CRAIN'S DETROIT BUSINESS

Real Estate

Hefty stacks of capital needed to get affordable housing projects off the ground

By Nick Manes

Amid a housing shortage in metro Detroit, around Michigan and the country in general, the question is often asked: Why is affordable housing in such short supply?

The simple answer, according to industry experts, is that affordable housing — generally defined by the federal government as housing for which the occupant is paying no more than 30% of gross income for housing costs, including utilities — is subject to the same headwinds as the broader commercial real estate sector, and sometimes even more so.

Think construction, appliances and maintenance.

So affordable housing developments often need hefty stacks of capital to come to fruition.

"All those expenses are just as present in affordable units as they are in market rate, and you're working with controlled rent," said Josh Ghena, senior vice president of equity business funding for Cinnaire, a Lansing-based affordable housing finance nonprofit. "And the amount of money coming in is less."

Capital stacks

The so-called capital stacks, the layers of financing needed to complete a housing development, tend to have far more mechanisms when the development is considered affordable, as opposed to a project in which all of the units will be rented at market rate.

With a market rate apartment deal, the financing tends to be much "cleaner," according to Ghena. Typically, capital for a market rate development will consist of equity by the developer and debt, generally from a bank, and sometimes private equity investment.

By contrast, affordable apartment deals tend to have much more complexity and several more layers of financing. Federal Low Income Housing Tax Credits make for the most common mechanism used by affordable developers.

A developer will apply for the credits, usually at the state level, and should they be approved, in most cases the credits will be sold to an investor in exchange for the equity capital and the investor will see a reduction in their corporate tax liability over a period of 10 years.

On top of the LIHTC financing, developers — at least in Michigan — will often tap state and local grants and loans, as well as other tax abatements and tax increment financing.

The layering of such financing often adds time and complexity to the project, and "every minute counts" in such deals, especially during volatile economic times such as the present, said Adam Ferguson, a principal at Southfield-based commercial real estate financing firm Bernard Financial Group.

"The numbers you penciled (in) yesterday all of a sudden don't work today," Ferguson said. "And so ... it just takes so long for these projects to get off the ground, and then when you think you're ready to go, something in the market happens."

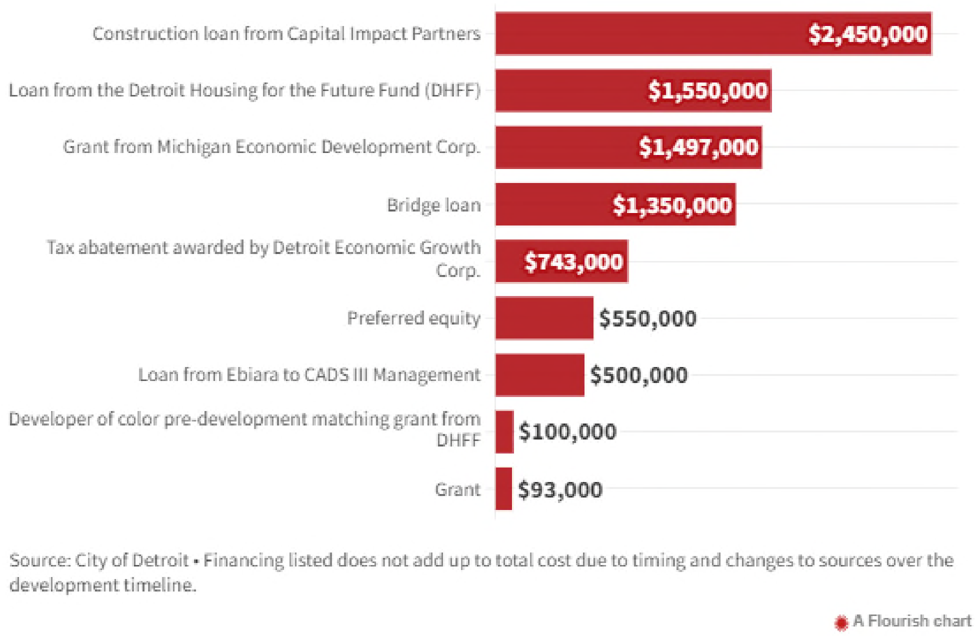
Given that reality, Ferguson said his firm aims to "dual track" as much as possible, meaning that while developer clients are working to build their capital stack, mortgage originators like Bernard are working with financial institutions, all in the hope of saving "a week, a month or two months."

Additionally, affordable housing projects, at least those built by for-profit developers, tend to see scant returns. Take for example, a renovation planned for a vacant building near Detroit's Boston-Edison neighborhood using myriad financing mechanisms.

The $8.4 million redevelopment into 42 mixed-income residential units reserved for those making between 50% and 120% of the area median income would see a return of around 5.4% after 20 years. By comparison, a typical investment in other forms of commercial real estate can see returns of roughly double that amount.

How financing stacks up

Affordable housing developments often need hefty capital stacks to come to fruition. For example, The Beauton, a $7.3 million mixed-use building in the wo will bring 29 units new affordable housing to Detroit. A variety of financing was required to make the project happen, including:



Source: City of Detroit • Financing listed does not add up to total cost due to timing and changes to sources over the developm

A Flourish chart

Complexities abound

For their part, government officials tasked with administering the various financing mechanisms acknowledge the complexity of the situation.

"We're at a time where housing demand is high and getting housing developed for the current need in our state is difficult," said Amy Hovey, executive director of the Michigan

State Housing Development Authority, the state's housing agency. "And while we have more and more funding tools that we have access to, it's complicated to make them all work together."

While difficult and often costly to produce, the need is great. Per figures from MSHDA, some 48% of renters and 18% of homeowners in Michigan paid more than 30% of their income on housing.

Metro Detroit, meanwhile, is one of a handful of major metro areas where rents are still on the rise, despite falling nationally. Experts attribute the growth in rental rates to demand far outpacing supply.

Officials with the city of Detroit, who have been involved in scores of affordable housing deals in recent years, note that LIHTC clearly isn't enough to make developments pencil out.

"Nationally, you can look at the sources for affordable housing and conclude there is not enough," said Julie Schneider, director of the city of Detroit's Housing and Revitalization Department.

Schneider noted the city has used about $40 million in one-time federal money from the 2021 American Rescue Plan Act toward affordable housing initiatives.

The state's housing agency is also working to make additional funding available, Schneider and other city officials were quick to note, pointing to $150 million in supplemental funding the agency has received. Those dollars are needed as it comes at a time when the federal government is doing little to increase tax credit allocations, according to Schneider.

Several sources also pointed to the recent legislative expansion in the state of TIF dollars for housing development as another financing mechanism that developers will be able to utilize.

Finding solutions

So will government money alone solve the situation? While it may not hurt, experts say that could move into a precarious situation.

"If you take your community development hat off and you say, 'I'm just a taxpayer,' I don't want to see the United States in general — and the Midwest and Michigan in particular — in a situation where the entire segment of housing — or at least a huge chunk of it — is predicated exclusively on what happens in Congress through public appropriations," said Eric Hanna, president and CEO of Michigan Community Capital, a Lansing-based affordable housing developer and financial organization. "That's a very scary thought."

While funding is obviously important, the government, Hanna said, could help greatly in terms of getting more people into skilled trades, which could help bring down costs.

"I think those are really important things to do in terms of reversing population loss in the state in terms of rationalizing the cost for construction," Hanna added. "And all of those things trickle into a more affordable product, and more participants in the market, which also creates more affordability."

Other developers in the affordable housing space also tout a host of solutions. Amin Irving, the founder, president and CEO of Ginosko Development Co. in Novi, shared with Crain's via email a host of policy prescriptions that he believes would be helpful in bringing more affordable housing to market.

A few of Irving's ideas are below:

- Make cost efficiency (with a standards of design floor) be the most heavily weighted metric in awarding precious government subsidies. Housing agencies have continuously diluted incentives for developers and contractors to reign in their development costs. If every development team is offered $1 million in government subsidies, then the development team that can build (or rehab) the greatest number of units with that same $1 million should always win the subsidy. That is not the case now.
- Demand accounting audits that don't just cost certify construction costs but require forensic audits that actively seek out construction fraud and unnecessary construction markups.
- Address construction bonding fees that are supposed to be there to mitigate risk, when in fact the terms within the bonding agreements effectively eliminate their own risk. It's an unnecessary cost if the risk is ultimately on the owner or developer anyway.

Add supply to drive down costs

While such policy moves could be of assistance, some experts say the best solution is simply to build, baby, build.

Minneapolis is one example where such a solution has helped, as Bloomberg reported in August.

The Upper Midwest city in May became the first major metropolitan area to see annual inflation fall below the Federal Reserve's target of 2%. Its 1.8% pace of price increases was the lowest of any region that month.

The Bloomberg report attributes that milestone, at least in part, to the city's move five years ago to eliminate zoning that allowed only single-family homes, and since 2018 the city has invested $320 million for rental assistance and subsidies.

In doing so, Minnesota's largest city has seen a boom in apartment and condo development. Per the Bloomberg report, the metro area now has some of the slowest rent growth in the country, and residents pay a smaller chunk of their income toward housing costs relative to comparable metro areas.

So, adding supply is clearly a large part of the equation to help drive down housing costs. Michigan Gov. Gretchen Whitmer has called for adding or renovating 75,000 housing units over five years.

Hovey, the MSHDA director, said the state is on its way toward meeting that goal, but the true need is far greater, and Michigan remains far from seeing such a spike in new supply that prices would trend downward.

"The governor put a goal of 75,000 units over a five-year period and we are in line at the state to meet that goal, and we're excited about that. The tools are working," Hovey said. "But we need 190,000 units. And so while I think we're going to surpass that 75,000 units — and I'm excited and I'm proud of that — we have a ways to go."

— Bloomberg contributed to this report.

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