

# Risks in Affordable Housing Development: Important Factors to Watch

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The definition of risk is the possibility (or probability) that you will fail to achieve your goal. All the goals necessary to achieve your housing production objective contain an element of risk. Though housing development is risky, nonprofit developers can control or reduce risk if they understand and identify specific factors that contribute to it.

There are two types of risk: *inherent risk* and *needless risk*. Inherent risk is always present, but there are a number of techniques that can help to control it. On the other hand, a nonprofit developer's decision or negligent actions can cause needless risk. Needless risk can also be prevented by understanding and following proper procedures, hiring qualified staff, providing proper training and support to your staff and addressing issues early.

Nonprofit housing developers are exposed to relatively high risk because they deliberately purchase homes for rehabilitation in distressed communities, serve clients with lower incomes and operate within narrow profit margins. Therefore, it is important that nonprofits understand where risk exists and how to minimize it.

In the section that follows, risk issues are explained for each major phase of nonprofit housing development.

## 1. **Acquisition**

Nonprofit organizations often face the challenge of selecting and purchasing decent housing that can be acquired and sold to low income home buyers at a reasonable cost. This acquisition process can be risky if the proper research is not conducted prior to purchase. Before purchasing a home to rehabilitate and resell, a feasibility study should be conducted to ensure that the acquisition and estimated costs are acceptable and that the unit can be rehabilitated and sold for a reasonable price without taking a financial loss.

## 2. **Financial Management**

This is another area of risk that must be carefully considered when performing housing development functions. Nonprofits cannot sustain any size financial losses for long. Therefore, we recommend that nonprofit organizations create a strong financial and record-keeping system in order to avoid inherent development risk related to budgets and cash flow.

## 3. **Team Selection**

Many nonprofit organizations have difficulty finding reputable, experienced, qualified and reliable contractors, architects and staff. Determining the right team for your program can be very risky but is an important component to the success of the project. Hire a strong development team by utilizing and implementing an effective qualification process.

#### **4. Project Design and Construction Specifications**

These are the tools that will help you achieve your ultimate goal – the completion of your project to your expectations. To successfully complete a housing project, housing organizations should begin by determining the needs of their market and understanding local building codes and financial requirements to develop the appropriate design standards of their product. Require accurate drawings and specifications from the architect to avoid confusion and misinterpretation, which can easily lead to future disputes.

#### **5. Production Management**

This is a vital part of the project. Production managers should be knowledgeable and experienced and should possess the ability to balance risk and cost. The production manager should also be able to track the project's progress; monitor the budget, cash flow and schedule; anticipate problems; and provide solutions.

#### **6. Performance Guarantees**

This is a method used to solicit promises from the contractor to ensure that the job is completed on time and within budget. Nonprofits should require a form of performance guarantees from their contractor that could include: retainage, release of liens, letters of credit or payment and performance bonds.

#### **7. Change Orders**

Nonprofit housing developers are often exposed to risk because they may have to hire contractors that are low bidders. This can be risky because the contractor may be compelled to inflate their profit margins by submitting costly change orders to the owner. This problem can be mitigated by carefully reviewing all change orders and requiring the architect and those authorized to review and sign all change orders prior to payment. Requiring a fixed overhead and profit on change orders often deters contractors from submitting unnecessary change orders.

#### **8. Operations and Maintenance**

The risk associated with operations and maintenance usually occurs long after the project has been completed and the tenants or buyers have moved in. This problem is usually the result of poor workmanship or the use of inferior materials in the homes. It is recommended that the owner require a one-year guarantee from the contractor on the housing product and that a final walk-through be conducted between the owner, buyer and the contractor to ensure that all punchlist items have been satisfied prior to buyer move-in.

For more information on risk and recommendations on mitigation, visit The Enterprise Foundation's online [Developer Support System](#)

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