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THE AFFORDABLE HOUSING CONUNDRUM

Demand for the product is growing, but developers are struggling to make the numbers pencil out.

By Kristin Hiller

A shortage of more than 7.2 million affordable housing units exists nationwide for households with incomes at or below the poverty level, defined as 30 percent of area median income, according to the National Low Income Housing Coalition. But finding affordable housing is not just an issue for impoverished people. Typically, renters who earn up to 60 percent of area median income are also eligible to live in affordable housing properties.

Clearly, affordable housing developers are in demand. The challenge they face is figuring out how to make their projects financially feasible amid rising construction costs and an intense

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The Habitat Company is undertaking a $200 million redevelopment of a vacant Chicago Housing Authority site in Chicago's North Lawndale area. Known as Ogden Commons, the development is slated to include up to 400 units of mixed-income housing.

SEPARATE BRANDS, SHARED AMENITIES

Dual- or tri-branded hotel projects offer advantages for developers, operators and guests alike.

By Kristin Hiller

In Indianapolis, HRI Properties is developing a dual-branded Hyatt Place and Hyatt House hotel within the city's Wholesale District.

Chicago's McCormick Place, the largest meeting facility in North America, attracts nearly 3 million visitors each year. Connected to the 2.6 million-square-foot convention center is Hilton's first tri-branded hotel development. The 23-story property, which opened in August, includes a 184-room Hilton Garden Inn, a 187-room Hampton Inn and a 95-room Home2 Suites all under one roof.

When developer First Hospitality Group first learned of the opportunity to develop a hotel at the site, the Chicago-based firm assessed the landscape. According to Stephen Schwartz, chairman and CEO, there was a 1,600-room Hyatt and a 1,200-room Marriott Marquis nearby as well as a 1,000-room full-service Hilton property. But there was a "supreme lack of select-service in the area," he says.

Hilton now has nearly 100 dual-branded properties within its portfolio and another 225 in the pipeline. "The popularity of the multi-brand model is no surprise, given that they offer several benefits for brands, owners and guests alike," says Bill Duncan, global head for Hilton's All

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regulatory process. After all, these are low-income producing properties.

"In the affordable world, we know there's a need, but how can we finance it?" asks Charlton Hamer, senior vice president of The Habitat Company's Affordable Group in Chicago. "It takes all sorts of initiatives, policies and incentives to help fill the gap and help finance these developments."

For David Cooper, managing director of Columbus, Ohio-based Woda Cooper Cos. Inc., which exclusively develops and owns affordable housing units, the most immediate solution to today's affordable housing crisis is more financial resources. Nearly all the new affordable housing built in the United States is financed with capital generated through the federal Low-Income Housing Tax Credit (LIHTC) program. National banks or other large companies typically purchase the tax credits.

Based on its population, each state is allocated a certain amount of tax credits that can be used per year for affordable projects. That cap provides a limit to what can be built, explains Cooper.

"The cap has grown a little bit over the years, but it hasn't come close to keeping up with demand," says Cooper. "Really the only solution would be more resources, or more tax credits and other programs to help defray the costs of building affordable housing."

Woda Cooper uses a typical capital structure of roughly 70 percent equity and 30 percent debt for its projects. That's how the company can afford to charge a lower rent, states Cooper.

That said, Woda Cooper has had to adjust its development strategy to combat rising costs. This includes avoiding sites that need a lot of infrastructure work and steering clear of undertaking costly adaptive reuse projects. The developer is also building projects in areas that generate relatively higher rents.

Instead of constructing multi-building townhouse projects, Woda Cooper is focused on building mid-rise buildings of three to four stories. These are more efficient to build, according to Cooper.

In Columbus, Woda Cooper is nearing the opening of its first Passive House project known as Fairwood Commons. The theory behind Passive House construction is to create an airtight structure that results in a high level of energy efficiency. Cooper expects to achieve at least a 60 percent savings in energy usage compared with typical construction.

At the end of last year, Woda Cooper completed Grand View Place, a 68-unit, $12 million property in Grand Rapids, Michigan. All of the units were designated for individuals who earn up to 60 percent of the area median income. Twenty-one of the units were set aside for homeless or disabled veterans in the area.

Woda Cooper works with a local nonprofit to identify veterans in need and coordinate additional supportive services. Low-income housing tax credits allocated by the Michigan State Housing Development Authority and an equity investment by City Real Estate Advisors LLC helped fund the project. Huntington Bank provided first mortgage financing.

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Layers of funding

When it comes to project funding, all affordable housing developments have a gap that needs to be filled with either some tax incentive or soft money. Dominium, a Minneapolis-based developer with a large emphasis on affordable housing, works with a wide range of local, regional and national banks as well as an equity investor who will buy the tax credits. Furthermore, almost all of Dominium's developments are financed with tax-exempt bonds. This approach "allows for the project to receive more favorable financing because the lender is exempt from taxes on the interest received," says Jean Ferguson, a vice president with the company.

These additional layers of financing from the stakeholders involved in the transaction make the overall process much more time-intensive than that of a market-rate development, adds Ferguson.

In August, Dominium broke ground on Millberry Apartments in St. Paul, Minnesota. The firm is simultaneously developing The Legends at Berry, an affordable project designated for seniors.

Also in the Minneapolis area, Dominium is redeveloping the historic Fort Snelling Upper Post into a 170-unit project. The design will pay homage to the fort's history and veterans will be given preference as residents. The Fort Snelling Upper Post site was part of the larger Fort Snelling military base established in 1819. The Upper Post buildings, constructed starting in 1879, were utilized as a defense facility, administration base and rehabilitation center for wounded veterans.

In general, Dominium has narrowed the width of buildings and developed standard floor plans in order to contain rising construction costs, according to Ferguson. This approach efficiently streamlines the design process thereby lowering architectural fees.

River North Senior Apartments is an affordable housing property within Dominium's portfolio. The fully leased property is located in Coon Rapids, Minnesota. Median income in the area is $80,000, according to Jean Ferguson, a vice president with the company.

Costs stack up

Hamer of Habitat Affordable Group says that affordable housing devel-

Evergreen Real Estate Group is developing Northtown Apartments and Northtown Branch, a housing and library project in Chicago's West Ridge. The development will provide 44 senior apartments, including 30 public housing units and 14 affordable residences.

opment essentially has all the same costs as market-rate development. But when affordable developers go after extra funding, it comes with a significant amount of requirements that can even increase overall costs, says Hamer.

"We're already dealing with a gap that we have to fill," he says. "The issue is how do we look at policy to help us lower auxiliary costs that we have when we get government funding."

In the Chicago area, Hamer would like to see more real estate tax incentives. "Gross operating income for a market-rate property versus an affordable property is quite different. You shouldn't look at it the same as far as real estate taxes are concerned," he says. Granting exemptions for a limited time frame or a graduated scale of paying taxes that would provide more time for growing revenue are some potential ideas in Hamer's view.

Policy discussion regarding affordable housing is something Hamer considers the white elephant in the room. "We can't look at the development of affordable housing as just development. There are many multipliers from it, and it's a part of economic development as well," he says.

Habitat recently received approval to move forward with plans for a $200 million redevelopment of a vacant Chicago Housing Authority site in Chicago's North Lawndale area. The developer worked with local employers Sinai Health System and Cinespace Chicago Film Studios to gain additional land for the project, which will span 10 acres. Known as Ogden Commons, the development is slated to include up to 400 units of mixed-income housing with approximately 100,000 square feet of commercial and retail space. Completion is scheduled for 2021.

One program impacting development strategies for firms like Habitat is the Opportunity Zone program. Created by the Tax Cuts and Jobs Act of 2017 and signed into law by President Donald Trump, this program incentivizes investment in economically distressed areas of the country. Investors can defer, and ultimately reduce, capital gains taxes on any asset by reinvesting the gain in underfunded communities. Up to $100 billion could be deployed over the next several years, according to a new report from Cushman & Wakefield.

"With limited or stagnant funding in regard to creating affordable housing, this conduit is an opportunity," says Hamer. "It will help bring needed investment, primarily equity, into affordable projects."

In fact, Habitat is currently structuring a deal to use a Qualified Opportunity Zone fund for a new development. Though too early to disclose details, the firm hopes to break ground on the first phase in late 2019.

"We need to encourage more capital flow to underserved markets that traditionally have not seen institutional and private equity investment," says John Williams, president of Irvine, California-based Avanath Capital Management. "The new Opportunity Zone provision is one way to do this."

Beyond opportunity zones and low-income housing tax credits, Williams believes that continued support from Fannie Mae and Freddie Mac is instrumental in preserving the supply of affordable housing. "Policymakers must understand the critical role that Fannie and Freddie play, and support these entities in continuing their financial allocations to affordably priced housing," he says.

In November, Fannie Mae committed to investing up to $145 million in three LIHTC funds in order to provide capital for affordable rental housing in underserved markets. The Federal Housing Finance Agency approved Fannie Mae's re-entry into the LIHTC market as an equity investor in November 2017.

Just as affordable housing developers have more regulations to follow, owners of affordable housing assets such as Avanath must also comply with numerous regulations. But the patience required tends to pay off.

According to Williams, affordable housing properties often outperform market-rate apartments because they exhibit high occupancy rates and little turnover. The turnover rate in Avanath-owned properties is approximately 15 percent per year, whereas the average turnover for a market-rate property can approach 50 percent, he says.

Earlier this year, Avanath acquired the 582-unit Hinsdale Lake Terrace in Willowbrook, a suburb of Chicago, as well as the 86-unit Drexel Court in Chicago's South Shore neighborhood for $72.2 million. Avanath plans to make upgrades to both of the mid-1900s era properties.

Since turnover has a direct impact on the bottom line for investors, Williams views affordable housing as a relatively more stable asset class when compared with market-rate units.

Cooper has a similar mindset. Of the approximately 340 affordable housing developments Woda Cooper has completed over the past 28 years, the company has only sold one. "When we build something, we're going to hold it for a long time," he says. "We try to use durable materials and put the property in a position where 10 or 20 years later it's still in good condition and serving its purpose." ■