On the Level: A Quarterly Forum for Construction and Rehab Issues

BY JACK JENSEN

This quarter's question, submitted by Frank Cornier, NHS of Rochester, New York: How do I choose a property for acquisition/rehab/sale?

Dear Frank: Short answer – Make it personal and use your common sense. Try to imagine that you and your spouse are considering buying the house for your family. Here's a whole handful (count' em) of rules of thumb.

Rule #1: Don't buy the first house you see.

Always, always start with mission check. For your family, the questions are: Do I want this real estate in this neighborhood? Will we love it? Can we afford it? For your nonprofit, re-read the mission statement on the wall. Will acquisition/rehab/sale activities revitalize this community? Does this particular property currently blight the community? Is it architecturally worth saving? Why won't the private sector do it? Will this project have impact in proportion to the expenditure of your resources?

If the project isn't a good fit for your "family" – for the mission – move on to the next opportunity. "On average, somebody offers us a house a week," says Paul Mazzarella, Ithaca, New York, NHS's executive director. "So you must start with a clear sense of what you're going to accomplish. What you're trying to do in your program should define what properties you go after. In Ithaca, we target the real eyesore properties no one else will touch, because we believe that they will have the greatest impact on revitalizing neighborhoods. Other organizations do, and should have, different priorities, depending on the needs of their community and their own organizational goals."

In hot markets, you may be paying top dollar for acquisitions in order to ensure the supply of affordable housing in a gentrifying neighborhood – entirely different problem, with different solutions.

Rule #2: Always look a gift horse in the mouth.

Even a free house might not be a bargain. The next step is the physical examination of the patient, starting (as your own doctor does) with the financial health (or at least insurance status) of the patient. What liens and judgments cloud the clear transfer of title?

"The title issue is obviously critical," agrees Mazzarella. "And so is the initial price tag. We have to buy at the bottom of the market, even with a lot of subsidy available, to make these pencil out. That means going to foreclosures, or dealing with landlords in distressed situations, targeting particular neighborhoods, and that starts to define our priorities."

Most NeighborWorks® organizations get their properties plenty distressed, often off the HUD or USDA auction rolls.

Begin with the acquisition cost, and then start adding the rehab costs. To start, which broad category of rehab will be required to bring the property up to the sale standards of the neighborhood – minor, moderate or major? With the new lead-based paint regulations, the $5,000 and $25,000 threshholds become critical. Are there major structural flaws needing engineering?

You don't necessarily need a detailed estimate at this point, but you'd better have a pretty good ballpark figure, so you need access to examine the whole patient – the basement, the roof, and the crawlspaces – pretty thoroughly while you're still in the "courting" phase. You might as well do your comprehensive estimate early, since you'll need one eventually. Consider bringing along someone from your list of approved contractors, just like you'd do with your own house purchase. Their dollar estimates are likely to be more accurate than yours are, since they have to live with them every day.

How is the structure? How are the major systems? What environmental time bombs are lurking around (e.g., fuel tanks, asbestos, lead paint)? "We're moving toward doing complete gut-rehabs now, in large part as a result of these new lead regulations," says Mazzarella. "Not only do you get rid of all the lead hazard up front, but you also have more flexibility in redesigning the interior to better meet the needs of the modern homebuyer."

Rule #3: Sometimes the best deals are the ones you walk away from.

To tell the difference, you have to run the numbers – a lot of numbers. Using one of the sophisticated spreadsheets that are available (Enterprise's Housing Developer Pro®, or the New York district's Quick and Dirty Housing Feasibility Analyzer), add up all the hard and soft costs of the project, and all the sources of funds needed to match that number. You will undoubtedly need to weigh the subsidy available against the market reality, because eventually you'll have to either sell or rent this property.

Don't underestimate the soft costs. Always reserve adequate contingency funds, especially in renovations. Ten

percent is the minimum – go for 15 percent if you can. And, by all means, include a developer fee, to keep your team going so you can do more of these in the future. Ten percent is a minimum developer fee – go for 15 percent here too. No matter what, you need to log the office time to identify the best opportunity. Run five projects to net one keeper.

In the end, of course, it will all come down to being able to accurately judge the market for the product. So if you don't commission a formal market study, you at least need to run an informal one. "We have a good sense of the market value of our properties because we're in that market all the time, through our other rehab/resale activities and our home-ownership program," says Mazzarella.

If you do enough projects in a small area, you begin to define the market yourself. Still, you need to know exactly how many houses of this size and condition have been sold in the area over the last year, and at what prices. Your board should want answers to these questions: If we can't sell it, what can we rent it for? Will those rents cover our costs? How about after it's sold? Remember – don't do a deal you wouldn't do for your own family. If clients have to move, will they be able to re-sell the house for the mortgage we're negotiating for them? In the event they must, for some reason, rent it out, can they make it in the current market?

Rule #4: A job worth doing is worth doing well.

More common sense. Rehab the property enough. A "cosmetic" renovation serves no long-range purpose. Maintain a high standard for your community. The difference between what the market will bear and what needs to be done is where the public dollars fit, so use enough of them to do the job well. Use good architects; use contextual details; demand quality from your contractors and suppliers.

Your job is both to raise the property values of the neighborhood, and to provide your clients with a good investment. The public's interest isn't served by a half-baked renovation. Saddling a low-income family with a roof that's only got a few years left, or a boiler that's due to blow, is bad business. In a few years, the property will look as bad as it did before the slapdash rehab, and the family will likely be in default on its loan. "We find it's worth the extra money up front to really tighten up the house from an energy standpoint, since it makes the ongoing operating costs so much more affordable," says INHS's rehab coordinator John Rogers. "If the client can't handle the utilities, they're probably not going to make the loan payment, either."

Rule #5: If you're going to do it, turn it!

Finally, before you pull that trigger on the deal, do a final systems check. You shouldn't be in the rehab/resale biz if you don't have the organizational infrastructure to crank the project to the closing table. To be successful, run the job like you were using your own money. The meter is ticking from the minute you first looked at the property. Once you have title, you're on the hook for taxes, utilities, insurance, security, maintenance and interest charges, which can be thousands a month on a single house. Interest alone on an 8 percent construction loan of $50,000 is $334 a month.

You'll need every duck consistently saluting in their rows – starting rehabs on the day of the closing, marketing the properties even earlier than that, so that the new owners get the keys the same afternoon as the punch list is completed. Rehab/sale is no place to "park the crew," during slow times. To make the job go well, pay the contractors fairly but quickly. Use a line of credit if you must, but keeping the bucks flowing is the surest way to keep a good pool of qualified pros happy and moving. Once you start spending, get to the finish line as fast as you can. And expect to leave $20,000 to $30,000 on the table each time you do one right.

Best training opportunities? Neighborhood Reinvestment Training Institutes have excellent classes in Affordable Housing Development, Project Feasibility Analysis, Design and Specification for Rehab Specialists, Cost Estimation for Rehab Specialists, Rehab Management, and Coping with the New Lead-Based Paint Regulations, among others. Or ask your district to help you organize a local training.

Two final insider's tips:

- Don't always bid at the bank foreclosure sale. Wait until the bank has to put it up for auction with no takers, and then negotiate with them. They're likely to be twice as eager to get it off their books.
- As a 501(c)(3), you can offer the seller the difference between a fair-market appraisal of their property and your purchase price as a tax write-off. This costs you nothing but definitely sweetens the deal.

Probably more of an answer than you bargained for, eh Frank?

Sincerely, JJ ■

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