Task Force on Long-term Sustainability of Affordable Housing: Affordable Rental Housing Informational Overview

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Minnesota Housing

Our Vision

All Minnesotans live and thrive in a safe, stable home they can afford in a community of their choice.

Our Mission

Housing is foundational to a full life and a thriving state, so we equitably collaborate with individuals, communities and partners to create, preserve and finance housing that is affordable.

Topics

- Difference between Market Rate and Affordable Rental Housing
- Role of the Federal Low Income Housing Tax Credit Overview and Loans
- Rent and Income Restrictions: Area Median Income
- What are Underwriting Standards?
- Minnesota Housing Consolidated RFP
- Resource Availability
- Preservation Initiatives

Background on the Agency

- Independent agency established in 1971
- Seven-member board
- Annual independent financial audit and rating Agency reviews
- No ongoing state appropriations used for Agency operating costs
- We do not own or operate housing

Minnesota Housing

Multifamily Rental: Financing affordable rental construction and preservation

Housing Stability: resources to help prevent and end homelessness

Single Family Home Ownership: mortgages, down payment assistance, rehab loans

Manufactured Housing: preservation, infrastructure work

Policy and Community Development: capacity building, working with the Minnesota legislature

Local Government Housing Programs: Bring it Home Vouchers, Grants to Local Governments

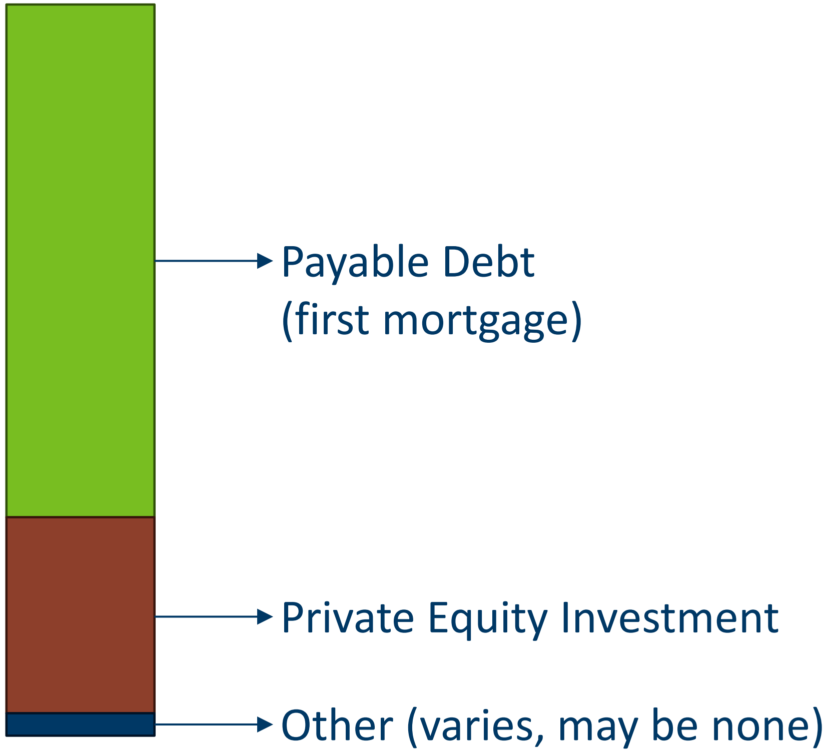
Market Rate Rental Housing

Operating Budget

- **Market Rate Rental Income**
- Expenses
  - Management
  - Utilities
  - Maintenance
  - Insurance
  - Property Taxes
  - Deposits to Replacement Reserves
- Rental Income – Expenses = Net Operating Income (NOI)

- NOI must be high enough to make debt payments AND provide a market rate return on the equity investment
- Debt and equity are the primary sources to construct new rental housing

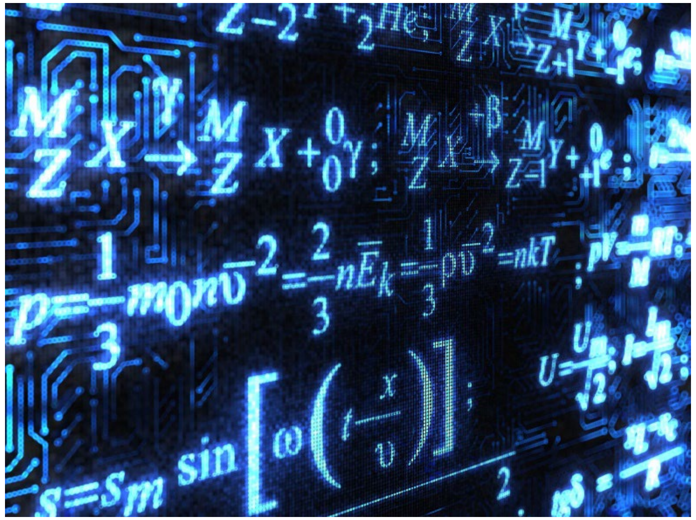
Funding Sources



Affordable Rental Housing

Operating Budget

- **Affordable Rate Rental Income**
- Expenses
    - Management
    - Utilities
    - Maintenance
    - Insurance
    - Property Taxes
    - Deposits to Replacement Reserve
- Rental Income – Expenses = Net Operating Income (NOI)



- Less rental income but generally same types of expenses as market rate housing results in lower NOI.
- Lower NOI means reduced or no ability to make debt payments or to provide equity returns.
- Without the ability to make debt payments or provide equity returns, an affordable rental project cannot access conventional sources to build or preserve the rental housing.

Federal Low Income Housing Tax Credit (HTC) Overview

- Established in the Tax Reform Act of 1986
- Administered by the Internal Revenue Service (IRS)
- Largest funding source to construct and preserve affordable rental housing
- HTC investor provides equity to developers/owners to construct or preserve affordable rental housing in exchange for a tax credit to offset their federal tax obligation → replaces private equity and some or all of the payable debt
- HTC investors are often banks, insurance companies or collections of businesses that have a federal tax obligation

Federal Low Income Housing Tax Credit (HTC) Overview

- Two Flavors:
  - 9% HTC – Each state receives a certain amount each year based on population *($2.90 of HTC per capita in 2024)*
  - 4% HTC – Limited by amount of Tax-Exempt Bond Volume Cap allocated to each state
- HTC Allocators: Minnesota Housing, Minneapolis, St. Paul and Dakota County
- Tax-exempt Bond Volume Cap Allocators: Minnesota Housing, Minneapolis, St. Paul, Dakota County and Minnesota Management and Budget (MMB)
- Qualified Allocation Plan (QAP) is a document required by the IRS that sets the policies and procedures for the 9% HTC and 4% HTC

Federal Low Income Housing Tax Credit (HTC) Overview

- HTC Rent/Income Limits
  - 40% of units at 60% AMI; or
  - 20% of units at 50% AMI; or
  - Average Income Test
- In most cases, 100% of the rental units are rent/income restricted by the HTCs
- Other funding sources may also carry rent/income requirements and other programmatic requirements that are layered with the Federal HTCs
- HTC is a capital subsidy and not a rent subsidy
- An HTC project may or may not have rental assistance (for example, project-based section 8, Housing Support)

Federal Low Income Housing Tax Credit (HTC) Overview

- ~15-year relationship between the developer/owner and the investor
  - Investor owns 99%+ of the project as a *limited partner*
  - Developer/owner is the *general partner* and is responsible for day-to-day management, operations, guarantees, operating deficits, etc.
  - Federal law requires at least 15 years of rent and income limit compliance; most states require at least 30 years
  - Investor receives the HTC benefit over a ten-year period
  - IRS can recapture the HTCs and the investor will require the developer to repay some or all of the equity if the project does not meet rent and income requirements
  - Investor has their own compliance and asset management requirements
  - After 15 years, the investor usually exits the partnership

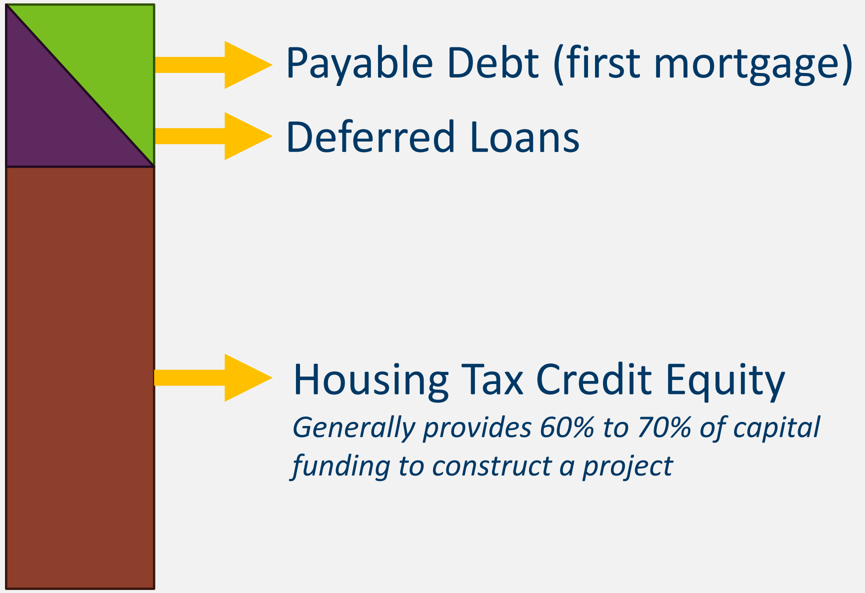
Federal Low Income Housing Tax Credit (HTC) Overview

- After 15 years
  - When the investor exits the project, the developer often seeks to take full controlling ownership
  - Most properties with HTC must maintain affordability requirements for at least an additional 15 years, which is referred to as the “Extended Use Period”
  - Rent/Income limits remain in place during the Extended Use Period
- Most states prioritize longer term affordability than required by the IRS
- Many federal tax requirements that often require legal and certified public accountant expertise

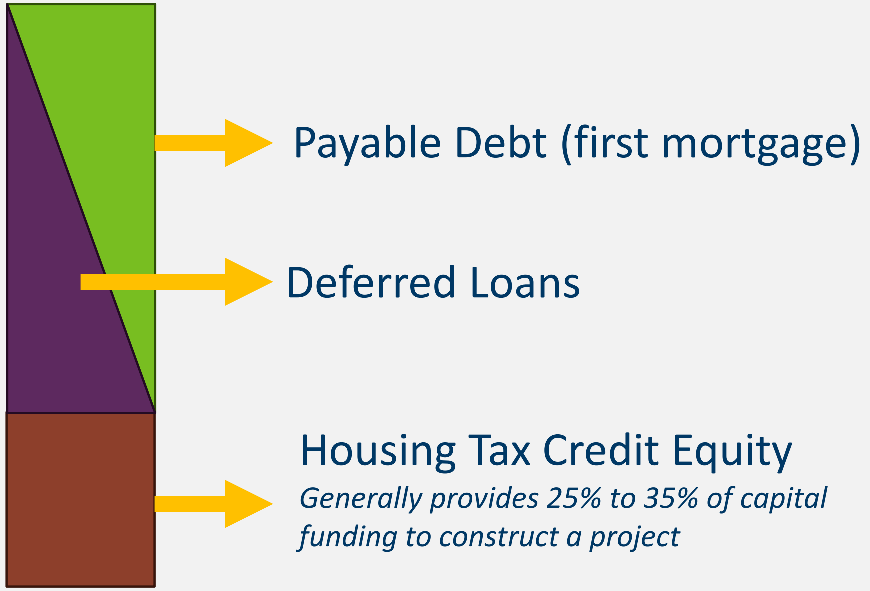
HTC Equity in a Project

- Traditional private equity is replaced with equity generated by the Federal Low Income Housing Tax Credit (HTC)
- Payable debt is reduced or eliminated
- With no need to provide private equity returns and low or no debt service payments, a project can set lower rental rates

9% Housing Tax Credit Example



4% Housing Tax Credit Example



Federal Low Income Housing Tax Credit (HTC) Overview

Simplified HTC Equity Example:

1. Developer receives an allocation of $1.5 million of 9% HTCs.
2. Developer issues a request for proposals to investors that have an interest in offsetting their federal tax obligation.
3. HTC investors will provide an offer to the developer to "purchase" the HTCs for a set amount. For example, 85 cents for each $1 of housing tax credit (along with <u>many</u> other business terms and obligations).
4. In this example, the developer would receive $12.75 million of equity to construct the project, and the investor receives $15 million in tax credits to offset their federal tax obligation.

$1,500,000 (9% HTCs)
<u>x 10 (Years)</u>
$15,000,000 (9% HTCs)
<u>x 85 cents (HTC pricing)</u>
$12,750,000 (Equity to Project)

Note:

- *Equity pricing is based on market conditions and investor demand*
- *Investor disburses the equity to the developer over time*
- *Investor receives the credits in equal installments over 10 years*

Loans

Why loans?

- HTC equity cannot pay for all project costs and loans are needed to fully fund projects
  - The amount of HTC equity a project can receive is based on certain types of project costs, and not all costs help generate HTC equity leaving a funding gap.
- Grants and forgivable loans generally have a negative impact on the HTCs
- Loans must be “bona-fide” debt—meaning the debt has a maturity date, often has an interest rate and has a theoretical ability to be repaid
- Most projects have two or more loans (some with many, many more)

Loans

Two Primary Types of Loans:

- Amortizing Loan (often referred to as a first mortgage)
  - Required payments
  - Market-based interest rate and commonly 30+ year terms
  - May be provided by a private or public lender
- Deferred/Gap Loans
  - Usually no regularly required payments until maturity
  - Almost always a public funder (local, state, federal)
  - May have an interest rate; usually only if requested by the HTC investors
  - Loan term is often 30 to 40 years
  - Almost always includes additional programmatic requirements for the term of the loan—rent/income limits, eligible uses, eligible populations (workforce, senior, supportive housing)

Affordability Requirements
Rent and Income Limits

- Area Median Income (AMI)
  - Median Income = half of households are above, and half of households are below
  - Calculated by HUD on an annual basis for each county and metropolitan area
  - Primary component to determine the maximum rents and income limits for any projects with HTCs
  - Often used by publicly funded programs to set rent and income limits
- 2024 AMI Limits: Two bedroom with four people in the household:

AMI		Metro	Duluth	Rochester	Worthington	Detroit Lakes
30%	Income	$ 37,260	$ 28,560	$ 35,160	$ 27,480	$ 27,510
	Max Rent	$ 838	$ 642	$ 791	$ 618	$ 619
50%	Income	$ 62,100	$ 47,600	$ 58,600	$ 45,800	$ 45,850
	Max Rent	$ 1,397	$ 1,071	$ 1,318	$ 1,031	$ 1,032
60%	Income	$ 74,520	$ 57,120	$ 70,320	$ 54,960	$ 55,020
	Max Rent	$ 1,677	$ 1,285	$ 1,582	$ 1,237	$ 1,239
Median Income		$124,200	$95,200	$117,200	$80,700	$91,700

- For units without project based rental assistance of some kind, the listed rent is the amount of rent a household must be able to pay

Underwriting

- What is Underwriting?
  - Process of assessing financial feasibility
  - Evaluates a project’s income, expenses, cash flow and financing structure
  - Evaluates development costs and reviews funding sources
  - Based on the available information at the time of review: Does the project and funding structure appear financially viable?
- Considers such questions as:
  - Are the rents supportable by the market?
  - Are the expenses comparable to other similar properties operating in the market? How do the expenses compare to other properties owned by the developer?
  - Are the HTC and loan terms reasonable?
  - Stress testing financial assumptions—for example, vacancy rates, inflation assumptions, cash flow, interest rates
  - How to size reserves?

Underwriting

- Point-in-time
- Performance will vary from underwriting assumptions over time
- Projecting operations
    - First 15 years
    - 15 years and beyond
- Affordability periods of 30, 40 and 50 years
- Underwriting standards evolve over time but those changes don’t retroactively affect operating developments

Underwriting

Who does Underwriting?

- Public and private funders
- HTC Investors
- Lenders
- The developer

What are the standards?

- Based on the market and varies by funder/lender/investor
- Adjusts over time
- Adjusts for the project

Stakeholders

Multifamily Consolidated RFP Overview

- Annual funding allocation process
- "One Stop" application
  - Multiple project types
  - Multiple funding resources
  - One scoring process (Self-Scoring Worksheet)
- Match Funding to Eligible Uses and Project Types

Multifamily Consolidated RFP Project Types

Project Types

- Workforce Housing
- Permanent Supportive Housing
- Preservation
- Senior Housing

Construction Types

- New construction; acquisition (land and structures); rehabilitation; adaptive reuse/conversion; preservation

Multifamily Consolidated RFP Funding Resources

State Resources

- Economic Development and Housing Challenge (EDHC)
- Housing Infrastructure Bonds/Appropriations (HIB/HIA)
- Preservation Affordable Rental Investment Fund (PARIF)
- Flexible Financing for Capital Costs (FFCC)
- Low and Moderate Income Rental (LMIR) First Mortgage
- HTC Equity Bridge Loans/Construction Loans
- State Housing Tax Credit

Federal Resources

- 9% Housing Tax Credits
- 4% Housing Tax Credits
- Tax Exempt Volume Cap Limited Bonds
- HOME Investment Partnerships (HOME)
- National Housing Trust Fund (NHTF)
- HUD Section 811 Project-Based Rental Assistance

Program Guides: https://www.mnhousing.gov/rental-housing/housing-development-and-capital-programs/program-guides-and-manuals.html

Multifamily Consolidated RFP Selection Framework

Selection Framework	
Eligibility	Strategic and Selection Priorities/Score
Project Type	Underwriting and Building Standards
Organizational Capacity	Available Funding
Financial Capacity	Geographic Balance

Consolidated RFP Selections and Funding Resources

- Extremely Competitive – Selection rate of 20% to 30% of applications based on available resources
- Federal
  - 9% HTCs – May support 7-9 projects each year
  - 4% HTCs – Varies; Due to higher funding gaps, the number of selections varies widely based on resources
  - Appropriations for Deferred/Gap Loans – $12-$15 million per year
- State
  - Base Budget Appropriations for Deferred/Gap Loans – $10-$12 million per year
  - Housing Infrastructure Bonds or Appropriations for Deferred/Gap Loans
    - $765 million since 2012
    - Varies by year; three of the years since 2012 have had $0
    - Includes non-rental housing uses (manufactured housing preservation, single family home ownership)

Consolidated RFP Selection Summary

Year/Activity Type	# of Projects	% of Projects	# of Units	% of Units
2020	**24**		**1,389**	
New Construction	18	75%	987	71%
Preservation/Rehab	6	25%	402	29%
2021	**22**		**1,227**	
New Construction	17	77%	952	78%
Preservation/Rehab	5	23%	275	22%
2022	**17**		**1,002**	
New Construction	14	82%	864	86%
Preservation/Rehab	3	18%	138	14%
2023	**28**		**1,486**	
New Construction	17	61%	875	59%
Preservation/Rehab	11	39%	611	41%
Total (2020 - 2023)	**91**		**5,104**	
New Construction	66	73%	3,678	72%
Preservation/Rehab	25	27%	1,426	28%

General Project Progression

Project Concept
- Generate Concept
- Feasibility Review
- Apply for Funding

Selected for Funding
- Local land use approvals
- Architectural Design
- Final Underwriting
- Closing and Construction

Operations
- Occupancy
- Rent/Income Compliance
- Asset Management

End of Regulatory Compliance Period

Refinance/seek new loan for improvements and maintain affordability

Regulatory requirements expire. Owner may exit the program, continue operating as unrestricted or sell.

Minnesota Housing
Housing Tax Credit Portfolio

- Projects with federal HTCs with Minnesota Housing oversight
  - ~750 properties with Housing Tax Credits
  - ~40,000 units
- HTC Properties Reaching Year 15 or Year 30 in the 2025 through 2034 period:

	2025 -2029		2030 to 2034	
	Projects	**Units**	**Projects**	**Units**
Year 15	86	4,635	120	9,423
Year 30	130	3,884	127	4,585

Challenges

- Housing stock is aging and buildings often need capital improvements after 20+ years
- Operating cost challenges (e.g. insurance costs, staff, maintenance)
- Supportive housing service funding
- Property management/maintenance staffing
- Rehabilitation costs
- Rent collection/need for rent assistance
- Higher refinancing costs

Preservation

- Significant preservation needs
  - Substantial rehabilitation
  - Targeted asset management needs (for example, new boiler or roof)
- Preserving housing has consistently been a priority for the Agency, dating back to the Agency's creation
- Preservation resources not scaled to the need
  - Unlike many other states, Minnesota has dedicated preservation programs as well as resources where preservation is an eligible use (e.g. Housing Infrastructure), but the programs are not scaled to the need
  - State and federal resources focus on rehabilitation work and not operating cost challenges or supportive services.

Minnesota Housing Preservation/Stabilization Work

- Interagency Stabilization Group
- Underway
  - 2024 Consolidated RFP selections
  - Publicly Owned Housing Program
  - Rental Rehab Deferred Loan Program
  - State Housing Tax Credit RFP
  - Stable Housing Organization Relief Program
  - Low Income Rental Classification
  - Deferred loan debt forgiveness for specific sources of funding

Minnesota Housing Preservation/Stabilization Work

Upcoming

- New Community Stabilization resources targeting for
  - Distressed multifamily housing, including permanent supportive housing
  - Naturally occurring affordable housing
- Exploring scoring changes to further emphasize preservation work in the 2025 Consolidated RFP
- Bring it Home Rental Assistance
- Strengthen the Supportive Housing System

Thank you!

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