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
2. New Construction – Greater MN
3. Rehabilitation – Metro
4. Rehabilitation – Greater MN

To address the issue of varying costs among developments for singles, families, and large families, the calculation of TDC per unit includes adjustment factors to bring these costs into equivalents terms. The adjustments reflect historical differences. For example, new construction costs for family/mixed developments are typically 17% higher than the costs for developments for singles. Thus, to make the costs for singles equivalent to those for families/mixed, TDCs per unit for singles are increased by 17% when making cost comparisons.

This cost containment criterion only applies to the selections for competitive 9% credits. It does not apply to 4% credits with tax-exempt bonds.

The purpose of the criterion is to give developers an incentive to "sharpen their pencils" and eliminate unnecessary costs and/or find innovative ways to minimize costs. 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 (4 points) to be less than the points awarded under other criterion, including economic integration, location efficiency, workforce housing, permanent supportive housing for households experiencing homelessness, and others.

Process for Awarding Points

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

Group all the 9% tax credit proposals into the 4 development type/location categories:

- New Construction – Metro
- New Construction – Greater Minnesota
- Rehabilitation – Metro
- Rehabilitation – Greater Minnesota

Adjust the costs for developments for singles and large families to make them equivalent to the costs for family/mixed developments. See the second column of Table 1 for the adjustments. For example, the TDC per unit for large-family new-construction projects is multiplied by 0.96 to make it equivalent to the costs for a family/mixed development. Specifically, if the TDC per unit is $240,000 for a large-family development, it is multiplied by 0.96 to compute the equivalent cost of $230,400.

After adjusting the costs 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 4 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.

The cost thresholds in the third column reflect the historical mid-point costs for family/mixed developments in each group.

Table 1: 2017 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	1.17	$242,000
New Construction Metro for Families/Mixed	1.00	
New Construction Metro for Large Families	0.96	
New Construction Greater MN for Singles	1.17	$192,000
New Construction Greater MN for Families/Mixed	1.00	
New Construction Greater MN for Large Families	0.96	
Rehabilitation Metro for Singles	1.30	$193,000
Rehabilitation Metro for Families/Mixed	1.00	
Rehabilitation Metro for Large Families	0.85	
Rehabilitation Greater MN for Singles	1.30	$153,000
Rehabilitation Greater MN for Families/Mixed	1.00	
Rehabilitation Greater MN for Large Families	0.85	

"Metro" applies to the seven-county Twin Cities metro 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 square footage.

Implementation Details

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

A different process occurs for the second round of tax credit selections. For each of the four competition groups, the cost per unit of the proposal at the 50th percentile in round 1 (using the identification process and adjustments outlined earlier) will determine the cut point or threshold for receiving points in round 2.

In the self-scoring worksheet, all proposals that believe they have contained their costs should select these points; however, during the final scoring by the Agency, staff will take away the points from those proposals not in the lower half of costs for each of the four categories. (To identify the 50% of proposals with the lowest costs in each category, the Agency will include the costs of all proposals/applications 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 costs.)

If a project receives points under this criterion, failure to keep project costs under the applicable cost threshold will be considered an unacceptable practice and result in negative 4 points being awarded in the applicant's next round of tax credit submissions.

The "applicable cost threshold" will be determined by the cost-containment selection process. Within each of the 4 development/location types, the cost per unit of the proposal at the 50th percentile (using the identification process identified earlier) 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 cost of $190,000, all new construction developments in Greater Minnesota receiving the cost-containment points will need to have a final cost per unit at or below this threshold when the project is completed. In making the assessment, the final costs for new-construction single developments will be multiplied by 1.17 and compared with the $190,000 threshold. Likewise, the final costs for large family developments will be multiplied by 0.96.

Under this process, there will be some cushion for cost overruns for projects that have proposed costs 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 costs will have to be at or below its proposed costs to avoid the negative 4 points. Because applicants will not know if their project is the one at the 50th percentile until after applications have been submitted and funding decisions have been made, all applicants need to carefully assess their proposed costs and the potential for cost increases.

This cost containment competition does not apply to proposals/applications seeking 4% tax credits with tax exempt bonds. However, as discussed below, Minnesota Housing will assess the cost reasonableness of all tax credit proposals, including 4% credits, using the Agency's predictive cost model.

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.

Predictive Cost Model And Cost Reasonableness

Besides awarding cost-containment points under this criterion, Minnesota Housing will also evaluate "cost-reasonableness" of all proposed tax credits developments (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 total development costs using data from developments that the Agency has financed in the past (adjusted for inflation) and industry construction costs from RSMeans. 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 total development costs for each project with its predicted costs 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 4% credits and the 50% that do not receive points under the cost-containment criterion.