Equity

The high cost of creating affordable housing

By Judith Crown

Credit: Geoffrey Black

David Block, director of development at Evergreen Real Estate Group, at Encuentro Square, the new affordable housing project on the west end of The 606 trail.

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apartment in River North or Lincoln Park.

"That's really expensive," acknowledges David Block, Evergreen's director of development. But as he and most other builders of affordable housing will tell you, the system of funding is not exactly rational.

Costs are driven by the byzantine rules of the federal tax credit system that require builders to assemble a "capital stack" of funders, each with sets of fees and requirements. On top of that comes ever more rigorous government standards for accessibility, sustainability and design. Developers and their architects win points from public agencies awarding the projects by striving for net zero carbon emissions by using materials such as solar panels, triple-pane windows and upgraded insulation.

"If a Martian dropped down from the sky and looked at how America develops affordable housing, they would think we're nuts," says Hipolito "Paul" Roldan, CEO of the nonprofit Hispanic Housing Development Corp. "They would be right."

Affordable housing provides essential financial security and stability for lower-income families.

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Commentary: Affordable housing doesn't have to be this complicated

expenses that make it an increasingly expensive undertaking, an irony that is not lost on developers and housing advocates in Chicago.

Demand has risen since the start of the COVID pandemic while the supply of affordable rentals has shrunk. The DePaul University Institute for Housing Studies estimates that Chicago is short nearly 120,000 units. On top of that is the influx of thousands of migrants who are scrambling for housing and sleeping in public shelters, churches and tents.

Much of the rising expense of affordable housing is due to pandemic-era inflation in material and labor — costs that are also born by market-rate builders. On the one hand, it's hard to argue against the merits of building sustainable and accessible apartment buildings. But could some of the bells and whistles be set aside in order to fund more apartments?

"You can complete a project that's on the cover of Architectural Record that houses 200 people and costs $800,000 a unit," says Chicago architect Mike Jerabek, a partner at WJW Architects. But could an additional 100 people be accommodated in a more modest, but still high-quality building?

The high cost to build an affordable apartment doesn't mean tenants pay more. Rents are tightly regulated and capped based on family income. In Chicago, a family of four with an income of $55,000 would pay between $1,200 and $1,300 a month for a three-bedroom apartment, depending on utilities.

New York Times columnist Ezra Klein has diagnosed the conundrum as "everything-bagel liberalism." Government sometimes tries to accomplish so much within a single project or policy that it ends up failing to accomplish anything at all, Klein wrote in an April opinion piece. If you add too much to the bagel, it can become a black hole from

Another reason for the higher costs: Federal resources haven't kept up with inflation, Block says, making financing more complex and expensive. Evergreen and its nonprofit partner LUCHA, or Latin United Community Housing Association, split the Encuentro Square project into two legal components and employed two categories of tax credits. It took nearly four years to get the project financed. Legal fees are more than $600,000, three times the cost of a market-rate apartment tower, Block estimates.

But developers are long accustomed to navigating this world. "As a developer, I'm an instrument of broader public policy," Block says. "I can help implement urban redevelopment policy that a mayor or council proposes. It's not for me to say this is good or bad use of public money. At the end of the day, I'm trying to get a project built."

Paying lawyers, administrators and everybody else

This cost equation pressures developers in all large U.S. cities. The primary tool for funding affordable housing is the Low Income Housing Tax Credit, a political compromise of the Ronald Reagan era that took from Congress the power of appropriating funds. Instead, the Treasury Department issues tax credits to government housing authorities that award them to local developers. The developers then work with syndicators, or middle men who locate the tax credit investors who supply the equity of the deal, usually banks or big corporations.

That's not the end of the journey. Developers fill out the capital stack with other financing, such as federal loans, city tax-increment financing funds and multiple mortgages. (Mayor Brandon Johnson's administration plans to issue bonds for affordable housing, replacing funding from TIF districts that are set to expire over the next five years, Crain's has reported. The TIFs were considered an inequitable source because they are located only in certain parts of the city.) There could be 10 funders, each with fees, requirements and reviews.

The current labyrinth is a mechanism to pay lawyers, administrators and everybody else, says Roldan, whose organization is close to completing a 64-unit building in the

The use of tax credits is a costly process. "Yes, absolutely it is," says Marisa Novara, city Housing Commissioner during former Mayor Lori Lightfoot's administration and now vice president of community impact at The Chicago Community Trust. "Frustration about this cost plays out locally, but it's important to understand this is a national decision," she says.

It would be far cheaper for the federal government to directly fund construction of affordable housing, experts say. But there's no guarantee that a polarized Congress would appropriate the money. A generous interpretation of the federal policy is that it avoids fights in Congress that would be inevitable if direct appropriations were required, Novara says. The consequences of national policy to fund affordable housing indirectly through tax credits are incredibly high transaction costs, she adds.

Projects with public subsidies represent only about 30% of affordable housing construction or rehabs. Much affordable housing is built and preserved by independent contractors who rehab two-, four-or six-flats, what commonly is referred to as naturally occurring affordable housing, or NOAH. They operate without public money and can typically upgrade apartments in the range of $200,000 to $300,000, thus enabling them to keep rents low. If they don't use public funds, they can charge a combination of market-rate and lower rents, and eventually sell the building if they don't have a mission to preserve the housing as affordable.

One nonprofit that develops and preserves affordable housing mostly without public dollars is Chicago Metropolitan Housing Development Corp., or CMHDC, which has redeveloped more than 700 units in city neighborhoods over the past few years. The average cost is around $200,000 per apartment, says CEO and Executive Director Rafael Leon.

CMHDC focuses on neighborhoods in transition, such as Uptown, Ravenswood and Hermosa, where property values are rising. "It's important to retain affordable housing in areas that are changing, otherwise there won't be affordability," he says.

"Granted we're not doing brand-new construction or a gut rehab," Leon says. The buildings don't have amenities such as a gym or computer room. "But we're providing hand, many families would prefer to forego those add-ons and pay $200 a month less, Leon says.

There's not a choice to be made between rehabbing four-flats and using subsidies to build new projects as both are needed, experts say. "It's not either-or," Novara says. "We

have buildings that need to be rehabbed and should be part of the NOAH stock. That's important work. But we also have vacant land (and older buildings in disrepair) that we can turn into assets using tax credits."

Above and beyond

You can call it everything-bagel liberalism, but when it comes to dispersing public funds, cities attach strings in the interest of the public good. One priority is building affordable housing in gentrifying neighborhoods so that residents aren't priced out.

architects say.

"The city wants the building to fit in. It shouldn't be distinguishable from the rest of the neighborhood," says Jeff Bone, a partner at Landon Bone Baker Architects."That way people won't be stigmatized."

New affordable housing projects also can be vehicles for revitalizing depressed neighborhoods. When that happens, there's often additional infrastructure work to be done. The Fifth City Commons, previously called Garfield Green, in East Garfield Park, required sidewalks, an alley and utility poles because the site had been long vacant, says William Eager, senior vice president for the Midwest region at the Preservation of Affordable Housing, or POAH. That additional work contributed to a cost per apartment on the high end of the scale, at $898,837. But the project presents an opportunity to drive investment in the neighborhood, Eager says.

Fifth City Commons is the most expensive of 11 affordable Chicago Housing Department projects that closed last year. Perhaps more typical is DL3 Realty's $40 million Thrive Englewood project at $644,679 per apartment, and 43 Green Phase ll in Bronzeville, a joint venture of P3 Markets and The Habitat Company at a per-unit cost of $559,294 — still higher than many market-rate projects.

When it comes to construction, durability is tantamount since buildings designated for affordable housing are supposed to last 30 years or more, experts say. That can mean thicker drywall, masonry facades and stormwater detention.

"When you use housing tax credits, you're developing for the long term," says Joy Aruguete, CEO of the nonprofit developer Bickerdike. "You're making sure the systems can endure for decades." Because there's not a lot of money generated through rent and rent increases, it's necessary to frontload the project financially, adding reserves for repairs and replacement, she adds. "We take a portion of rent and add that to our replacement reserves, but it's never going to be enough for the large capital work you need to do 20 years down the road," Aruguete says. Total costs for two pending Bickerdike projects are more than $700,000 per unit, up from merits of their projects. Teams often go substantially above and beyond the city code to win tax credits and other funding, says Block of Evergreen Real Estate. Such add-ons can help save utility and operating expenses for tenants and managers, but the difference between a silver and gold LEED-certified building is negligible, he says.

Developer Peter Holsten, president of Holsten Real Estate Development, adds, "There is a lot of architectural ego that goes into these developments. They're pretty high-profile."

One project that showcases the state of the art in sustainability is POAH's Fifth City Commons, which dates back to former Mayor Rahm Emanuel's administration. The city at the time solicited projects that could be showcased in C40 Cities, a global initiative of urban centers that are striving to confront the climate crisis.

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The 43-unit Fifth City Commons building, which is 25% complete, employs an energy-efficient passive house design, including all-electric mechanical and appliances (no fossil fuels), high-grade insulation, triple-pane windows and solar panels.

Those green amenities contribute to the building's eye-popping cost of nearly $900,000 per unit. "It's a showcase. It sets an example of what you can do," Eager says. "Do you do it every time? Probably no. But over time, green design, like the passive house, will become a lot more standard," he says.

Chicago and most U.S. cities have departed from the drab institutional designs that used to be the rule in affordable housing, which is a good thing, experts say. But has the pendulum swung too far? "If we keep adding scope and requirements that increase costs, there will be fewer units produced," says architect Jerabek. "Where do you draw the line?"

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