



MULTIFAMILY UNDERWRITING STANDARDS

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Minnesota Housing does not discriminate on the basis of race, color, creed, national origin, sex, religion, marital status, status with regard to public assistance, disability, familial status, or sexual or affectional orientation in the provision of services.

An equal opportunity employer.

This information will be made available in alternative format upon request.

Minnesota Housing's Multifamily Underwriting Standards are current as of the date on the cover page. These Standards reflect Minnesota Housing's general approach to underwriting, but they are not meant to be comprehensive, nor to address every possible situation. If you have a question as to how the Standards will apply to a particular project, it is best to consult Minnesota Housing early in the development process. Minnesota Housing will update the Standards as appropriate at the sole discretion of Minnesota Housing.

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Borrower/Owner

- Borrowers must be an “Eligible Mortgagor” as defined in Minnesota Housing’s statute. (Minn Stat. 462A.03, subd. 13.)
- Single asset entities are required for all Minnesota Housing non-recourse loans.
- Loans to multiple asset entities will be limited to deferred loans and will be recourse.
- Guarantor (amortizing loans) or financially responsible party (deferred loans) must have acceptable performance on other Minnesota Housing loans and must not be undercapitalized for the scale of the proposed project.
- For **amortizing debt**, at least one individual or corporation with adequate financial capacity must guarantee:
 - Construction completion
 - Operating cost shortfalls for the term of the loan
 - Debt service payments until the development has achieved 1.15 debt service coverage (assuming stabilized expenses) for 3 successive months. In the case of nonprofits, the guaranty can come from the parent nonprofit entity.
- When a development is located on **tribal land**, both deferred and amortizing loans must be guaranteed by the tribal government. The guaranty may be in the form of a tribal council resolution from the governing body and must address:
 - Construction completion
 - Operating cost shortfalls
 - Debt service payments (prior to stabilized operations)
- A full credit review for all loans is required for final loan approval.
- The development is responsible for the costs of the appraisal, environmental reviews, market study, title insurance and closing, legal fees, publication and all other costs incurred by the borrower as a result of the borrower applying for or securing a loan with Minnesota Housing.

Underwriting Standards

INCOME

Rent Revenue

Rent and income limits vary by project. Refer to each program guide for additional details. Rents shown in the 402 and year one of the cash flow will be the rents that will be in effect when the development is placed in service. Operating developments will be underwritten at current rents unless there is sufficient evidence that a rent increase for the development is feasible in the local market.

For developments with project-based Section 8 rental assistance, Minnesota Housing will underwrite and size debt based upon the lower of HUD-approved rents under the HAP or market rents. In the case of developments pursuing renewal options that allow for staged-in HUD-approved 'after rehab' rents, Minnesota Housing will allow the higher rent levels to be incorporated into the underwriting, but will underwrite a transition reserve into the development budget.

Long Term Homeless (LTH) Units

LTH units with Group Residential Housing (GRH)

For LTH units where household members will have access to Group Residential Housing vouchers, the gross rents should be underwritten at the following levels:

- Efficiencies and 1 bedroom units: Recommended maximum gross rent level of \$670 per unit. Note: total available GRH is \$867, but \$200 may be used by the tenant for other housing expenses, and the administrator may also use a portion for administration, which is the preferred GRH use.
- Larger units (more than 1 bedroom): GRH can also be used for families, but the rent/income payment structure is more complex. Consult with the local county or the state Department of Human Services for assistance in developing the GRH rent structure. The total amount of available assistance is \$867.
- Justification should be submitted to support cases where higher gross GRH rent levels are needed.
- GRH gross rents cannot exceed the gross rents paid by non-GRH tenants for comparable units in the development.
- If GRH is anticipated for more than 4 units, a vacancy factor higher than 7% should be used (the percentage utilized should be agreed upon by Minnesota Housing) or 10% of the potential rental revenue from the GRH units should be disregarded. The disregarded income can be accounted for under the Rental Loss Section of the Minnesota Housing 402 form, Part 2d, *Miscellaneous Unrealized Income*.

LTH units that do not have access to a rental subsidy

To ensure long term financial viability and affordability to the tenants, the amount of rent to be paid by the LTH household should be affordable to the target population. The following is based on data from the Homeless Management Information System (HMIS). If a rent subsidy, including GRH, is **not**

available to the development, the gross rent (contract rent + tenant- paid utilities) should be underwritten at the following levels:

Target Population	Monthly Gross Rent Per Unit
SRO & Efficiency / Singles (only)	\$100
1 BR / Singles or Families with Children	\$130
2 BR or larger / Families with Children (only)	\$180

Other Income

The amount of Other Income (fees, laundry, and parking) should be reasonable and comparable to other developments within the region. The amounts will be evaluated by Minnesota Housing’s Housing Management Officers.

Commercial Space

Income from commercial space will be underwritten on an exception basis only. Five years of operating history will be required, and Minnesota Housing will determine an appropriate vacancy rate in its sole discretion.

Vacancy Factor

Vacancy will be underwritten at the greater of market (as determined in the appraisal) or 7%. Section 8 assisted properties may be underwritten at 5% vacancy if justified by historic operations. Minnesota Housing will determine the appropriate vacancy rate in its sole discretion.

MANAGEMENT AND OPERATING EXPENSES

The management and operating (M&O) budget will be based on the year the development is placed in service. For operating properties, the historic M&O expenses will be used, with appropriate adjustments for projected economies attributable to the proposed rehabilitation.

M&O expenses (net of real estate taxes and reserves) will be evaluated and analyzed in relationship to comparable properties in Minnesota Housing's portfolio, the expense comparables in the appraisal and other information deemed relevant and appropriate.

M&O expense numbers are calculated on a per room basis. The rental rooms per unit are calculated as follows:

Unit Type	Rental Rooms Per Unit
Bed/Shelter	2.0
EFF/SRO	2.5
1BR	3.5
2BR	4.5
3BR	6.0
4BR	7.0
5BR	8.5

The proposed M&O expenses should be based on the developer/management company's current portfolio and supported by:

- Actual operating data provided by the developer/management company for similar developments
- Circumstances and/or significant changes to the economics of the development's current marketplace, such as increased utility costs and property insurance
- Operating trends of the developer or management company

The owner supporting the proposed M&O expenses should include:

- For new construction:
 - Copies of the year-end operating information from 3 comparable developments that have been in operation at least 5 years
- For existing properties:
 - Copies of audited financial operating expense statements for at least 3 stabilized years

In sizing its funding awards, Minnesota Housing reserves the right to adjust the proposed M&O expense numbers based upon the information supplied, specified development type, circumstances and/or significant changes to the economics of the development's current marketplace. Minnesota Housing will also use its M&O database to compare projected M&O expenses with audit data from comparable property types.

Property Taxes

All properties that are eligible for LIRC or PILOT must participate in the applicable programs. For more information, refer to the section on LIRC on Minnesota Housing's website.

Replacement Reserves

Reserves for replacement shall be budgeted at no less than \$300 per unit per year for senior housing and \$450 per unit per year for all other housing. If the Physical Needs Assessment/Capital Needs Assessment indicates a higher amount to address future capital needs, then the higher amount will be required.

CASH FLOW

The proforma cash flow will assume revenue increases of no more than 2% per year and operating expenses increases of no less than 3% per year. (Note: Developments with expense-based rents can use income and expense inflation factors that are equivalent). Developments with project based Section 8 will assume revenue increases no greater than historic average or 1.5% per year. A partially assisted project would have a prorated inflation factor. The appropriate inflation factors are subject to change by Minnesota Housing, based on changes in the economic outlook.

The development must have a breakeven cash flow after all expenses and reserves for 15 years on a proforma basis. The cash flow must include mandatory expenditures such as bond fees.

Debt Coverage Ratio

The level of risk presented by a development, including overall quality, current market conditions, and other factors, will be considered when making the determination of what level of debt service coverage a particular mortgage will require.

Conditions that may dictate a higher debt service ratio include:

- Lack of neighborhood stability;
- Negative market analysis;
- Rehabilitation projects where unanticipated capital costs may occur; and
- Any other factor that, in Minnesota Housing’s judgment, presents enough uncertainty to warrant an increase in this ratio to mitigate risk.

The minimum debt coverage ratio for underwriting is as follows:

<u>9% LIHTC New Construction</u>	<u>4% LIHTC New Construction</u>	<u>Acquisition Rehab and Refinance</u>
1.15X DCR	1.20X DCR	1.20X DCR
<u>Mixed Income</u>	<u>90%+ of Units Sec. 8 Assisted</u>	<u>Equity Cash Out/Refinance</u>
1.20 DCR	1.15X DCR	1.25X DCR

DEVELOPMENT BUDGET

Acquisition

(Please refer to related Appraisal Requirements in this guide)

Purchase Price

- Minnesota Housing will size its first mortgage and deferred funding awards based on the lesser of the option/purchase agreement purchase price or the appraised value of the property following selection for funding.
- For a related- or affiliated-party transaction that occurs within three years of a previous arms-length third-party transaction, and if Minnesota Housing deferred funding is requested, the deferred funding award will be based upon the lesser of the previous third party transaction's purchase price with no adjustment for appreciation or depreciation or the appraised value of the property following selection for funding.
- For details on the appraisal methodology, refer to the appraisal section of the Underwriting Standards.

If a development was part of a portfolio acquisition, Minnesota Housing will use the Certificate of Real Estate Value to establish the initial purchase price. If a development was part of a land and/or building subdivision, Minnesota Housing will use a reasonable allocation from the Certificate of Real Estate Value to establish the initial purchase price.

For a related-party transaction that occurs at the time of closing and requests Minnesota Housing deferred funding, Minnesota Housing staff will evaluate the amount of equity take-out and may resize its funding award.

Acquisition-Related Costs

There will be three-year look-back on acquisition-related costs. The following costs should be included in the Acquisition or Refinance Existing Debt Costs section of the 402 (VI. Development Cost, A. 1.c) - 4.) as applicable:

- Relocation
- Lender fees and three years or less of interest on an acquisition loan up to a 6% interest rate
- Legal costs related to acquisition
- Title insurance
- Capital improvements made since acquisition (if documented)
- Taxes, insurance, security, maintenance, utilities

Including such costs in the Acquisition section of the 402 does not change how they are treated by Minnesota Housing for the purpose of calculating the percentage of Intermediary Costs.

Minnesota Housing will size its first mortgage and deferred funding awards based only on the acquisition related costs incurred in the three years prior to the Minnesota Housing Board of Director's selection date.

During the pre-development holding period, all net cash flow from operations except for a reasonable asset management fee must be directed toward holding costs and improvements if Minnesota Housing deferred funding is requested.

General Contracting Fee Limits

Contractor's Profit

The maximum contractor profit is 6% of net construction costs. Net construction costs are defined as construction costs and on-site work not including contractor profit, general requirements, and overhead.

General Requirements

The maximum general requirements allowed are 6% of the net construction costs. Costs to be considered include: on-site supervision, signs, field office expenses, temporary sheds and toilets, temporary utilities, equipment rental, clean-up costs, rubbish removal, permits, watchmen's wages, material inspection and tests, all of the general contractor's insurance (except builder's risk), temporary walkways, fences, roads and other similar expenses.

Contractor's Overhead

The maximum allowance for overhead is 2% of net construction costs.

The contractor fee limits may deviate from the above-noted maximum allowances so long as they do not exceed 14% of net construction costs in the aggregate.

Developer or Owner as Contractor

When there is an identity of interest between the developer or owner and the contractor, in addition to the fee limits stated above, the combined balance of developer fee, contractor profit, contractor overhead and general requirements may not exceed 20% of the total development costs less the developer fee.

Refer to Minnesota Housing's Contractor's Guide for more detailed information.

Construction Contingency

A construction contingency is required.

For new construction developments, a minimum of 4% construction contingency, subject to Minnesota Housing review, is required.

For rehabilitation developments, a minimum of 7% construction contingency, subject to Minnesota Housing review, is required.

Cost savings remaining at the end of the construction or rehabilitation, if any, may be deposited in the Replacement Reserve Account, reduce Minnesota Housing funding, or be put to another appropriate use approved by Minnesota Housing.

Architect Fee Limits

Separate allowances for design and construction administration are calculated based on the gross construction cost on the 402 Form. The design allowance (75%) is provided at the completion and acceptance of the working drawings and specifications (i.e., at closing). The construction administration allowance (25%) is provided over the course of construction.

Developer Fee Limits

The developer fee is provided to the developer of rental housing for the time and energy expended on and risks associated with putting a development together. Developer fees include developer overhead, developer processing fee, if applicable, developer profit, and any other amounts received by the developer as approved by Minnesota Housing. The developer fee must be attributed only to the development. **A developer fee may not be allowed in a project that involves refinancing only.**

In some instances, the developer may delegate some of its responsibilities to a third party, such as a processing agent or consultant. In such cases, the delegated responsibilities must be thoroughly understood by all parties involved, and the fee paid to the third party shall be included in the calculation of the permitted maximum developer fee.

A developer fee can be included in the total development cost of the project. The maximum allowable developer fee is based on a percentage of the total development cost less the developer fee.

Development Type	Size	Maximum Developer Fee
New Construction or Rehabilitation	First 50 units	15%
New Construction or Rehabilitation	Units 51 and over	8%

No more than 50% of the non-deferred developer fee can be paid at closing, with the remainder available at the final draw. For tax credit developments, any developer fee paid before construction completion cannot be paid with Minnesota Housing funds.

Development Cost Escrow

To provide long-range financial stability for multifamily developments receiving a Minnesota Housing amortizing first mortgage loan, a Development Cost Escrow (DCE) is established. The DCE is funded out of Minnesota Housing loan proceeds and provides assurance of financial stability if the development experiences difficulty during marketing and operations. In effect, the DCE constitutes early borrowing, recognizing the fact that it would be difficult, if not impossible, to raise capital at a later time when the development might be in trouble and helping ensure the ongoing financial success of the development for the benefit of the owners, investors, and tenants.

The DCE is a long-term reserve for use under certain extraordinary circumstances as defined in the Minnesota Housing Regulatory Agreement. When necessary, the DCE may be applied by Minnesota

Housing to provide for amenities and design modifications in the interest of improving the marketability or livability of the development, to pay principal and interest on the mortgage note, and to pay current and delinquent operating expenses. The DCE is not intended for use for improvements or additional capital costs prior to final closing, or to cover the cash shortfalls incurred during initial marketing. Minnesota Housing does not authorize use of the DCE in lieu of approved reasonable and necessary rent increases.

The amount of the DCE depends on a number of factors, but it is generally 4% of the loan amount. Minnesota Housing retains the DCE as a cash escrow, and any interest earned on the investment of the DCE (after debt service is paid) may be used to increase the borrower's return on equity up to 15%.

The DCE continues to be held by Minnesota Housing if the loan is assumed; is credited towards the loan balance in the case of a prepayment; and is returned to the borrower at the time of final loan maturity .

Working Capital Escrow

At the time of initial closing of a Minnesota Housing amortizing first mortgage loan, borrowers are required to establish a Working Capital Escrow (WCE), funded with cash or an irrevocable unconditional letter of credit in an amount equal to 3% of the loan excluding DCE (i.e., net loan amount). Minnesota Housing may use the WCE on behalf of the borrower to pay unanticipated costs during construction and operating deficits during the rent-up period.

The WCE remains at 3% for the first year after the final closing, 2% for the second year, and 1% for the third year. Each year that the WCE is reduced, that portion of the funds and interest earned thereon are returned to the borrower. For letters of credit, the instrument is replaced with a new one in the reduced amount.

Based on Minnesota Housing mortgage credit review, bond rating agency or marketing requirements, Minnesota Housing may require the borrower to extend the period of the WCE or require a larger WCE.

Cash to fund the WCE shall not be derived from the proceeds of any development budget sources including equity. The WCE is not included in the total development costs.

Rent-Up Escrow

At the time of initial closing of a Minnesota Housing amortizing first mortgage loan, borrowers are required to establish a Rent-Up Escrow (RUE) for new construction projects (and some rehabilitation projects), funded with cash or an irrevocable and unconditional letter of credit in an amount equal to 3% of the loan excluding DCE (i.e., the net loan amount). Minnesota Housing may use the RUE on behalf of the borrower to pay for development expenses during the initial lease-up period; the RUE is held until a predetermined economic occupancy is reached. After the predetermined economic occupancy requirements are achieved, the letter of credit and/or the remaining cash and interest earned thereon are returned to the borrower.

Based on Minnesota Housing mortgage credit committee review, bond rating agency or marketing requirements, Minnesota Housing may require the borrower to extend the period of the RUE or require larger RUE.

Cash to fund the RUE shall not be derived from the proceeds of any development budget sources including equity. The RUE is not included in the total development costs.

Initial Deposit to Replacement Reserve

Minnesota Housing may require an initial deposit to the replacement reserve, depending upon the 20-year capital needs assessment and the level of on-going contributions to replacement reserves.

SOURCES & FINANCIAL STRUCTURING

Appraisal Requirements (A two-stage process)

All appraisals MUST be ordered by Minnesota Housing.

- The cost of appraisals must be borne by the borrower, and funds must be on deposit with Minnesota Housing before any appraisal is ordered.
- The borrower must provide information to Minnesota Housing in order to have others named as users of the appraisal.

Developments Requesting 2013 RFP/2014 HTC

At the time of selection, all developments will require an **Agency Ordered Appraisal** to support the acquisition costs identified at the time of application. The appraised value will be used by Minnesota Housing and its funding partners in sizing funding awards. (Refer to the Acquisition and Acquisition Related Costs section of this guide for additional information on how appraised values will be used).

All costs incurred for the appraisal and any revisions, will be the responsibility of the applicant. Appraisals completed for other lenders **ordered by the applicant will not be accepted.**

DEVELOPMENTS EXEMPT FROM THE APPRAISAL REQUIREMENT AT THE TIME OF SELECTION:

- Acquisition price under \$100,000
- Land only where there is no identity of interest* (MN Housing reserves the right to secure an appraisal at the borrower's expense at a later date in its sole discretion)
- Single family homes (1-4 family) that are aggregated under one loan (MN Housing will use assessed value unless the borrower requests an appraisal for determining "acquisition cost" as defined in the Agency's Underwriting Standards.)
- Property on tribal lands
 - * "Identity of interest" is used broadly to include non-arm's length transactions, related party transactions

Developments Approved Prior to the 2013 RFP/2014 HTC

At the Time of Selection, an As-Is Appraisal is Required

The "as-is" appraisal will be used in establishing "acquisition price" as defined for Minnesota Housing's underwriting and loan sizing. As-is appraisals are required for any property with an acquisition price over \$100,000 (for both deferred loans and amortizing loans).

- **Land Only for New Construction**
Fee simple value of the land. The market value appraisal will consider the real property's zoning as of the effective date of the appraiser's opinion of value. If the real property consists of more than one parcel, the parcels will be combined in one appraisal with one value conclusion.
- **Acquisition/Rehab**
 - Fee simple "as-is" value of the existing multifamily property assuming market rate rents. The appraiser will assign a separate value for both the building and the land; and

- Fee simple, in “as-is” condition, with existing restricted rate rents. The appraiser will assign a separate value for both the building and the land.
- Adaptive Re-Use
Fee simple market value of the property whose use can be adapted for an alternate use. The valuation will assume the highest and best use permitted by law and economically feasible in the current market. The appraiser will assign a separate value for both the building (s) and the land.

Prior to Closing – Amortizing Loans

An as-completed appraisal is required to establish loan to value.

- An “as-completed and stabilized” appraisal is required for all amortizing loans.
- The “as-is” and “as completed and stabilized” appraisals may be combined only if the project has plans and specifications at 75% completion and if the closing will occur within 6 months from the date of the appraisal.
- Two hypothetical values are required:
 - As completed and stabilized, subject to restricted rents
 - As completed and stabilized, assuming market rate rents
 - The lesser of the two values will be used to determine loan to value for Minnesota Housing’s underwriting.
- Minnesota Housing will finance no more than 87% of appraised value (85% for refinance only loans or loans that are refinanced with \$15,000 or less per unit in rehabilitation).
- Plans and specifications must be no less than 75% complete for the appraiser to establish the “as completed” value.
- The appraisal must be conducted no more than 6 months prior to closing (or the borrower will be required to pay for an appraisal update).

Prior to Closing – Deferred (Non-Amortizing) Loans

For non-amortizing loans, Minnesota Housing requires an appraisal prior to closing similar to that required for amortizing loans (above). Borrowers should discuss this requirement with their assigned underwriter and if appropriate, a waiver to use another lender’s appraisal may be sought through Minnesota Housing’s Mortgage Credit Committee. Any waiver of this requirement will be determined in Minnesota Housing’s sole discretion.

Tribal Land

Appraisals are not required for properties located on tribal land.

HUD Risk Share

HUD Risk Sharing insurance is required for all amortizing first mortgage loans.

Minnesota Housing generally insures at Level I, if Minnesota Housing determines that HUD Level II insurance is appropriate, more stringent underwriting requirements may apply.

All amortizing first mortgage loans must meet the debt coverage ratios and other requirements included in these Underwriting Standards.

Calculating Minnesota Housing Deferred Debt on Mixed-Income Developments

Minnesota Housing deferred debt shall only be used for and based upon the financing gap on affordable (rent restricted) units.

Minnesota Housing Eligible Mortgage Costs (Mortgageable Costs)

The first year's mortgage insurance premium may be financed with Minnesota Housing loan proceeds (LMIR or deferred).

Minnesota Housing's required reserves may be funded with loan proceeds. They must be held by Minnesota Housing and used in Minnesota Housing's discretion.

Refinancing

For any refinance, existing guarantors are expected to remain in place. Cash out to a partner or member, and subsequent release of a guarantor, will be subject to a thorough analysis of the development's economics (cash flow and capital improvement requirements) plus the remaining guarantors' creditworthiness.

For amortizing loans being refinanced where rehabilitation is not "substantial" (less than \$15,000 per unit in hard costs) and the ownership is not changing, the new loan must:

- Amortize;
- Meet these Underwriting Standards;
- Have adequate upfront and ongoing reserves budgeted to fund the capital needs identified in a Capital Needs Assessment and approved by a Minnesota Housing architect.

Minimum Tax Credit Equity Pay-In at Closing

For all projects funded by LIHTC equity, the equity investor must pay out at least 20% of the total tax credit equity at the initial or construction loan closing before any of Minnesota Housing's funds will be advanced. (A higher percentage may be required for new syndication entrants to the Minnesota LIHTC market or on small projects where 20% equity is not deemed adequate by Minnesota Housing.)

Equity Bridge Loan Structuring

The following requirements apply to equity bridge loans when Minnesota Housing's amortizing loan (LMIR) and/or Minnesota Housing's deferred loans are used to finance the development.

- If Minnesota Housing's LMIR funding is to be used during the construction period and the equity investor **does not** have a security interest in the property:
 - The Minnesota Housing LMIR loan will be in first position. The bridge lender will be secured with an assignment of the capital contributions from the investor;
 - The borrower will guarantee the principle and interest payments and operating expenses until the development has reached stabilization; and
 - After the initial 20% equity installment, Minnesota Housing LMIR proceeds will be advanced at no greater than equal proportion (pari passu) with the equity or equity bridge funding.

- If Minnesota Housing’s LMIR funding is used during the construction period and the equity investor/bridge lender **does have** a security interest in the property :
 - The Minnesota Housing LMIR loan will be in first position. The equity bridge loan will be in second position. Minnesota Housing’s LMIR funding is always released last after all bridge funding is fully expended, regardless of the cost of other funds;
 - The bridge loan mortgage must contain a “springing release” clause, to allow Minnesota Housing to endorse have HUD the LMIR note in a timely manner.
- If Minnesota Housing or funding partners are providing only deferred loan(s), then a minimum of 20% equity investment OR 30% equity bridge loan proceeds must be paid up front, prior to Minnesota Housing and/ or funding partner deferred loan proceeds being released. (Syndicators new to the Minnesota LIHTC market or smaller developments may require higher than a 20% initial investment.)
- If the project is Minnesota Housing bond financed (with 4% LIHTC) **and** Minnesota Housing provides an equity bridge loan to meet the 50% test:
 - Minnesota Housing’s equity bridge loan cannot exceed 70% of the total anticipated equity pay-in as described in the limited partner agreement;
 - Minnesota Housing will require an assignment of the general partner’s interest in the Limited Partnership;
 - Minnesota Housing will require the equity bridge loan to be fully guaranteed by one or more individuals or corporations approved by Minnesota Housing;
 - Minnesota Housing’s first (equal to the permanent loan amount) and second mortgage (equal to the equity bridge loan amount) must be fully collateralized per Minnesota Housing standards;
- If Minnesota Housing’s amortizing loan (LMIR) is an end loan, then pay-off and release of the bridge loan/construction mortgage is a condition of the Minnesota Housing end loan closing.