Cost Containment at Minnesota Housing

September 25, 2013

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Items for Discussion

1. Predictive Cost Model
2. New Cost Containment Criterion in QAP for LIHTC
3. Survey Results – First Year of Implementing QAP Criterion
4. Analysis of TDC Trends – Results from the Last Decade
5. Conclusions

Predictive Cost Model

Predictive Model Overview

- Econometric regression model that predicts TDC per unit based on 18 factors
- Uses data from 374 projects that Minnesota Housing financed between 2003 and 2013 (costs adjusted for inflation)
- Also uses cost data from RSMeans as a benchmark
- Model is used to assess cost reasonableness of all tax credit, RFP, and pipeline applications
- First created in 2006; updated annually

Factors in Predictive Model

- Type of work (e.g. new construction vs. rehab)
- Building type (e.g. walk up, townhome, etc.)
- Building features (e.g. underground garage, large common areas, etc.)
- Location
- Size of project
- Size of units
- Financing sources (e.g. LITHC and number of sources)
- Population served (e.g. long-term homeless)
- Added cost issues (e.g. historic preservation and environmental abatement)

Predictive Model – Assessing Cost Reasonableness

- Calculate difference between a project's predicted costs and proposed costs
- If difference greater than 25% of predicted costs, ask developer for clarification, justification, and possible adjustment
- If staff finds the high costs justified, project eligible to move forward, but high cost flagged for Minnesota Housing board with a description of the justification

QAP Cost Containment Criterion for LIHTC Projects

LIHTC Scoring Criterion in 2014/15 QAP

- New this year
- Applies to regular tax credit applications; does not apply to 4% credits with tax-exempt bonds
- 4 points available to 50% of applications with lowest costs
  - Broken out by development type and location

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Process for Awarding Points

- Group all applications by type and location
  - New Construction – Metro
  - New Construction – Greater Minnesota
  - Rehabilitation – Metro
  - Rehabilitation – Greater Minnesota
- Adjust costs for developments for singles and large families
- Rank order costs from lowest to highest within each group
- Identify the 50% of applications with the lowest costs

Rationale of New Criterion

- Need to be cost-effective as possible:
  - Large & growing need for affordable housing
  - Limited (potentially shrinking) resources
- Other selection criteria in QAP add costs; need counter balancing criterion
- A large share of added costs are covered by credits as basis increases, which can influence cost containment incentives
- Nationally, cost of tax credit projects are receiving scrutiny – possible target for tax reform

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Balancing Cost Containment with Other Considerations

- Housing Quality and Life-Cycle Costs
  - Projects must meet the Agency's:
    - Design standards
    - Green standards
- Other Priorities
  - Other priorities include:
    - Supportive housing for LTH
    - Access to transit
    - Access to jobs
    - Working in higher-income areas
    - Others
  - Very deliberate pointing structure

Policy and Priority Context of Cost Containment Scoring

Criterion	Pnts	Criterion	Pnts
Supportive Housing for LTH	110	Intermediary (Soft) Costs	6
Preservation of Federally Assisted	40	Stabilization	5
Unacceptable Practices	-25	Workforce Housing Community	5
Rental Assistance	21	Economic Integration	5
Financial Readiness to Proceed	14	Minimizing Transportation Costs	5
Lowest Income / Rent Reduction	13	**Cost Containment**	**4**
Strategically Targeted Resources	12	High Speed Internet Access	1
Preservation of Existing LIHTC	10	Smoke Free Building	1
Federal/State/Other Contribution	10	QCT / Community Revitalization	1
Household Targeting	10	Eventual Tenant Ownership	1
Foreclosure	10		

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Cost Containment Survey Results

Survey Overview

- Purpose – To learn more about:
  - The impact the cost containment criterion had on proposed costs and projects
  - Why developers made their cost containment decisions
  - Areas for improvement
- Survey Details:
  - 26 different developers submitted at least one regular LIHTC application
  - 26 surveys sent out
  - 12 responses

Lead-in Question

Did you pursue additional cost containment activities because of the new scoring criterion?

- Yes – 4 developers
- No – 8 developers

Questions for “Yes” to Additional Cost Containment

What additional cost saving activities?

- Modular construction
- Less durable materials
- Less curb appeal (no brick)
- Smaller units
- Reduced landscaping
- Laundry in common area (not individual units)
- No safe room for slab-on-grade townhomes
- Reduced level of rehab
- Kept developer fee below 15%

Questions for “Yes” to Additional Cost Containment

What will be the impact?

- 2% to 14% cost savings (depending on project)
- Impact on tenants, neighborhood, and life-cycle costs:
  - No safe rooms – reduced tenant safety
  - Less durable materials– increased life cycle costs
  - Less curb appeal and exterior work – less acceptance by neighbors
  - Reduced rehab – increase future rehab costs

Questions for “No” to Additional Cost Containment

Why didn’t you propose additional cost savings?

- Already pursued all viable options
- Additional reductions in upfront costs will increase life-cycle costs
- With 15-year tax credit guarantee need to keep property competitive for long period
- Need to keep additional cost savings options in the proposal in case costs increase and need to be reduced later

Questions for “No” to Additional Cost Containment

What cost containment activities / strategies did you consider but not pursue?

- 3-story walkup, rather than townhomes
- Away from transit
- Away from job centers
- Easier site to work with
- Less durable materials
- Less efficient systems
- Simpler design
- Smaller units
- Less common space
- Less expensive landscaping

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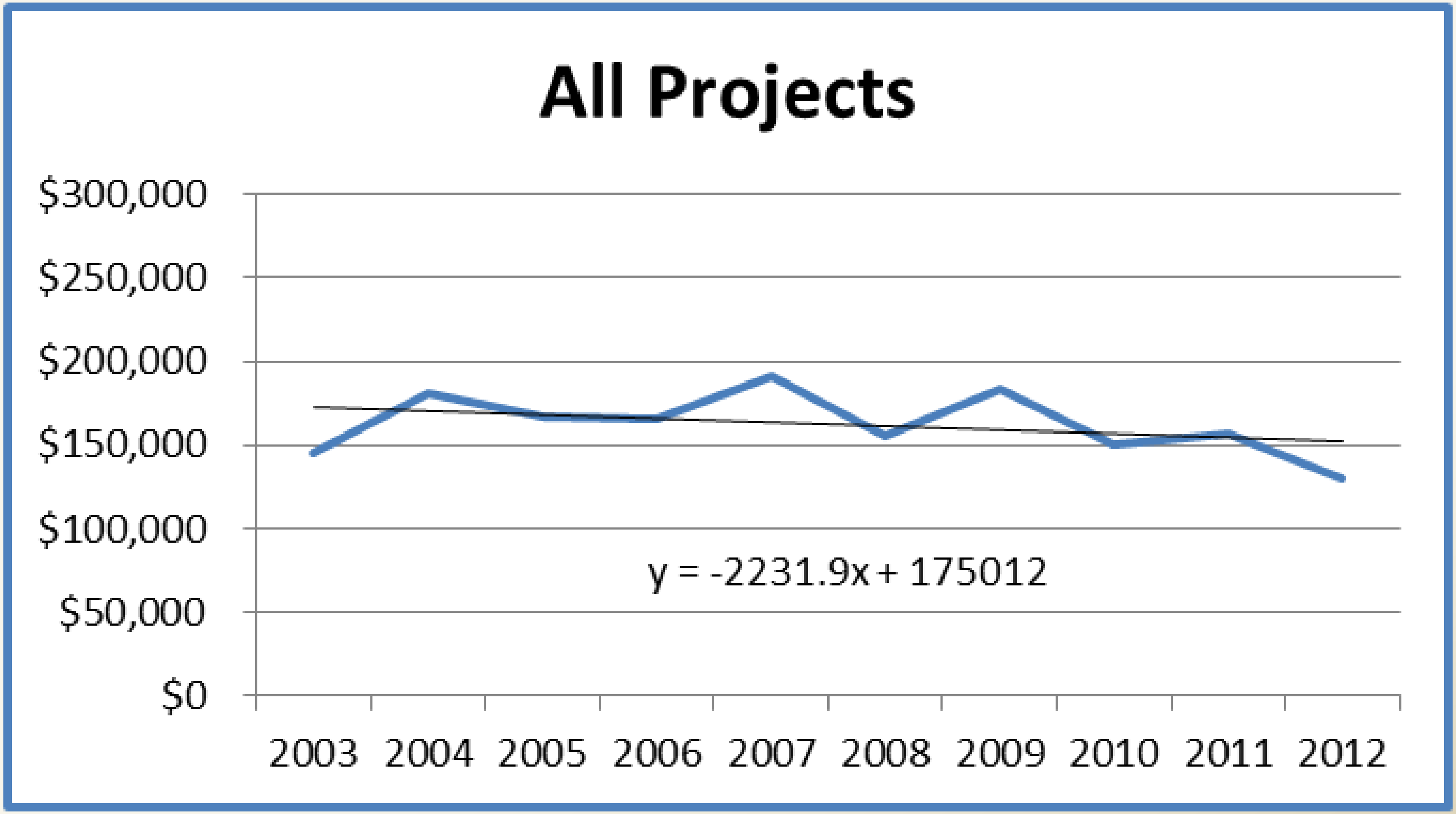
Final Question

How can the criterion be improved?

- Drop the criterion
- Base on it life-cycle costs, not just upfront TDC
- Base on it tax credits per unit, rather than TDC per unit
- Exclude assumed debt from TDC
- Go back to the original proposal that listed specific cost thresholds
- Identify specific types of costs that need to be reduced, rather than overall costs
- Provide specific thresholds for specific types of costs
- Share details on Agency's cost data
- Acknowledge higher costs for urban sites, polluted sites, supportive housing projects, etc.
- Acknowledge that costs are hard to predict a year ahead

Intern Report on Cost Trends

Cost Trends: All projects



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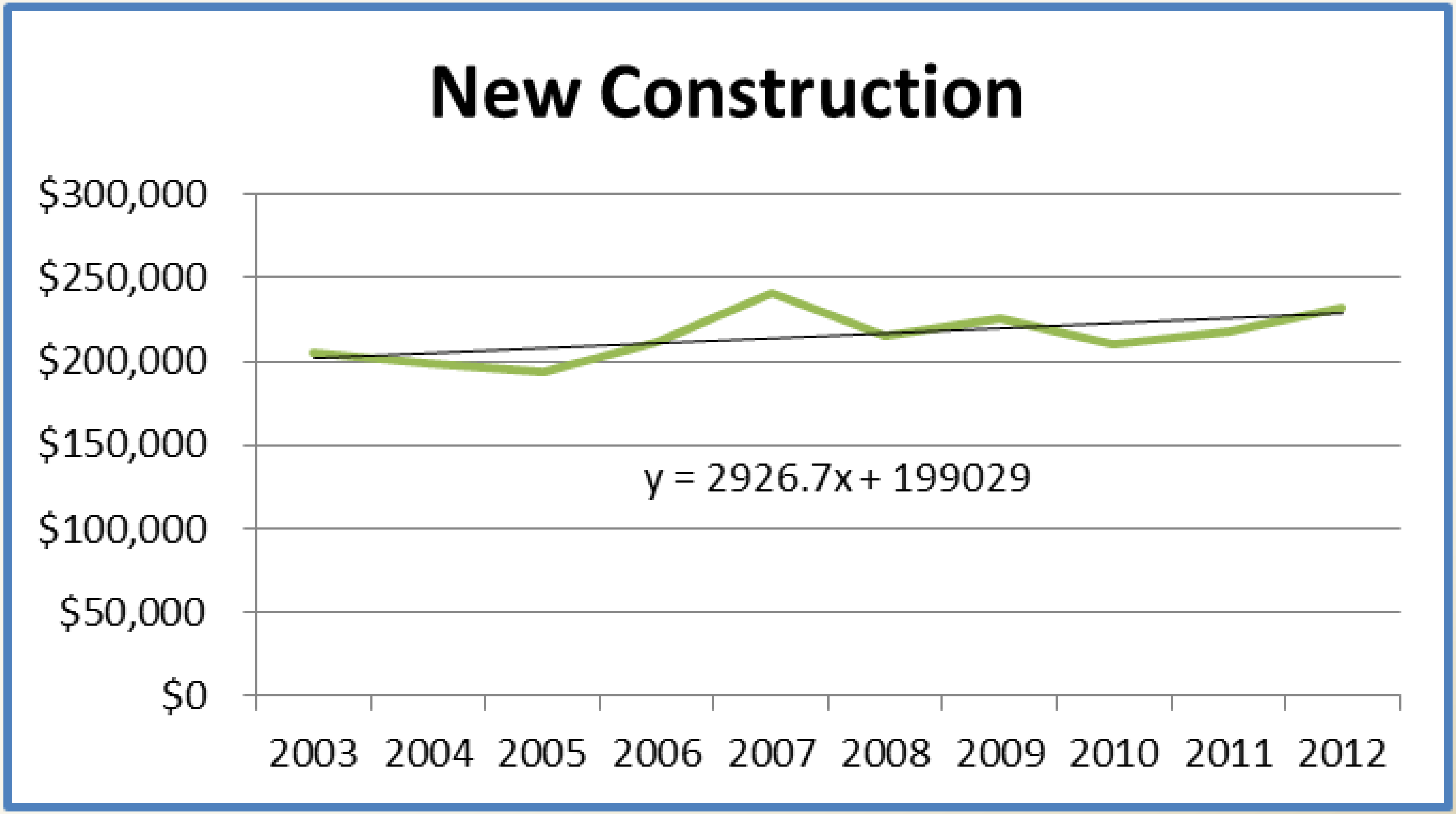
Cost Trends: All New Construction



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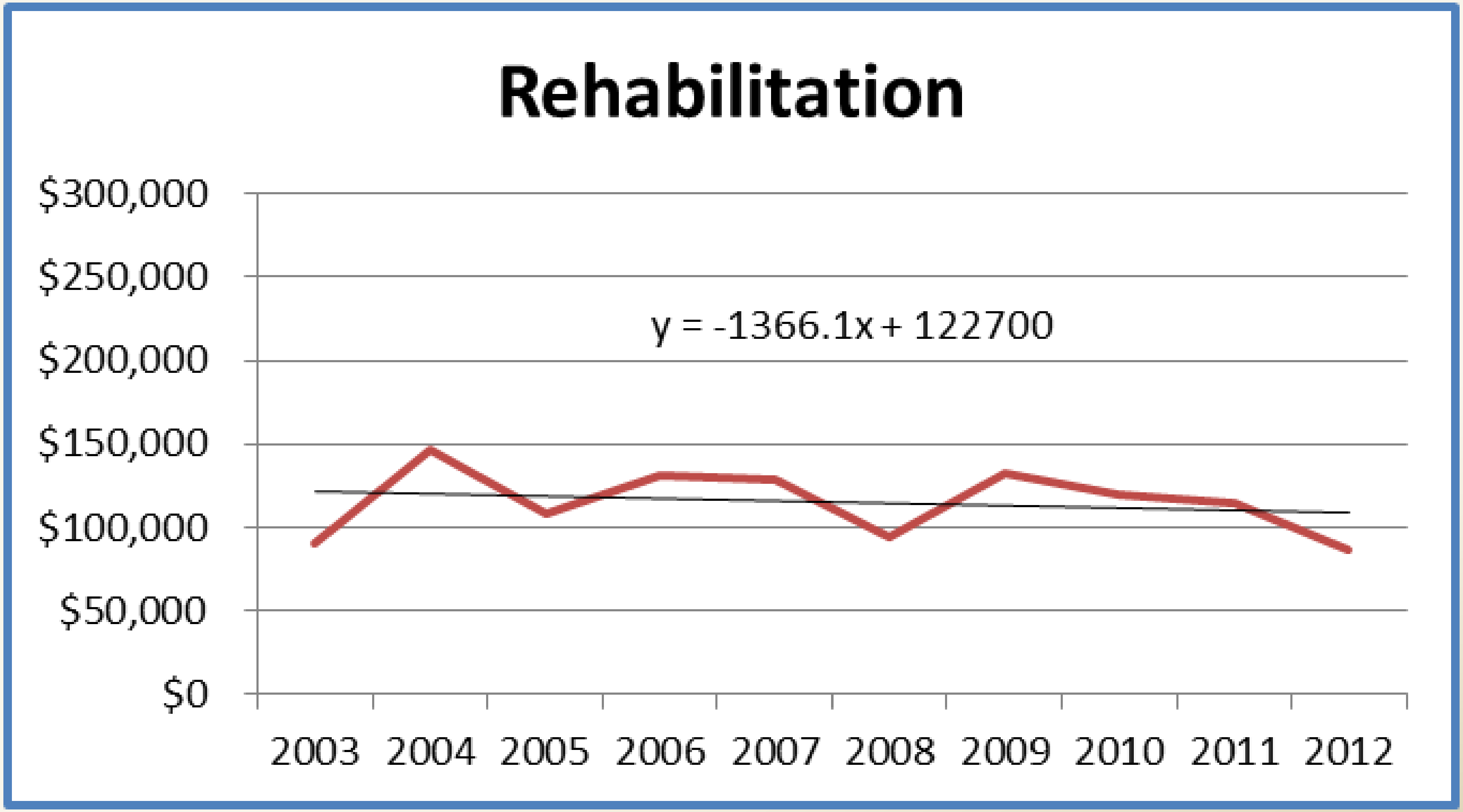
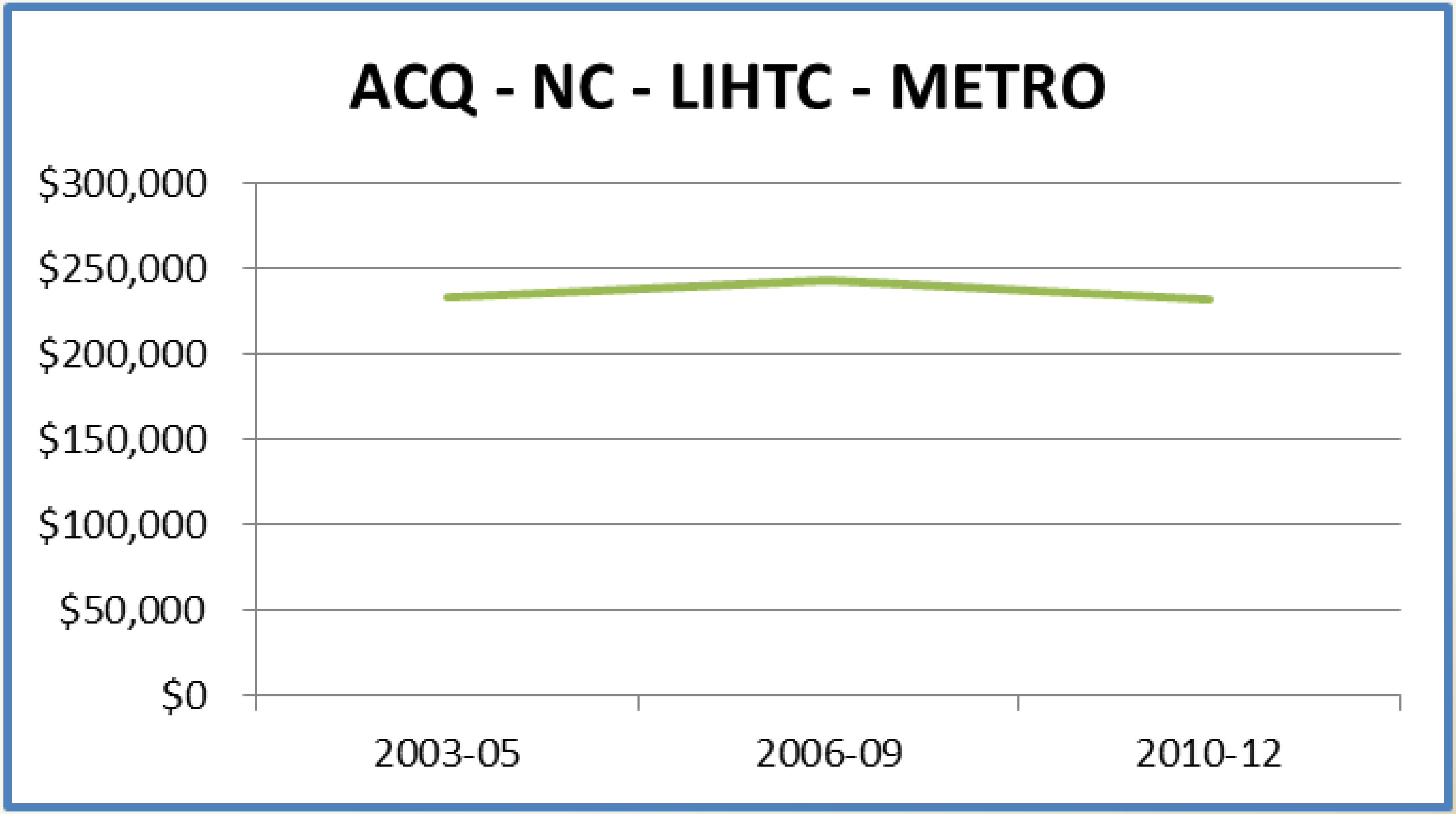
Cost Trends: All Rehabilitation



Cost Trends: Grouping Projects

Project Type				Sample Size	Average TDC Per-unit
ALL				412	$161,791
ALL ACQ PROJECTS				284	$186,825
ACQ	NEW CON	LIHTC	METRO	70	$237,308
ACQ	NEW CON	NON LIHTC	METRO	18	$202,842
ACQ	NEW CON	LIHTC	GR. MN	45	$186,321
ACQ	NEW CON	NON LIHTC	GR. MN	25	$183,501
ACQ	REHAB	LIHTC	METRO	37	$197,399
ACQ	REHAB	NON LIHTC	METRO	39	$123,891
ACQ	REHAB	LIHTC	GR. MN	29	$149,746
ACQ	REHAB	NON LIHTC	GR. MN	21	$117,403

Cost Trends: With Acquisition, New Construction, LIHTC, in Metro



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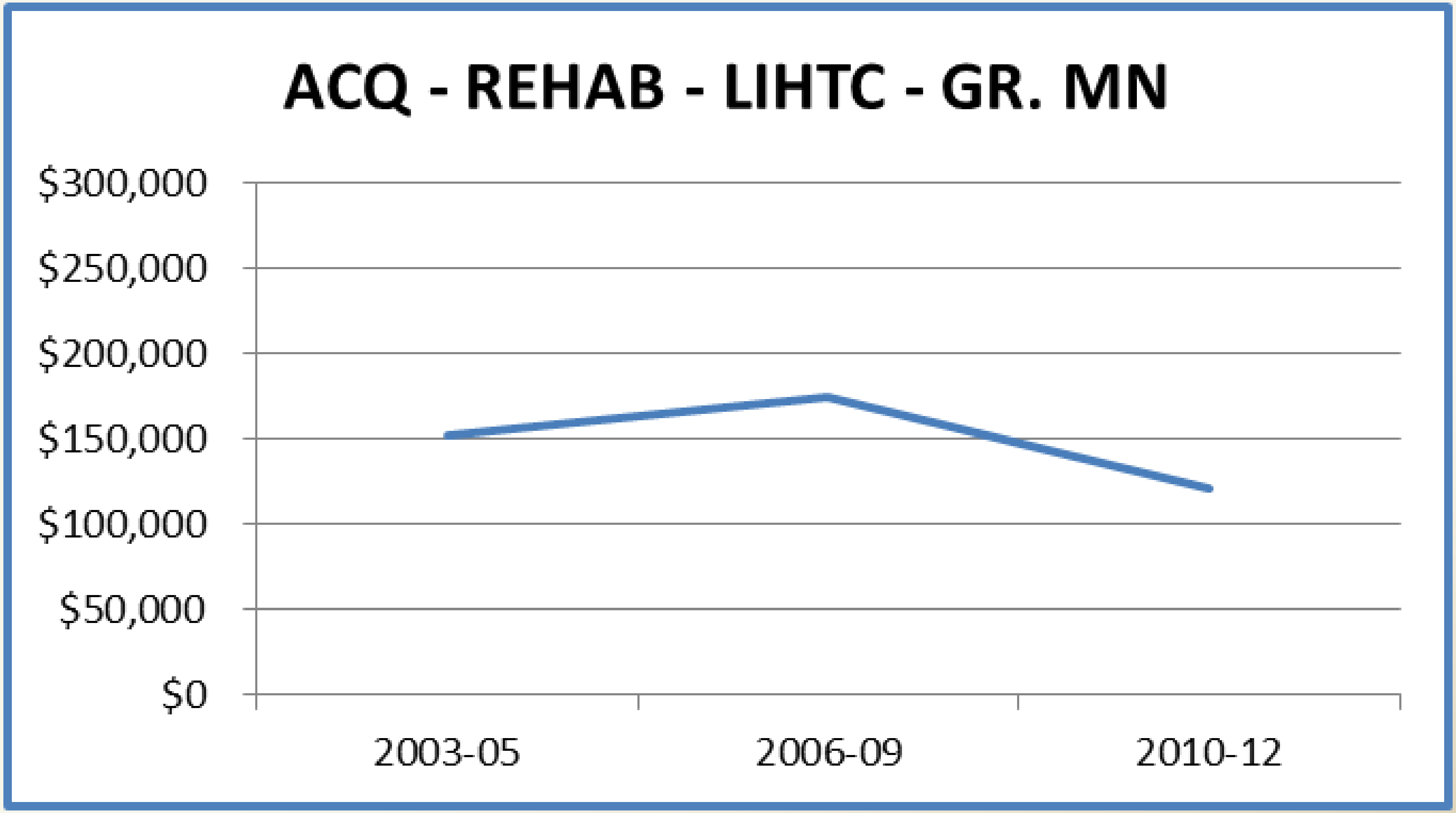
Cost Trends: With Acquisition, Rehabilitation, LIHTC, Greater MN



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Conclusions

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- Current cost containment activities by developers are working relatively well
- Cost containment is still important – growing need and limited resources
- Need to balance cost containment with other objectives and priorities
- Current QAP scoring structure does not appear to be distorting priorities:
  - Just 4 points
  - Holding off on cost containment that goes too far
- Areas for improvement:
  - Life-cycle costs
  - Collaboratively addressing unnecessary costs

For More Information

Contact:

John Patterson

john.patterson@state.mn.us

(651) 296-0763

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