

# Affordable Housing Development in Ward 3



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# Outline

1. **Site Acquisition: What Makes Ward 3 Different**
2. **Affordable Housing Finance 101: Understanding the Tools**
3. **Example: Building a Three Bedroom Affordable Apartment**
4. **Land Valuation and Zoning Strategies**

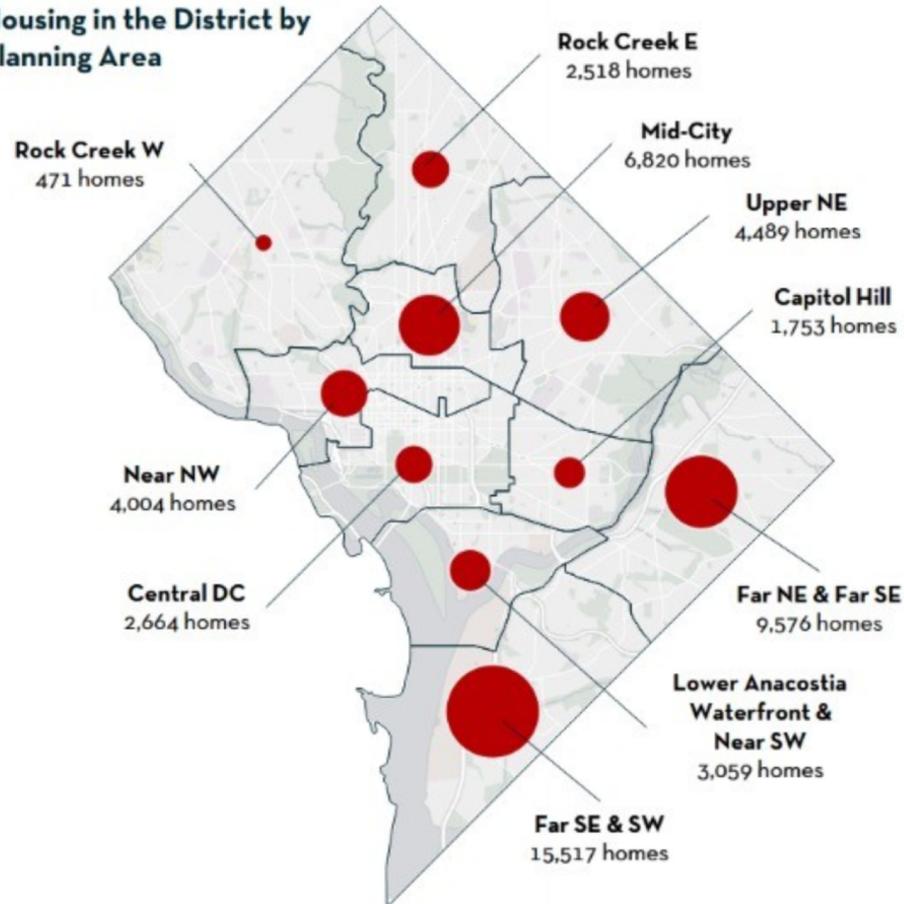
1. Site Acquisition: What Makes Ward 3 Different

# Affordable Housing in DC – Traditional Approaches

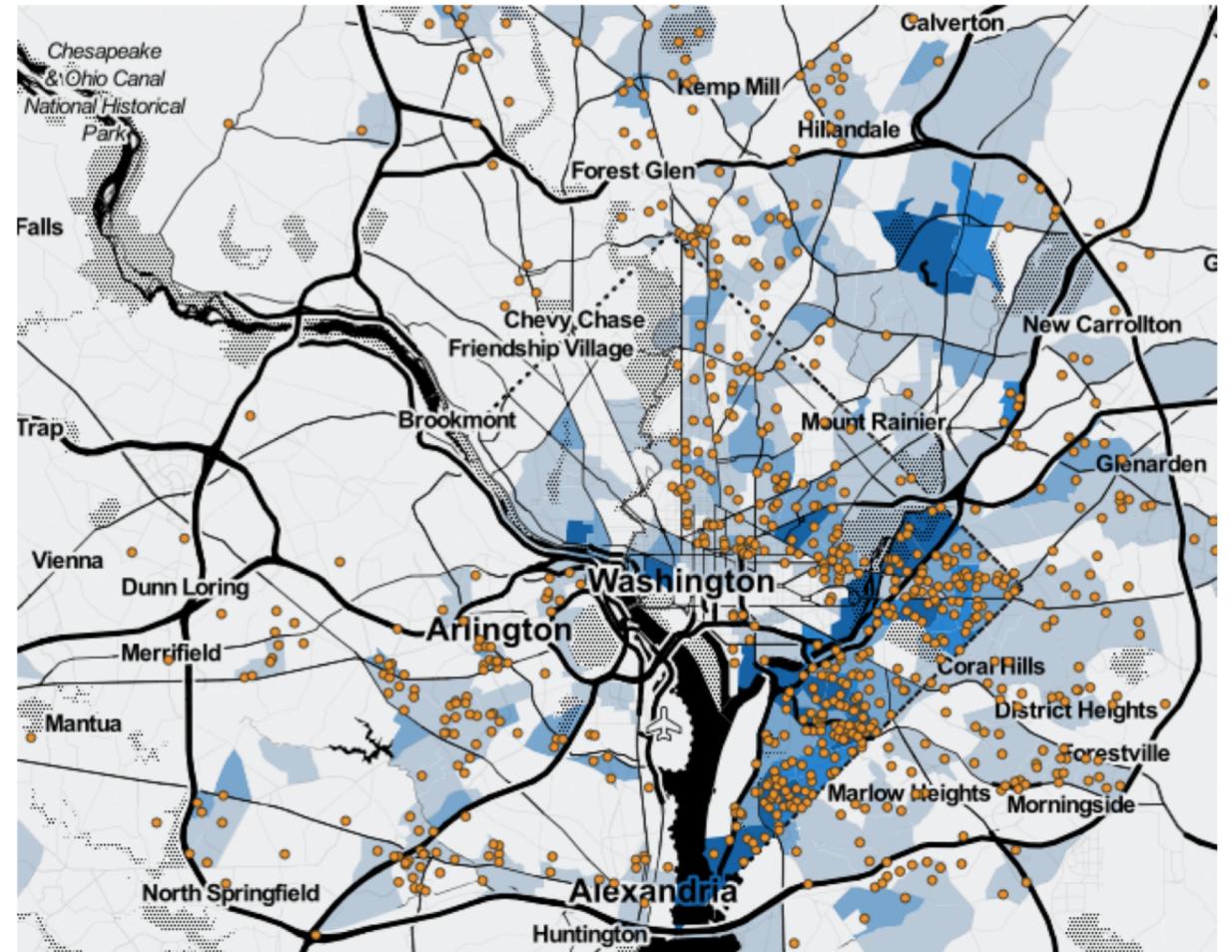
- 1. Preservation Projects:** Tenant Opportunity to Purchase Act
- 2. City-Facilitated Projects:** Public Land Dispositions
- 3. Socially-Minded Land Owners:** Faith Community Redevelopments

# Lack of Affordable Housing in Ward 3 Limits Preservation Opportunities

Distribution of Subsidized Housing in the District by Planning Area



Distribution of Section 8 Housing



# Lack of Publicly Owned Land Limits Public Land Disposition Opportunities

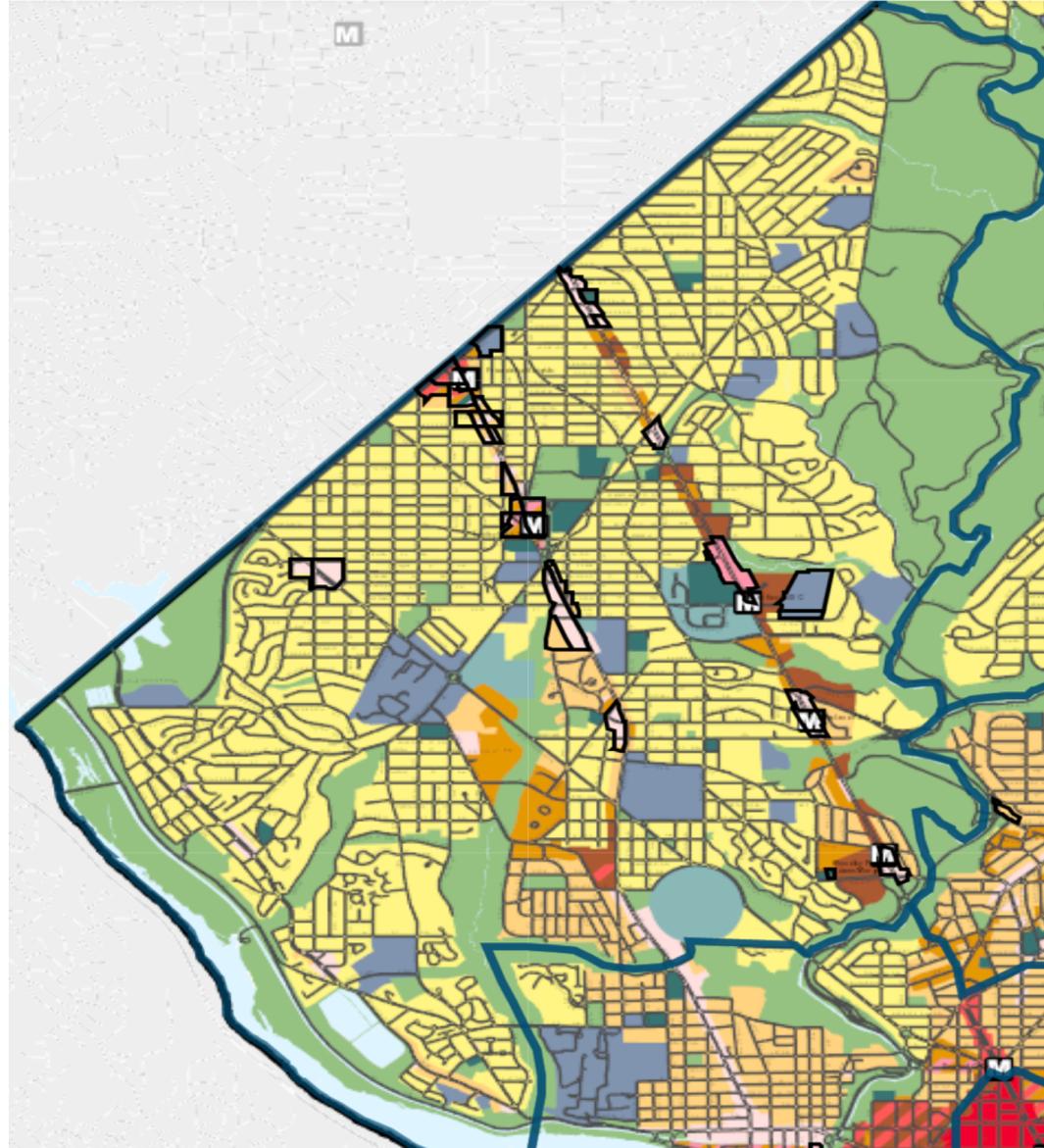
## Legend

### Proposed Comprehensive Plan Future Land Use

#### Land Use Categories

-  Residential-Low Density (RLD)
-  Residential-Moderate Density (RMOD)
-  Residential-Medium Density (RMED)
-  Residential-High Density (RHD)
-  Commercial-Low Density (CLD)
-  Commercial-Moderate Density (CMOD)
-  Commercial-Medium Density (CMED)
-  Commercial-High Density (CHD)
-  Institutional (INST)
-  Federal (FED)
-  Local Public Facilities (LPUB)
-  Parks, Recreation, and Open Space (PROS)
-  Production & Technical Employment (PROTECH)
-  Water

Public Land



# Some Social Opportunities – But Most Land Owners **Want Highest Price**

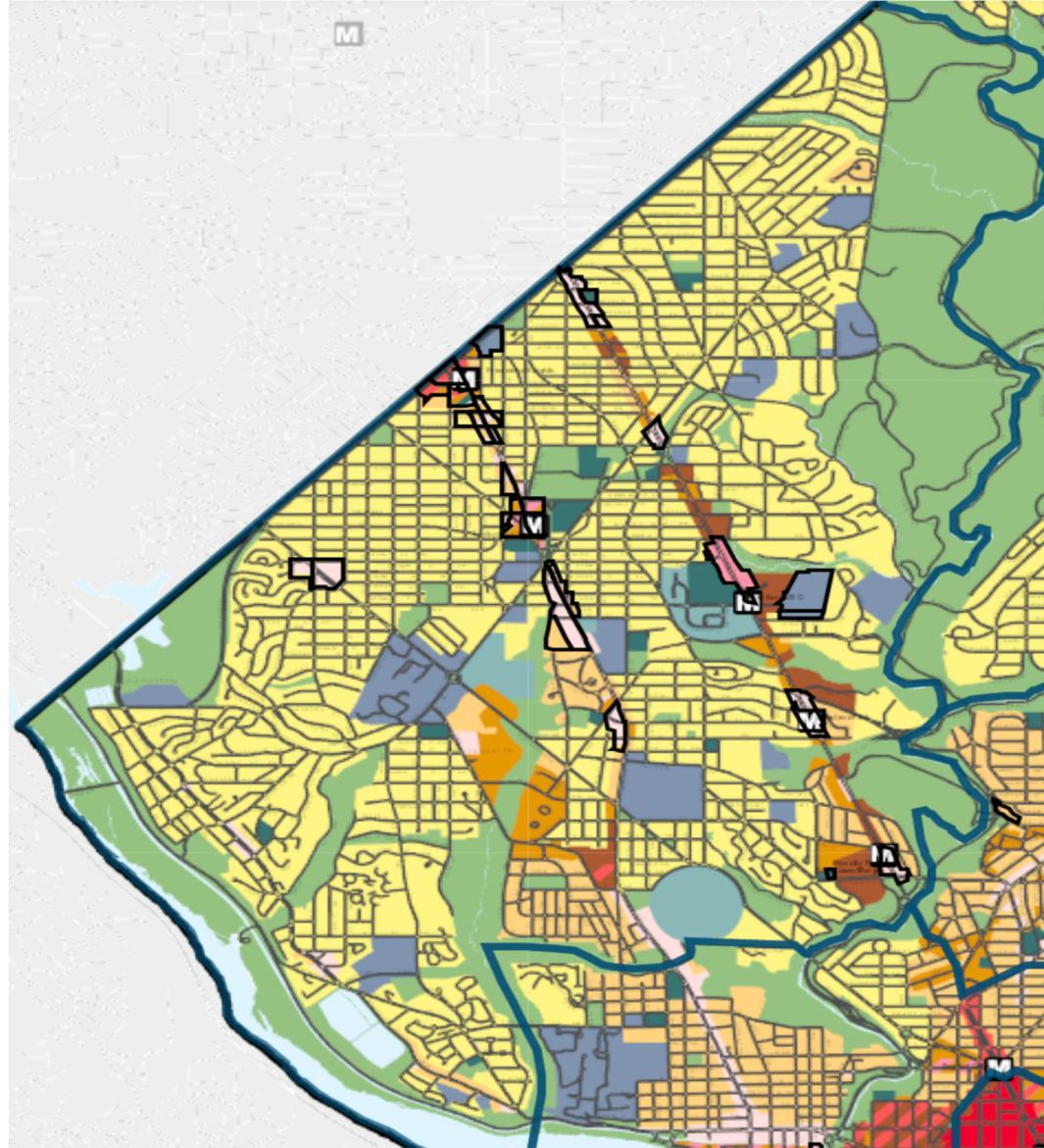
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**Private Land**



# Intense and Fast Competition When Properties Come On Market

Commercial Real Estate

**Exclusive: More than 200 potential buyers show interest in the Marriott Wardman Park**

**Fannie Mae building atop Van Ness Metro station sold for \$24.8 million**

Commercial Real Estate

**Mazza Gallerie mall in Northwest D.C. sold at auction**

# Solution: Making Unsolicited Offers at Market Rate Price



## 2. Affordable Housing Finance 101

*Understanding the Tools*

Like Buying a Home, New Buildings Are Financed With Debt and Equity

# Debt

- When Buying a Home: Depends on **Monthly Income** and **Interest Rates**
- When Building a Building: Depends on **Income** (Rent minus Expenses)
- For Affordable Projects: Lower Rents → Lower Income → **Smaller Loan**

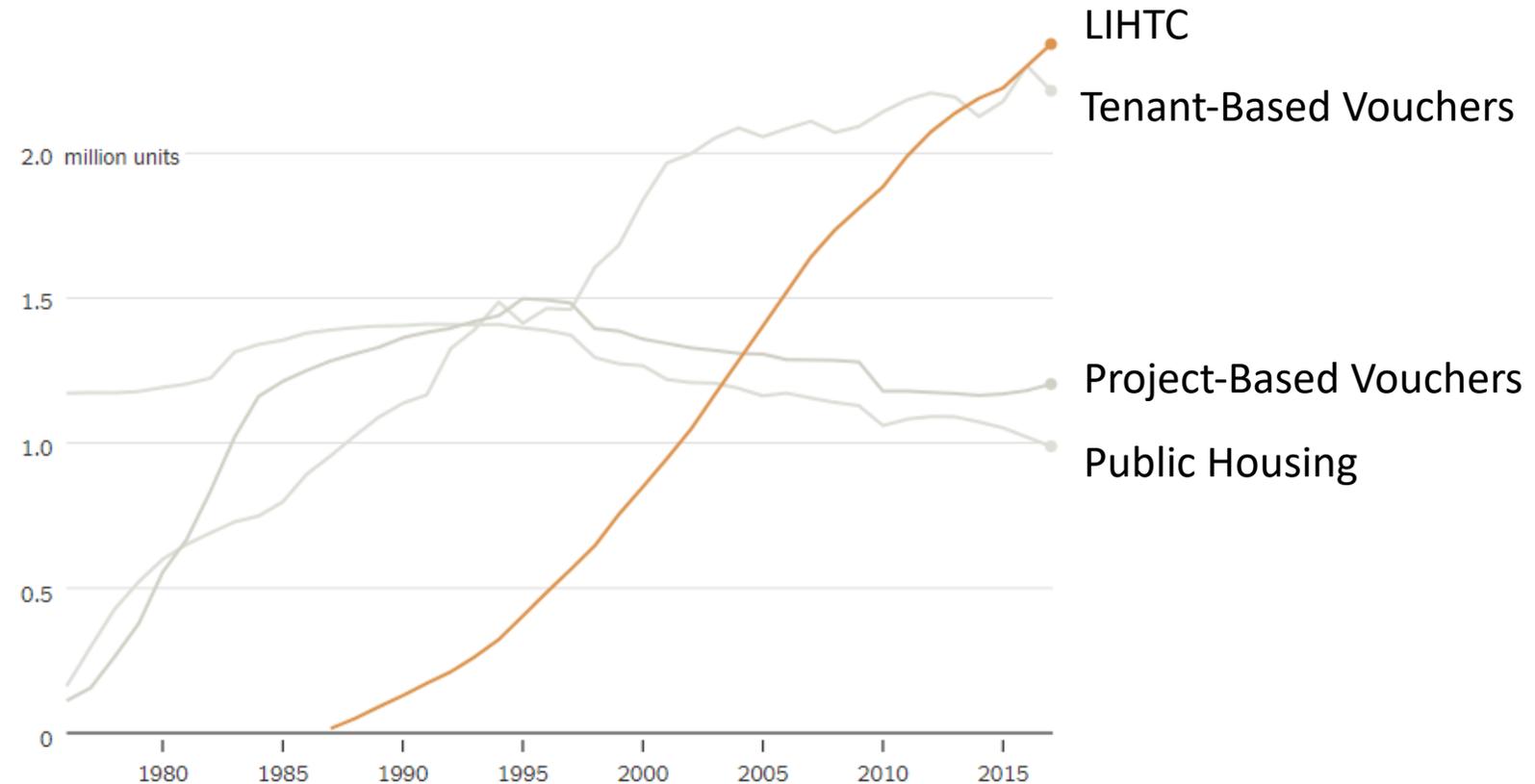
# Equity

- When Buying a Home: **Down Payment**
- When Building a Building: Often Raised From **Institutional Investors**
  - Often Expect **12-15% Annual Return** – Premium vs. Real Estate Stocks
- For Affordable Projects, Equity Returns Usually **Not Sufficient** to Attract Investors
- Instead, affordable housing developers often use **Low Income Housing Tax Credits (LIHTC)**

# LIHTC is now the largest federal affordable housing program

## The Changing Shape of Housing Assistance

Affordable units built by developers with the help of tax credits house more low-income households than other major housing assistance programs in America.



# Additional Gap Financing

- Mortgages and LIHTC equity are usually **not sufficient** to fully cover costs
- Projects need to find ways to fill this “**gap**” between Sources and Uses
- Three sources of gap financing:
  1. Grants
  2. Operating Subsidies
  3. Subordinate Debt (“Second” Mortgage)

# Affordable Housing Development: Sources and Uses

## Sources

First Mortgage

LIHTC Equity

Green Building Grant

+ Housing Production Trust Fund

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**Total Funding Sources**

## Uses

Land/Property Acquisition

Construction Costs (“Hard”)

Design, Permitting, and Legal Costs (“Soft”)

Financing Costs

Reserves (Construction and Operations)

+ Developer Fee

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**Total Development Costs**

=

### **3. Example: Building a 3 Bedroom Affordable Apartment**

# Model Assumptions

- **Apartment Size:** 1,000 sq. ft.
- **Affordability:** 50% of Area Median Income (AMI), ~\$60,000 income for 4 people
- **Building Type:** Low-rise wood frame apartment, \$205 per sq. ft. construction costs
- **Operating Subsidy:** 100% Property Tax Abatement (available to non-profits in DC)
- **Acquisition Cost:** \$0, Land given away for free (more info on land value later)
- **Mortgage Terms:** 4% APR, 40 year amortization

# Operating Budget

**Gross Rent:** \$1,670 monthly (50% AMI limit)

**Net Rent:** \$1,550 monthly (\$120 deduction for tenant-paid utilities)

**Annual Rent:**  $\$1,550 * 12 = \$18,600$

**Annual Operating Expenses:** \$7,200

**Net Operating Income (NOI):**  $\$18,600 - \$7,200 = \$11,400$

# Development Budget

**Total Square Footage:** 1,176 (assumes 85% is “core” residential space →  $1,176 * 85\% = 1,000$ )

**Construction Costs:** \$205 per sq. ft.

**Construction Contingency:** 5% of total construction budget

**Design, Permitting and Other “Soft” Costs:** 10% of total construction budget

**Financing Costs (Construction Interest, LIHTC/Mortgage Fees):** 10% of total construction budget

**Total Development Costs:**  $(1,176 * \$205) * (1 + 5\% + 10\% + 10\%) = \$301,350$

# Financing Sources

*Note: Specific formulas for mortgage and LIHTC equity not shown*

**NOI:** \$11,400 (See Operating Budget)

**First Mortgage Size:** \$189,422 (Calculation based off NOI, 4% interest, 40 year amortization)

**LIHTC Equity:** \$82,732 (Calculation based off Development Budget, LIHTC credit pricing)

**Total Sources:** \$189,422 + \$82,732 = **\$272,154**

# Sources and Uses

## Sources

First Mortgage = \$189,422

LIHTC Equity = \$82,732

+ **Gap = \$29,196**

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**Total Funding Sources = \$301,350**

## Uses

Land Acquisition = \$0

Construction Costs = \$241,080

Soft Costs = \$24,108

Financing Costs = \$24,108

Construction Contingency = \$12,054

+ Developer Fee = \$0

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**Total Development Costs = \$301,350**

# Understanding the Gap

- **Key Takeaway:** It costs more to build an affordable 3-bedroom apartment in DC than that unit earns in rent to pay for its construction
- Factoring in average land costs (~\$100,000 per unit), the gap realistically is closer to **\$129,000** rather than \$29,000
- The model also assumes \$0 in operating reserves (dangerous for long-term management) and \$0 in developer fee (developer earns no revenue)
  - **Not realistic** assumptions

## **4. Land Valuation and Zoning Strategies**

# Land Value Basics

- A single piece of land is **exclusive**: only one development can be created on a given site
- When multiple, mutually exclusive projects bid on land, **only one can be selected**
- Ex: A specific plot of land can be a farm or a building or a park, but not **all three at once**
- Land value is determined by the “**highest and best use**” – the use of the land that will result in the maximum price

# “Highest and Best Use” Analysis

- When different projects are modeled for the same piece of land, land value is determined by whatever the project can **afford to pay** for the site
  - Assume that all other factors (construction costs, projected rents and expenses) are **fixed inputs**
  - Land price is the **output** of the model
- Ex: Three projects considered for a vacant lot:
  - Market-rate apartment can afford to pay **\$5 million**
  - Office building can afford to pay **\$4 million**
  - Factory can afford to pay **\$2 million**
- The land is valued at **\$5 million** based on the expected “highest and best use” as a market-rate apartment building
- Because the office and factory projects cannot pay \$5 million for the project (based on financial models), they are **financially unviable** and thus cannot proceed

# Comparing Land Value for Apartment Projects

- Highest and Best Use analysis also applies to comparisons **between similar projects**
- It is particularly useful in understanding why the market in DC is not producing more **middle-income housing** (i.e. affordable at 80-100% AMI levels)
- Ex: Compare three proposals for a 180-unit 4 story building with same unit mix
  - Project 1 Rents: \$1,900 for studio, \$2,400 for 1 BR, \$3,400 for 2 BR units
  - Project 2 Rents: \$1,500 for studio, \$2,000 for 1 BR, \$3,000 for 2 BR units
  - Project 3 Rents: \$1,200 for studio, \$1,800 for 1 BR, \$2,500 for 2 BR units
- All other inputs **held constant**: construction costs, interest rates, equity returns, etc

# Comparing Land Value for Apartment Projects

- Resulting land value (output of model):
  - Project 1: **\$17.5 million**
  - Project 2: **\$5 million**
  - Project 3: **\$0** (Actually, negative → “Gap” financing needed)
- As a result, the land is worth **\$17.5 million** and **only Project 1 is viable**
- Project 2 **will not work** if it has to pay \$17.5 million for land, Gap financing needed
- In reality, owner could choose to sell land at **below market rates**
  - However, this rarely happens unless owner is (a) The Government (b) Mission-driven entity

# Implications of Land Value Analysis

- This “Highest and Best Use” Analysis helps explain why cheaper market-rate projects are **not getting built in DC**
- Because luxury projects are able to **outbid** non-luxury projects for land, demand for luxury housing in certain neighborhoods makes building cheaper housing in those neighborhoods **financially unfeasible**
- Public gap financing tools can help, but **equity concerns** about using public subsidies for middle class housing rather than low-income housing (i.e. 80-100% AMI vs. 0-60%)

# How Zoning Impacts Land Values

- By limiting what can be built on a particular site, zoning codes can **artificially restrict** the value of land
- Example: If an apartment project could afford \$10 million for a site, but a single family detached home could afford \$2 million, “highest and best use” indicates a **\$10 million value**
- However, if the site is zoned for single family detached homes only, it is worth **\$2 million instead**

# Upzoning for Affordable Housing

- By upzoning land to less restrictive uses, it is possible to **“unlock” existing land value**
  - Ex: Upzoning the single family home site to allow apartments creates \$8 million in value (\$10 million - \$2 million)
- Creative upzoning that unlocks land value in exchange for affordable housing can make it **financially feasible** to produce apartments with lower rents, because there is no direct competition with luxury projects
- Example Part 2:
  - Single Family Home can pay **\$2 million** for land
  - Luxury Apartments can pay **\$10 million** for land
  - Affordable Apartments (using LIHTC) can pay **\$4 million** for land
- By upzoning the parcel to allow affordable apartments only, the land becomes worth **\$4 million** and the affordable project is now **financially feasible** (not competing with \$10 million land value project)
- However, **difficult to standardize** because construction costs and interest rates change, so land values fluctuate

# Portner Place



- 48 Unit Section 8 garden apartment built on U St in 1970s after the riots
- Landlord put the building up for sale in 2012, tenants at risk of displacement
- Tenant association partnered with Somerset Development Co. to exercise TOPA rights (Tenant Opportunity to Purchase Act)

# Portner Flats



- Rather than rely on the Housing Production Trust Fund, Somerset **subdivided the lot and sold half** to a market-rate housing developer (Trammell Crow)
- This provided the gap financing necessary to **build a new all-affordable building** on the other half, doubling the original unit count from 48 to 96 units

# Portner Flats

- The proposed redevelopment was approved for a **Planned Unit Development (PUD)**, allowing a taller building than by-right zoning
- This PUD was fundamental in **increasing the land value** enough to fund the acquisition and match the highest market-rate offer
- Acquisition costs were **\$17 million**, sale of market-rate parcel provided **\$12 million** in gap financing
- Site went from **48 affordable units to 384 units** (96 affordable and 288 market rate) in a high-demand area

# Conclusion

- In Ward 3, **site acquisition** is a major challenge and the first step to building affordable housing
- In affluent neighborhoods, **high land values** make affordable housing development particularly tricky
- There are financing tools – such as **LIHTC** and the **Housing Production Trust Fund** – which can help
- **Upzoning** is another critical supplement that unlocks additional land value and captures it as an investment in affordable housing
- Upzoning is **time intensive** and **high risk** during interim period – need substantial community support