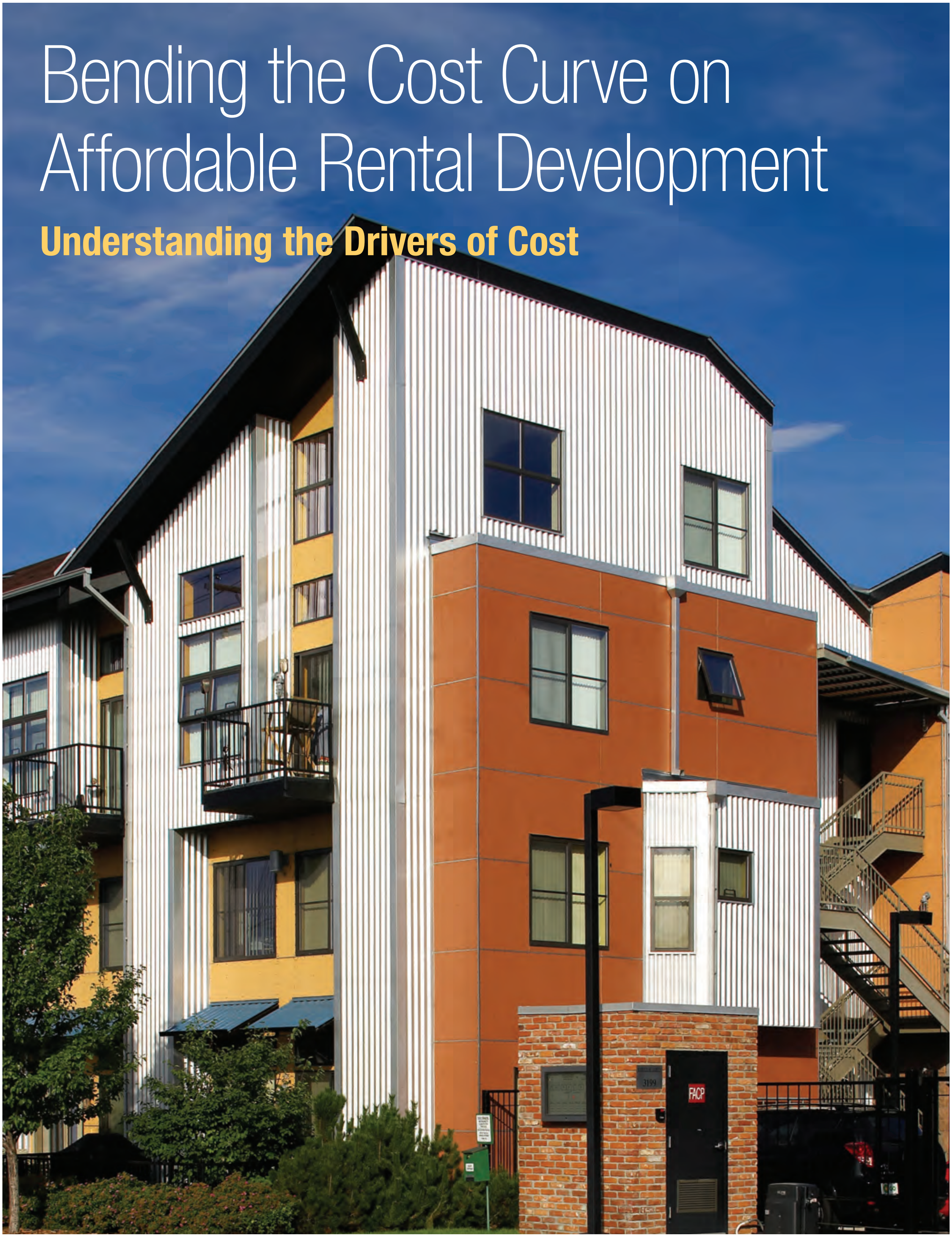
Bending the Cost Curve on Affordable Rental Development

Understanding the Drivers of Cost



Urban Land Institute
Terwilliger Center for Housing

Enterprise

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About Enterprise

Enterprise Community Partners works with partners nationwide to build opportunity. We create and advocate for affordable homes in thriving communities linked to jobs, good schools, health care services, and transportation. We lend funds, finance development, and manage and build affordable housing while shaping new strategies, solutions, and policy. Over more than 30 years, Enterprise has created 300,000 homes, invested nearly $14 billion, and touched millions of lives.

About Enterprise Policy

The Enterprise Public Policy team works with members of the U.S. Congress, the Obama administration, community development organizations, and other stakeholders to safeguard, expand, and improve housing and community development initiatives that support low- and moderate-income households. The Policy Development and Research division provides thought leadership and data-backed recommendations to influence housing and community development policy, addressing both emerging policy issues and long-term needs.

About ULI

The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. Established in 1936, the Institute today has nearly 30,000 members worldwide, representing the entire spectrum of the land use and development disciplines. ULI relies heavily on the experience of its members. It is through member involvement and information resources that ULI has been able to set standards of excellence in development practice. The Institute has long been recognized as one of the world's most respected and widely quoted sources of objective information on urban planning, growth, and development.

About the Terwilliger Center

The mission of the ULI Terwilliger Center for Housing is to expand housing opportunity by leveraging the private sector and other partners to create and sustain mixed-income, mixed-use urban and suburban neighborhoods that incorporate a full spectrum of housing choices, including workforce housing, compact design, and connections to jobs, transit, services, and education. The Center achieves its mission through a multifaceted program of work that includes conducting research, publishing, convening thought leaders on housing issues, and recognizing best practices that support the mission of the Center.

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Understanding the Drivers of Cost

THE NEED FOR MORE AFFORDABLE rental housing is on the rise, but so are the costs to develop that housing. In September 2012, Enterprise Community Partners and the Urban Land Institute's Terwilliger Center for Housing launched a joint research effort to examine the various factors affecting the cost of developing affordable rental housing.

The research team convened roundtable discussions in five cities—Chicago, Denver, Los Angeles, New York City, and San Francisco—to explore the issue of cost. Additional interviews were held with an array of practitioners, developers, financiers, and policy makers in five additional markets: Boston, Houston, Minneapolis, Pittsburgh, and Seattle. In total, these discussions allowed the research team to engage with more than 100 key stakeholders representing weak and strong markets, different population sizes and geographies, and a range of political and policy environments.

As a result of these conversations and other analysis, Enterprise and the Terwilliger Center have identified several elements as common drivers of costs in the development of affordable rental housing. In addition to exploring cost drivers, this research highlights recommended actions that may bend the cost curve and facilitate movement toward a more efficient and lower-cost affordable rental housing delivery system.

Why does lowering costs matter?

Tackling the question of how to lower the cost of developing long-term affordable rental housing has important financial and political implications. As public funding sources come under threat—in efforts to reduce government expenditures or simplify the tax code—it becomes increasingly necessary to identify opportunities to lower the cost of providing affordable homes. This research is of interest to both the development community and policy makers at all levels of government. In particular, this research will be useful for local and state government officials seeking the most efficient use of scarce resources.

Affordable housing delivery is shaped by a number of procedures, regulations, and policies instituted at all levels of the system—each with associated costs. Development costs may be dictated by site constraints, design elements, local land use and zoning restrictions, building codes, delays in the development process, efforts to reduce long-term operating costs, and the affordable housing finance system. Most affordable developments rely on multiple funding streams, both equity and debt, each of which carries its own set of requirements and compliance costs. While there may be some alignment of affordable housing land use regulations, financing tools, or programs, far too often developers must seek a complex series of approvals or obtain waivers to bring a project to

The Kalahari, New York, New York.

fruition. This process alone can introduce costs through delays to the development timeline as well as introduce additional uncertainty and risk, which, in addition to regulatory barriers, can also increase costs.

A rich literature on regulatory barriers to affordability exists. Much of that literature focuses on specific elements of constraint related to land use and zoning, process delays, and building codes. However, relatively little work has been done to examine how all of these issues, along with financing, interact with and affect affordable housing development. Our research is designed to fill this gap. In order to build a more cost-effective affordable housing delivery system, it is important to identify the factors that make housing development more expensive. Conversations with practitioners throughout the country yielded a significant list of cost drivers. These elements vary by market, project type, and funding source. While some cost drivers are unique to the affordable housing sector, others are experienced by all developers trying to work in a given jurisdiction. This discussion paper, the first in a series, identifies the most commonly cited cost drivers, provides a brief overview of their impact and applicability, and includes high-level recommendations to promote a more efficient delivery system. Future installments of this series will include a full report with detailed, actionable recommendations as well as market-based analyses and case studies.

What drives cost and why?

Project Scale

While a significant portion of the cost of a project is directly related to its size and scale, many costs—such as land, legal expenses, and funding application fees—are fixed or otherwise not directly correlated to the number of units in a project. These fixed costs make smaller projects less economical on a per-unit basis. Therefore, in some circumstances, per-unit project costs could be reduced by removing the barriers to larger projects.

To create additional units, a developer could build on a larger lot or develop an existing site more intensely. While the former method can bring some economies of scale, land and soft costs may increase as a result. A better method of achieving greater cost-effectiveness may be to develop more units on a given site through increased lot coverage, greater building height, or the construction of smaller units.

However, oftentimes there exist significant barriers to increasing the number of units built on a given site, including the following: a lack of demand for additional units; inadequate funding to cover the incremental increase in total development costs; and requirements on density, size, amenity, or design features imposed by governments or funders. It should also be noted that additional density does not necessarily lead to lower costs. For example, larger projects may require a shift from wood-frame to more expensive steel construction. Alternatively, a project might be built in phases, thus increasing soft costs.

Project Design and Construction

While the cost of affordable housing is a significant concern, it is important to recognize that savings should not come at the expense of quality. When affordable housing is poorly designed, unattractive, and unsafe, it will fail to meet the primary social goal of providing decent shelter for lower-income households.

The importance of design and construction quality has been proved over the years, both through failures (such as the high-rise public housing projects that have required expensive redevelopment) and successes (including mixed-income developments and Low Income Housing Tax Credit projects). Furthermore, many developers intend to own and operate an affordable housing development in perpetuity, whereas comparable market-rate developers might operate under a shorter time horizon. Therefore, higher upfront costs may be justified if the measures improve the long-term viability of the project; some developers have begun to design and build with life-cycle costs in mind.

That being said, policy, financial, and regulatory barriers to controlling design and construction costs also exist:

- **Community concerns.** Project designs may need to incorporate certain elements to comply with regulatory requirements, address community opposition, or meet other policy goals.

- **Site selection.** Given limited financial resources and a more drawn-out development time frame, many developers have difficulty locating appropriate sites for affordable housing development. In some cases, affordable developers secure sites from the public sector, often redeveloping disinvested infill sites as part of a comprehensive redevelopment plan. As a result, affordable projects are often built on more challenging sites than market-rate projects. When these projects use public resources, developers are often also held to higher standards for environmental remediation.

- **Price of construction labor.** Construction costs are highly market-specific, based on factors including the strength of the market, the level of workforce unionization, and the types of projects being built.

- **State and local regulations.** Regulations may prohibit innovative building techniques. Significant interest exists in construction models that incorporate manufactured, modular, and panelized housing. Factory-based work can yield savings based on economies of scale in material purchases and the ability to work in a controlled environment, among other factors. Prefabrication can be used in both the single- and multifamily sectors.

Finally, certain industry practices influence costs. Many developers use customized designs for each project, which can be expensive and time-intensive. Developers can often achieve economies of scale by using standardized designs and products throughout the portfolio. Furthermore, the repetition of standardized design and construction could help identify inefficiencies in the process, which could potentially lead to lower costs.

Finance and Underwriting

Real estate development is fundamentally shaped by the sources of capital available. For market-rate residential and commercial projects, both investors and developers generally share the common and (comparatively) simple goal of profit maximization. The financing process is more complicated for affordable housing deals. By targeting lower-income households, the developer is reducing or eliminating opportunities for the same level of profit as in a market-rate project to provide a social good. The reduced ability to earn a profit has several implications:

- **Investors who are purely yield-driven are less likely to participate in this market.** While this loss of capital availability is partially offset by public and mission-driven institutions, the decrease in overall competition in the marketplace gives the remaining investors more power to dictate terms.

- **The deals will likely be much more complicated.** While some lending institutions will provide conventional financing for affordable deals, developers must balance these sources with lower-cost capital from investors who have motivations beyond profits. As a result, developers may be forced to structure the deal around the terms and goals of the funder, rather than the needs of the marketplace. Since affordable housing capital is limited, developers must often assemble multiple layers of funding for a given deal.

The following sections address the various cost-related implications of the affordable housing finance system in more detail.

Capital Availability

In general, market-rate deals are much more flexible than affordable housing deals. Market-rate developers can raise capital for the overall company or a portfolio of properties and then deploy it quickly. Investors are taking risk based on the overall financial health of the company or a pool of deals, rather than each individual deal. This gives investors and developers more flexibility to adapt to changing market demands and cost pressures.

Affordable housing projects, on the other hand, generally are financed with a mix of public and private capital tied to the specific development or jurisdiction. The requirements of public programs and the investors who participate in them influence the types of projects that get built. The affordable housing community has adapted its development model to fit the standard requirements and structures of these types of deals. It is difficult to change the framework in which affordable housing developers operate, since doing so requires changes to laws, regulations, developer practices, and investor expectations.

The lack of capital availability prevents developers from undertaking certain financing structures and project types, which has significant implications for cost control. For example:

- **Affordable housing finance is mostly project based.** Developers must identify properties, begin scoping out a deal, and then start to assemble financing. This creates delays and increases costs. Entity- or portfolio-level capital is rare, but if such financing were available, developers could quickly and strategically deploy this capital when opportunities arise.

- **Financing for the acquisition of multifamily projects needing little to no rehabilitation is scarce.** Affordable housing developers without flexible capital are at a disadvantage in competing for these properties, especially in hot markets. In addition, funders—both public and private—can add requirements and regulations that decrease the cost-effectiveness of these investments.

- **Financing is often unavailable or more costly for smaller multifamily projects.** Small-scale deals can result in lower yields for investors. Also, transaction and soft costs generally account for a proportionally higher percentage of costs in these deals, making them less feasible for developers.

- **Capital is often unavailable or difficult to use for deals that incorporate innovative building types or construction methods.** This includes accessory dwelling units and prefabricated structures.

- **Mixed-income projects often struggle to obtain financing.** Mixed-income projects can contribute to economic diversity and community revitalization, and, in some scenarios, rents from market-rate units can cross-subsidize affordable units. However, financing these deals can be difficult, as many investors either deal exclusively with market-rate projects or affordable projects. Within the same financial institution, some lenders separate their affordable and market-rate lending into different departments that may not be accustomed to coordinating, which could add complexity, uncertainty, and risk to the deal.

Deal Structure

The structure of an affordable housing deal is often dictated by the primary funding sources. Many of the characteristics of the deal directly or indirectly lead to increased costs, including:

- **Type of contract.** Many affordable housing deals are financed on a “cost-plus” basis, in which a developer submits a funding application with a proposed budget that enumerates project costs, plus a developer fee. Successful applications will receive a funding allocation based on this budget, which reduces the direct incentive to lower costs.

- **Fees.** Many project fees—including developer fees, architecture fees, legal fees, etc.—are based on a percentage of total development costs. This structure creates an incentive to increase, rather than lower, project costs.

- **Tax credit allocations.** Housing credit allocations are made early in a process that can take several years to complete. When projecting the budget, developers have an incentive to hedge against the risk of cost inflation and overruns by increasing their upfront figures, since opportunities for a revised allocation are limited. Once the allocations are made, there is little incentive for developers to use less than the full allocation. Equity investors base decisions on the expectation that they will use the full allocation, and therefore savings generally come out of the developer fee.

- **Risk.** Since profit margins are lower for affordable deals, lenders and equity investors have an increased incentive to minimize their risk profile, leading to tighter underwriting standards. Risk aversion can also lead to a preference for a narrow range of standardized deals. While in some cases this financial conservatism can lead to better project financial performance, it can also increase soft costs and limit project flexibility.

- **Capital reserves.** Developers must set aside a portion of funding for reserves, which are used to cover construction cost overruns, shortfalls in operations funding, a loss of public subsidy, or ongoing maintenance needs. Adequate reserves are necessary, as developers and project managers often make use of a portion of those funds. However, investor risk aversion has led to stricter reserve requirements, driving upfront capital costs higher. This is exacerbated by macroeconomic conditions; operating expenses are rising at a faster rate than the income levels on which project rents are based.

Despite their influence on deal structure and project costs, equity investors rarely provide enough capital to finance the entire project, especially for deals that reach households with incomes below housing credit eligibility limits. Therefore, developers must seek out other sources of financing to complete the deal. Furthermore, regulations governing some public funding sources mandate or provide incentives for obtaining additional or "matching" sources of financing, resulting in a "layered finance" structure that has a significant influence on costs, including:

- **Additional paperwork, fees, and due diligence expenses.** Incorporating multiple sources of funding requires specialized consultants and duplicative professionals (such as attorneys and accountants).
- **Reduced competition.** Deal complexity can narrow the range of developers and professionals to those with the capacity and experience to balance multiple funding sources. This can lead to funding being directed to the highest-capacity developers and professionals, but can have the perverse effect of creating heightened barriers to entry for new market participants, reducing competition, and stifling innovation.
- **Longer timelines.** More complex deals take longer to assemble, which increases both soft costs and land holding costs.
- **Compliance issues.** Developers must generally comply with multiple (sometimes conflicting) standards and regulations, which drives up complexity and costs. In some circumstances, a developer may be required to conduct the same appraisals, reviews, and inspections separately for each funding source.

Another consequence of insufficient funding is that developers may choose to develop larger projects in phases as separate deals. While phasing may be necessary in some circumstances given developer capacity, numerous costs are associated with project phasing, including soft costs (developer fees, application fees, legal fees, and other professional fees) that are incurred at each phase. In addition, the more extensive timeline increases land holding costs. That being said, phased development can have important benefits in some circumstances, such as minimizing displacement.

Program and Investor Requirements

Investors and public funding programs can also influence costs based on the specific terms under which funding is made available, including regulations, program requirements, and timing.

First, funder requirements can increase hard costs by imposing specific design and construction standards, though these requirements are more commonly associated with municipal zoning requirements. For example, some funding programs and investors institute rehabilitation minimums for acquisition deals. The rationale behind these minimums is that investors want to mitigate risk, and would prefer to invest more money in a project to ensure that the property is of high quality and will last. If the property deteriorates, they are at greater risk of not being repaid. While these minimums may serve as a barrier to more cost-effective development, they could constitute money well spent if they extend the useful life of the building. Other examples of specific investor requirements affecting hard costs are parking minimums and fee structures, unit size minimums, storage standards, and amenity requirements.

Investors and funders also influence costs by the timing and methods in which funds are distributed. A notable example is the process through which housing credits are allocated. State housing finance agencies (HFAs) hold annual competitions for housing credits, then developers who receive an award sell those credits to investors through a process called syndication. HFAs determine which projects get funded through their qualified allocation plans (QAPs), which set minimum standards and provide point-based criteria for meeting state priorities. HFAs must balance multiple priorities from a large number of applicants, and the evaluation process can be lengthy.

These time delays can have significant cost implications, most notably in securing sites and contractor services. Since most affordable housing projects rely on the developer's ability to obtain housing credits, many developers do not complete the site purchase until they receive the allocation. As a result, purchase prices must be inflated to compensate the seller for the uncertainty and the extended length of time to close the deal. In circumstances when developers do have full site control/ownership prior to the allocation process, they incur holding costs while the housing credit application is under review. The same principle applies to identifying the rest of the development team—contractors and other professionals require a premium to compensate for the uncertain timing.

HFAs also frequently revise the standards and incentives in their QAPs. While examination and improvement are important, they often create a steeper learning curve as developers must adapt to frequent changes. A lack of QAP consistency can also narrow the field of developers, as those who are less experienced with the program may not be able to react as swiftly and effectively to QAP changes. Developers must also comply with other funding timelines. The funding application cycles for secondary financing do not always align with the QAP review timing, further adding to time and costs.

Many research participants stated that significant challenges exist to using tax-exempt private activity bonds, which provide the debt financing for deals that use 4 percent housing credits. First, the interest rates on bond financing are not always competitive with other types of debt, particularly FHA loans. However, unlike the 9 percent housing credit program, developers do not have the flexibility to use more competitive sources, and must use bonds to access housing credits. To comply with this requirement while obtaining more competitive long-term financing, developers sometimes use tax-exempt bonds (incurring all the associated costs), only to repay those bonds after one year when a better source of takeout financing is available. In the meantime, negative arbitrage on the bonds drives up costs further.

Incentives to Meet Other Social Policy Goals

While market-rate projects are primarily assessed according to financial viability, affordable housing projects—particularly those funded through the housing credit program—must compete for funds and are assessed against a variety of social policy standards. The amount of financing available for affordable housing is insufficient to meet demand. Therefore, minimum standards and scoring incentives in QAPs (as well as other funding programs) drive what gets built, as developers compete to meet these standards and design better-scoring projects. While many of these goals are desirable, meeting them can increase hard, soft, and ongoing compliance costs. Research participants cited the following standards and incentives as having a notable effect on development costs:

- **Site-specific incentives.** Some state HFAs offer location-specific incentives for projects near transit, in infill locations, or in targeted community revitalization areas, among others. In some cases, these sites can be more expensive, such as price premiums for transit-served properties. In others—such as infill locations—the site requires significant demolition, remediation, or preparatory work. In addition, the incentives themselves can increase the cost of the property—knowing that the QAP is creating demand for a certain site type, sellers/brokers often increase their asking price.
- **Commercial space.** In an effort to promote mixed-use development and broader economic growth in a neighborhood, some QAPs include incentives for including on-site commercial space. Developers can have trouble filling these spaces, especially in "up-and-coming" neighborhoods. When commercial activity does eventually improve, subsequent private market participants stand to benefit from the initial investment and risk taking.
- **Community engagement.** Some HFAs give priority to projects that can demonstrate community support. This puts projects that are facing not-in-my-backyard (NIMBY) opposition at a significant disadvantage, without regard to the quality of and need for the project. In these circumstances, the developer may be forced to adopt project densities or make design changes that are not optimal for the project, thereby increasing costs.

- **Match and leverage requirements.** Many QAPs include a minimum match, a leverage requirement, or additional incentive points for exceeding a given standard. To improve competitiveness, some developers may add project features in order to pursue additional funds and enhance the leverage score.
- **Other incentives or requirements.** These include historic preservation rules and mandatory project amenities such as community rooms, computer labs, and green space.

Green building and energy efficiency requirements and incentives constituted the most widely discussed social policy goals throughout the research process. Many HFAs have incorporated environmental sustainability into their minimum requirements or added incentive points for meeting performance standards or obtaining a third-party green certification. While many elements related to green building and energy efficiency can add cost, Enterprise's research has shown that these costs can be offset by long-term utility savings.[1] Thus, these measures may in fact be more cost-effective overall. Unfortunately, several barriers to achieving the full potential of green building–related cost savings exist, including:

- **Underwriting.** The financial community does not always accept these savings when underwriting the deal as a result of a number of factors, among them unfamiliarity with green building practices and uncertainty over utility rates and payback periods.
- **Waivers.** Developers sometimes have difficulty getting agency waivers or adjustments to utility allowances (or other regulations) necessary to recoup costs.
- **Other requirements.** HFAs, governments, and funders sometimes require overly specific measures that may not be cost-effective given the specific project context (for example, requiring individual metering for all units in a senior/supportive housing project).

When the cost-effectiveness of affordable housing projects is being evaluated, the most frequently used data point is total development costs (TDCs), which include all upfront development costs, including construction costs, soft costs, and reserve capitalization. Whether they are calculated on an aggregate or per-unit basis, TDCs include the costs of meeting the aforementioned goals to which market-rate projects are generally not subject.

TDC data also fail to account for the added social benefits brought about by many affordable housing projects. For example, affordable housing developers often focus on revitalizing disinvested communities. By taking the first step to work in these communities, affordable housing developers generally increase their upfront costs and remove barriers to entry (and costs) from market-rate deals, further skewing cost comparisons.

Another reason TDC data are not a complete measurement of cost-effectiveness is because they fail to account for longer-term costs. Some project elements can either extend the useful life of the building (such as more durable materials) or reduce operating costs (such as energy- and water-saving measures). Simple evaluations of upfront costs can ignore these life-cycle savings.

Incentives for Cost Control

While many QAPs and funding competitions include incentives that drive up costs, a significant number also explicitly include cost-control elements. When designed correctly, cost-control requirements and incentives can serve as a counterweight to other incentives that encourage increased expenditures, pushing developers to find more efficient methods of achieving those goals.

However, poorly designed cost controls can result in a "race to the bottom" in terms of quality and create barriers to certain projects, such as developments that serve families or vulnerable populations. In addition, inaccurately calculated cost caps can even lead to increased costs, as developers and contractors sometimes bid up to the maximum allowable level.

State and Local Regulations

State and local regulatory frameworks have a notable effect on costs. However, unlike affordable housing financing and program requirements, these factors often affect both market-rate and affordable projects (though in practice the effects are not always equal).

Many state and local regulations and fees have reasonable justifications, including environmental protection and ensuring adequate infrastructure. However, other regulations are inefficient at best and discriminatory at worst. Land costs and entitlement and permitting fees can create a substantial cost floor, before a developer even breaks ground, regardless of the developer's efficiency or the project type. As a result of these higher baseline costs, the ability of market-rate housing to reach people with lower income levels is limited and affordable housing subsidies result in fewer units.

Impact Fees and Entitlements

Most jurisdictions impose a number of conditions before allowing developers to proceed with construction. First, they must either conform to the existing zoning requirements of the parcel, or obtain the necessary variances and entitlements in order to proceed. In addition, jurisdictions generally impose either direct requirements to develop or improve the infrastructure surrounding the development or impact fees, which are used to fund infrastructure and service improvement across the jurisdiction.

In many cases, these requirements are necessary to manage growth sustainably, and developers should pay a fair share for the general upkeep and maintenance of the community. However, inefficiencies in the process can inhibit affordability for the following reasons:

- **Impact fees and infrastructure development requirements** can be excessive and are sometimes instituted in lieu of politically controversial tax increases.
- **Jurisdictions may also put narrow limits on by-right development,** in an effort both to exert greater control over the types of projects that are built and to address community concerns.
- **Flat impact fees that are not scaled based on unit type or size are regressive,** imposing higher costs on smaller projects that may actually have less impact.
- **The extended time frames and unpredictability associated with the zoning, permitting, and entitlement process** can increase both hard and soft costs.
- **Community opposition can inhibit a project.** In many jurisdictions, communities are given an opportunity to weigh in on proposed development projects before they are allowed to proceed, which can lead to increased costs related to time delays or negotiated design enhancements. At worst, community opposition can lead to the cancellation of the entire project.
- **When developing outside the urban footprint, developers in some jurisdictions have to pay the full cost to extend infrastructure.** With the new infrastructure in place, other developers may follow and build at much lower expense. Such a structure may be useful in urban areas attempting to control sprawl and encourage infill development. However, this can create a significant barrier to affordable housing in rural areas.

Regulations Affecting Project Type

Aside from direct fees and process-related delays, the state and local regulatory framework can influence building types and design, as well as the number of units built.

- **Parking minimums were the most frequently cited barrier over the course of our research.** In addition to the hard costs associated with parking construction, dedication of large amounts of land for parking reduces the number of affordable units that can be built and drives up per-unit costs. Developers can still accommodate greater density by incorporating structured parking, but such projects have significantly higher construction costs than those that comprise surface parking. Recent research supports the assertion that the removal of parking restrictions can increase affordability.[2]
- **Jurisdictions can also directly influence the types of projects that can be built through density requirements, height maximums, and size minimums.** Zoning codes can also restrict the locations in which affordable housing can be developed.
- **Some jurisdictions also ban or make it difficult to build specific types of projects.** Group homes, microunits, and accessory dwelling units (ADUs) often face challenges because they are not by-right project types.

Regulations Affecting Hard Costs

Jurisdictions can also impose regulations or restrictions that have a direct impact on site preparation and construction costs.

- **Building codes.** Oftentimes, these codes include accessibility requirements, historic preservation protocols, and energy- and water-efficiency standards. Codes may even dictate the specific type and size of amenities that must be incorporated into the project.
- **Rehabilitation standards.** Similarly, many jurisdictions require that major rehabilitation projects be brought up to code for new construction. This can lead to significant increases in costs, or make rehabilitation projects cost-prohibitive. This problem can be avoided by adopting separate rehabilitation codes.
- **Site selection.** Jurisdictions can have an impact on hard costs by influencing the type of sites that affordable housing developers can use. Many deals are driven by land purchases from the public sector, where the jurisdiction identifies land for the development of affordable housing, often as part of a broader community revitalization strategy. Many sites require costly environmental remediation or other site preparation challenges.

Regulations Regarding Public Procurement and Development Team Selection

As previously discussed, the timing and choice of development team members can have a significant impact on costs. The efficiency of the development team is affected by marketplace competition, familiarity with regulations and program requirements, and an ability to value-engineer early in the development process, among other factors. The following federal, state, and local rules affect who can participate as part of the development team and/or their compensation levels, directly affecting the project budget:

- **Qualified contractor regulations.** In an effort to ensure that public spending goes toward qualified entities, jurisdictions sometimes create approved vendor lists. While this may prevent lesser-qualified or lower-capacity professionals and subcontractors from receiving public funds, it also can decrease competition and result in higher costs.
- **Procurement preferences.** Jurisdictions may influence the development process to meet other social goals, including but not limited to increasing diversity among public contractors. These preferences/requirements include local hiring, minority- and woman-owned business enterprises (MBE/WBE), HUD Section 3 (hiring preferences for low-income workers), and setasides for nonprofit entities.
- **Wage rate regulations.** Prevailing wage rules, including federal Davis-Bacon standards, can have a significant impact on costs, depending on the labor market in which the project is being built. These standards often require construction workers and trade professionals to be compensated at or near union-level pay rates. This increases costs, which jurisdictions must balance against the social goals of the measure.

  Setting aside the direct impact of these measures on costs, there also are additional challenges in how these policies are implemented that can further increase labor costs. For example, residential rates are generally lower than commercial rates. However, in some circumstances shelter-based projects are classified as commercial (either as a result of project size or the inclusion of a significant commercial component in mixed-use projects) and therefore must use higher rates. In addition, if there are not enough residential contractors in an area to determine the regulated wage, commercial construction rates are used, which can increase costs.

Conclusion

The degree to which the cost drivers identified through our research apply to specific projects varies by market, and there may be other factors that can influence an individual project's expenses. Nevertheless, our research demonstrates that the drivers of cost come at all points in the development process and are deeply intertwined. Eliminating or mitigating these drivers will require multiple parties to engage and collaborate to build a more efficient affordable housing delivery system.

What are the recommended actions?

As the previous section explains, bending the cost curve is a complex challenge that this discussion paper just begins to address. In a forthcoming report, Enterprise Community Partners and the ULI Terwilliger Center for Housing will provide additional detail and analysis on the drivers of cost, including how they may vary across different markets. This report will also identify a set of specific, actionable recommendations for lowering the cost of affordable rental housing delivery. These recommendations will fall into six broad categories:

1. **Promote cost-effectiveness through consolidation, coordination, and simplification.**
   Financiers and jurisdictions can facilitate reduced costs by streamlining the deal assembly and approval processes, consolidating overlapping requirements and due diligence, and coordinating sources of funding.

2. **Remove barriers to reducing construction costs and mitigating delays.**
   Jurisdictions can help lower costs by eliminating barriers to timely and efficient development team assembly; reducing regulatory- and zoning-related fees, delays, and restrictions; and allowing innovative design and construction techniques, including some common in market-rate development.

3. **Facilitate a more efficient deal assembly and development timeline.**
   Both financiers and local governments should take action to shorten the development timeline to the greatest extent feasible while still maintaining quality. Also, governments should take action to streamline and standardize the permitting and approval process and promote policies that facilitate by-right development. HFAs also can promote efficiency and consistency by ensuring the timely release of any changes to QAPs and limiting the frequency of such changes.

4. **Improve and align incentives.**
   While savings can be achieved by creating financial and regulatory incentives for cost control, it is also important to ensure that quality is maintained and that hard-to-reach populations can still be served. Therefore, it is important that funders do the following: develop appropriate metrics for affordable housing costs; remove perverse incentives within programs; and implement carefully studied direct incentives or requirements for cost control, as appropriate for the state, market, or building type in question. In balancing cost control with efforts to meet other policy or community goals, jurisdictions should explicitly consider or separate out the associated additional costs of these project elements.

5. **Improve the flexibility of existing sources of financing and create new financial products to better meet needs.**
   A more cost-effective delivery system can be achieved by improving the flexibility of existing financing sources and developing new products to better meet developer needs, such as entity-level financing and more flexible sources for the preservation of existing housing.

6. **Support the dissemination of information and best practices.**
   The diversity of markets, jurisdictions, and developers across the country creates significant opportunities for experimenting with different cost-control measures. Therefore, it is important to disseminate the results of these experiments so that others can learn from both best practices and mistakes. Avenues for information dissemination and knowledge sharing can include the following: forums on industry standards and best practices, the development of a community of practice around costs, and the creation of competitions or other incentives to encourage jurisdictions and developers to adopt cost-control measures.

End Notes

1 Yianice Hernandez and Peter Morris. *Enterprise Green Communities Criteria: Incremental Cost, Measurable Savings Update*. Enterprise Community Partners, June 2012. http://www.enterprisecommunity.com/servlet/servlet.FileDownload?file=00P3000000DTXI6EAH.

2 Michael Manville. *Parking Requirements as a Barrier to Housing Development: Regulation and Reform in Los Angeles*. Los Angeles, CA: Lewis Center for Regional Policy Studies, Institute of Transportation Studies, UCLA, March 2010. http://lewis.ucla.edu/content/parking-requirements-barrier-housing-development-regulation-and-reform-los-angeles.

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