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Small Wonders

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Small Wonders

Too tiny to enjoy economies of scale and many financing programs, small projects require early collaboration and smart planning

Jack Capon Villa is big with ambition.

The development is the first supportive housing community for adults with developmental disabilities in Alameda, Calif., just outside Oakland.

The three-story development stands a mile high on social mission, but it's firmly grounded in size, with just 19 affordable apartments.

The project is among the many good small affordable housing developments—those around 30 or fewer units—that have been built in recent years despite the odds being stacked against them.

“Small projects are challenging,” says Susan Friedland, -executive director of Satellite Affordable Housing Associates (SAHA), the Berkeley, Calif.-based nonprofit developer behind Jack Capon Villa. “We generally do them because it's absolutely a mission-driven project.”

Other times, the stars align and a developer will find an infill site that makes sense and works out even if it has a tiny footprint that poses considerable size constraints on a future building.

In either case, the developer will travel a tough road because many of the programs used to develop affordable housing are better suited to larger developments. For example, it's pretty near impossible for a small individual deal to use bond financing, -because the transaction costs are too high. Investors and lenders also generally prefer bigger projects.

Named after a longtime Alameda resident who was the force behind the area's Special Olympics program, Jack Capon Villa started with strong community and government backing. Supporters wanted to create a place for adults with developmental disabilities to live independently and to help relieve the anxiety of aging parents who were worrying about what would happen to their grown children when they could no longer care for them.

SAHA and the Housing Consortium of the East Bay were able to make the \$8.3 million development possible by assembling multiple layers of financing, including \$5.8 million in low-income housing tax credit (LIHTC) equity from investor Bank of America Merrill Lynch and syndicator Enterprise Community Investment. The team also secured \$1.4 million in local redevelopment agency money, a funding source that has since been eliminated.

Small projects are critical because they are often appropriate for a special-needs population or the surrounding community, says Rich Gross, vice president and Northern California market leader for Enterprise.

He points out how Jack Capon Villa fits into its neighborhood of single-family homes and small developments. “That's what community-based development is about,” Gross says.

When building a small project, developers should work early on with their financing partners. In the case of a LIHTC project, this will help a syndicator identify potential investors for the deal.

“Relationships—that's key for us,” Gross adds, noting that Enterprise and SAHA have worked together for 15 years. Those ties go a long way in funding future deals no matter the size.

Small-Project Challenges

In the small town of Colby, Kan., about 55 miles from the Colorado border, Cohen-Esrey Real Estate Services recently transformed a historic hospital into workforce housing.

"Our market study showed that there was a significant amount of substandard housing in Colby," says R. Lee Harris, the company's president and CEO. "We also heard that there was pent-up demand for quality affordable housing, since nothing had been added to the market for years."

The firm settled on developing 30 apartments. It could have squeezed in more units but chose to be careful in a town with only 5,000 people.

"There's very little margin for error in small projects in small markets," Harris says. "In Colby, we couldn't [afford to] be wrong about the market and its depth because there weren't nearby small towns to draw from. We had to rely solely upon the population base in Colby."

The veteran developer pushes for "hurt me" market studies no matter how difficult the findings may be.

"Don't tell us what you think we want to hear—tell us how it really is," he says. "We want to see the lowest-possible capture rates—usually 5% or less for a workforce project and 10% or less for a seniors project."

St. Thomas Historic Residences opened in August and was fully occupied by the end of September.

Cohen-Esrey has developed projects ranging in size from as small as nine units to as large as 184 units.

Overall, most of the nation's LIHTC properties are a pretty good size: The average is 75.6 units for properties placed in service between 1995 and 2012, according to a Department of Housing and Urban Development database.

The main challenge with developing small projects is they are unable to achieve the economies of scale seen in large deals. That means the cost per unit will generally be higher.

In addition, they can end up with a relatively high vacancy percentage with just one or two units off line, says Tony Bertoldi, executive vice president of syndication and investor relations at City Real Estate Advisors (CREA).

For LIHTC syndicators like Bertoldi and other financing partners, there are fixed costs associated with the closing process, investor review, and management. Smaller equity deals provide fewer sources to manage those expenses and make smaller deals less profitable for them.

"We don't have a cutoff on deal size but find that deals below \$2 million worth of equity require additional consideration and thought as it relates to these costs and the decision to move forward," Bertoldi says.

CREA is working with developers on several small deals, -including the 20-unit Main Street Cottages in Princeton, Ind., by Milestone Ventures. The \$4 million development is using about

\$3.2 million in LIHTC equity.

The seniors housing project is small for several reasons: It's on a modest infill site; it sits next to another, 36-unit seniors development by the developer; and it's acting as a pilot project by using modular construction, says Chuck Heintzelman, principal of Milestone Ventures in Indianapolis.

The development is expected to be completed around July.

In addition to LIHTCs, Main Street Cottages is being financed with a Federal Home Loan Bank of Indianapolis Affordable Housing Program award and a loan from Old National Bank.

To make deals more feasible, many developers are moving toward smaller units to curb development costs, which may also allow for more units per acre, says Charles Anderson, executive vice president of acquisitions at CREA. He advises developers considering smaller developments to avoid conventional permanent debt in favor of HOME, the Federal Home Loan Bank's Affordable Housing Program, or other forms of public funding. "Small deals typically require less public resources and tend to be more successful on their requests as a result," he says.

Another challenge can be finding contractors for small projects in small markets, and that means higher costs.

A plumbing contractor that was originally going to work on the St. Thomas project took other jobs when the development ran into a delay. The next-cheapest subcontractor was substantially more expensive.

The \$7.4 million development was financed using LIHTCs, federal and state historic tax credits, and a Federal Home Loan Bank Affordable Housing Program loan. R4 Capital funded the federal tax credits.

This model, with its historic component, allowed Cohen-Esrey to eliminate permanent debt and keep rents low.

Small projects can also be more challenging to operate once they're built. The problem of not having economies of scale extends to the management and operations side. It can also be harder to find qualified managers because of the limitations on compensation. "Further, small properties with low rents typically generate low levels of management fees," Harris says.

On the operations side, developments require a certain level of staffing whether there are 15 or 30 units.

"Most of our small projects are special-needs developments that have some operating subsidy, either project-based Sec. 8 or capitalized operating reserves like state Mental Health Services Act funding," says SAHA's Friedland. Her organization has developed projects ranging in size from about 12 to 100 units.

At Jack Capon Villa, SAHA obtained project-based rental assistance, so residents pay no more than 30% of their income for rent.

Latest Strategies

Lawrence CommunityWorks (LCW) recently opened the 18-unit Casa di Anna project in its

hometown of Lawrence, Mass.

The development is named after Anna LoPizzo, an Italian -immigrant textile worker killed during the infamous 1912 Bread and Roses labor strike in Lawrence. LCW did this to honor LoPizzo, who lived in the neighborhood, and all the working people who have given Lawrence its rich immigrant history.

Casa di Anna helps fill the need for affordable family units in the community by providing two- and three-bedroom apartments, says Hershey Hirschkop, senior project manager. It also redevelops a property that used to be home to an old Italian-American club.

?Many developments need to stay small in order to be compatible with the scale of the neighborhood,? Hirschkop says. More than just a housing developer, LCW is active in all aspects of community building in Lawrence.

About half of the funding for the \$6.6 million project came from LIHTCs that were allocated by the Massachusetts Department of Housing and Community Development and syndicated by Massachusetts Housing Investment Corp. (MHIC).

?Casa di Anna is an important project that provides critically needed new, quality affordable housing for the neighborhood,? says Christine Vincenti, investment officer at MHIC.

Lawrence CommunityWorks turned a vacant, underutilized site into a development that is reflective of the community.?

Small developments play a significant role in the overall housing market. According to American Housing Survey estimates, about 35% of occupied rentals are single-family homes and another 19% are in buildings with two to four units. Apartment buildings with 10 or more units account for only 30% of the rentals.

Freddie Mac launched a commercial loan program for small rental properties in October. The company said it will buy and securitize small multifamily loans between \$1 million and \$5 million and with at least five apartment units. Freddie Mac leaders anticipate the average loan to be about \$2.5 million.

In announcing the program, David Brickman, Freddie Mac's multifamily executive vice president, said that, historically, -local lenders have financed small multifamily properties, and debt capital isn't widely available across the country from national lenders with standard products.

Recognizing the role these properties play and the challenges they face, other agencies, too, are looking for ways to support small projects.

The Connecticut Housing Finance Authority has adopted a strategy to help encourage such development. Its efforts include participating in a loan pool with area Community Development Financial Institutions (CDFIs) to provide financing to owners of small properties. There's also a pilot program called Come Home to Downtown that helps owners create housing opportunities at small underutilized properties while revitalizing neighborhoods across the state.

Small developments are also a focus of the Florida Community Loan Fund. The CDFI won a \$4 million Wells Fargo NEXT Award for Opportunity Finance to expand its Florida

Preservation Fund last year. The loan program targets projects of five to 100 units, with an emphasis on those with five to 50 units because they're prevalent in Florida, and it's difficult to find financing for them.

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