



TOOLKIT

# SINGLE FAMILY FOR SALE

Single Family Detached, Condominiums and  
Scattered Site Acquisition, Rehabilitation and Sales

**Affordable  
Single Family  
Homeownership  
Projects**



### **Disclaimer**

This fact sheet was produced by the California Community Economic Development Association, in partnership with the Community Action Partnership National Office, as part of the U.S. Department of Health and Human Services, Office of Community Services. The “Community Economic Development” publication series is designed to increase the knowledge of processes for community economic development projects nationwide. The contents of this manual are presented as a matter of information only. Nothing herein should be construed as providing legal, tax, or financial advice. The materials referenced and the opinions expressed in this product do not necessarily reflect the position of the U.S. Department of Health and Human Services, Office of Community Services, and no official endorsements by that agency should be inferred.

Support for the Community Economic Development project and this toolkit is provided by the Department of Health and Human Services Administration for Children and Families, Office of Community Services (OCS), grant award number: 90ET0426/01.

Entire contents copyright © 2011 Community Action Partnership. All rights reserved.

# **SINGLE FAMILY FOR SALE: Single Family Detached, Condominiums and Scattered Site Acquisition, Rehabilitation and Sales**

## **TABLE OF CONTENTS**

Introduction and Use of this Guide .....	4
First Phase: Initial Development Steps .....	5
Go/No Go/Modify .....	12
Second Phase: Detailed Development Process .....	12
Financing Notes .....	16
Development Notes .....	17
Final Note .....	18

# **SINGLE FAMILY FOR SALE:**

## **Single Family Detached, Condominiums and Scattered Site Acquisition, Rehabilitation and Sales**

This guide is intended for use by community development practitioners interested in developing affordable single family homeownership projects. Projects may vary and include single family subdivisions, multi-unit condominiums and single family acquisition rehabilitation projects. This guide will help organizations understand the complexities of development and the commitment needed to proceed. It will also detail the degree of support needed by community, local government, and public and private sector partners.

Most importantly, this guide will outline and take you through the key steps in the development process. As non-profit developers, it is important to minimize unnecessary costs. To assist you we have divided the development process into phases. The first phase can be accomplished with existing staff. Staff time must be allocated to conduct the preliminary work needed to make sound decisions on whether to proceed, and if so under what plan. With a decision to move forward, this guide will help you navigate through the more extensive development process. The initial preliminary analysis describes a process that once practiced, could apply to most real estate development activities.

The first phase allows your organization to “test the waters” and determine if there is a real possibility that a project can be done. You will be outlined steps that are to be accomplished by staff and supported by a preliminary (voluntary) project development team (board members, friends and supporters of your organization). General information about the project is gathered from the community and funding sources. This process allows you to determine the level of community support and funding resources. It allows you to ascertain the availability of the potential site(s) and its ability to meet project needs.

The initial phase requires commitment from your staff and organization. There are little or no costs incurred in this phase

In the second phase, we have detailed the steps needed to complete a project. This phase requires your organization to invest predevelopment funding. Predevelopment allows you to conduct the necessary “due-diligence” to ensure the project is feasible. Expenses will be incurred

Projects might be designed to provide added benefits by including “green” or other energy-efficiency measures. Projects could incorporate service programs and include added features such as shared community gardens, swimming pools, child care facilities, learning centers or libraries. These added community benefits may incur additional development costs that you or your partners will need to consider.

For experienced developers, this guide could also be used as a checklist of important issues and provide a refresher on the process for this type of development.

In single unit for sale properties, affordability is created by grants and low interest loans made to develop and build the project. A high percentage of these funds will be passed on to buyers and will take the form of second, and possibly third and fourth trust deeds. With this financing, regulatory requirements from various financing sources may include affordability requirements. These requirements ensure that properties are sold to qualified low and moderate income families.

Additional requirements may include shared equity provisions to maintain affordability upon sales (if the new buyer decides to sell the property, the equity gains can be shared) or limits re-sales to other qualified buyers. The second trust deed (and other subordinate debt) usually has a very low interest rate or is deferred until the property is sold.

The development of for sale units is difficult and complex, yet projects have been developed by nonprofit community development organizations for many years. Much of the difficulty comes from the need to market and sell the homes to qualified individuals and families. Each funding source will have its own requirements that will dictate the buyers' qualifications. Each buyer must meet the requirements of the 1st, 2nd and sometimes 3rd and 4th trust deed lender. The layering of multiple requirements increases the difficulty to find qualified buyers.

Developer fees will likely come from the sales of the last few units. If you need to drop prices, it will be taken out of your fee. Remember, you will be paying construction loan interest until the units are sold and any and all cost overruns will be deducted from your developer fee or "profit".

It is imperative that you partner with a home assistance service program that pre-qualifies buyers and provides homeownership training (if you do not already provide these services). This should enhance the sales of your units and provide you with a number of "qualified" buyers.

In some instances the conventional lender will require you to pre-qualify a number of potential buyers, require deposits or may require a stricter pre-sale requirement (loan approval). Coordination between the development time schedule (when the units can be sold) and the pre-qualification/sales process is imperative. The longer the gap, the more carrying costs erode your profit margin.

In many regions community development organizations have grown and specialized in developing affordable for sale housing. It may be beneficial to partner with an experienced developer for your initial project. You would build capacity and ensure that the project retains the amenities and services your community needs by participating in the ownership structure and management.

**SCATTERED SITE NOTE:** For those of you involved in scattered site, acquisition, rehabilitation and sales we have added notes and tips throughout this document. There are two major national initiatives that currently support for sale housing. They are:

1. The Neighborhood Reinvestment Corporation, (known as NeighborWorks America) was chartered by congress in 1968. The organization supports community development in the United States by providing grants and assistance to 235 U.S. community development organizations. The Neighborhood Housing Services network's core business focused on single family home ownership and has actively developed (new construction and acquisition) units while providing training and assistance to families through classroom training and mortgage assistance.
2. Since early 2009, community development organizations have become active in stabilizing communities hit hard by foreclosures through support from the Federal Government's Neighborhood Stabilization Program (NSP). NSP is being allocated in annual rounds to local governments, community based organizations, and other development entities.

NSP are federal funds used to stem the negative impact of a high number of foreclosures in communities and cities. The NSP recipient designs the program which is targeted to, and used in a specific geography. NSP funds are allocated to public and private development entities for the acquisitions of foreclosed properties. The developer will subsequently make needed improvements, and resell the properties to primarily low and moderate income families. The grant funding will help lower cost by becoming subordinated low or deferred interest loans. In many instances NSP funds are matched with local CDBG, HOME or other subsidies) to increase affordability. Note: Many organizations in the NeighborWorks network have received NSP funds or actively participate in local NSP programs.

Scattered site development has additional layers of issues developers must contend with. Costs and management issues related to scattered site construction and the cost of security needed to guard the properties from theft while units are on the market are major problem. We will note differences and discuss issues in the final section of development notes.

Development is a team effort. This guide describes who should be part of the development team, what partners should be included in the process, and identifies ingredients and steps that are essential for a successful project.

### **This guide includes the following sections:**

1. Use of this Guide: An overview of the types of affordable housing development projects that can be developed with assistance from this guide.
2. First Phase: Initial Development Steps. This section includes the steps needed for an organization to clarify its development concept and to determine if a project is possible. It explains who you should initially talk to and what information you would need to decide to proceed with your project. These are the steps needed to clarify what you want to do and gather the data needed to explain your project in the hopes of garnering interest by project funders and partners. In many ways, this is the basic information needed to develop your concept paper. Once you decide to proceed, we will retrace many of these activities to include greater details needed for project and financing approvals.
3. Go/No Go: This is the point that you and your organization would use the data collected to decide if you should proceed. If you do proceed, you will know what resources or assistance are needed. This guide suggests ways to keep costs minimal prior to the Go/No Go decision (main resource will be staff time). The next phase entails more time and financial commitments by your organization. You will incur predevelopment expenses (a great portion will be funds used for consultants that will verify many of the development assumptions such as market demand, development cost, and appraised value)
4. Second Phase: Detailed Development Process: These are the steps that outline the development process. It will identify key development steps and important project resources. This section will provide insight into the essential steps needed for the successful completion of your project.
5. Financing Notes: This section will provide some detail on sources of financing and how they are used in the development of affordable housing.
6. Development Notes: These are some “tips” that we have compiled from experienced developers that highlight important considerations.

### **This guide should be used for the following types of projects:**

1. Single family affordable subdivision projects. In some instances, the sales targeting may be mixed and targeted to low/moderate income buyers and some units are targeted as market rate housing. This strategy may be desirable if the organization’s goal is to create an economic mix in order to avoid having an income segregated neighborhood. Units sold at market inherently have greater market sales risks.
2. Condominium (for sale affordable projects). Higher density projects may be the only means to keep units affordable; however this structure introduces another level of development and planning with the inclusion of common area expenses and the need for homeowner associations.
3. Single family scattered site acquisition rehab and sales.

### **Key Items to Note:**

1. Single family detached units generally have a very high per unit cost resulting in the need for significant non-debt support.
2. The subsidies are used through the development (construction) phase and will roll into soft secondary financing to assist low and moderate income homebuyers.

3. For Sale projects have unique development requirements and processes. The majority of skills acquired from multi-family and commercial development are not easily transferable.
4. Successful single family development and sales programs will usually have a vertically integrated system that includes project development, homeownership training to interested families, asset (savings) programs, prequalification process and closing assistance. These additional services can be provided by local partners but is essential for timely success.
5. Market risks are greater in for sale projects. Your project is competing against all other homes for sale in your region. In our current economic slump, home prices are very low resulting from excess inventory of available units. Foreclosures continue to add to this inventory. In many markets, the cost of constructing a new unit may be higher than local sales prices.
6. Neighborhood Stabilization Program (NSP): There are significant funds allocated to local governments and non-profit organizations through NSP. NSP is designed to allow for the acquisition, improvement and resale of foreclosed properties and includes targeting to low and moderate income buyers. The NSP funds allow for developers (both for-profit and non-profit) to acquire, improve and sell homes. The funding is used for all phases and can be used to provide subordinate debt to increase affordability. Several rounds of funding have been made that allows for more flexible uses such as acquisition and development of multi-unit properties. It is incumbent that you explore the opportunities created by this national program and understand how it is being implemented in your community.
7. Affordability is created by the use of subsidies (soft secondary financing). These subsidies come from many different sources however each has its own requirements that the buyers must meet. As a result there might be significant demand for affordable for sales housing, but the families that meet a multitude of requirements may be limited.

### **FIRST PHASE: INITIAL DEVELOPMENT STEPS:**

1. Market need by target population: The first step is to make sure there is a need for for-sale housing in the targeted community. It is also important to ascertain what type of for-sale housing is desired, i.e., single family detached, condominiums, new construction or acquisition/rehab. Is there a demand from low and moderate income buyers and if so, at what price range should the units be. You should have a strong understanding of the scope and types of affordable housing needs in your community. This can be verified by various sources including:
  - a. Community Plans
  - b. Community Planning Meetings
  - c. Local Government
  - d. Community Organizations
2. Local Government Funding: Local government funding will be needed unless there are other sources of project equity. Remember, affordability to your targeted population is measured by what the individual or family could afford in mortgage payments, usually from a first trust deed through a conventional lender. The remaining development cost must be made up from "other" financing, usually local government or private sector grants. If the development cost for a unit is \$300,000., and the moderate income family (based on family income in your community or city) can only afford a conventional loan of \$80,000, then the difference of \$220,000 must come from other subordinate debt or grants. Key issues and resources include:
  - a. Funding availability: Sources include:
    - i. CDBG (Community Development Block Grants)



- ii. HOME (HUD funds to State and eligible local governments) for affordable housing development for low and moderate income communities and individuals
    - iii. Redevelopment Agency: Tax Increment funds from redevelopment projects
    - iv. Neighborhood Stabilization Program: NSP funding that has flowed from the Department of Housing and Urban Development (HUD) to local jurisdictions and non-profit development organizations. Each will develop their own priorities and uses of the funds.
  - b. Key departments:
    - i. Housing Dept
    - ii. Redevelopment Agency
    - iii. Community Development Dept
  - c. Expectation of Public Benefit: All programs will have high expectations for public benefit. (Based on market need)
3. State Federal and Other Funding Sources: These sources are needed to complement funding availability at the local level. The funding will take the form of local government equity. In some cases it may be a substitute source; however these sources vary significantly state to state. It is not uncommon to have the local sources augmented by state or other sources.
- a. State Sources/Programs (Grants and Project Equity)
    - i. CDBG/HOME: If you are in a smaller jurisdiction, your CDBG/HOME funds may be administered by the State. (Check with the community development or housing department).
    - ii. Bonds, Housing Trusts, Permanent Sources: In many states, affordable housing bonds may have been approved or an affordable housing trust fund created to support affordable housing development.
  - b. Other Sources: Foundation and corporations may want to support an important local project and can provide grant funding (equity). The Federal Home Loan Bank (FHLB) is divided by districts that serve several states. Most have Affordable Housing Program (AHP) grants available on annual cycles.
  - c. Confirm Funding Cycle: For all sources, make sure you recognize the timing for each funding cycle. The “art” in many of these developments is having the right application ready for each of the funding cycles. Sources may have requirements of prior approval from other funding.
  - d. Confirm Eligibility: Is your organization eligible for the targeted assistance? Is your location and project eligible?
4. Locate Site: Locating a site is a key step and should be investigated early (same time as you search governmental resources).
- a. Zoning/Allowable Use: Subdivisions require public improvements that include streets, curbs, gutters, utility service (sewer, gas, water and electricity). Depending on the site location (urban or rural), these improvement may be cost prohibitive. Check to see to what extent you will need to pay for utility hookups and how much space is needed for streets and sidewalks.
  - b. Amenities: The investigation of the funding sources will result in an outline of requirements for site and project area amenities (bus stops, markets, recreation, schools, etc.)
  - c. Restrictions: Check the deed and planning restrictions for the site.
  - d. Use Compatibility: Is the project compatible with neighboring uses?



- e. Availability/Ownership: Is the site available? If it has been available, why? (cost, environmental issues, development constraints, etc.)
5. Preliminary Development Team: The informal development team is tasked to investigate and define the project. If feasible, the team will proceed with development of the project. The team will represent the organization and their activities will be bounded by board or organizational approvals. In this preliminary phase, your organization is trying to minimize costs by looking for volunteers and friends to provide estimates.
- a. Project Manager: The key individual is the project manager who might be a hired professional or a member of management. Time will be allocated to the manager to properly investigate the project. If the manager does not have development skills or experience, a development consultant, volunteer interested party or board member may be recruited to support the manager.
  - b. Architect/Contractor: The architect/contractor could be a board member or friend of the organization who can provide some input and insight into the projects design, development issues and can provide rough cost estimates. Local contactors can give you a rough cost per square foot estimate based on design and use.
  - c. Site Planning/Engineer: It might be harder to find this expertise, however you may have an architect who has some knowledge in this area. This person will be able to give you an idea of how many units you can build and may be able to sketch a tract map. The engineer or contractor can also estimate the off-site expenses and requirements.
  - d. Consultant (Financial, Development and Planning): At this early stage the consultant could be a volunteer, board member or someone who might be interested in supporting the project and have development and finance experience and skills. If the organization has an experienced project manager a development consultant would not be needed.
6. Preliminary Feasibility of the Project: Now that you are comfortable that the right project resources are available and you have the team to support your efforts, the next steps will help you clarify the scope of the project and determine work tasks. With these final steps your organization should be able to make an informed decision to proceed with the project (or to proceed by meeting certain conditions).

If you proceed, predevelopment funds will be needed and a portion will be “at-risk”, meaning that compensation for the expenses incurred is unlikely unless the project is completed. Remember, this analysis is important to determine if you should proceed and if so under what conditions. Any issue or potential problems that you have identified will need to be addressed to allow you to continue. These steps include:

- a. Planning:
  - i. Local Plans, General Plan: How is the intended use reflected in local/community plans? Is it consistent with the general plan?
  - ii. Previous Development Efforts: What has happened to the proposed site? Why is it available? Has anyone else attempted similar development activities?
- b. People: You must identify the supporters and opposition. What would they want to see in the project if you were to proceed? Community support is essential. Organized “Not in My Back Yard (NIMBY)” efforts can end or significantly delay your project. Talk to:
  - i. Local Planning Staff
  - ii. Local Elected Officials
  - iii. Community (homeowners association, neighborhood councils, community organizations)

and key community leaders)

- c. Preliminary Design: Your project team and the data gathered will enable you to determine the following:
  - i. Unit Mix: Bedroom mix and scheduled sales prices
  - ii. Project Use: Will the units be targeted to seniors, family or large families (or a mix). Will units be targeted to special needs populations and if so, what are their requirements and needs?
  - iii. Amenities: Will you include a community garden, play area or pool?
  - iv. Density: What densities are allowed? What makes sense for your community?
  - v. Local Design Standards: What must be included in design?
  - vi. Funding Design Requirements: What do the funding sources require?
- d. Preliminary Financial Feasibility: Financial feasibility is the most important step in your preliminary project analysis. Here you will begin to make adjustments based on resources and what you can afford to develop.

Now that you know what you are building and where, this is your initial attempt at determining project costs, sources of financing and ultimately the overall feasibility of your project. Your lenders will always ask for sources and uses: who is paying and what are they paying for. Our analytical steps will look at uses (costs) first and then look at what sources you have to pay for them.

- i. Uses (Costs): Together, the two following cost items will equal your project's development cost.
  - 1. Hard Cost / Construction Cost Estimate: Based on square footage and uses, your development team will be able to estimate construction hard costs (what it costs to build the project). You will also be able to estimate the offsite costs (curbs, gutters and utilities).
  - 2. Soft Cost Estimate: These are all of the other costs that are not part of the actual construction. This includes some consultants, reserves and fees.
- ii. Sources: This is your estimate of what funding sources might be available to you, how much you may be able to obtain and what the financing terms are. Sources will need to match uses and any debt (loans) must be able to be repaid from the project's cash flow. In for-sale projects, the sales proceeds from each unit sold are used to pay down the construction loan.

You should also check the funding requirements for these sources. Do you and the project team qualify for the tax credit or financing? Does your project meet the requirements and financing guidelines for all other sources?

This is your preliminary analysis, so be CONSERVATIVE. Do not use lower estimates just to be eligible for a funding source. Ultimately, development expenses will usually be higher due to unforeseen events. Additional expenses will be harder to support after you have already been approved at a lower amount.

- 1. Equity: Any cash that you may have for this project.
- 2. Other Equity: Include "soft debt" from local government. These are the CDBG, HOME or RDA funds that are at a low interest and/or repaid on a deferred basis (when there is available cash flow). Much of these sources will provide financing used for construction

(or acquisition and rehab) and will remain in the project by rolling into subordinate debt for the homebuyers.

3. Debt: The maximum conventional loan a lender is willing to provide to a project is generally based on the value estimated after construction. Conventional lenders will have a maximum Loan-to-Value (LTV) that limits their participation. This construction loan will be taken out (or re-paid) by the sales proceeds. In some instances the construction lender is willing to provide "bridge financing", e.g., financing to bridge other funds such as City financing or other grant funds that will not fund during construction.

There are two measures used by banks and lending institutions to determine the maximum loan they will provide a project. The bank will use the loan size equal to the lower of the two following standards. They are:

- Loan to value (LTV) is a ratio (percentage) used by banks to determine the maximum loan a project could receive based on its calculated value. A 75% LTV would mean that the maximum loan for project valued at \$1 million dollar project would be \$750,000. A 75% LTV is typical for projects. In a more "challenging" market the LTV could be as low as 60%.
  - Debt Service Coverage Ratio (DSCR) is a ratio of what the maximum loan for a project would be based on its ability to make loan payments. This calculation will be required by most conventional lenders and although it does not appear to be applicable to for sale projects, the analysis will be based on the assumption that the units cannot sell and become rental properties. A DSCR of 1.20 would mean that a project would need total income per month (less expenses) to be greater than 120% of the monthly debt payment. You would have 20% extra cash available after you make your monthly payment to the bank. DSCR might be as low as 1.10 in some economic markets.
4. Gap: This is the additional amount for which you have not been able to identify a source. As a result, you will need to go back and locate "other equity" sources or seek increased commitments. You might also look to cut costs by reviewing materials and amenities. More units or higher rents can also be part of your analysis.
  5. Timing: You will need some preliminary discussions with potential construction lenders. Depending on the size and scope of your project, they may impose a condition that requires your project to be built in phases (to lessen sales risks). This condition can significantly alter the projects timing and costs.
7. Securing Preliminary Support: Based on this more in-depth analysis, you will need to loop back and conduct additional meetings to ascertain the level of support and level of funding commitments from the sources noted below. This is the phase of work where your organization will maximize its local community support, political connections, board connections and goodwill to obtain commitment from key sources of financing. You will need support from:
    - a. Organizational Support (Board, Staff)
    - b. Local Community
    - c. Local Government
    - d. Debt, Equity, and Gap Sources

## GO/NO GO/MODIFY

This is the point where the organization can determine if it is willing to spend funds to start project predevelopment. Remember, to this point you have committed some staff time and incurred very little expenses. The information you have gathered will give you an indication of whether or not you have a feasible project that you would be willing to invest predevelopment expenses on.

## SECOND PHASE: DETAILED DEVELOPMENT PROCESS

Now the work begins. The following steps will help you and your development team and partners proceed through the development process with the intent of closing financing and developing the project. You will need a technically competent development team and partners who will conduct the detailed analysis and work. Project details will be researched and completed. Designs will be finalized. Costs will be confirmed. Loans and grants will be approved by lenders, public and private sector funders. Agreements will be consummated. Construction will start and the project will be completed.

### 8. Predevelopment (Refine Assumptions)

- a. Site Control: Begin the process to gain site control.
  - i. Letter of Intent: The letter of intent (LOI) is your written offer to the seller that outlines the terms and condition of the sale. This is drafted with your broker or real estate specialist and should include clauses to ensure your deposit is refundable and that there is ample time to conduct the studies needed to proceed. These projects take a great deal of time (negotiating multiple sources of financing where many have a long approval process). It is critical that ample time is negotiated. If there appears to be strong interest from a funding source, it might be prudent to allow payments to be made to the owner (portions of the deposit going "hard").
  - ii. Negotiations: Site acquisition is a negotiation with offers and counteroffers. The actual sales price will usually be determined by the appraisal (most local governments cannot pay for a site above the appraised value). In some cases when the appraisal is lower than the seller is willing to accept, other costs borne by the seller might be paid by you.
- b. Site Due Diligence: Most of the following items are required by lenders and investors and will require predevelopment funds to engage these 3rd party studies.
  - i. Title Report
  - ii. Appraisal
  - iii. Soils
  - iv. Environmental
  - v. Seismic
  - vi. Flood
  - vii. Noise
  - viii. Traffic Studies
  - ix. Historic and Local Public Development Requirements
  - x. Subdivision / Tract Map (for subdivisions and condominium projects)
  - xi. Off Site Plans, Specifications and Costs
  - xii. Draft Homeowners Association Regulations (for planned unit subdivisions and condominium projects)

- c. Entitlement/Planning: The planning department will confirm that your project meets all local planning restrictions, code and utility easement requirements.
  - d. Market Assumptions (Market Study): The market study will assess the marketability of the proposed units based on location, amenities and comparable sales rates. The study will estimate the time needed to sell units (absorption). Some funding sources may require a 3rd party study. NOTE: The absorption rate for affordable units is usually longer than the rate for unsubsidized units due to the multi-layers of prequalification requirements by all of the participating funding sources. If the lender requires a phased development make sure this is factored into the absorption analysis.
  - e. Design: Design and site plan work should begin.
  - f. Confirm Construction and Operating Assumptions: Based on the more formal plans, you will be able to confirm construction costs.
  - g. Appraisal: You may need to engage an appraiser to determine the sales price of the land. If it is not absolutely needed it is a cost that could be avoided and be included in the appraisal commissioned by the lenders. The appraisal will be needed if you have predevelopment funds that are to be used for site acquisition (funding from another source, usually local government).
9. Refine Development Team: This is the project development team who will close the financing and build your project. The team will consist of professionals who are hired to assist in the completion of the project. Bids will usually be taken to decide on key project participants such as the contractor and engineer.

It is incumbent upon you to do your due diligence (homework) to ensure that the consultants and subcontractors have the skills, experience, time and financial capacity to complete the work. You may also want to talk to your lending sources (public and private sector) to make sure the team members meet their requirements (license and bonding). They may also have recommendations and provide insight from past experiences. Key members of your team include:

- a. Architect: Will move from design to working drawings and specifications
- b. Contractor: Your lenders will have certain bonding and insurance requirements for the contractor.
- c. Engineer:
- d. Sub-Division Map Engineer
- e. Attorney:
- f. Accountant
- g. Energy Consultant: If you are trying to meet certain energy efficiency goals.
- h. Funding Sources: This would include all of the sources of debt and equity needed in the project. These sources must be in agreement about the project; its cost, who is paying for what, when the funding occurs, the development time frame and in the case of debt and bridge-loans, when they will be repaid.

## 10. Financing

- a. Review Debt, Equity and Gap Financing Application: Each source will have specific requirements for approval. There are separate checklists of forms, documents and studies that are needed for each lenders approval. Be aware that any unforeseen condition will likely trigger the need for more information and may create additional financing requirements or contingencies. Also note the timing requirements for the sources of financing, some may

- require a prior commitment from other sources before they can approve or consider your application.
- b. Refine Development Pro Formas Based on Funding Source Requirements and Conditions: Each source will determine the size of their commitments and the conditions of their funding. There is a possibility that many of the conditions will not be in sync with others, and there will be a need to negotiate a solution. In addition, the loan amounts will typically be less than anticipated and/or additional funds may need to be set aside to meet unanticipated conditions. There may be a need to locate additional sources or request more funds.
  - c. Commission Appraisal: The appraisal is usually commissioned by the first trust deed lender and might be shared by other participating lenders and funding sources. Make sure you check to see how this process could be combined to save costs. The appraiser will determine an “as is” appraisal, the value upon completion of construction, and a value upon lease-up. If you have a mixed use project, they will need to value each segment and determine an overall value (appraisal costs will be higher).
  - d. Obtain Conditional Commitments: After review of the application and underwriting the project, the lenders will make a “conditional commitment” subject to a number of items that can include but not be limited to: appraisal, review of environmental, review of architectural design and specifications, approval from participating lenders, approval of related entitlements, and conditions as a result of other findings from 3rd party reports.
  - e. Take Out: Unlike multi-family rental projects where there is only one take out / permanent loan, the source for single family development construction loans is from a number of individual mortgages for the units sold. In many instances, mortgage lenders will agree to work with you to become one of the primary mortgage providers, however they will each only agree to a limited number of mortgages. This allows the risk to be shared by more than one lender. Depending on your development reputation and track record of your development team, many financial institutions seek opportunities to meet their Community Reinvestment Act (CRA) lending requirements for low and moderate income mortgages and many have designated staff for this function. (This may not be as true in the current economic climate).
11. Site Acquisition: During this process (preferably early as possible), you should have an approved letter of intent (purchase agreement) and have opened escrow.
12. Project Entitlements: Project entitlements include:
- a. Preliminary Plans: Your architect will submit preliminary drawings to the City for initial review. The City will respond with changes and other requirements
  - b. Plan Check: Plan review undertaken by the planning department
  - c. Design Review: Local and/or community review or review by lender(s).
  - d. Building, Utility, Public Safety, Public Works Requirements
  - e. Subdivision / Track Map: Your consultant will prepare a preliminary tract map and begin the approval process (through the State Department of Real Estate or other unit charged with map approvals). The department will process the map and require submissions by your engineer.
  - f. Off-Site Approvals: Off-site improvement plans and specifications are submitted and reviewed. Local jurisdictions typically require a bond for offsite expenditures
  - g. Community Input/Approval
  - h. Finalize Plans, Specifications



- i. Final City Approval (community hearings and approval from the Land Use and Planning Commission and from the City (Council)): You must know beforehand that approval is likely. If there is opposition, you should be ready to “prove your case” for project approval. This may include bringing a busload of seniors or supporters and have them call the council or commissioners offices.
13. Additional Construction Loan Requirements: These are the key items outlined by lenders as a condition of closing
- a. Final Working Drawings: This includes drawings and specifications
  - b. Construction Contract: Lenders or investors may require certain types of contracts (cost or cost plus). Note on Construction Bids: The bid process begins when the working drawings and specifications are ready. Check with participating lenders on their requirements for the contractors bidding on the project (credit history, bonding capacity, prevailing wage compliance, insurance, etc.)
  - c. Architect Agreement: Usually standard American Institute of Architects form
  - d. Homeowners Association Documentation
  - e. Department of Real Estate Approvals
14. Construction Loan Closing
- a. Fulfill Other Funding Conditions
    - i. Escrow Account/Instructions: The escrow instructions are critical and include all of the documents, exhibits and approvals that must be presented before closing and recording of the documents. Escrow also manages the funding process (from lenders, investors and other grant sources) and payments to participating parties and consultants.
    - ii. Other: Signed construction contracts, approved drawings, permit approvals and funded reserves.
  - b. Documentation: All of the loan documents, funding agreements, inter-creditor agreements, partnership agreements and deeds are drafted by respective attorneys and reviewed by you and your attorney.
  - c. Negotiations: Representatives of every source of debt and equity participates in negotiations while closing the financing. You (the project), bear the cost of all attorney fees. It is essential to manage your attorney to ensure their fees are not being generated by insignificant negotiations. Business decisions should be the center of negotiations.
  - d. Execution: Signing by all parties and subsequent recording of documents.
15. Start Construction: Construction cannot begin until the documents are signed and approval to proceed is given. In some cases, demolition and site preparation might be approved under a separate contract and funded outside of the construction financing.
16. Construction Period Management
- a. Monthly Draws
    - i. Inspections: There are usually monthly meetings with all participating entities (various lenders, architect, contractor, building inspector, and the owner). Your participation might be through a hired construction manager who has experience in all aspects of construction. All parties should agree on the percentage of completion and how it matches the completion schedule. Your construction manager will help ensure that costs and change orders are justified.
    - ii. Architect Sign Off: See above



- iii. Change Orders/Clarifications: Your construction manager is important in managing change orders and approving clarifications (between contractor and architect). All parties must agree on any change order.
  - iv. Draw Request: As part of the inspection meeting, the draw request is reviewed. Construction progress is agreed upon, bills reviewed and change orders examined and approved (signed by all parties).
  - v. Lien/Lien Releases: Upon completion of work by various trades and suppliers, lien releases are issued, signed and forwarded for recordation.
  - vi. Payments: Per the loan agreement, funds are released by the construction lender and participating lenders (city and/or state sources) to the construction account managed by your organization. You will subsequently transfer funds to the contractor. The agreement also defines the turn-around period for funding by both the bank and by you to the contractor.
- b. Pre Qualification: Each funding source has restrictions on family income and family size. Potential buyers must be pre-qualified and in many cases pre-approved. Because of the multitude of funding sources, the prequalification and preapproval process can be very time consuming. Each funding source must approve each buyer based on their requirements. It is not unheard of to have approval processes take 2-5 months. Many potential buyers are not willing to wait or undergo a time consuming and arduous process. The amount of prequalification or preapprovals is usually dictated by the conventional lender.
  - c. Construction Completion
  - d. Architect Sign Off: Final completion sign off
  - e. Building Inspection Sign Off: Completion and issuance of the Certificate of Occupancy is by the city building inspector
17. Sales/Move In: Lenders will require a certain level of sales be reached before final loan approval. This is especially true in condominium projects or projects with shared cost common spaces. This is to insure that there are enough homeowners to cover the projected costs that will be covered by the Homeowners Association. NOTE: The developer will make up the shortfalls once sales and move-in proceeds.
18. Project Stabilization (Construction Lender Repayment): The construction lender will be repaid by the sales of units through the proceeds from the individual sales. Funds will include first trust deed proceeds and any other subordinate debt that was not paid in during the construction period. The terms of the repayment are defined in the loan agreement.

## FINANCING NOTES

1. Conventional Debt Terms: Repayment terms of the conventional loan will vary depending on the perceived risk in a project (the more risk, the more stringent the terms will be). Development risk is mitigated in different ways and can include:
  - a. Phased Development: Depending on the size and configuration of the project a lender may require the development be completed in phases. To lessen risk they want to make sure sales meet the absorption schedule before additional construction financing disbursements are made.
  - b. Repayment Requirement: Lenders will refer to the term par. Par is the amount for each unit if the conventional construction loan were evenly allocated to all of the units. For example,

a construction loan for \$10 million to develop 100 units, would equal a par value of \$100,000 per unit. Lenders might require a quicker repayment and require repayment at 110% of par, or \$110,000 from each unit sold. This would allow the lender to be repaid after the sales of 90 units. The remaining sales of units would be your “developer’s fee” (less any other payments you agreed to make).

2. Equity:
  - a. Residual receipt loans and grants provided by public and private sources (local and state funds). These are loans repaid if there is cash available.
  - b. Direct grants and foundation support
  - c. These funds are used to acquire the site, or enter the project during construction and in most cases will roll into subordinate financing for the homebuyer. Each will have its own restrictions.
3. Predevelopment:
  - a. Hard to get unless you have a strong balance sheet or have an extensive successful track record
  - b. Local government is your best source
  - c. Intermediary sources such as Local Initiatives Support Corporation, Enterprise or the Low Income Investment Funds are cheap but may take some time to approve
  - d. Other Community Development Loan Funds (CDFI’s)
  - e. Commercial Bank lines of credit. Many institutions offer lines using investment funds in the form of equity equivalent loans. These are based on organizational financial strength.

## **DEVELOPMENT NOTES**

1. Use real estate brokers experienced in larger commercial transactions to locate and acquire sites.
2. Be aware that land costs will be restrained by local government sources which are typically limited by the appraised value.
3. Don’t fixate on the first site or project you find or focus only on one project. In most instances you will find one possible project out of several that you investigate.
4. Negotiate ongoing fees with local gap lenders (with residual receipt financing), to ensure that excess cash flow does not go to repay the gap loan (instead of going to management fees or project services).
5. Make sure there is cushion in the development budget. You will never have too much money, and expect the most unexpected reasons for cost over-runs. It is difficult to go back to equity and grant sources for more funds.
6. Keep architect in check for cost purposes.
7. Keep lawyers in check for cost purposes.
8. Keep consultants in check for cost purposes.
9. Do not build for developer fees, benefits to the community will always be greater than any financial returns you will generate.
10. The stronger the development team, the stronger the project and its ability to find solutions when problems arise.
11. Having services and programs for the residents will make a significant improvement in the

projects long term viability and success.

12. If you do not have experience, consider partnering with someone with extensive experience and with someone you like. You will be with them for 15 years or more, working closely in stressful situations leading up to the closing of the financing and managing the units once they are occupied.
13. Make sure you have staff designated to be the point person or “quarterback” for the project. He/she will be responsible for communicating with staff and management and with all of the project development team members. They must be responsible and have the ability to multi-task assignments.
14. Negotiate hard with your lenders. If you do not have this skill, use a consultant. Total purchase amount, terms, dates/time and repayment schedules are all negotiable.

## **FINAL NOTE**

Development of single family, for-sale housing is not easy and requires a strong commitment from the organization and the members of the development team. The goal can be accomplished with the support of the community, local government and interested financial institutions. It is most important to have staff dedicated to the project and if they do not have the expertise, locate resources to support and guide the effort.

This document is intended to be a guide that outlines some of the key issues and identifies possible solutions and steps. It is not intended to be your source since every project has its own issues, concerns and peculiarities and its own unique solutions. The document is not intended to encourage any organization into project development but only to lay out some of the key steps and issues once the decision is made to proceed.





Community Action Partnership  
1140 Connecticut Avenue, NW, Suite 1210  
Washington, DC 20036  
202.265.7546 | fax 202.265.5048  
[www.communityactionpartnership.com](http://www.communityactionpartnership.com) | [www.partnershipCED.org](http://www.partnershipCED.org)