not recovered, the costs will have an impact to the financial stability of the organization. ROI notes the importance of accurately estimating soft costs as being "absolutely necessary for a successful project. Soft costs can eat you alive." (p.34:2001) ROI also stresses that the housing developer must conduct an extraordinary amount of due diligence before spending any precious predevelopment funds, and must always balance the "can do" with the "what if?" (p.2:2001) Adequate funding sources, clearly identified before a project is purchased, are important factors in managing risk.

A significant source of revenue to the agency is the developer fee. This money is part of the project's construction budget, which is paid at the end of the construction period. ROI recommends 10% of the total development costs to be budgeted as the developer fee. Without it, the agency cannot continue to develop real estate. (p.35:2001) These fees are the last item paid, and the most vulnerable for getting cut back if other project costs are over budget. Development fees received versus those originally projected at the beginning of the projects varied widely – with one project only receiving \$86,000 of the \$180,000 budgeted due to project delays and cost overruns. This can have a large impact to an agency relying on development fee income to sustain operations of the organization. Due to this issue, along with several other factors experienced during the same timeframe, MNHS was forced to cut back staffing by 30% and eliminate the Economic Development program, which had recently been established. Other statewide partners also have experienced this problem. One lost 23% of their budgeted income from developer fees, and had to let staff go. Another agency counts on 35% of their budgeted

income from developer fee revenues, and would be in the same situation if the fees were lost. With a clear policy in place these types of risks can be quantified and appropriate strategies can be implemented in a timely manner.

The need for a clear policy and procedure manual to mitigate risks was confirmed in an article written by Ron Johnston from Neighborhood Reinvestment Corporation, a national housing support network. “A lot of nonprofit CDCs have not established anything approaching a deliberate, dedicated process to assess, categorize and manage risk on either a project basis or the organization as a whole. The lack of preparedness can disable or even permanently sink an organization. Therefore, community development organizations must pay greater attention to the business of risk management.” (p.82:2001/2002).

As mentioned previously, there are seven housing groups in New Hampshire involved in this project. They all vary in demographics and the services they provide to the community. LACLT serves 79 households with affordable rental housing, working in the communities of Laconia, Gilford, and Gilmanton NH. There are a total of 7,692 rental housing units in this area, with approximately 500 receiving subsidy. THP owns and manages 137 units in Rockingham, Strafford, and York Counties of NH, which 72 units under construction and 40 units in the pipeline. They have serviced 635 households with affordable rental housing. CHT owns and manages 67 units of family housing, serving the Cheshire County area of NH. Perhaps the closest in services and housing concerns would be MNHS and NHSGN. The population size of Manchester, according to the 2000 census data is 107,006, Nashua’s population ranks second at 86,605. There are

9,633 more households in Manchester and 4,031 more families than in Nashua. The median income is \$40,505 in Nashua and \$31,911 in Manchester. There are approximately 10% more Manchester residents working within their community versus Nashua residents as well. The number of housing units in 1999 in Manchester was 45,892, with 28,934 being multi-family housing. Nashua had 35,387 total units, with 17,927 as multi-family. AHEAD works in the communities of Littleton, Berlin, Bethlehem, Woodsville, Lancaster, Lisbon, Whitefield, and Franconia NH. The average family they assist earns \$16,000 as a single parent with two children. The elderly residents they assist earn \$8,000, most from Social Security benefits. CATCH has created 142 units of affordable housing, serving 300 people in the central region of the state in Merrimack County.

The assumption I made at the beginning of this project was that all of these agencies had similar concerns regarding housing development controls. This assumption was due to my own experiences working with MNHS, and proved to be correct after asking other agencies for their concerns. I also assumed that having a tool such as a development policies and procedures manual would assist agencies in their work. This assumption is yet to be proved, as the policies have been drafted, but not implemented at this time. It will take time to determine what effect they will have in the operations of the development process. The other assumption I made was that the communication between the real estate development and accounting staff was inadequate. Both groups within the statewide partnership network agreed this was a source of part of their problems.

The participation of the group has been fairly low. Although the meetings we have had were productive, most people are too busy to schedule meetings outside of the office regularly. No one besides the staff at MNHS has been involved in creating the draft manual. The statewide partners all agreed it was important, but do not have time or interest in putting it together. It seems they would like someone to hand it over to them for review and perhaps to use for their own purposes, but that's about it. Perhaps their participation will increase as the drafts are sent out in April 2003.

Project Goals

Internal controls will be established and monitored at MNHS to improve communication and reporting for new projects. Statewide partners will become more active in working together to create synergy between the real estate development and accounting staff.

By implementing a development policies and procedures manual, staff will be able to streamline their processes, increase efficiencies, and make decisions with a better understanding of the implications to the agency. The statewide group will act as a resource to assist each agency in implementing and improving their processes. This project will build capacity of the staff involved in housing development. Capacity is difficult to measure, however costs of future development projects compared to ones prior to implementation and the recognition of more development fee income (to what was budgeted) will assist in determining the success of the process. In order to judge this appropriately, agencies will have to analyze past performance as well.

Project Objective

By April 2003, I will have a draft manual for development policies and procedures. I will distribute it to all of the statewide partners for feedback. The content of this manual will break down into the following categories:

- ✓ The four stages of the development process:

Predevelopment, Development, Project Management, and Asset Management

- ✓ Identification of the roles for key staff members involved:

Real Estate Development Team, Accounting Team, Executive Director, and
Property Management

- ✓ Risk Management – internal controls

General ledger

Cost control plan

Cash flow

Reporting frequencies

Communication log

Project Flow Chart

These items will address the reporting needed for providing actual costs for each project on a regular basis. The reports will lead to better discussion of project status between the accounting and development team. The identification of roles and responsibilities will address the expectations of each staff member in the process. The communication log will be used to provide documented progress of each project. It will reflect the data shared, issues discussed, and quantify potential risks at each stage in the development process. This discussion will also allow managers to identify and correct any discrepancies in reporting from their review. This process will allow staff to focus

on current activities, rather than review of past discussions. It can also be utilized as a tool for the Executive Director to measure performance of the group. The project flow chart provides a visual document for staff to follow in determining their roles and responsibilities during each phase of the development process.

The background of this project began when MNHS was involved in a real estate project that had significant delays and high predevelopment costs. The predevelopment costs were very high due to this project being occupied at the time of purchase, having the heating system quit shortly after purchase, and having to apply for two years of tax credit rounds in order to have enough money to start construction. Construction delays stemmed from unapproved mortar for historic tax credits and cold temperatures which did not allow for remedying the situation for several months. Because there was not a clearly defined process in place to manage these risks, and due to inadequate communication between the real estate development and accounting staff, MNHS had to take some drastic measures including staff cutbacks of 30%, and a large reduction to the development fee income budgeted. Had these costs been precisely tracked and communication been more frequent, with a common understanding between departments, the risks associated with this project could have had less of an impact to the organization. There would have been more time to address the situation and make appropriate decisions.

The stakeholders for this project include the staff at MNHS, the statewide partnership of affordable housing developers, the funding agencies, the communities serviced by these developments, and the low-income housing residents. The staff of MNHS is

looking for guidance to develop housing more efficiently and use resources wisely. The statewide partnership is also looking for these same benefits. The funding agencies want to ensure that their funds are being used to maximize benefits to the residents served. The community seeks a larger supply of affordable housing to accommodate its population. The residents want a decent, affordable place to live.

None of the seven statewide partner agencies currently have a written document to guide their development process. Until this past year, the accounting staff had met as a group to discuss issues of importance, but the development staff had not met in the same manner, or with the accounting staff to talk about issues they have in common. Many agencies have been frustrated with the lack of a procedure to follow. They feel that often times, managers are making decisions without clear communication to others that are impacted by those decisions. Most agencies have a difficult time in getting the development and accounting team's reporting to reconcile, which adds to the level of frustration. They all are concerned about how to pay for predevelopment costs on new projects and how to handle the risks associated with housing development.

Results

Major Outputs for successful completion:

- Discussion results from focus group meetings
 - ◆ 14 people representing 8 statewide nonprofit groups attended meeting in June 2002.
- Discrepancies of data between real estate and accounting department reporting
 - ◆ Met with internal staff to determine how to streamline reporting, focused on departmental needs, objectives to be met, timing, and accuracy.
- Existing Real Estate Development Manuals
 - ◆ Rural Opportunities Inc.
- Discussion results from the perspective of the auditing firm for affordable housing agencies
 - ◆ Held meeting with auditors to discuss their opinion on how to structure the flow of work internally to maximize efforts, reduce duplication, and increase accuracy.
- Documented risk assessment of prior MNHS projects
 - ◆ Determined percentage of fees budgeted each year versus actual receipt of funds.
 - ◆ Looked into loss of fees and what caused it.
- Feedback from distribution of draft manual to update and make necessary changes or adjustments
 - ◆ To determine usefulness, applicability, any items not covered that should be, how to implement strategies once adopted by the organization.
- Communication established by departments
 - ◆ Log reports with managers on progress.
- Project flow chart for responsibilities

- ◆ Visual aid for staff
- ◆ Follows process through all stages
- ◆ Ensures clarity on *what* needs to be done and by *whom*

Major Outputs achieved:

- Discussion results from focus group meetings
- Discrepancies of data between real estate and accounting department reporting
- Existing Real Estate Development Manuals
- Discussion results from the perspective of the auditing firm for affordable housing agencies
- Project flow chart for responsibilities
- Communication log established by departments

Major Outputs partially achieved:

- Documented risk assessment of prior MNHS projects

Major Outputs, no tasks have been initiated:

- Feedback from distribution of draft manual to update and make necessary changes or adjustments
 - ◆ This manual will be distributed in April 2003.

Monitoring Indicators Used to Judge Project Performance:

- ✓ Has consistency between department's reporting been achieved?
 - 100% accuracy on all reporting
- ✓ Are regular communication logs being utilized to measure progress on projects?
 - Bi-weekly report in log
- ✓ Are projects being assessed for risk and budgeted for accordingly?
 - Risk assessment tool utilized for each project at MNHS beginning Summer 2003.
- ✓ Are development costs being accurately reported (check against cost certification)?

- 100% accuracy on all reporting
- ✓ Are developer fees being achieved at the goal level set by the organization each year?
 - 25% budgeted income from internal fees; 10% fee on development projects
- ✓ Is there a sense from staff and management that they are well informed about existing projects?
 - Ask staff during review periods about what is working and what needs improvement
- ✓ Has a risk management feedback loop been created with management and the Board?
 - Evaluate their knowledge on current projects at least twice a year – questionnaire to analyze how we are doing with respect to communication
- ✓ Does all staff buy-in to the importance and practice of the risk management strategies detailed in the Development Policy and Procedure Manual?
 - Ensure policies are being upheld by all team members on a consistent basis
- ✓ Develop database to track results
 - Measurement tool will provide comparisons between projects

Conclusions/Recommendations

The goals and objectives for this project have not changed, however some of the details of what to include in the manual have been enhanced from the discussions held with the statewide partners. We have also recognized that the manual, in and of its self, will not solve the issues faced in developing affordable housing. Effective communication between departments that results in minimizing cost impacts and provides a clearer understanding of the situation will positively affect the organization's ability to manage risk.

If the statewide partners had met sooner than June 2002, we may have been able to get a draft manual together and have the feedback necessary to implement the full document. Then we could have measured the results of having this process in place on upcoming development projects. It has also been challenging to get the statewide partners to follow up on items they are working on. While they feel that this project is important, they tend to get caught up on the day to day activities and cannot focus on the larger picture. There was a missed opportunity for me to be involved with the statewide partners in December 2002, as someone else organized the group meeting for a date that I could not attend, due to my school schedule. I have not been in touch with the participants yet to find out how the meeting went. Although I was happy to see them taking initiative to meet to discuss understanding the legal documents on a partnership agreement, I did feel left out.

I would give the following advice to someone doing a similar project for CED: getting things done will always take longer than you initially anticipate, and don't get discouraged if participants are not as eager to do the work as you are.