Minnesota Housing Finance Agency

Board Agenda Item: 7.B
Date: 1/26/2017

Item: Amendment, Qualified Allocation Plan (QAP), Procedural Manual, and Self-Scoring Worksheet, 2018 Housing Tax Credit (HTC) Program

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Request Type:

☒ Approval
- ☒ Motion
- ☐ Resolution

☐ No Action Needed
- ☐ Discussion
- ☐ Information

Summary of Request:
Staff requests approval of an amendment to the 2018 Housing Tax Credit Program Qualified Allocation Plan (QAP), Procedural Manual, and Self-Scoring Worksheet. Following an additional public comment period from January 26, 2017 until February 9, 2017, staff will seek final approval of these amendments at the February 2017 board meeting.

Fiscal Impact:
Housing Tax Credits are a federally sponsored program and will not have any direct fiscal impact on the Agency's financial condition. However, recommendations contained in this board memo and the proposed amendments to the QAP may have a significant impact on the ability of the Agency to have access to tax-exempt private activity bonding authority to conduct its single family and multifamily program activities.

Meeting Agency Priorities:
- ☒ Address Specific and Critical Local Housing Needs
- ☒ Finance Housing Responsive to Minnesota's Changing Demographics
- ☒ Preserve Housing with Federal Project-Based Rent Assistance
- ☒ Prevent and End Homelessness
- ☐ Reduce Minnesota's Racial and Ethnicity Homeownership Disparity

Attachment(s):
- Background
- Summary of Proposed Revisions
- Revised Cost Containment Methodology
- Amended 2018 Housing Tax Credit documents (changes made since October are tracked)
- Public Hearing Comments
- Written Public Comments

BACKGROUND

The Federal Tax Reform Act of 1986 created the Housing Tax Credit Program (HTC) for qualified residential rental properties. The HTC Program is the principal federal subsidy contained within the tax law for acquisition/substantial rehabilitation and new construction of low-income rental housing.

Section 42 of the Internal Revenue Code (IRC) requires that each allocating agency develop a Qualified Allocation Plan (QAP) for the distribution of the tax credits within its jurisdiction. The QAP is subject to modification or amendment to ensure the provisions conform to the changing requirements of the IRC, applicable state statute, the changing environment and to support State housing priorities.

Minnesota Housing's HTC Program administration includes use of the following documents: a Qualified Allocation Plan (described above); a Procedural Manual that includes detailed definitions and procedures for implementation of the QAP, and a Self-Scoring Worksheet that assigns points for how well a project meets the funding priorities of Minnesota Housing's HTC Program. The HTC Program is generally reviewed and revised each year to ensure it meets IRS requirements and supports State housing priorities.

Copies of the current QAP and Procedural Manual are available on the Agency's website, www.mnhousing.gov (Home -> Multifamily Rental Partners -> Funding -> Tax Credits -> 2017 Procedural Manual and Documents).

A draft set of proposed changes to the 2018 QAP and Procedural Manual in the form of a blackline version of the Self-Scoring Worksheet was approved by the board at its October 19, 2016 board meeting. On October 23, 2016, in accordance with Section 42, the Agency published a notice soliciting public comment on the proposed changes. Minnesota Housing staff held the public hearing on Thursday, November 16, 2016. In response to the large number of comments, the Agency extended the public comment period until November 30, 2016. The Agency also continued to gather feedback in December and January by hosting a webinar and separate developer, city and advocate listening sessions. A developer session was held on December 15, 2016, and additional sessions were held on January 12 and January 13, 2017.

A summary of the proposed changes was made available to the public in advance of and at the hearing for review and comment. Seven members of the general public attended the hearing in person and provided oral comments on the QAP, and 60 comments were submitted. Copies of the written comments are attached.

Staff is now presenting a revised set of proposed amendments to the 2018 QAP, Procedural Manual and Selected Criteria. This report includes a blackline of the QAP, Procedural Manual, and Self-Scoring Worksheet, reflecting the revisions currently being proposed. A summary of these revisions, the rationale for them, public comments and staff responses are also attached.

Summary of Proposed Revisions to the Amended 2018 Tax Credit Program, Qualified Allocation Plan (QAP), and Procedural Manual

At the October and November 2016 board meetings, staff proposed certain amendments to the Qualified Allocation Plan (QAP) for the Housing Tax Credit Program. Public comments on the proposed amendments to the 2018 QAP were submitted to the Agency in November. In December and early January, the Agency continued to gather feedback and engaged with a number of stakeholders regarding the impact of the proposed changes. The Agency hosted a webinar, as well as developer, city, and advocate listening sessions for people to learn more about the proposed amendments and take part in the discussion. Staff carefully reviewed and considered all of the comments. Changes made as a result of comments and additional analyses by staff are detailed below.

Recommended changes to the Qualified Allocation Plan, Procedural Manual, and/or Self-Scoring Worksheet

At the May 26, 2016 board meeting, the Minnesota Housing board approved the 2018 Qualified Allocation Plan (QAP), including several revisions to the original draft of the 2018 QAP. These revisions were proposed partially in response to public comments concerning the increasing scarcity of tax-exempt Private Activity Bonds (PAB) allocated to the state by federal law. The commenters requested that the Agency closely manage the allotment of authority for PAB for affordable housing assigned by Minnesota statute to governmental issuers. When projects receive an allocation of PAB for affordable rental housing, they must separately request an allocation of 4% housing tax credits from Minnesota Housing (or from the City of Minneapolis, the City of St. Paul, Dakota County or Washington County for projects located in those jurisdictions) if they wish to use such credits. Accordingly, Minnesota Housing and the other tax credit sub-allocators must address the requirements for allocating 4% housing tax credits within their QAPs.

At that time, staff recommended and the board approved a 40 point minimum score in order to receive an allocation of 4% credits under the 2018 QAP, increased from a previous minimum score of 30 points. The board also approved a new policy that Minnesota Housing will not allocate 4% tax credits to support an allocation of PAB in an amount greater than 53 percent of a project's eligible cost basis, as defined in low-income housing tax credit rules.

Staff recommends that the proposed QAP amendments and policy changes apply to: projects that submit an application for 4% tax credits on or after October 1, 2016; and projects that submitted an application for 4% tax credits prior to October 1, 2016 but have not been recommended for non-selection (either as part of the RFP or as a pipeline application) on or prior to the date of this board report. The requirements of the QAPs for 4% tax credit allocations in effect on September 30, 2016 will apply to all projects for which an application has been received by Minnesota Housing prior to October 1, 2016 and for which Minnesota Housing has not recommended non-selection.

Staff is now proposing amendments to the 2018 QAP as a means of ensuring that 4% housing tax credits are awarded to projects that meet the highest priority affordable rental housing needs in the state of Minnesota. Staff recommends that the board approve the following changes to the 2018 QAP and the related policy recommendations.

1. **Initial Recommendation - Increase the minimum score required to receive an allocation of 4% tax credits to 50 points.**

Public Comments Summary (staff responses italicized):

The Agency received one letter in support of the proposed revisions.

The minimum point threshold for 4% projects has been 30 points for several years. The proposed point requirement is too high; the Agency should consider reducing it back to 30 points.

In the 2018 QAP adopted in May 2016, the Agency restored the minimum score required for 4% credits to 40 points. The minimum score had previously been reduced from 40 points to 30 points in April 2013 for the 2014/2015 QAP in response to a public comment that pointed out that tax-exempt bonding authority was not at the time a scarce resource, and was going unused. To maximize use of tax-exempt bonding for multifamily affordable housing development, which would have otherwise gone unused, Minnesota Housing decreased the score to 30 points. For the previous ten years, the minimum score required for 4% projects was 40 points, and prior to that it was 50 points.

Increased scoring will prohibit certain types of projects, such as senior housing, family housing, 80-20, and developments serving individuals at 60% AMI from being developed.

A 50 point threshold will require very specific siting of housing within communities.

This 50 point requirement will effectively reduce access to Minnesota Housing resources.

Will reduce housing affordable to household earning 60% of AMI, who are underserved.

In our current Strategic Plan, Minnesota Housing has a principle of targeting affordable housing resources to households that face the highest barriers to obtaining stable, affordable housing. Addressing specific and critical local housing needs is also a strategic priority.

As tax exempt bond resources become scarce, finding the appropriate threshold for 4% tax credits is critical to meeting both of these objectives in a way that is fair for communities across the state. The QAP is designed to support developments that meet a variety of different community needs, including access to jobs, access to high quality schools, and serving households with barriers to accessing high quality affordable housing. The QAP also provides points to projects that have local contributions and developments that are part of a larger community planning process.

With this combination of objectives, the goal is to ensure that projects that meet a compelling community need can successfully access necessary resources. While not every project will be successful because there are not enough tax exempt bonds available to support every development, we expect that a variety of developments will access resources to meet a range of community needs.

The Agency has completed a scoring analysis to ensure that the point level is not too high and is a good fit for various types of developments. This research revealed that a score of 50 points could prohibit certain types of projects, thus Minnesota Housing is proposing to maintain the minimum score of 40 points. Given the increased scarcity of bonding authority, returning the point to the threshold to the previous level is appropriate. Historically, this was the threshold for years from 2004 to 2014 and Agency analysis shows that it is reasonable. In addition, the Agency is proposing an additional 13 possible point for 4% tax credit deals. This results in an overall increase in the possible scoring for 4% developments. Additional details are discussed later in Items 3 and 5 of the report.

In order to meet the increased scoring, the project will have to incorporate supportive

housing, homelessness, and deep rent restriction to qualify. This will require an additional gap subsidy that is not currently available.
The Agency is proposing to maintain the threshold at 40 points. Staff analysis concludes that meeting the 40 points will be possible without an additional gap subsidy, especially given that the Agency is proposing an increase in potential points for 4% tax credit deals.

Final Recommendation - Proposed Change Resulting from Public Comment: Maintain the current minimum score for 4% tax credits at 40 points. This change is reflected in the corresponding documentation (QAP, HTC Manual, and Self-Scoring Worksheet).

2. **Initial Recommendation - Add the requirement that a project must meet at least one Strategic Priority Policy Threshold in the QAP under which the project was selected.**

   The current QAP, which requires 9% projects to meet at least one of the Strategic Priority Policy Thresholds (Access to Fixed Transit, Greater Minnesota Workforce Housing, Economic Integration, Tribal Housing, Planned Community Development, Preservation, and Supportive Housing), does not apply to projects using Private Activity Bonds and 4% tax credits. Staff is proposing that all housing tax credit projects meet at least one Strategic Priority Policy Threshold.

Public Comments Summary (staff responses italicized):

The Agency received two letters in support of the proposed revisions.
The Agency should consider analyzing the access to fixed transit and economic integration strategic priorities. There are certain geographic areas that appear to be missing.
The Agency should consider adding Naturally Occurring Affordable Housing to be included under Preservation.
The Agency has not proposed any changes to the current methodologies or categories in the 2018 QAP. All of the methodologies will be reviewed and revised in conjunction with the 2019 QAP development. The Agency encourages stakeholders to provide any input during the public comment period for the 2019 QAP.

Senior housing is not included, and this is a priority for many local communities.
The Planned Community Development strategic priority was created specifically for housing created in response to the needs of local communities. Senior housing could meet this priority.

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Final Recommendation - Proposed Change Resulting from Public Comment: No proposed change

3. **Initial Recommendation - Require that owners of projects qualifying for 4% tax credits under the 2018 QAP maintain the credit units in the projects for at least 30 years and Sections 42(h)(6)(E)(i)(II) and 42(h)(6)(F) of the Internal Revenue Code shall not apply to the projects.**

   The QAP currently requires 9% projects to maintain affordability for a minimum of 30 years. This does not apply to projects using Private Activity Bonds and 4% tax credits. Owners of such projects retain the right to terminate the restrictions at the end of the 15-year compliance period in the event Minnesota Housing does not present the owner (if requested by owner) with a qualified contract for the acquisition of the project, as allowed for by IRS regulations.

Staff proposed a revision to the QAP to require 4% projects to waive the Qualified Contract Process and maintain affordability for 30 years.

Public Comments Summary (staff responses italicized):

The Agency received several comments in support of the change.

The Agency should only require waiver of the right to Qualified Contract if it is providing 9% credits or other scarce state resources, as 4% projects have a different financial structure, one that relies more heavily on debt and lender requirements, and this requirement will make those deals more difficult, if 30 years of affordability is required.

The priority of the Agency is to provide affordable housing to low income Minnesotan's and ensure its long-term affordability. The Agency understands that this proposed requirement may affect the financial structure of some 4% deals; however to accommodate for this the Agency is recommending a new scoring criterion point system that allows flexibility but also incentivizes the developer to extend the affordability period.

Historically the Agency has only required a 30-year LURA if it has allocated 9% credits or invested other scarce state resources.

The Agency has always required a 30-year LURA. Section 42 requires a 30-year extended use period for all Tax Credit properties. The Agency requires owners of 9% projects to waive their right to terminate via Qualified Contract. Historically, the requirement for 4% projects varied. In 2002, the Agency removed the option for Qualified Contract and the 30-year minimum was required for all projects, and in the 2007 QAP the option for Qualified Contract for tax-exempt deals was restored.

Final Recommendation - Proposed Change Resulting from Public Comment: Staff's recommendation is to require owners of projects qualifying for 4% tax credits under the 2018 QAP to maintain affordability for at least 20 years. In addition, staff is proposing to create a new scoring criterion titled Long Term Affordability (Scoring Criterion 1.g) under the Greatest Need – Tenant and Affordability Targeting.(Scoring Criterion 1 on the Self-Scoring Worksheet). This new category would provide an additional 7 points to 4% projects that agree to waive the Qualified Contract for 30 years.

4. Initial Recommendation - Minnesota Housing will institute a new pre-application for determination of 4% tax credit eligibility.

This process will be available to developers as a means of receiving a tax credit scoring determination prior to submitting an application for Private Activity Bonds to MMB or Minnesota Housing. Developers will be strongly encouraged to submit such a pre-application. Most affordable rental housing projects will not have a viable financing plan unless the projects also receive an allocation of 4% housing tax credits. Given the proposed changes, staff is also recommending that developers use a new pre-application for determination of 4% tax credit eligibility prior to applying for an allocation of Private Activity Bonds so they know whether the projects they are proposing will meet these new, higher standards.

Public Comments Summary (staff responses italicized): No public comments received.

Final Recommendation - Proposed Change Resulting from Public Comment: No proposed change.

5. **Initial Recommendation - Minnesota Housing will require a waiver from the board for any project seeking 4% tax credits whose total development costs exceed the predictive model by more than 25%.**

   Staff recommends that the total development costs of all projects requesting 4% tax credits be reviewed for comparison with the Agency's predictive cost model. Any project with costs exceeding the predictive model by more than 25% will require a waiver from the board.

Public comments Summary (staff responses italicized):

Several comments were received in support of this cost containment requirement, particularly from city and county staff.

The predictive model requirement could cause possible timing delays and would lead to more risk to for 4% developments.

The Agency received a number of comments concerning the predictive model process and how it could negatively impact developments if they had to pursue board approval prior to preliminary determination and closing. We understand that there are a number of timing issues to take into consideration with bond projects, particularly for developments with an allocation of bonds from MMB. In order to accommodate for this, the Agency will incorporate the predictive model determination into the pre-application process. Predictive model analysis and board approval can be pursued earlier than the submission of the 42M application. Developers will submit a one page pre-application document with the required information provided by the applicant and will receive a determination letter upon approval. The determination letter will consist of Agency approval, expiration date of approval, the project's per unit costs as a percentage of the predictive model, and the project cost cap beyond which a board waiver will be required. This change in process and on-going national scrutiny regarding total development costs justifies the requirement to analyze project costs, regardless of whether there are non-Agency funding sources to pay for higher costs.

The Agency's predictive model does not adequately account for the higher costs in historic adaptive re-use deals.

The Agency received a number of comments expressing concern that the predictive model cannot accommodate for projects with different financial structures, including bonds, historic preservation, and adaptive reuse. The predictive model calculation accommodates for a number of parameters. This includes different financial structures and various types of developments. It also incorporates controls for historic tax credits and adaptive reuse projects. Since 2009, we have closed 10 historic preservation adaptive re-use projects, and only one of the nine required a waiver to the predictive model.

Final Recommendation - Proposed Change Resulting from Public Comment: Staff will incorporate the predictive model determination into the pre-application determination process. In addition, the Agency is proposing that 4% deals to be eligible for the six points under the Cost Containment scoring category (Scoring Criterion 5.c) under the Efficient Use of Scarce Resources (Scoring Criterion 5 on the Self-Scoring Worksheet). Points will be awarded based upon cost containment thresholds established in RFP/HTC Round 1. For each of the four competition groups, the cost per unit of the proposal at the 50th percentile in Round 1 will determine the per unit total development cost cap for 4% developments claiming the points. Thresholds will be released no later than September 30 for projects receiving bond allocations during the following year.

6. Public Comments Received Not directly Related to the Changes Proposed in October.

Public Comments Summary (staff responses italicized):

The Agency received one letter in support of the withdrawal of the 2017 amendment.
The Agency received two letters in support of the expanded public input process.
The Agency should be clear about the reasoning for the change.
For the first time in more than 10 years, the amount of carryover of tax-exempt bonding authority available for rental housing will substantially decrease. Additionally, for the first time since 2007, nearly the entire allocation of resources in the affordable housing pool was used for affordable housing. Prior to 2016, there were un-used housing pool funds that flowed to the unified pool. This is no longer the case.
The Agency should consider the timing of the amendment and ramifications to developments in process and allow a reasonably long effective date so participants have an opportunity to accommodate for the potential impact of these rule changes.
Staff proposed at the November 17 board meeting to withdraw the amendment to the 2017 QAP, and the board approved the recommendation. In addition, staff recommended continued dialogue on an amendment to the 2018 QAP, which provides approximately one year's notice to the development community of the revisions.
The Agency should engage all stakeholders and allow for public input to ensure the creation of a QAP that meets the priorities of state and of local governments.
Minnesota Housing became aware that a significant number of rental projects were expected to be submitted for private-activity bonding authority in 2017, but had no way of knowing all of the projects that could be affected by an amendment. Therefore, we recommended to the Minnesota Housing board that they immediately commence a public comment period, with broad notification of the comment period, so that every effort could be made to reach sponsors and local communities that may be affected. The public comment process allows us to gain input from stakeholders and a better understanding of the potential consequences of the proposed changes. It is our opportunity to hear from stakeholders and help us craft a final policy. Because the proposed amendments may impact projects that are already in the planning stages, we felt that the only way to ensure that all projects are treated fairly is to notify the public and invite comment through a formal public comment process.
In response to initial public comment, Minnesota Housing has now withdrawn the amendment to the 2017 QAP, the public comment period was extended for the 2018 QAP, and dialogue sessions were held in December and January. In addition, another public comment period will commence following board approval. We look forward to continuing this dialogue and welcome comments to the revised recommendation.
The Agency should consider the long-term ramifications in the affordable housing marketplace including fewer affordable multifamily units being built, fewer construction

jobs, and a lack of trust and predictability for developers working in Minnesota.

The intent of the proposed revision was not to reduce the number of affordable housing units being constructed or renovated. Due to current scarcity, not all projects currently proposed can move forward. Projects will be limited due to scarcity of bonds, not due to these changes. These changes are a recommendation on how to prioritize projects for this limited resource to handle this scarcity. The Agency has addressed the lack of trust and predictability by withdrawing the amendment for the 2017 QAP. In addition, the Agency has expanded the public comment process.

The QAP and application process is too complex and should be simplified. Complexity increases costs, makes it difficult for new developers to receive funding and difficult for all developers to assess competitiveness.

While the Agency's approach is very similar to that of many other state allocating agencies, Minnesota Housing acknowledges that the QAP is a complex policy document that promotes and balances multiple competing priorities given the scarcity of resources. The Agency does provide several tools to assist both new and incumbent developers, including training, individual technical assistance, and the Community Profiles tool that applicants use to search locational priorities contained in the QAP. Staff will conduct an extensive review of the scoring criteria for the 2019 QAP to determine whether any may be eliminated, combined, or made into threshold requirements and removed from scoring.

Minnesota Housing should not use bonding authority for Single Family, as the funds will support households with higher income levels and will not be leveraged with 4% tax credit equity. These changes mean that more resources will go to single family housing. The Agency has a conflict of interest in this regard.

Minnesota Housing has deployed significant resources for both homeownership and rental opportunities throughout the state. Our support resources of rental housing projects statewide using Housing Infrastructure Bonds has helped ensure that tax exempt bond funds do not expire. Minnesota Housing's use of tax exempt bonds for homeownership has created thousands of first-time homebuyers across the state and helped address the homeownership gap between white households and households of color. Our single family lending activity allows the Agency and local communities to provide additional affordable housing resources as down payment and closing cost assistance, rehabilitation loans, and gap financing for rental housing projects.

In response to the scarcity of tax-exempt bonds, Minnesota Housing made several changes in 2016 to reduce the use of tax-exempt bonds for homeownership. This includes issuing more taxable debt. This change, along with others, has reduced our use of tax exempt bonds for homeownership in 2016. In 2016, approximately $400 million in tax –exempt bonds will be used for rental, while $232 million has been used for homeownership.