



Real Estate Southern California

Everyone agrees that Southern California needs more affordable housing, but the path to creating it is fraught with complications stemming from regulations, layers of financing and environmental and neighborhood opposition. The vast majority of ground-up multifamily development in this region is for class-A, luxury apartment communities that can generate the rents needed to justify the costs of development. And while there is also much redevelopment taking place, it's usually for market-rate apartments that might have a small component of affordable, but not enough to satisfy the huge demand.

"The region's complex development process, specifically for affordable housing, is multi-faceted," says Elizabeth Hull, an attorney with Best Best & Krieger in San Diego. "Stringent city regulations, broad state environmental statutes, funding issues and neighborhood opposition all play a role in complicating the process."

Hull says at the city level, developers are up against multi-layer approvals as concerns regarding a project's zoning, height, design and parking are addressed. With each review—be it at a city-council, planning-commission or design-review board meeting—stipulations can be added and project adjustments forced to be made. "In addition, the California Environmental Quality Act adds a level of difficulty to the process by requiring that local agencies identify and mitigate potential significant environmental impacts."

According to David Musial, SVP and director of Capital One Community Finance in Los Angeles, it's important to note that affordable development has always been a complex business. "That

said, rising costs—on both the acquisition and labor fronts—have exacerbated the situation. Acquisition costs have been driven by the fact that in Southern California, like so many other geographic markets across the county, it's a seller's market. Affordable housing developers are frequently competing with their market-rate counterparts, who can pay more for land. Labor costs have increased due to the ramp-up in construction activity across the Los Angeles and Orange County metro areas, causing demand for prevailing-wage and non-prevailing-wage construction jobs to rise. All of this can make an already complex environment even more so."

Costs for developing any multifamily project are high, but these costs hit the affordable sector much harder because of its need to keep rents low. "From the cost of land and building materials, to the time and expense of the entitlement process, it simply costs a lot of money to get a project approved and built," relates Ofer Elitzur, a partner with Cox, Castle & Nicholson in San Francisco. "And when the project is an affordable-restricted community that generates less rental income than a market-rate project, that makes it harder still to develop. Second, the sources of subsidy that are available to bridge that funding gap and make an affordable-housing project 'pencil out' are harder to come by in post-redevelopment-agency California. The state and local subsidy programs that remain available to affordable-housing developers are often over-subscribed and underfunded, leaving affordable-housing developers to compete for scarce resources."

Further, he notes, local resistance to affordable-housing devel-

To address concerns surrounding the development of COMM22 in San Diego, MVE hosted and attended community meetings, facilitated workshops, prepared fact sheets and worked closely with community groups to promote the benefits the project would ultimately provide to the area.

Solving the Enigma of Affordable Housing Development

How real estate professionals are dealing with the increasingly complex process of providing this much-needed product to the region

By Carrie Rossenfeld

opment often derails the public approval process for proposed affordable projects. “It’s NIMBYs who oppose any and all development in their local jurisdiction or citizens who have a generalized concern about sharing their neighborhood with affordable-restricted apartment complexes,” he says. “Public officials sometimes fear voter backlash if they approve affordable projects.”

And with sources of funding having dried up at the state, local and federal level, financing the “gap” between native yields and financeable yields is yet another hurdle to overcome. Jim Andersen, SVP at High Street Residential in Los Angeles, points out, “Affordable housing has fallen, in large part, to market-rate developers as inclusionary housing within a market-rate project. This has led to a number of different rules for each municipality, which strains underwriting of deals and creates uncertainty in the marketplace for developers and investors.”

Andersen adds that many stakeholders are requesting rule changes that would impact the level of affordability and the rent levels expected. “This has created a drive for new initiatives and municipal regulations that will continue to burden all developments. Also, since the disbanding of the Community Redevelopment Districts in California a few years back, a key source of housing funds to create catalytic projects has also gone away, creating concentrated pockets of development that do not require CRA financing and doesn’t allow for development in neighborhoods sorely needing affordable housing.”

Daryl Carter, founder, chairman and CEO of Avanath Capital Management in Irvine, CA, isn’t so sure, however, that the process of affordable-housing development in Southern California has become more complicated. “Certainly, multiple layers of financing,

multiple government constituencies and environmental-impact analysis make affordable development and redevelopment more complex than conventional. This has always been the case and simply the nature of the beast.”

Rather, the challenge in recent years has been the cost of producing affordable housing—both new development and redevelopment, he notes. A combination of higher land and development costs and longer timeframes for permits/entitlements processing have made the development of both affordable and conventional housing more expensive. “Certainly,” he states, “this increased cost contributes to the complexity as more subsidy and soft financing is needed to make developments pencil out.”

Yet, Carter adds, at least one area has become less complicated: “It is much easier to convince public officials and private investors of the compelling case for new and renovated affordable housing. The affordability challenges and demand for affordable rentals are unquestioned.”

NIMBYism in affordable housing development cannot be underestimated. While the process for the California Tax Credit Allocation Committee has become more complex, one of the leading factors stymying affordable housing development is “the resistance and skepticism from the surrounding community,” says Darin Schoolmeester, principal at MVE + Partners. “These concerns of existing residents are often focused around an increase in traffic, density, diversity in demographics and myths about multi-family development.”

To combat NIMBYism, Schoolmeester says the goal of each project his firm undertakes is to create a new development that complements the existing neighborhood while enhancing the overall

community. “We incorporate public benefits with placemaking elements like open space, parks and neighborhood-serving retail and improve connectivity with trails, plazas and greater access to transit.”

MVE took this approach for Avalon West Hollywood, a mixed-use community currently under construction, that offers both market-rate and affordable senior housing. The project features a 15,000-square-foot grocery store and an additional 10,000 square feet of retail and restaurant space, as well as a public plaza that will serve the existing community and promote pedestrian activity. “While the concept of delivering a project that enhances the community applies to general multifamily and mixed-use as a whole, it is essential in helping to gain support for affordable housing developments,” says Schoolmeester.

A key step that MVE employs with its development teams to address the neighborhood concerns is to create a proactive advocacy plan for early communication with all stakeholders. “This opens up a dialogue that provides transparency in terms of the project’s plans and benefits,” says Schoolmeester. “By doing so, we are able to listen and thoughtfully respond to questions, address concerns and build relationships with neighbors.”

As was the case with the preparation process for COMM22, a transit-oriented affordable development in the Logan Heights district of San Diego. This community features 200 affordable and senior units, 13 of which were designated for underserved transition-aged youth (i.e., those exiting the child welfare or juvenile justice systems) with mental illness eligible for supportive services under the Mental Health Services Act program. To address concerns surrounding the development, the team hosted and attended community meetings, facilitated workshops, prepared fact sheets and worked closely with community groups to promote the benefits that COMM22 would ultimately provide to the residents and public.

Hull says there isn’t much that can be done on a project level to eliminate or mitigate the factors slowing down affordable-housing development, but developers are working at the legislative level to find fixes. “Together with organizations such as the Building Industry Association and affordable-housing advocates, developers are working toward systematic changes to streamline the approval process,” she explains. “In June, Gov. Jerry Brown included \$400 million for low-income housing in the state’s \$122-billion budget. The proposal that would help developers find funding is tied to the Streamlining Affordable Housing Approvals bill, which aims to speed up approvals for developers setting 5% of residential units aside for affordable housing.” At press time, the measure was held up in the state legislature.

Cities across Southern California are also implementing programs to expedite the complex processes, Hull mentions. “Qualifying affordable, in-fill and sustainable housing projects in San Diego are given priority and face a quicker development-review and permitting processes.”

Musial says in order to remain competitive with market-rate developers and investors, some affordable-housing developers search for predevelopment dollars to tie up and/or take down a



MVE incorporates public benefits with placemaking elements like open space, parks, retail and improved connectivity with trails, plazas and transit, as seen in Avalon West Hollywood, a mixed-use community currently under construction.

property as quickly as possible. Others seek out projects involving public-private partnerships where the real estate is contributed to the partnership under a long-term lease and/or soft loan.

“These are some of the solutions I’ve seen to deal with the problems associated with acquisitions costs,” he shares. “To mitigate labor cost issues, many developers look to partner with their general contractor early in the development process. Some general contractors may provide input about construction processes that are being proposed, and they can even develop more cost-effective approaches without compromising quality. Having a general contractor involved early on can also make for a more accurate bidding process, with faster turnaround time.”

Elitzur stresses that the most successful affordable-housing developers invest time and resources to win over public support in the jurisdictions where they seek to develop; to investigate, apply for and procure subsidized loans, grants and other scarce resources for affordable-housing development; and to value engineer-proposed affordable projects to build them as efficiently as possible. And Andersen recommends interfacing with stakeholders and municipal decision makers early and often. “Early agreement on targets for affordable housing allows for the developer to appropriately shape the deal with some level of certainty.”

Avanath’s business model is one of acquiring, renovating and preserving affordable apartments, and it views the complications of this industry as a continuum—from the initial acquisition through a long-term holding period, says Carter. “So, we view the complications over the long term and have strategies in place to address them. We are vertically integrated, from our initial acquisition and investment capitalization through ongoing operations by our property management platform and eventually a seven-to-12-year holding period. Therefore, we have a consistent philosophy in our interactions with investors, public entities and our residents—from our acquisition team to our onsite property management team. Also, we maintain an ongoing relationship with our federal, state, and local public partners that is cultivated by both our executive team and our onsite operating teams.”

Those involved in affordable housing development are also applying cost-containment measures to stem spiraling production expenses. While larger projects have economy of scale when it

comes to hard costs, or brick-and-mortar expenses, Hull points out that projects of all sizes can reduce costs associated with architecture, engineering and insurance, or permit and tax fees. Those soft costs, she says, “are really the only ones with any room for play. It should be noted, though, that projects cutting soft costs could face more community opposition and could take longer to approve—which could inadvertently wipe out the initial cost-saving measures.”

She adds that fewer regulatory impediments would not only help the approval process, but would also help cut rising costs. “Today, projects must gain approval from community, architecture and design-review boards, planning commissions and city councils. By cutting through the red tape and streamlining the process to include fewer approval hurdles, soft costs could be greatly reduced.”

Musial says it’s important to follow practical cost-control measures, which involves partnering with and actively involving your general contractor early in the planning stage and pre-development process. Andersen adds that additional sources of funding must be made available to aid in filling this gap, as well as a recognition that simpler and less-costly construction methods need to be used, including elimination of parking for fully affordable projects. “Creative solutions must be sought and advanced in order to increase the production of affordable housing.”

To keep rents at its communities affordable, Avanath is focused on keeping its acquisition and renovation costs as low as possible. “We are equally focused on keeping our ongoing operating expenses as low as possible while maintaining attractive and well-maintained apartments for our residents,” says Carter. Some of the firm’s strategies include:

- Performing “smart” renovations, where improvements are highly value engineered. For instance, rather than replacing entire kitchen cabinets, they often resurface them and replace the

hardware. “We improve, without over-improving,” says Carter.

- Focusing on a number of markets that have been underserved by institutional capital, such as Long Beach, Ontario, and Oakland. “We are able to purchase in these markets at more favorable acquisition prices,” says Carter.
- Making investments in energy efficiency in areas that will have a payback on the firm’s investments and potentially lower the resident utility costs.
- Aggressively seeking out improved operating efficiencies. “For instance, we focus on recycling and consolidating trash receptacles as a way of reducing operating expenses,” says Carter.

For its part, MVE often starts with exploring an efficient parking design and has implemented a wood-podium-building configuration for one of its affordable developments, Alegre Apartments in Irvine, CA. “This solution allows us to avoid costly subterranean parking structures while achieving the desired high-yield parking ratio,” says Schoolmeester. “Efficient and smart design of unit plans can provide additional cost savings in affordable developments like the Woods at Playa Vista. Emphasizing flexible and multi-functional spaces, such as open-unit plans or dual-purpose storage closets, can help minimize costs and maximize efficient use of space.”

MVE also recognizes that employing innovative technology and construction methods can drive cost savings by streamlining processes, promoting accuracy, and reducing construction issues and complications, leading to accelerated construction timelines. Schoolmeester says. The use of pre-fabricated building components, for instance, helps to minimize labor costs, accelerate construction and mitigate onsite human errors. ♦

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