2021 QAP - Cost Containment Methodology

Background

Cost containment points are awarded to the 50% of proposals with the lowest total development costs (TDC) per unit in each of the following four groups:

1. New Construction – ~~Metro~~Twin Cities 7-County Metropolitan Area (Metro)
2. New Construction – Greater MN
3. Rehabilitation – ~~Metro~~Twin Cities 7-County Metropolitan Area (Metro)
4. Rehabilitation – Greater MN

The process divides the proposals into the four groups so that proposals are competing for the cost containment points with somewhat similar proposals. The process also levels the playing field with respect to the size of the units in the proposed development. ~~To address the issue of d~~Developments with larger units typically have~~ing~~ higher costs than developments with smaller units~~, the scoring process includes cost adjustments related to the size of the units~~. ~~Specifically~~To account for this, the process also classifies proposed developments as~~ largely for~~:

- Singles (~~primarily~~ SROs, efficiencies, and 1 bedroom units are 75% or more of all units),
- Large families (~~primarily~~ 3+ bedroom units are 50% or more of all units), and
- Families/mixed (developments with all other bedroom mixes).

The process then applies adjustments to bring the TDCs for these different sized developments into equivalent~~s~~ terms~~ and reflect historical differences~~. (The adjustments are shown in Table 1 on page 3.) For example, ~~new construction~~ TDCs per unit for ~~family/mixed~~new construction developments for singles are typically ~~16% higher~~lower than the TDCs for developments for ~~singles~~families/mixed. Thus, to make the TDCs for singles equivalent to those for families/mixed for cost comparison purposes, the TDCs per unit for singles are increased by 16% ~~when making cost comparisons~~(multiplying by a 1.16 adjustment). Similarly, the TDCs per unit for new construction developments for large families are typically higher than the TDCs for developments for families/mixed. To level the playing field, the process reduces the TDCs per unit of large family developments by 5% (multiplying by a 0.95 adjustment). The adjustment factors shown in Table 1 are based on historical differences in developments that Minnesota Housing has financed in the past.

The purpose of the cost containment criterion is to give developers an incentive to "sharpen their pencils" and eliminate unnecessary costs and/or find innovative ways to minimize costs. However, Minnesota Housing does not want developers to compromise quality, durability, energy-efficiency, location desirability, and ability to house lower-income and vulnerable tenants. To ensure that these priorities are not compromised, all selected developments must meet Minnesota Housing's architectural and green standards. In addition, the Agency has intentionally set the points awarded under the cost containment criterion (6 points) to be equal to or less than the points awarded under other criterion, including economic integration, location efficiency, workforce housing, permanent supportive housing for households experiencing homelessness, housing for people with disabilities, and others.

The cost containment criterion applies to the selection of proposals for both 9% credits and 4% credits with tax-exempt bonds; however, the processes for awarding the points are different for the two types of credits.

Process for Awarding Points for Proposals Seeking 9% Credits

To carry out the competition for the points, the following process will be followed for all proposals seeking competitive 9% credits:

- Group all the 9% tax credit proposals into four development type/location categories:
  - New Construction – Metro
  - New Construction – Greater Minnesota
  - Rehabilitation – Metro
  - Rehabilitation – Greater Minnesota

- Adjust the TDCs for developments for singles and large families to make them equivalent to the TDCs for family/mixed developments, which levels the playing field for cost comparison purposes. See the second column of Table 1 for the adjustments. For example, the TDC per unit for large-family new-construction projects (which typically have higher costs) is multiplied by 0.95 to reduce and make it equivalent to the costs for a family/mixed development. Specifically, if the TDC per unit is $26~~5~~0,000 for a large-family new-construction development, it is multiplied by 0.95 to compute the equivalent TDC of $247,0~~37,5~~00.

- After adjusting the TDCs for single and large-family developments, order all the proposals by TDC per unit within each of the four groups from lowest to highest.

- Within each group, award 6 points to the 50% of proposals with the lowest TDCs per unit.

  - If the number of proposals in a group is even, the number of proposals eligible to get points =
    (Number of proposals in group)/2

  - If the number of proposals in a group is odd, the number of proposals eligible to get points =
    (Number of proposals in group)/2
    Rounded down to nearest whole number

  However,

    - If the next proposal in the rank order (of those not already receiving points) meets that group's threshold (see the third column of Table 1), that proposal is also eligible to get points, or
    - If that proposal's TDC per unit is higher than the threshold, it does not get points.

Only proposals that claim cost containment points on the self-scoring worksheet **and** are in the lowest half of the costs for their group will actually receive the cost containment points.

For each group, t~~T~~he cost thresholds in the third column reflect the historical mid-point costs for family/mixed developments ~~in each group~~that Minnesota Housing has financed in the past.

Table 1: 2021 QAP - Adjustment Factors and Thresholds to Determine if Middle Proposal Gets Points if Odd Number in Group

	Cost Adjustment to Families/ Mixed	Threshold Test if Odd Number of Proposals
New Construction Metro for Singles (increase historically lower costs to level the playing field)	1.16	
New Construction Metro for Families/Mixed	1.00	$273~~67~~,000
New Construction Metro for Large Families (decrease historically higher costs to level the playing field)	0.95	
New Construction Greater MN for Singles	1.16	
New Construction Greater MN for Families/Mixed	1.00	$217~~12~~,000
New Construction Greater MN for Large Families	0.95	
Rehabilitation Metro for Singles	1.23	
Rehabilitation Metro for Families/Mixed	1.00	$218~~13~~,000
Rehabilitation Metro for Large Families	0.83	
Rehabilitation Greater MN for Singles	1.23	
Rehabilitation Greater MN for Families/Mixed	1.00	$173~~69~~,000
Rehabilitation Greater MN for Large Families	0.83	

- “Metro” applies to the ~~seven-county Twin Cities metro area~~Twin Cities 7-County Metropolitan Area, while “Greater MN” applies to the other 80 counties.
- "Singles" applies to developments where the share of efficiencies and 1 bedroom units is 75% or greater.
- "Large Families" applies to developments where the share of units with 3 or more bedrooms is 50% or greater.
- "Families/Mixed" applies to all other developments.
- “New Construction” includes regular new construction, adaptive reuse/conversion to residential housing, and projects that mix new construction and rehabilitation if the new construction gross square footage is greater than the rehabilitation gross square footage.

Implementation Details for 9% Credit Proposals

Tribal Proposals. To recognize the unique costs and situation of projects on Tribal lands, these projects will receive a 15% adjustment to their TDCs. Their proposed TDCs will be reduced by 15% when they compete for the cost-containment points.

Self-Scoring Worksheet and Awarding Points. All applicants that want to pursue the cost containment points must claim the 6 points in the self-scoring worksheet; however, during the final scoring by the Agency, staff will take away the points from those proposals not in the lower half of TDCs for each of the four categories. (To identify the 50% of proposals with the lowest costs in each category, the Agency will include the TDCs of all proposals seeking 9% tax credits, not just those electing to participate in the competition for cost containment points by claiming the points in the self-scoring worksheet. However, only those electing to participate in the competition by claiming the points in the self-scoring worksheet will be eligible to receive the points if they are in the lower half of project TDCs.)

Applicable Cost Threshold and Unacceptable Practices. If a project receives points under this criterion, failure to keep the actual TDC under the "applicable cost threshold" will be considered an unacceptable practice as described in the Housing Tax Credit Manual.~~and result in negative 4 points being awarded in the applicant's next round of tax credit submission. [See the section on Implementing Negative Points for more details.]~~

The "applicable cost thresholds" will be determined by the cost-containment selection process. Within each of the 4 development/location types, the TDC per unit of the proposal at the 50th percentile (as identified in the process outlined above) will represent the "applicable cost threshold" that projects receiving cost-containment points will need to meet (with appropriate adjustments for single, family/mixed, and large family developments). For example, if the 50th percentile proposal for new construction in Greater Minnesota is a family/mixed development with a per unit TDC of $215,000, all new construction family/mixed developments in Greater Minnesota receiving the cost-containment points will need to have a final TDC per unit at or below this threshold when the project is completed.

Within the 4 development/location types, separate thresholds will be published for single, family/mixed, and large-family developments, using the cost-adjustment factors in Table 1. In the example above, if the family/mixed category has a $215,000 threshold, the threshold for large-family developments will be $226,316 ($215,000 divided by 0.95 equals $226,316). The thresholds for large-family developments are increased to account for the typically higher costs associated with these developments with larger units.

Under this process, there will be some cushion for cost overruns for projects that have proposed TDCs less than the applicable cost thresholds. However, the project at the 50th percentile, which is the basis of the applicable cost threshold, will have no cushion. Its actual TDC per unit will have to be at or below its proposed TDC per unit ~~to avoid the negative 4 points~~. Because applicants will not know if their project is the one at the 50th percentile until after proposals have been submitted, all applicants need to carefully assess their proposed costs and the potential for cost increases.

If developers are concerned about their costs and keeping them within the "applicable cost threshold", they should not claim the cost-containment points in the self-scoring worksheet.

Round-2 Process. A different process is used for the Round-2 tax credit applications and selections. The Round-1 "applicable cost thresholds" will serve as the thresholds for determining if a Round-2 tax credit proposal receives the cost containment points. Like Round-1, Round-2 proposals will need to claim the 6 cost containment points on the self-scoring worksheet to be eligible; and the unacceptable practice provision, as described in the Housing Tax Credit Manual, will apply ~~developers for selected projects that receive the points will receive negative 4 points for their next tax credit submission~~ if they receive the 6 points and do not keep their actual TDCs within the applicable cost thresholds. ~~[See the section on Implementing Negative Points for more details.]~~

Process for Awarding Points for Proposals Seeking 4% Credits

Minnesota Housing will publish the "applicable cost thresholds" from the Round-1 competition for 2021~~0~~ 9% credits by September 30, 2020~~19~~. Proposals for 2021~~0~~ 4% credits must have TDCs within these thresholds to receive the cost containment points.

To be eligible for the points, an applicant must claim the 6 cost containment points on the self-scoring worksheet; and the unacceptable practice provision, as described in the Housing Tax Credit Manual, will apply if they receive the 6 points and do not keep their actual TDCs within the applicable cost thresholds.~~developers for selected projects that receive the points will receive negative 4 points for their next tax credit submission if they~~

~~do not keep their actual TDCs within the applicable cost thresholds. [See the section on Implementing Negative Points for more details.]~~

~~Implementing Negative Points for Actual Costs above the Applicable Cost Thresholds~~

~~The penalty will be assessed against a future credit request of the same funding round for which the points were initially awarded.~~

- ~~Tax credit developments that exceed the cost containment threshold and were awarded points in a competitive funding round (Consolidated RFP or Supplemental Round 2) will receive the penalty on the next tax credit application submitted to either of these competitive funding rounds.~~
- ~~Tax credit developments that exceed the cost containment threshold and were awarded points via the 4% only allocation process will receive the penalty on the next 4% only (42M) tax credit application if the points were necessary to meet the minimum point requirement.~~

Predictive Cost Model and Cost Reasonableness

Besides awarding cost-containment points under this criterion, Minnesota Housing will also evaluate "cost-reasonableness" of tax credits proposals (even those that do not receive points under this criterion) using the Agency's predictive cost model. The model is a regression analysis that predicts TDCs per unit using data from developments that the Agency has financed in the past (adjusted for inflation) and industry-wide data on construction costs. The model measures the individual effect that a set of explanatory variables (which includes building type, building characteristics, unit characteristics, type of work carried out, project size, project location, population served, financing, etc.) have on costs. During the process of evaluating projects for funding, Minnesota Housing compares the proposed TDC per unit for each project with its predicted TDC per unit from the model. The Agency combines the model's results with the professional assessment of the Agency's architects and underwriters to assess cost reasonableness overall. The purpose of the cost-reasonableness testing (on top of the cost-containment scoring) is to ensure that all developments financed by Minnesota Housing have reasonable costs, even those that do not receive points under the cost-containment criterion.