

# 2019 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
2. New Construction – Greater MN
3. Rehabilitation – Metro
4. Rehabilitation – Greater MN

To address the issue of developments with larger units having higher costs than developments with smaller units, the scoring process includes cost adjustments related to the size of the units. Specifically, the process classifies developments largely for:

- Singles (primarily efficiencies and 1 bedroom units),
- Large families (primarily 3+ bedroom units), and
- Families/mixed (developments with other bedroom mixes).

The adjustments bring the TDCs for these developments into equivalent terms, and they reflect historical differences. For example, new construction TDCs for family/mixed developments are typically 16% higher than the TDCs for developments for singles. Thus, to make the TDCs for singles equivalent to those for families/mixed, the TDCs per unit for singles are increased by 16% when making cost comparisons.

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 Minnesota Housing 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. 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 0.95 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 new-construction development, it is multiplied by 0.95 to compute the equivalent TDC of \$228,000.

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 =  $(\text{Number of proposals in group})/2$
- If the number of proposals in a group is odd, the number of proposals eligible to get points =  $(\text{Number of proposals in group})/2$   
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: 2019 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	1.16	\$262,000
New Construction Metro for Families/Mixed	1.00	
New Construction Metro for Large Families	0.95	
New Construction Greater MN for Singles	1.16	\$209,000
New Construction Greater MN for Families/Mixed	1.00	
New Construction Greater MN for Large Families	0.95	
Rehabilitation Metro for Singles	1.23	\$210,000
Rehabilitation Metro for Families/Mixed	1.00	
Rehabilitation Metro for Large Families	0.83	
Rehabilitation Greater MN for Singles	1.23	\$166,000
Rehabilitation Greater MN for Families/Mixed	1.00	
Rehabilitation Greater MN for Large Families	0.83	
<p>"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 gross square footage.</p>		

**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 six points in the Self-Scoring Worksheet; however, during the final scoring by Minnesota Housing, 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, Minnesota Housing 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 and result in negative four points being awarded in the applicant’s next round of tax credit submissions.

The “applicable cost thresholds” will be determined by the cost-containment selection process. Within each of the four development/location types, the TDC per unit of the proposal at the 50<sup>th</sup> 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 50<sup>th</sup> percentile proposal for new construction in Greater Minnesota is a family/mixed development with a per unit TDC of \$210,000, 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 four 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 \$210,000 threshold, the threshold for large-family developments will be \$221,053 (\$210,000 divided by 0.95 equals \$221,053).

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 50<sup>th</sup> 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 four points. Because applicants will not know if their project is the one at the 50<sup>th</sup> 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 six cost containment points on the Self-Scoring Worksheet to be eligible; developers for selected projects that receive the points will receive negative four points for their next round of tax credit submissions if they do not keep their actual TDCs within the applicable cost thresholds.

### **Process for Awarding Points for Proposals Seeking 4% Credits**

Minnesota Housing will publish the “applicable cost thresholds” from the Round-1 competition for 2019 9% credits by September 30, 2018. Proposals for 2019 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 six cost containment points on the Self-Scoring Worksheet; developers for selected projects that receive the points will receive negative four points for their

next round of tax credit submissions if they do not keep their actual TDCs within the applicable cost thresholds.

### **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 Minnesota Housing’s predictive cost model. The model is a regression analysis that predicts TDCs per unit using data from developments that Minnesota Housing 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. Minnesota Housing 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.