# Economic Development and Housing Challenge Program

2019
EVALUATION REPORT

Program Evaluation Division

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

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**OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 2019

Members of the Legislative Audit Commission:

Statutes authorize the Minnesota Housing Finance Agency to administer numerous programs to address the need for affordable housing in our state, including the Economic Development and Housing Challenge program.

We found that the Minnesota Housing Finance Agency has generally done a good job of administering the Economic Development and Housing Challenge program, but we also identified opportunities for improvement and review. This report presents our findings and recommendations.

Our evaluation was conducted by Jodi Munson Rodríguez (project manager), Andrew Duncan, and Laura Schwartz. The Minnesota Housing Finance Agency cooperated fully with our evaluation, and we thank them for their assistance.

Sincerely,

| | |
|---|---|
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# Summary

## Key Facts and Findings:

- The Economic Development and Housing Challenge (EDHC) program has a broad statutory purpose to provide grants or loans to "support economic development and redevelopment activities or job creation or job preservation within a community or region by meeting locally identified housing needs." (p. 7)
- EDHC must also be used to "address the housing needs of the local workforce." (p. 7)
- The Minnesota Housing Finance Agency (MHFA) administers the program and has used its statutory authority to broadly interpret some of the EDHC statutes' key terms. (pp. 47-49)
- EDHC is a flexible program that can be used to award funds to several types of organizations for a variety of activities, including new construction or rehabilitation of existing housing. (p. 49)
- Stakeholders told us that the flexibility of the EDHC program is one of its most positive aspects. (p. 49)
- On average, MHFA made 39 EDHC awards per year, totaling about $18 million each year from 2013 through 2017. (p. 13)
- MHFA has developed internal procedures that have promoted consistent application review processes, but some aspects of those processes were not entirely transparent. (pp. 23, 38)
- The application processes for EDHC funding have been time consuming and complex for some applicants. (pp. 18-19, 35)
- Numerous applicants that responded to our survey described ways in which the application processes were complicated or burdensome. (pp. 19, 35)
- At the same time, most survey respondents indicated that MHFA's guidance during the application process was helpful. (pp. 20, 35)
- Based on our review, MHFA has generally followed key legal requirements when awarding EDHC funds, although it has not strictly complied with certain rules. (pp. 26-30, 39-42, 44)

## Key Recommendations:

- The Legislature should review the EDHC program statutes to determine whether the program's broad purpose and flexibility accurately reflect legislative priorities. (p. 49)
- MHFA should increase its efforts to work with stakeholders to streamline its application processes for EDHC funds. (p. 53)
- MHFA should review EDHC rules to determine whether they are clear and contribute to an efficient and effective award process. (p. 55)

**The Minnesota Housing Finance Agency (MHFA) has generally done a good job administering the Economic Development and Housing Challenge (EDHC) program.**

**MHFA has used the flexibility of the EDHC program to award funds to a wide variety of projects.**

## Report Summary

According to the Minnesota Housing Finance Agency (MHFA), about 550,000 Minnesota households are "cost burdened," meaning they pay more than 30 percent of their incomes on rent or house payments. Statutes authorize MHFA to administer programs to address the need for affordable housing in Minnesota, including the Economic Development and Housing Challenge (EDHC) program.[1]

The EDHC program is flexible. It provides funding to various types of entities—including cities, tribal housing corporations, nonprofit organizations, and private developers—to develop affordable rental and owner-occupied housing. It can also be used for a wide variety of activities, such as constructing apartment buildings or rehabilitating existing homes.

The EDHC program is largely funded by appropriations from the General Fund. The Legislature appropriated an average of $10.5 million in base funding to the program each year between fiscal years 2012 and 2019.

**There are several differences between rental and owner-occupied EDHC projects and their respective application processes.**

Some EDHC requirements differ for rental and owner-occupied housing projects. For example, statutes limit the use of EDHC funds to serve households with up to 80 percent of state or area median income (whichever is higher) for rental housing and 115 percent of state or area median income for owner-occupied housing.[2]

The projects themselves differ, too. For example, 83 percent of rental projects from 2013 through 2017 involved new construction, while just 31 percent of owner-occupied housing projects did. The majority of owner-occupied housing projects involved rehabilitation. As another example, all of the EDHC awards that MHFA provided to rental projects from 2013 through 2017 were in the form of deferred loans. On the other hand, only 41 percent of owner-occupied housing projects received loan awards, while 86 percent received grants. (Some projects received both loan and grant awards.)

The application processes for the two types of projects also differ. For example, the rental application process is more competitive than the owner-occupied one. From 2013 through 2017, only 39 percent of rental housing project applications received funding through the consolidated process, while 78 percent of owner-occupied projects received at least partial funding.

**The EDHC program is so broad and flexible that we found it difficult to determine that a project did *not* fit within its purpose.**

By law, the purpose of the EDHC program is to "support economic development and redevelopment activities or job creation or job preservation within a community or region by meeting locally identified housing needs." EDHC funds must also be used to "address the housing needs of the local workforce."[3]

MHFA has broad authority to interpret the program's purpose. Statutes do not define key terms such as "locally identified" or "workforce." In addition, statutes state

[1] *Minnesota Statutes* 2018, 462A.33.

[2] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[3] *Minnesota Statutes* 2018, 462A.33, subds. 1(a) and 3.

that the chapter governing MHFA's activities "shall be liberally construed to effect its purpose" because those activities are "necessary for the welfare of the state of Minnesota and its inhabitants."[4]

We reviewed the files of projects selected for EDHC funding from 2015 through 2017 and determined they all fit within the program's statutory purpose.[5] But, these determinations were not always easy to make. In some cases, MHFA funded projects in which it was unclear whether a housing need was "locally identified," or in which some of the people housed by the projects were not expected to be employed. However, we ultimately determined that the agency was within its broad statutory authority to fund these projects using EDHC funds.

We recommend the Legislature review the EDHC statutes to determine whether its broad purpose continues to reflect legislative priorities. If the Legislature intended for EDHC funds to be used in a more targeted way, it should amend statutory language to clarify the purpose or define key terms.

**MHFA has awarded EDHC funds to rental and owner-occupied housing projects through two well-managed, but complex consolidated application processes.**

MHFA has awarded EDHC funds, along with funds from other sources, through two annual consolidated applications—one for rental and one for owner-occupied housing projects. The agency has implemented several quality-control measures in its award processes. For example, the agency has provided annual training to staff that review applications. In addition, staff have used standardized templates to score applications. Based on our review, the agency also generally used key best practices for awarding funds.

At the same time, the application processes are complex; the rental application is especially so. Both applications require applicants to submit a large amount of information, including narratives and financial documents. Applicants for rental housing funds must also submit information about expected income and operating expenses, among other things. Two separate individuals we interviewed described the rental application process as "arduous." One applicant told us, "The whole thing was super confusing…the complexity of the process puts barriers up…."

We recommend the agency increase collaboration with stakeholders to streamline the application processes. An MHFA official told us the agency's complex requirements allow staff to better compare competing projects, thereby increasing fairness and transparency within the application process. Although we applaud the agency's efforts, they have resulted in significant complexity that may create obstacles for some applicants.

**Most applicants we surveyed indicated that MHFA's guidance on the application processes was helpful, but we identified some aspects of the processes that were not entirely transparent.**

We surveyed all organizations that applied for funds through the 2017 consolidated processes.[6] Most responded that MHFA's application

**Although applicants told us MHFA provided helpful guidance, the application processes were complex and time consuming for some applicants.**

[4] *Minnesota Statutes* 2018, 462A.24.

[5] We reviewed all 18 rental housing projects and a sample of owner-occupied housing projects (29) selected for EDHC funding in those years.

[6] We surveyed all 66 organizations that submitted consolidated applications for funding in 2017 and received 52 responses, for a response rate of 79 percent.

**MHFA complied with most of the requirements that govern the EDHC program, but did not strictly follow certain rules.**

instructions were clear and that the technical assistance the agency provided during the application process was helpful. More than a dozen survey respondents praised agency staff for the support they provided.

At the same time, we found that the agency has not clearly communicated some aspects of the award processes with applicants. For example, MHFA has scored applications using numerous criteria, but has not provided the final scores to applicants for owner-occupied housing project funding. As another example, MHFA uses a complicated process for choosing rental projects to fund with EDHC dollars. Some applicants told us they did not understand certain aspects of the selection processes.

As MHFA streamlines the application processes, it should ensure that application instructions clearly explain how projects are scored and selected for EDHC funding.

**Based on our review, MHFA generally followed key legal requirements when awarding EDHC funds.**

EDHC awards are subject to numerous legal requirements. For example, the agency must finance "approximately" equal numbers of housing units in the Twin Cities metropolitan area and the non-metropolitan area "to the extent practicable."[7] It must also ensure that applicants demonstrate sufficient organizational capacity to complete their proposed projects.

MHFA generally followed these and other key legal requirements we reviewed when selecting both rental and owner-occupied housing projects to receive funding. For example, the agency must give preference to projects that include contributions from nonstate sources. MHFA must also give preference to projects located near jobs, transportation, and services, among several other preferences.[8] Based on our review of MHFA's award processes, the agency considered these preferences as required when evaluating proposals in its 2017 award processes.

However, we also found that MHFA did not strictly follow some rules. For example, rules state that owner-occupied housing projects eligible for EDHC must be able to be completed within 20 months of signing a contract for loan or grant funds.[9] We found that MHFA extended 70 percent of its contracts for owner-occupied housing funding beyond 20 months for projects selected from 2013 through 2015.

As another example, projects funded with EDHC dollars must have rent or house payments that are "affordable to the local workforce."[10] Rules define this as no more than "30 percent of the wages being paid in the local area as the wages are described in the application" by the applicant.[11] But, MHFA did not require all applicants to submit the specific wage data required by rules in their 2017 applications.

We recommend that MHFA reexamine some of the requirements in its rules to determine whether these rules contribute to an effective, efficient award process.

[7] *Minnesota Statutes* 2018, 462A.33, subd. 2.

[8] *Minnesota Statutes* 2018, 462A.33, subds. 1(b) and 3.

[9] *Minnesota Rules*, 4900.3646, subp. 1D, published electronically June 11, 2008.

[10] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[11] *Minnesota Rules*, 4900.3610, subp. 2, published electronically June 11, 2008.

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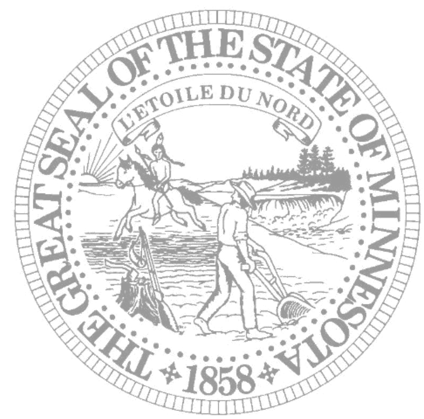
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# List of Exhibits

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# Introduction

Access to affordable housing is an important issue for Minnesota. Many households across the state are burdened by unaffordable rent or house payments. In addition, an estimated 7,600 Minnesotans experience homelessness on any given night.[1] A lack of affordable housing can affect many aspects of people's lives, such as their health, access to education, and ability to work. A lack of housing within a community can also affect the ability of local employers to recruit and retain employees, which may hinder local economic development.

The Legislature created the Economic Development and Housing Challenge (EDHC) program to provide grants and loans to develop affordable housing that addresses the needs of local workforces. Unlike many of the evaluations that we conduct, the Legislative Audit Commission did not select this evaluation topic in response to concerns from lawmakers or members of the public about the specific program. Rather, the commission selected it in response to broader concerns about shortages of affordable housing across the state, and in response to our legislative mandate to evaluate an economic development incentive program each year.[2]

Although the EDHC program meets the criteria outlined in our legislative mandate, it is not a traditional economic development incentive program, and we were unable to evaluate it as such. For example, we did not attempt to determine its effect on employment or wages. Instead, we focused on the extent to which the agency has complied with laws and best practices when awarding program funds. We conducted only a limited review of the processes the agency used to monitor the projects once they were completed. Our primary research questions were:

- **To what extent did the Economic Development and Housing Challenge program meet its purpose?**

- **How well did the Minnesota Housing Finance Agency (MHFA) administer the program?**

To answer these questions, we used a range of research techniques. We reviewed relevant state laws and rules, as well as agency policies, procedures, plans, and reports. We analyzed program data from 2013 through 2017 related to program applications, projects that received awards, and the households served by those projects. We examined files—including application materials; agency scoring and evaluation documentation; and contracts, where applicable—for a sample of projects selected for EDHC awards in calendar years 2015, 2016, and 2017. In addition, we compared the agency's processes for awarding program funds with applicable best practices.

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[1] Minnesota Interagency Council on Homelessness, *Heading Home Together, Minnesota's 2018-2020 Action Plan to Prevent and End Homelessness* (St. Paul, 2018), 8. This is considered a minimum estimate based on a count conducted on a single night in the year.

[2] *Minnesota Statutes* 2018, 3.9735, subd. 2.

We also asked stakeholders for feedback about the program. At the beginning of the evaluation, we solicited input from members of the public through an open forum. Later, we surveyed all 2017 program applicants. In addition, we conducted four site visits, during which we visited housing projects and interviewed developers, property managers, and city officials.[3] Finally, we interviewed staff from the U.S. Department of Housing and Urban Development and several of MHFA's partners, including the Metropolitan Council, the Greater Minnesota Housing Fund, and the Minnesota Housing Partnership.

[3] We provide information about the projects we visited in chapters 2 and 3.

# Chapter 1: Overview

According to the latest estimates from the Minnesota Housing Finance Agency (MHFA), about 550,000 households across the state are "cost burdened," meaning they pay more than 30 percent of their incomes on rent or house payments.[1] The state's housing policy, which is codified in statutes, asserts that a shortage of affordable housing for low- and moderate-income families is harmful to the growth and development of the state's communities and to the welfare of its residents.[2] Statutes authorize MHFA to administer numerous programs to address this shortage.[3] This evaluation focuses on one of those programs—the Economic Development and Housing Challenge (EDHC) program.[4]

The EDHC program provides funding to organizations to develop affordable rental and owner-occupied housing.[5] The program is flexible. It can be used for a wide variety of activities, such as constructing large apartment buildings or rehabilitating existing houses.

This chapter provides background information about MHFA and the EDHC program. In the first half, we offer a brief overview of the agency and describe how the EDHC program fits into it. Because many of MHFA's programs are integrated with one another, and because EDHC is so flexible, the program touches many parts of the agency. In the second half of the chapter, we provide an overview of the EDHC program itself. We outline its key requirements and explore how they differ among rental and owner-occupied housing projects.

**Rental vs. Owner-Occupied Projects**

In the EDHC program, rental housing projects must involve housing with a minimum of four units used to accommodate persons or families on a rental basis. They cannot involve hotels or other establishments used on a transient basis.

Owner-occupied projects must involve housing that is the principal place of residence for the owner and the owner's household.

**— *Minnesota Rules*, 4900.3610, subps. 16 and 19**

# Agency Overview

## Governance and Finances

MHFA is a state agency with an atypical organizational structure and complex finances.

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[1] Minnesota Housing Finance Agency, *Affordable Housing Plan: October 2018-September 2019* (St. Paul, 2018), 2.

[2] *Minnesota Statutes* 2018, 462A.02, subd. 2.

[3] *Minnesota Statutes* 2018, Chapter 462A.

[4] *Minnesota Statutes* 2018, 462A.33.

[5] MHFA refers to these two types of housing as "multifamily" and "single family" housing, rather than rental and owner-occupied housing. We chose to use the terms stated in *Minnesota Rules*, 4900.3600 to 4900.3652, published electronically June 11, 2008. See the Glossary of Terms for definitions of these and other terms.

## The Minnesota Housing Finance Agency has significant independence compared to other agencies within the executive branch.

MHFA is considered a "component unit" of the state, which means that it is a legally separate organization for which the state is accountable.[6] Unlike most agencies, statutes provide MHFA with "sovereign powers" to carry out state policies.[7] Among those powers is the authority to issue bonds in the agency's own name. Because of this authority, MHFA has its own credit ratings. The management and control of MHFA is vested solely in the agency's board of directors.[8] The board comprises the state auditor and six members of the public who are appointed by the governor with the advice and consent of the Senate.[9] The board sets the strategic direction for the agency, issues bonds, and approves individual grant and loan awards, among other things.

Like most cabinet-level agencies, MHFA is under the administrative control of a commissioner.[10] The governor appoints the commissioner with the consent of the Senate.[11] Statutes authorize the commissioner to organize the structure of the agency, establish management procedures, appoint staff, and delegate duties to those staff.[12] At the end of Fiscal Year 2018, MHFA employed 243 full-time staff and 5 part-time staff. Those staff were organized into two core divisions—one for rental programs and one for owner-occupied programs—along with six support divisions.[13]

MHFA's financial resources come from a variety of sources. Like many agencies, it receives state appropriations, federal funds, and general obligation bond proceeds. The Legislature has also raised funds for MHFA through the sale of special bonds, called Housing Infrastructure Bonds.[14] In addition, the agency raises its own revenues from the bonds that it issues in its own name, fees and interest from the loans that it issues, and other investments. The funds MHFA receives through appropriations and bonding are subject to uses specified in law or in bond resolutions of the board; the agency has more discretion over how to use the other funds it raises.

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[6] The finances of MHFA and other component units are presented separately from the rest of the state and are not typically audited by the Office of the Legislative Auditor's Financial Audit Division. An independent firm audits the agency's finances annually.

[7] *Minnesota Statutes* 2018, 462A.04, subd. 1.

[8] *Minnesota Statutes* 2018, 462A.04, subd. 6.

[9] *Minnesota Statutes* 2018, 462A.04, subd. 1.

[10] *Minnesota Statutes* 2018, 462A.04, subd. 8(a).

[11] *Minnesota Statutes* 2018, 462A.04, subd. 8(a); and 15.06, subd. 2.

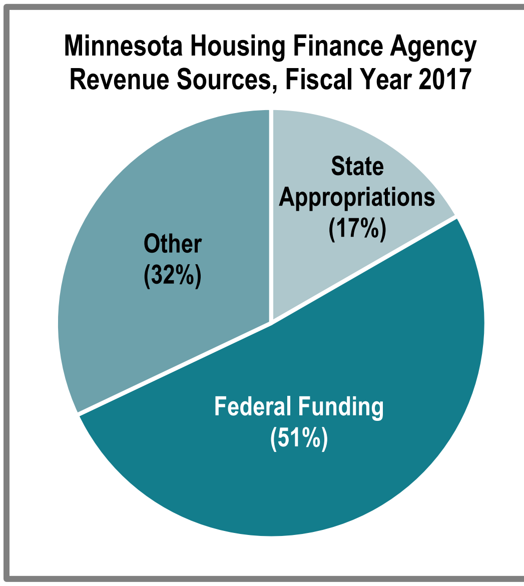
[12] *Minnesota Statutes* 2018, 15.06, subd. 6.

[13] MHFA refers to its rental housing division as the "Multifamily Division" and refers to its owner-occupied housing division as the "Single Family Division."

[14] *Minnesota Statutes* 2018, 462A.37.

**A relatively small portion of the Minnesota Housing Finance Agency's revenues come from state appropriations.**

According to its Fiscal Year 2017 financial report, MHFA's revenues totaled $372.6 million that year.[15] Only 17 percent ($62.2 million) of those revenues came from state appropriations. Another 51 percent ($191 million) came from federal funding. The remaining 32 percent ($119.4 million) came from interest and fees earned on agency-generated loans and investments and other income.




## Activities

Statutes authorize MHFA to administer numerous programs to address the state's shortage of affordable housing.[16]

**The Minnesota Housing Finance Agency administers many programs that are similar to products offered by traditional financial institutions, although they serve a public purpose.**

Statutes authorize MHFA to provide mortgages, short- and long-term loans, and refinancing to organizations that build or rehabilitate housing.[17] Traditional financial institutions, such as banks, also offer these products. MHFA, however, has the ability to lend money at interest rates below market rate or with no interest at all. The agency also provides grants. In exchange for these low- or no-cost financial products, MHFA's grant and loan recipients may be required to limit the prices of the housing units that they develop. They also typically must serve households with low or moderate incomes and—for rental housing—maintain minimum housing quality standards for a period of time. MHFA monitors whether funding recipients comply with these requirements.

In addition to these traditional financial products, statutes authorize MHFA to provide assistance directly to homeowners and renters. For example, the agency provides rental subsidies to certain populations, such as persons with mental illness. It also offers down payment assistance to qualified first-time homebuyers. On top of these state-authorized programs, MHFA administers several federal programs. For example, the agency processes monthly federal rental payments, commonly known as "Section 8," for property owners who rent units to low-income tenants.

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[15] Minnesota Housing Finance Agency, *Annual Financial Report: State Fiscal Year 2017* (St. Paul, 2017), 26-27.

[16] *Minnesota Statutes* 2018, Chapter 462A.

[17] A "mortgage" typically refers to an amortizing loan with interest in which the principal and interest are repaid on a payment schedule throughout the loan term. Mortgages and other amortizing loans differ from deferred loans, in which the principal and any interest are typically repaid in full at the end of the loan term. See the Glossary of Terms for definitions of these and other terms. *Minnesota Statutes* 2018, Chapter 462A.05.

## The Minnesota Housing Finance Agency awards many of its grant and loan funds through consolidated applications.

Each year, MHFA publishes a statewide "affordable housing plan."[18] The plan outlines the magnitude of the state's affordable housing shortage and the agency's plans to address it. MHFA has integrated a number of its programs and financial resources to support the key priorities and strategies in its affordable housing plans.

The clearest evidence of this integration is in the consolidation of the applications for several of MHFA's grant and loan programs. These programs use one of two consolidated application processes—one for rental housing programs and one for owner-occupied housing programs.[19] The agency uses the consolidated applications to award funding not only from MHFA's programs, but also from certain MHFA-administered federal programs and from other government and nonprofit funding partners.[20] MHFA commonly awards these funds through award "packages."[21] Because MHFA distributes EDHC funding through its consolidated applications, this evaluation also provided insight into some of the agency's other programs and its broader strategies and practices.

Agency officials that we spoke with described several benefits of using consolidated application processes. First, they told us that the consolidation creates efficiencies for applicants who have to apply only once, rather than numerous times, if they want to seek multiple types or sources of funding. Second, they said the consolidation allows MHFA and its funding partners to maximize their pooled resources. They said, typically, no single source of funding can cover the entire development costs of a new apartment building, for example. By pooling available resources, the agency can support a larger number of qualified projects.

Consolidated funding application processes like MHFA's are considered a national best practice for agencies that allocate tax credits from the federal Low-Income Housing Tax Credit program.[22] Under that program, MHFA allocates a federally limited number of tax credits to housing developers each year.[23] The developers that receive the credits sell them to investors to raise capital for their developments.[24]

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[18] For the agency's most recent plan at the time of this evaluation, see Minnesota Housing Finance Agency, *Affordable Housing Plan: October 2018-September 2019* (St. Paul, 2018).

[19] MHFA refers to these application processes as the Multifamily Consolidated Request for Proposals and the Single Family Request for Proposals.

[20] In 2017, the consolidated *rental* housing application included tax credits from the federal Low-Income Housing Tax Credit program, as well as funding from the Greater Minnesota Housing Fund, the Metropolitan Council, and the Minnesota Department of Employment and Economic Development. That year, the consolidated *owner-occupied* housing application included funding from the Greater Minnesota Housing Fund and the Metropolitan Council.

[21] We use the term "award package" to refer to all of the funding that an awardee received through either MHFA's consolidated rental or owner-occupied application.

[22] National Council of State Housing Agencies, *NCSHA Recommended Practices in Housing Credit Administration* (Washington, DC, 2017), 9-10. NCSHA represents the state housing agencies that administer the federal Low-Income Housing Tax Credit program.

[23] Certain cities and counties allocate some tax credits from the Low-Income Housing Tax Credit program on behalf of MHFA, as allowed by *Minnesota Statutes* 2018, 462A.222, subd. 1.

[24] In exchange for their investment capital, investors receive ownership shares in the developments. Investors also use the tax credits to reduce their tax burdens for a period of time.

Appendix A lists the programs that offered funding through MHFA's consolidated applications in 2017. We discuss the merits and challenges with MHFA's consolidated applications in subsequent chapters.

# Program Overview

We focused this evaluation on the EDHC program. In the rest of this chapter, we provide an overview of the program.

## History and Purpose

The Legislature established the EDHC program in 1999.[25] Over the past 20 years, it has undergone only a few substantial statutory changes, including changes to eligible recipients and activities.[26] An MHFA official told us that the Legislature created the program to address the shortage of housing available for the state's workforce.

**The purpose of the Economic Development and Housing Challenge program is broad.**

> **EDHC Statutory Purpose**
>
> "…to support economic development and redevelopment activities or job creation or job preservation within a community or region by meeting locally identified housing needs."
>
> **— *Minnesota Statutes* 2018, 462A.33, subd. 1(a)**

The EDHC program's enabling statutes state that it must provide grants or loans to "support economic development and redevelopment activities or job creation or job preservation within a community or region by meeting locally identified housing needs."[27] Statutes also specify that grants or loans must be used for housing projects that "address the housing needs of the local workforce."[28]

This broad statutory language leaves the program's purpose open to interpretation. Statutes do not define key terms such as "workforce" or "locally identified housing needs." They also state that the chapter governing MHFA activities "shall be liberally construed to effect its purpose" because those activities are "necessary for the welfare of the state of Minnesota and its inhabitants."[29] As a result, the program operates under a wide set of parameters.

[25] *Laws of Minnesota* 1999, chapter 223, art. 2, sec. 56, codified as *Minnesota Statutes* 2018, 462A.33.

[26] In 2001, the Legislature modified the types of activities that could be financed with program funds, the income eligibility limit for rental households, and the characteristics of projects that must receive preference in the funding process, among other things. In 2005, the Legislature modified the types of entities that could receive program funds. In 2007, the Legislature modified requirements about funding projects with contributions from nonstate sources. In addition, in 2008, the Legislature authorized the program to distribute special disaster relief funding to homeowners and rental property owners to address housing damaged by disasters. The Legislature allowed MHFA to waive certain program requirements when distributing disaster relief funding. This report does not evaluate the program's use of disaster relief funds. *Laws of Minnesota* 2001, First Special Session, chapter 4, art. 4, sec. 34, and art. 5, secs. 5-9; *Laws of Minnesota* 2005, First Special Session, chapter 1, art. 4, sec. 104; *Laws of Minnesota* 2007, chapter 135, art. 8, sec. 7, codified as *Minnesota Statutes* 2018, 2462A.33; and *Laws of Minnesota* 2008, chapter 247, sec. 9, codified as *Minnesota Statutes* 2018, 12A.09.

[27] As we define in the Glossary of Terms, "redevelopment" typically refers to constructing or rehabilitating sites with preexisting uses. *Minnesota Statutes* 2018, 462A.33, subd. 1(a).

[28] *Minnesota Statutes* 2018, 462A.33, subd. 3.

[29] *Minnesota Statutes* 2018, 462A.24.

Both agency officials and stakeholders told us the program fills a critical need for flexible financing. We discuss the broad nature of the program's purposes in more detail in Chapter 4.

# Requirements

Much of this report evaluates the extent to which MHFA has complied with legal requirements when administering the EDHC program.

**The Economic Development and Housing Challenge program is subject to numerous legal requirements.**

The EDHC program is subject not only to requirements set forth in the program's enabling statutes, but also to rules promulgated by MHFA.[30] Exhibit 1.1 outlines the program's key requirements. In this section, we compare how those requirements differ for rental and owner-occupied housing projects.

Some EDHC program requirements differ across rental and owner-occupied projects. For example, the program's statutes limit the incomes of the households that can benefit from EDHC-funded projects differently for rental and owner-occupied projects, as Exhibit 1.1 shows.[31] Alternatively, statutes allow the same types of entities, including nonprofit organizations, cities, and tribal housing corporations, to receive EDHC funds to develop both rental and owner-occupied housing.[32]

Similarly, statutes allow both rental and owner-occupied housing awardees to use program funds for the same types of activities.[33] For example, among other things, awardees may use program funds to construct new housing, rehabilitate existing housing, refinance existing housing loans, or cover financing gaps (which we discuss below). In practice, though, EDHC rental and owner-occupied housing projects involve somewhat different activities. Over the past five years, most EDHC-funded rental projects involved the construction of new buildings. Only a small number involved other activities, such as refinancing.[34]

Owner-occupied projects, on the other hand, received funding to perform a wider range of activities over the past five years. Nearly equal shares (around 30 percent each) involved (1) new construction; (2) rehabilitation of homes that were already occupied by their owners; or (3) the acquisition, rehabilitation, and resale of existing houses. The remainder (15 percent) involved neither new construction nor rehabilitation; rather, they provided

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[30] *Minnesota Statutes* 2018, 462A.33; and *Minnesota Rules*, 4900.3600 to 4900.3652, published electronically June 11, 2008.

[31] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[32] *Minnesota Statutes* 2018, 462A.33, subd. 2.

[33] *Minnesota Statutes* 2018, 462A.33, subd. 1(a).

[34] Refinancing with MHFA allows rental property owners to reduce their operating costs or extend the terms of their deferred loans. In exchange, it allows MHFA to impose or lengthen rent and income limits and quality standards for an extended period.

## Exhibit 1.1: Some program requirements are different for rental housing projects and owner-occupied housing projects, while others are the same.

| Program Requirements | Rental Projects | Owner-Occupied Projects |
|---|---|---|
| Definitions | Housing with a minimum of four units that is used to accommodate persons or families on a rental basis, not hotels or other establishments where units are used on a transient basis | Housing with no more than four housing units that is the principal place of residence for the owner and the owner's household |
| Eligible Households | Up to 80 percent of state or area median income (whichever is greater) at the time of initial occupancy | Up to 115 percent of state or area median income (whichever is greater) at the time of initial occupancy |
| Funding Mechanisms | 30-year deferred loan with low or no interest[a] | Grant; 20-month interim deferred loan with up to 2 percent interest; 30-year permanent deferred loan with no interest[b] |
| Eligible Funding Recipients | City, federally recognized American Indian tribe or subdivision located in Minnesota, tribal housing corporation, private developer, nonprofit organization, or owner of the housing, including an individual | |
| Eligible Activities | Construction, acquisition, rehabilitation, demolition or removal of existing structures, construction financing, permanent financing, interest rate reduction, refinancing, affordability gap financing, and value gap financing[c] | |
| Geographic Distribution | To the extent practicable, funding awards must be made so an approximately equal number of housing units are financed in the metropolitan and nonmetropolitan areas | |
| Match Funding | 50 percent of Economic Development and Housing Challenge (EDHC) program appropriations must be used for projects with financial or in-kind contributions from nonstate resources | |
| Economic Viability | Projects must be economically viable | |
| Affordability to Local Workforce | Rent or housing payments for the housing developed by the projects must not exceed 30 percent of the wages being paid in the local area, as described by an applicant in their application materials | |
| Organizational Capacity | Applicants must demonstrate sufficient organizational capacity to complete the project; this includes having related housing experience, having successfully completed similar projects, or partnering with experienced organizations | |
| Project Feasibility | Applicants must demonstrate overall project feasibility (the proposed site is appropriate for proposed housing, the proposed housing is needed in the market, costs of developing the housing are reasonable) | |

NOTE: This exhibit shows many of the program's legal requirements, but not all.

[a] Rules allow the Minnesota Housing Finance Agency (MHFA) to provide rental awards as grants if the project is receiving funding from another source that requires the award to be provided as a grant and the other source's award is larger than the award provided by MHFA. Rules also allow MHFA to impose interest rates on rental awards if the project needs a higher interest rate to use the funding with other sources. In addition, they allow MHFA to adjust the length of the loan term under certain circumstances. *Minnesota Rules*, 4900.3632, subps. 1-3, published electronically June 11, 2008.

[b] Rules allow MHFA to adjust the length of the interim loan term as well as the interest rates. *Minnesota Rules*, 4900.3634, subp. 2A, published electronically June 11, 2008.

[c] See the Glossary of Terms for definitions of certain terms.

SOURCES: *Minnesota Statutes* 2018, 462A.33; and *Minnesota Rules*, 4900.3610, 4900.3632, 4900.3634, and 4900.3648, published electronically June 11, 2008.

funding only to cover "affordability gaps." Affordability gaps occur when the price of a property exceeds the borrowing limit of an eligible buyer.[35]

Statutes specifically allow awardees to use EDHC funds to cover affordability gaps; they also allow them to cover value gaps.[36] Value gaps occur when the total cost to build or rehabilitate a house exceeds its market value. Some projects used EDHC funds to address both affordability and value gaps, while some addressed neither. Over the past five years, 36 percent of all owner-occupied housing projects received funding to address affordability gaps, while 56 percent received funding to cover value gaps.[37]

## Funding Mechanisms

EDHC program rules dictate the types of funding that projects can receive for different types of activities or under specific circumstances. Rental projects, for example, generally must receive funding in the form of a 30-year, no-interest deferred loan.[38] However, under special circumstances, rules allow MHFA to provide funds as grants, impose interest rates on loans, or vary the length of loan terms.[39] From 2013 through 2017, MHFA awarded no grants to its rental projects and attached interest rates to only 15 percent of its loans.

Rules allow owner-occupied housing projects, on the other hand, to receive funding via (1) grants, (2) 20-month deferred interim loans with up to 2 percent interest, or (3) 30-year deferred permanent loans with no interest.[40] Rules allow MHFA to award funding as grants only to cover value gaps, or in some other special circumstances.[41] Rules allow MHFA to award funding as interest-bearing (2 percent) loans to acquire, rehabilitate, demolish, or construct housing; they allow the agency to award funding as no-interest loans to bridge funding gaps not covered by first mortgages or other sources.[42] MHFA frequently provides both EDHC grants and loans together in owner-occupied housing project award packages. From 2013 through 2017, MHFA provided grants to 86 percent of the projects it funded and loans to 41 percent.

Rental and owner-occupied EDHC awardees repay their EDHC loan debts differently. Rental property owners may pay their debts in full at the end of 30-year loan terms using

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[35] Under program statutes, eligible borrowers may not have incomes above 115 percent of state or area median income, whichever is greater. *Minnesota Statutes* 2018, 462A.33, subd. 5.

[36] *Minnesota Statutes* 2018, 462A.33, subd. 1(a).

[37] Applicants can receive funding for more than one activity. For example, some owner-occupied housing projects that involved new construction or rehabilitation also addressed affordability gaps.

[38] *Minnesota Rules*, 4900.3632, subps. 1 and 2, published electronically June 11, 2008.

[39] Rules allow MHFA to provide rental awards as grants if the project is receiving funding from another source that requires the award to be provided as a grant and the other source's award is larger than the award provided by MHFA. Rules allow MHFA to impose interest rates on rental awards if the project needs a higher interest rate in order to use the funding with other sources. *Minnesota Rules*, 4900.3632, subps. 1-3, published electronically June 11, 2008.

[40] An interim loan is a short-term loan used to finance a project for a short period of time, such as while a borrower waits for permanent, long-term financing or during a construction period. Rules allow MHFA to adjust the length of the interim loan term. *Minnesota Rules*, 4900.3634, subps. 2-3, published electronically June 11, 2008.

[41] *Minnesota Rules*, 4900.3634, subp. 3, published electronically June 11, 2008.

[42] A first mortgage is the primary loan that pays for the property and that has priority over all other claims on the property. It is typically structured as an amortizing loan with interest. *Minnesota Rules*, 4900.3634, subp. 2, published electronically June 11, 2008.

reserves set aside over time or by selling their properties prior to the end of the loan term. Alternatively, they may refinance their debts with MHFA, extending their repayment periods and thereby extending their properties' affordability requirements. Owner-occupied housing awardees, on the other hand, use awarded funds to make loans to homebuyers or homeowners who are responsible for repaying the deferred loans to MHFA.

### Project Preferences

In addition to the program requirements discussed earlier, statutes and rules list numerous "preferences" that MHFA must consider when awarding EDHC funds.[43] For example, statutes require MHFA to give preference to projects that are accessible to transportation systems and that include contributions from nonstate resources. Exhibit 1.2 outlines these preferences. Statutes do not indicate how MHFA should prioritize these individual preferences. In the following chapters, we discuss in greater detail how MHFA carries out this task.

## Other Differences

In addition to legal requirements, other aspects of EDHC-funded rental and owner-occupied housing projects differ.

**Program funds accounted for only a small portion of the funding the agency awarded through the consolidated rental housing application process, but they composed the majority of funding the agency awarded through the owner-occupied process in recent years.**

Through the consolidated application processes, both rental and owner-occupied housing projects may receive funding other than from the EDHC program. For example, rental projects may receive tax credits from the federal Low-Income Housing Tax Credit program or mortgages from MHFA. We estimated that EDHC loans accounted for only 5 percent ($53.5 million) of the roughly $1.05 billion that MHFA awarded rental projects through the consolidated application from 2013 through 2017.[44] During the same period, however, EDHC funding composed more than 80 percent ($37.4 million) of the $46.3 million that MHFA awarded through the consolidated owner-occupied funding application process.[45]

[43] *Minnesota Statutes* 2018, 462A.33, subds. 1(b), 3, and 5; and *Minnesota Rules*, 4900.3650, published electronically June 11, 2008.

[44] Many rental projects received Low-Income Housing Tax Credits as part of their consolidated award packages. The $1.05 billion cited here includes the value of the tax credits after being purchased by investors. This figure does not include the funds awarded by MHFA's partners through the consolidated application process from 2013 through 2017.

[45] This figure does not include the funds awarded by MHFA's partners through the consolidated application process from 2013 through 2017.

## Exhibit 1.2: Statutes and rules require the agency to consider numerous preferences when awarding program funds.

| According to *statutes*, MHFA must give preference to comparable proposals that: | According to *rules*, MHFA must select proposals that best meet the greatest number of preferences. Preference must be given to projects that: |
|---|---|
| • Include regulatory changes or waivers that result in cost avoidance or reduction.<br>• Are accessible to transportation systems, jobs, schools, and other services.<br>• Include contributions from nonstate resources for the greatest portion of total development costs.<br>• Include contributions from local units of government, philanthropic, religious, or charitable organizations.<br>• Provide housing opportunities for an expanded range of household incomes within a community or provide housing opportunities for a wide range of incomes within a development. | • Include cost avoidance or cost reductions from regulatory changes, incentives, or waivers.<br>• Are located near jobs, transportation, recreation, retail, schools, and other services.<br>• Include financial contributions from local governments, area employers, or organizations that decrease the need for state funding.<br>• Include private investment.<br>• Provide or maintain housing for a wide range of incomes within a community or proposed housing development.<br>• Address housing needs of households of color, single female heads of households with minor children, and disabled individuals.<br>• Clearly identify goals related to the housing element of a cooperatively developed plan.<br>• Are part of the infrastructure necessary to sustain economic vitality.<br>• Maximize adaptive reuse of existing buildings; for new housing, demonstrate efficient use of land and infrastructure and minimize loss of green space.<br>• Project long-term affordability.<br>• Demonstrate the cost per unit is held as low as possible while not compromising the quality or sustainability of the proposed housing.<br>• Demonstrate the site and design is suitable for the needs of proposed tenants or homebuyers.<br>• Demonstrate ability to complete housing in a timely fashion and maintain it after completion.<br>• Address temporary priorities reflecting unexpected changes in the demand for short-term housing. |

SOURCES: *Minnesota Statutes* 2018, 462A.33; and *Minnesota Rules*, 4900.3610, subp. 21; and 4900.3650, published electronically June 11, 2008.

**The agency has provided much larger Economic Development and Housing Challenge program awards to rental projects than owner-occupied projects, but it has funded far fewer rental projects each year.**

From 2013 through 2017, EDHC rental project awards were more than six times larger on average (at $1.5 million) than owner-occupied project awards ($237,000), as the table below shows.[46] However, MHFA funded a much larger number of owner-occupied housing projects each year. Over the five-year period, MHFA provided EDHC funds to an average of only 7 rental housing projects each year, while funding an average of 32 owner-occupied housing projects annually. Over the five-year period, rental housing projects received in total an average of $10.7 million in EDHC funding annually, while owner-occupied housing projects received an average of $7.5 million.

**Average EDHC Awards per Year, 2013-2017**

| | Rental | Owner-Occupied |
|---|---|---|
| Number of projects funded | 7 projects | 32 projects |
| Individual award size | $1.5 million | $237,000 |
| Total awarded per year | $10.7 million | $7.5 million |
| Award size per unit | $41,600 | $30,900 |

The differences in award sizes and numbers between rental and owner-occupied housing projects reflected the differences between these projects themselves. For example, as we noted previously, in recent years most rental housing projects involved new construction while owner-occupied projects involved a greater variety of activities, including rehabilitating existing homes and providing affordability gap financing to home buyers. In addition, from 2013 through 2017, each rental project that received EDHC involved an average of 44 units, while each owner-occupied project that received EDHC involved an average of 12 units.

## Appropriations and Expenditures

The EDHC program is largely funded through legislative appropriations from the state's General Fund. However, MHFA uses agency-generated resources to pay for the EDHC program's administration. At times, MHFA has used EDHC rules, policies, and procedures as a means to distribute some of its other resources, including Housing Infrastructure Bond proceeds. In this report, we evaluated only projects that received loans or grants funded through legislative appropriations to the EDHC program.

**From fiscal years 2012 through 2019, the Legislature appropriated an average of $10.5 million annually in base funding to the program.**

In recent years, the EDHC program's base funding has grown by 86 percent, from $7 million in Fiscal Year 2012 to $12.9 million in Fiscal Year 2019.[47] In each of those

[46] These averages represent the total amount of EDHC funds awarded per award package. Some award packages contained multiple EDHC loans and grants.

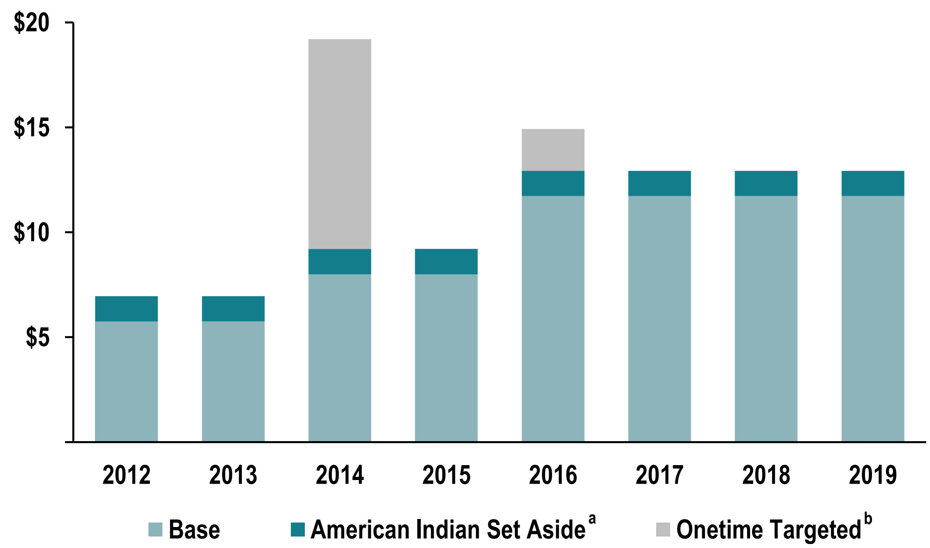
[47] These figures are not adjusted for inflation. In this context, "base" funding refers to all program appropriations except for onetime funding. The governor's office uses the base appropriations when developing the EDHC program budget for the next biennium. *Laws of Minnesota* 2011, First Special Session, chapter 4, art. 1, sec. 4, subd. 2; *Laws of Minnesota* 2013, chapter 85, art. 1, sec. 4, subd. 2; *Laws of Minnesota* 2015, First Special Session, chapter 1, art. 1, sec. 3, subd. 2; and *Laws of Minnesota* 2017, chapter 94, art. 1, sec. 3, subd. 2.

years, the Legislature set aside $1.2 million from the base funding for housing projects for American Indians.[48]

In addition to the program's base appropriations, the Legislature has appropriated some onetime funding to the program for "targeted" purposes. In fiscal years 2014 and 2016, the Legislature appropriated $10 million and $2 million, respectively, for projects in communities or regions with (1) low housing vacancy rates, (2) a local plan that identified housing needs, (3) actual or potential job growth, or (4) long commutes.[49] Exhibit 1.3 shows the program's base and onetime appropriations for fiscal years 2012 through 2019.

## Exhibit 1.3: The Economic Development and Housing Challenge program's base appropriations grew from about $7 million to $13 million from fiscal years 2012 through 2019.

**(In millions)**




NOTES: This exhibit presents appropriations from the General Fund to the Economic Development and Housing Challenge program by fiscal year. Appropriations are not adjusted for inflation. This exhibit does not include special disaster relief funds that the Legislature appropriated to the program.

[a] The American Indian set aside funding is part of the program's base appropriations.

[b] For fiscal years 2014 and 2016, the Legislature made onetime appropriations of $10 million and $2 million, respectively, for "targeted" purposes—for projects in communities or regions with (1) low housing vacancy rates, (2) a local plan that identified housing needs, (3) actual or potential job growth, or (4) long commutes.

SOURCES: *Laws of Minnesota* 2011, First Special Session, chapter 4, art. 1, sec. 4, subd. 2; *Laws of Minnesota* 2013, chapter 85, art. 1, sec. 4, subd. 2; *Laws of Minnesota* 2015, First Special Session, chapter 1, art. 1, sec. 3, subd. 2; and *Laws of Minnesota* 2017, chapter 94, art. 1, sec. 3, subd. 2.

[48] At the end of the year, MHFA may use any funds that were not committed to projects for American Indians for any other eligible program activity.

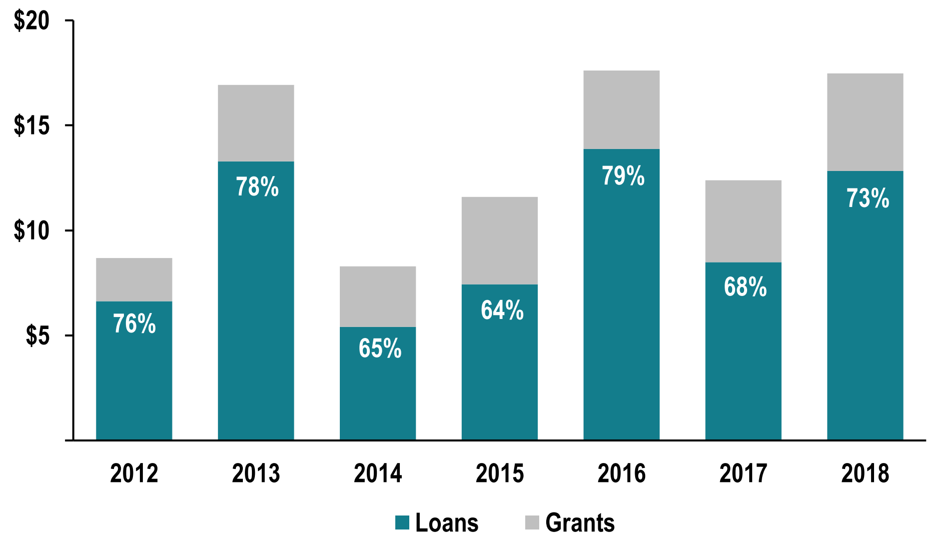
[49] *Laws of Minnesota* 2013, chapter 85, art. 1, sec. 4, subd. 2; and *Laws of Minnesota* 2015, First Special Session, chapter 1, art. 1, sec. 3, subd. 2.

**Loans composed nearly three-quarters of the program's expenditures each year from fiscal years 2012 through 2018.**

From fiscal years 2012 through 2018, 73 percent of EDHC program expenditures were loan awards, while 27 percent were grant awards. MHFA has used other agency resources to cover the program's administrative costs, as noted earlier. Exhibit 1.4 shows the program's grant and loan expenditures from fiscal years 2012 through 2018. During that period, expenditures from the program's base and onetime appropriations averaged $13.3 million per year.

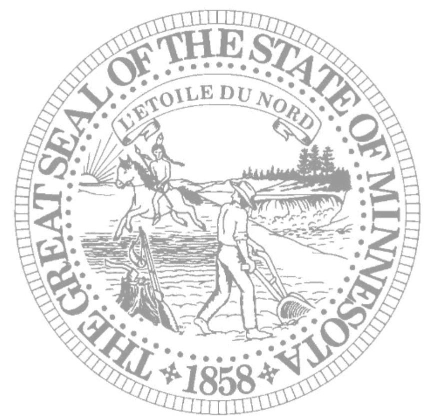
## Exhibit 1.4: Loans composed the majority of program expenditures from fiscal years 2012 through 2018.

**(In millions)**




NOTES: This exhibit shows Economic Development and Housing Challenge program expenditures from the program's General Fund appropriations by fiscal year. It does not show a small portion of expenditures that were used to pay an outside vendor to service the loans, which accounted for less than one half of one percent of expenditures each year. The Minnesota Housing Finance Agency uses resources other than the EDHC program's General Fund appropriations to cover the program's administrative costs.

SOURCE: Office of the Legislative Auditor, analysis of agency expenditures in SWIFT, the state's accounting system.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# Chapter 2: Rental Housing Projects

As we discussed in Chapter 1, the Minnesota Housing Finance Agency (MHFA) uses Economic Development and Housing Challenge (EDHC) program funds to finance both rental and owner-occupied housing.[1] In this chapter, we focus on rental housing projects. We describe the process MHFA uses to award EDHC funds and compare that process to requirements in law. We also describe the process MHFA uses to monitor projects' compliance with requirements. In addition, we provide an overview of the two rental projects we visited as part of our evaluation.

We found that both the process applicants must follow to apply for EDHC funds and the process MHFA uses to select EDHC awardees are complicated. However, most applicants told us MHFA's guidance through the application process was helpful and the criteria the agency used to select awardees were clear. We also found that MHFA generally followed the many rules that pertain to EDHC awards.

## Award Process

As noted in Chapter 1, MHFA distributes EDHC funds to rental projects through an annual consolidated funding application.[2] Through this consolidated application, MHFA considers applicants for more than a half dozen agency funding sources.[3] In addition, the Metropolitan Council, the Greater Minnesota Housing Fund, and other funding partners consider applications from the consolidated process for funding from their respective resources.[4] MHFA has provided EDHC funding to rental projects as deferred loans, most of them with no interest. Recipients do not make regular payments on deferred loans; rather, the entire loan balance is due on a set date, usually 30 years after the loan is made.

**The funding offered through the consolidated application for rental housing projects is competitive.**

MHFA receives many more requests for rental housing funds than it has funds available. The agency received applications for 55 rental projects in 2017, but only 25 projects were selected to receive funding using any sources available through the consolidated application. From 2013 through 2017, just 39 percent of the roughly 350 applications received funding.

The number of applications selected specifically to receive EDHC awards in 2017 was low compared to recent years. In 2017, MHFA selected just 4 of the 55 proposed projects to receive EDHC funds. As we noted in Chapter 1, MHFA made an average of seven EDHC

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[1] MHFA refers to these two types of housing as "multifamily" and "single family" housing, rather than rental and owner-occupied housing. We chose to use the terms stated in *Minnesota Rules*, 4900.3600 to 4900.3652, published electronically June 11, 2008. See the Glossary of Terms for definitions of these and other terms.

[2] This application is called the Multifamily Consolidated Request for Proposals.

[3] The consolidated rental application also includes tax credits from the federal Low-Income Housing Tax Credit program. Appendix A has a list of funding programs MHFA awarded through the consolidated application in 2017.

[4] In 2017, the consolidated rental application included funding from the Greater Minnesota Housing Fund, the Metropolitan Council, and the Minnesota Department of Employment and Economic Development.

rental housing awards per year from 2013 through 2017.[5] MHFA officials told us that the number of projects funded each year with EDHC can vary based on several factors, including the amount of funding applicants request and the number of units applicants propose to develop.

**Site Visit: The Meadows Townhomes**

**Developer:** D.W. Jones, Inc. **City:** Perham **Units completed:** 24 Townhomes

**EDHC award amount:** $2,503,140; 0 percent interest, 31-year deferred loan

**Local housing need identified:** The developer characterized Perham, a town of about 3,200 in northwest Minnesota, as a workforce community in which a lack of housing was impeding job expansion for local employers. A local employer submitted a letter in support of the project, stating that the employer needed 90 to 100 employees and was "scrambling" to fill jobs. The employer noted that a lack of housing and job vacancies are linked. A city official also submitted a letter stating that employers had struggled to fill jobs in recent years, and the availability of affordable housing was a significant factor in recruitment efforts.

SOURCE: D.W. Jones, Inc.

# Application Process

Through the consolidated application process, applicants submit one application in which they request one or more *types* of funding: deferred loans, Low-Income Housing Tax Credits, mortgages, and/or bond proceeds. Applicants generally cannot request specific funding *sources*. Therefore, to receive EDHC funds, an applicant would apply for a deferred loan (the funding method used to distribute rental housing EDHC funds), rather than for EDHC program funds directly.[6]

**Applying for Economic Development and Housing Challenge program funds for rental projects was complex and time consuming for many applicants.**

MHFA's consolidated application for rental housing funding is lengthy. Depending upon the type of funding that applicants request and the types of projects they propose, applicants may need to submit dozens of documents totaling hundreds of pages. For example, applicants must submit complex "workbooks" that contain more than a dozen spreadsheets.

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[5] Appendix B lists rental projects that MHFA selected to receive EDHC awards from 2015 through 2017.

[6] MHFA also awards deferred loans from other funding sources, such as the Preservation Affordable Rental Investment Fund.

In the workbooks, applicants must provide detailed data on the sources and uses of their projects' funding, their proposed operating costs, and the number of units they plan to complete, among other things. Applicants must also provide financial records, preliminary architectural information, environmental issues certifications, and numerous other documents.[7]

An agency official told us that this information is needed for MHFA to make the best funding decisions. The official said that if the agency did not request environmental information about a proposed building's location, for example, it could risk funding a project on an unsafe site. As another example, officials told us they must determine whether a proposed project will generate sufficient revenue to cover its expenses in the long term. In addition, officials told us that the consolidated application must satisfy the requirements of all funding programs awarded through the process, which adds to the complexity of the application.

> …MHFA should think about requiring fewer items for the initial application, until they're sure a project is being seriously considered for funding.
>
> **— 2017 Applicant**

We surveyed all 40 organizations that submitted a consolidated funding application for rental housing projects in 2017 to learn about their experiences with the application process.[8] We asked applicants to estimate how many hours their staff and consultants spent preparing their applications. Respondents estimated spending a median of 100 hours developing their 2017 applications, even though most of the respondents (27 of 31) reported having applied for funding in previous years. The four first-time applicants who responded to our survey reported spending a median of 125 hours on their applications. Applicants reported spending between approximately 40 and 640 hours on their applications. In addition, 45 percent of applicants reported that they hired consultants to help prepare their applications.

Numerous respondents offered critiques of the application process in their open-ended comments. About half of respondents indicated that parts of the process were complex or confusing. Further, about half of respondents noted ways in which the application process was burdensome, with some indicating this was especially true for applicants whose projects were not ultimately funded.

> The whole thing was super confusing and the only way we made it through was by hiring a consultant. The complexity of the process puts barriers up for organizations that aren't traditionally applying for this funding and don't know/are unable to hire a consultant.
>
> **— 2017 Applicant**

We also visited two rental housing projects that received EDHC funds. During those visits, we spoke with city officials as well as project development and site management staff about MHFA's consolidated application process. One city official called the application materials "super complicated." A consultant told us that in recent years, MHFA has required applicants to submit more details about a wider range of factors involving the project. The consultant said they think MHFA is trying to develop an objective measure of the "absolute best projects," but the agency is distinguishing between projects with minor differences at the cost of a huge amount of work for applicants. In Chapter 4, we further discuss the complexity of the application process.

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[7] In environmental issues certifications, applicants must disclose any known environmental issues, such as whether an existing structure contains mold or whether a site is located within ten feet of gas or power lines.

[8] We received 31 responses for a response rate of 78 percent. Some organizations submitted applications for more than one project; we surveyed those organizations only once regarding the rental application process.

**Most applicants responded that the Minnesota Housing Finance Agency provided support and instructions that were helpful in completing their applications.**

Although some survey respondents indicated that the application process was complex, the majority responded positively to questions we asked about MHFA's assistance with the process. Eighty-four percent of respondents replied that the application instructions were "somewhat clear" or "very clear." In addition, as shown in Exhibit 2.1, more than two-thirds of respondents replied that MHFA's technical assistance and other materials were helpful for them as they completed their applications.

Several respondents noted that a new online tool MHFA introduced in 2017 facilitated the application process. The new tool offers personalized checklists to remind applicants which documents to submit and provides instructions on how to complete the forms. It also allows applicants to submit documents electronically.

MHFA offers technical assistance to all potential applicants, and several stakeholders with whom we spoke said that this assistance was particularly helpful in completing consolidated funding applications for rental housing projects. For example, a developer and a consultant told us agency staff looked at their application materials prior to submitting them and suggested changes to improve their applications' scores, which they found helpful.

# Selection Process

Once applicants submit their consolidated funding applications, MHFA reviews them using a complex process that involves numerous staff. This process includes (1) reviewing a project's feasibility, (2) reviewing an applicant's organizational capacity, and (3) determining the application's score. MHFA may reject an application if staff determine that a proposed project is not feasible, that an applicant organization does not have the capacity to complete or manage the project, or that a project's score is too low.

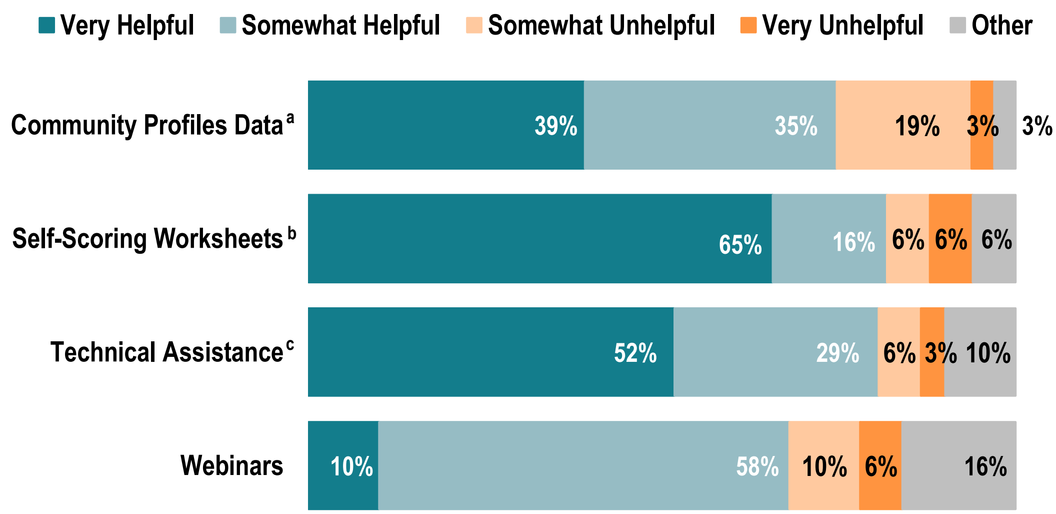
During the feasibility review, staff analyze applications to determine whether projects can be sustainable over time. For example, staff determine whether proposed rents can generate sufficient income to cover operating expenses. They also compare proposed project costs to the actual costs of comparable projects to determine whether they are reasonable.

The organizational capacity review involves assessing applicants' housing development experience and ability to maintain the proposed rental housing over the long term. Staff review the qualifications of project teams, which include developers, architects, and management staff. Staff determine, for example, whether a proposed project is more complex than an applicant's previous projects or whether the applicant can realistically manage the proposed project, given the volume of work they are already managing.

MHFA staff score applications for deferred loan funding (including EDHC funding) using different types of criteria.[9] One type of scoring criteria—threshold criteria—corresponds to the priorities identified in the agency's qualified allocation plan. The qualified allocation

[9] MHFA refers to these criteria as "strategic priorities" and "selection priorities" in application materials; however, we refer to them as "threshold criteria" and "selection criteria," respectively.

## Exhibit 2.1: Most survey respondents replied that assistance provided by the agency was helpful while completing their 2017 consolidated applications for rental housing funding.




NOTES: We asked applicants how helpful or unhelpful each of the types of assistance listed above were while completing their 2017 consolidated applications for funding. The "Other" category includes "Don't Know" and "Not Applicable" responses. There were no nonresponses for these questions. We surveyed 40 organizations and received 31 responses.

[a] Community Profiles, prepared by Minnesota Housing Finance Agency (MHFA) staff, contain data on economic and geographic factors that are intended to assist applicants in preparing their proposals. These factors include unemployment rates, rental vacancy rates, and median household incomes.

[b] Self-scoring worksheets contain a description of the criteria used to score applications and the maximum points available for each criterion. Applicants score their projects and submit documentation supporting their self-score to MHFA. These are used only by applicants requesting Low-Income Housing Tax Credits. Applicants for only deferred loans use a checklist that does not specify the maximum points available for each criterion.

[c] Technical assistance includes meeting with MHFA staff to discuss project specifics, such as project goals and targeted populations.

SOURCE: Office of the Legislative Auditor, survey of applicants to the 2017 consolidated funding application for rental housing projects.

plan is a federally mandated plan that describes how the agency will allocate its limited Low-Income Housing Tax Credits. All applications (including those for only deferred loan funding) must meet at least one of the threshold criteria to receive funding.

In addition to threshold criteria, MHFA scores applications on selection criteria. MHFA staff develop selection criteria with public input and assign each criterion a point value, shown in Exhibit 2.2. Applications are not eligible for points in all criteria. Each application may receive points only in certain criteria based on the characteristics of the individual project, such as the type of activity proposed, the geographic location of the project, or other factors. For example, a project that proposes to construct a new building would not be eligible for points under the criterion "preservation of affordable housing."

## Exhibit 2.2: The Minnesota Housing Finance Agency used a variety of criteria to evaluate applications for deferred loan funding for rental housing projects in 2017.

| 2017 Threshold Criteria and Possible Points (Projects must meet at least one criterion.) | |
|---|---|
| Access to fixed transit (25)<br>Greater Minnesota workforce housing (25)<br>Economic integration[a] (25)<br>Tribal sponsored (25) | Planned community development (25)<br>Preservation of affordable housing (25)<br>Supportive housing[b] (25) |
| **2017 Selection Criteria and Possible Points** | |
| Preservation of affordable housing (30)<br>Rental assistance (21)<br>Permanent supportive housing for households experiencing homelessness (19)<br>Housing that serves lowest income tenants/affordable to the local workforce (13)<br>Housing for people with disabilities (12)<br>Large family housing or single occupancy (12)<br>Financial readiness to proceed (14)<br>Designated tribal/rural area (10)<br>Federal/local/philanthropic contributions (10) | Economic integration[a] (9)<br>Location efficiency[c] (9)<br>Workforce housing communities (6)<br>Access to higher performing schools (4)<br>Minority-owned/women-owned business enterprises (3)<br>Universal design[d] (3)<br>Meaningful employer contributions (2)<br>High-speed internet access (1)<br>Qualified census tract community revitalization communities[e] (1)<br>Smoke-free buildings (1) |

NOTES: This exhibit displays criteria and total points available for each criterion (in parenthesis) for applications for *only* deferred loan funding, which includes Economic Development and Housing Challenge (EDHC) program funding. Criteria and point totals were slightly different for projects requesting Low-Income Housing Tax Credits *and* deferred loans. Projects were not eligible for points in all criteria shown; the total number of points for which a project was eligible depended upon the type of proposed project, the geographic location of the project, and other factors.

[a] Projects qualified for economic integration points if (1) the development contained a minimum percentage of both rent-restricted and unrestricted units, or (2) the development was located in a higher-income area.

[b] Projects qualified for supportive housing points if they set aside a percentage of units to serve people with disabilities or households experiencing homelessness.

[c] Projects received points for location efficiency if they were located within a specified distance from public transit stops or within walking distance from schools, grocery stores, or other services.

[d] Projects received points for universal design if they included all required design features, such as having bedrooms and bathrooms on accessible levels of the unit, and a specified number of optional design features that increased the accessibility of a unit for all people regardless of their age, size, ability, or disability.

[e] Projects received points for being located in designated qualified census tracts and being part of plans for community revitalization.

SOURCE: Minnesota Housing Finance Agency, *2017 Deferred Loan Priority Checklist* (St. Paul, 2017).

The selection criteria and point values we reviewed differed slightly for applications that requested only deferred loan funds and those that requested both deferred loan funds and Low-Income Housing Tax Credits. MHFA has not set a minimum score that projects applying for only deferred loans had to attain in order to receive funding.

**Although the Minnesota Housing Finance Agency has established procedures that promote a consistent application review process, some aspects of the process have lacked transparency.**

MHFA has implemented numerous protocols to ensure a consistent, thorough review process. First, it has developed an internal scoring guide that contains detailed instructions for staff about required documentation and items to include in certain calculations, such as which sources of funding can be counted as federal, local, or philanthropic contributions. Second, MHFA has provided training to staff that review proposals each year. Third, reviewers have met regularly to discuss questions. Fourth, certain types of applications have been scored by more than one staff person; those staff have discussed and resolved any inconsistencies.

While we found the internal review process to be thorough, it could be difficult for individuals outside of the agency to understand certain aspects of the process. For example, although MHFA's 2017 application instructions listed criteria that applicants had to meet related to feasibility and organizational capacity requirements, MHFA did not score applicants on these requirements, and application instructions did not clearly explain how the agency would determine whether applicants met either of these requirements. For instance, instructions stated that proposed projects had to be "economically viable" but did not indicate how MHFA determined viability.

We learned how the agency has made these determinations by speaking with staff and reviewing internal agency documents. To determine whether an applicant had sufficient *organizational capacity*, an MHFA official told us staff have reviewed development team qualifications, obtained input from various agency officials and funding partners, and used what an official called agency staff's "deep knowledge" of many applicant organizations. The official said staff have considered all of this input and used their best judgment in determining whether an organization had sufficient capacity to complete a project.

To determine whether a housing project was *feasible*, staff have analyzed area vacancy rates and proposed rents for the project, among other things. An MHFA official told us that feasibility determinations have been more "black and white" than organizational capacity reviews, but have still required judgment on the part of agency staff.

Similarly, MHFA has not clearly explained how it scored projects that requested certain types of funding. In its 2017 application, the agency clearly indicated the number of points available for each criterion used to score applications for Low-Income Housing Tax Credits. The application *did not*, however, inform applicants for deferred-loan-only funding (which includes EDHC funding) of the potential points their applications could receive for each of the scoring criteria.

## The Minnesota Housing Finance Agency uses a complicated process to select projects for Economic Development and Housing Challenge funding.

**MHFA considers a number of factors when awarding EDHC funds, including:**

- Agency priorities
- Type of funding applicant requested
- Geographic location of project
- Amount of funding project has secured
- Application score

MHFA tries to maximize its resources by using what the former commissioner described as a "best fit" approach to match available funding sources to eligible projects. Rather than fund the applications that received the highest scores, an agency official told us that staff evaluate each application separately against other applications that address the same agency priority and request the same type of funding.[10] In an effort to fund projects in different parts of the state, the agency also takes geographic location into consideration. Finally, staff told us they try to ensure projects have full funding and are ready to move forward after receiving MHFA awards, so the agency may prioritize using EDHC to fill funding gaps left by other programs. Using this approach means that a project that scores lower than some other projects may get funded because it addresses a specific agency priority, meets requirements for a certain funding source, or requires a deferred loan to fill funding gaps left by Low-Income Housing Tax Credits or mortgages.

We questioned whether this process made applications that requested *only* deferred loans (which include EDHC funds) less likely to be funded than applications that requested deferred loans *and* certain other types of funding, such as Low-Income Housing Tax Credits. Analyzing agency data from 2013 through 2017, we found the opposite. MHFA funded 35 percent of applications that requested only deferred loan funding, in comparison to 24 percent of applications for deferred loan funding and certain other types of funding.

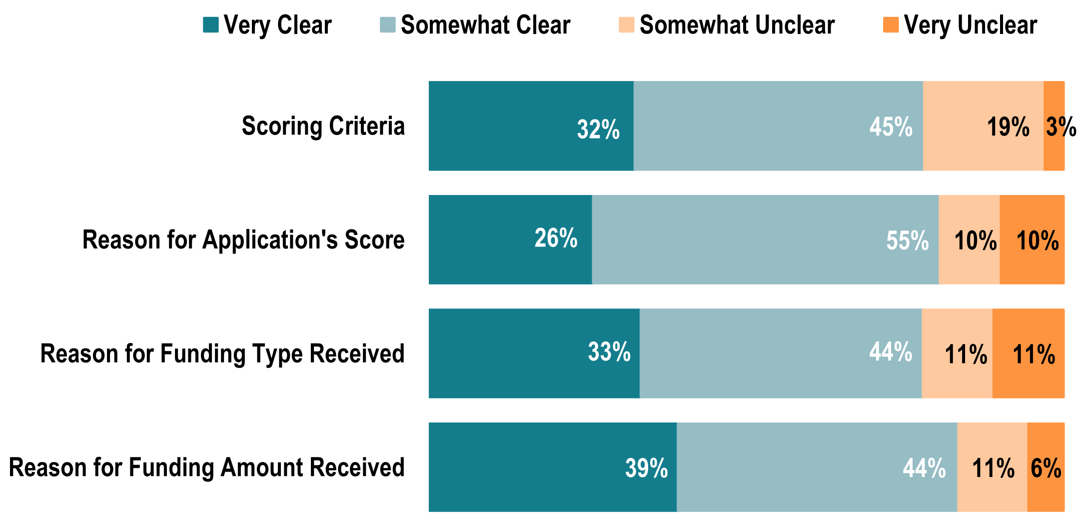
Because MHFA's selection process requires judgment on the part of agency staff, we also questioned whether it has been sufficiently transparent to applicants. Despite the issues we identified, most applicants that responded to our survey told us that key parts of the selection process were clear. As Exhibit 2.3 shows, 77 percent of respondents replied that MHFA's scoring criteria were "somewhat clear" or "very clear," and 81 percent replied that the reason MHFA gave their applications the scores they received were "somewhat clear" or "very clear."

However, some applicants told us they did not understand certain aspects of the selection process. For example, one noted that the scoring for a number of categories was ambiguous and occasionally seemed at the whim of the reviewer. Another told us that the complexity of the scoring process made it difficult to follow all of the agency's instructions.

We understand the need for some flexibility in the decision-making process and think the agency's selection process is reasonable, but we think the agency should explain its process more clearly to applicants and the general public. We discuss this recommendation further in Chapter 4.

[10] For projects competing for the federally limited supply of Low-Income Housing Tax Credits, the agency does score and rank projects, and select those with the highest scores. MHFA uses the approach described in this section to select projects to receive other sources of funding.

### Exhibit 2.3: Most survey respondents replied that key aspects of the selection process for rental projects were clear in 2017.




NOTES: We asked applicants how clear or unclear the aspects of the selection process listed above were during the 2017 consolidated application process. Percentages are out of 31 for "Scoring Criteria" and "Reason for Application's Score." Percentages are out of only the 18 applications that received funding in 2017 for "Reason for Funding Type Received" and "Reason for Funding Amount Received." There were no responses in the "Don't Know" or "Not Applicable" categories, nor were there any nonresponses for these questions.

SOURCE: Office of the Legislative Auditor, survey of applicants to the 2017 consolidated funding application for rental housing projects.

## Post-Selection Process

When agency staff finish evaluating and selecting applications, they prepare summaries of recommended projects for the MHFA board. The board then votes on whether to approve funding for the projects recommended by the staff, including EDHC loans.

After board approval, projects undergo another lengthy review process before they can finalize loan contracts and receive funds. During this process, agency staff continue the underwriting work that they began during the selection process. In underwriting, staff assess any risks associated with making the loan. MHFA may require awardees to meet certain conditions, such as securing additional, non-MHFA funding, before receiving their loan awards. Staff also collect additional information from awardees during this time, such as detailed architectural drawings. Agency officials told us each of these requirements—as well as applicants' responsiveness—can affect the underwriting timeline.

MHFA's application materials stated that this review should be completed within 20 months of board selection. However, an agency official told us that MHFA's goal is to finalize loan contracts sooner—within one year. In our analysis of the 35 projects selected to receive EDHC funds from 2013 through 2017, we found that 28 had closed at the time of our review. Of those 28 projects, 64 percent took more than 12 months to close, while 32 percent took more than 20 months. On average, loan contracts took 16 months to close, ranging from about 7 to 31 months.

# Compliance

EDHC statutes and rules lay out numerous requirements that MHFA must follow when awarding program funds. These requirements are far-ranging, covering everything from the types of activities eligible for EDHC funding to the types of information MHFA must consider when making funding decisions.

To determine whether MHFA has complied with requirements in its award process, we analyzed agency data from 2013 through 2017 and reviewed files for all 18 rental projects selected to receive EDHC awards from 2015 through 2017. For each project, we reviewed application materials, scoring and evaluation documentation, and other relevant information.[11]

## Application Selection Requirements

Statutes and rules set forth requirements for how MHFA must select among applications for EDHC awards. As we discussed in Chapter 1, MHFA must consider numerous "preferences" when awarding EDHC funds.[12] In addition to considering the EDHC-specific preferences in statutes and rules that we outlined in Exhibit 1.2, rules require the agency to award EDHC funds in accordance with the agency's affordable housing plan.[13] Rules also indicate that the agency may establish temporary priorities that reflect short-term demand for housing.[14]

We reviewed the threshold and selection criteria from calendar year 2017 to determine whether the agency had incorporated required preferences into the process it used to evaluate applications.[15]

**In 2017, the agency evaluated applications using preferences established in program statutes and rules, but prioritized some preferences over others.**

MHFA included all required preferences in its selection process and used the flexibility allowed by rules to establish additional criteria. More than half of the criteria that MHFA used to evaluate applications that requested only deferred loans in 2017 corresponded to EDHC-required preferences, such as the criterion that a proposed project be located near transportation, schools, jobs, and other services. Other criteria reflected additional agency-identified priorities. For example, one selection criterion that related to agency priorities, but not to EDHC preferences, provided one point to projects that proposed operating smoke-free buildings. (See points for other criteria in Exhibit 2.2.)

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[11] We reviewed loan contracts for only 10 of the 18 projects as part of our file review. MHFA was still performing due-diligence (review) activities for 8 of the 18 projects at the time of our review, so those projects did not yet have signed contracts.

[12] *Minnesota Statutes* 2018, 462A.33; and *Minnesota Rules*, 4900.3650, published electronically June 11, 2008.

[13] *Minnesota Rules*, 4900.3610, subp. 15; and 4900.3620, published electronically June 11, 2008. This plan, which MHFA board members have adopted annually, must provide details about projected resources available to the agency and the agency's plan for investing those resources.

[14] *Minnesota Rules*, 4900.3650, N, published electronically June 11, 2008.

[15] We reviewed criteria used to score applications that requested *only* deferred loan funding. The agency reviews criteria annually and revises them periodically; we reviewed the criteria from 2017, the year of the most recently completed application process at the time of our evaluation.

At the same time, the agency prioritized certain EDHC-specific criteria over others, which may be inconsistent with rules. Rules state that MHFA must give priority to projects that "best address the greatest number" of required preferences.[16] Rules also state that MHFA must distribute EDHC funds according to the agency's affordable housing plan.[17] MHFA has assigned varying point values to the criteria it uses to score applications, so applicants' scores do not indicate the *number* of preferences each application satisfies, but rather the *weight* the agency has given the criteria. It is unclear whether this rating system strictly complies with the two requirements in rules, which we discuss further in Chapter 4.

It is also unclear the extent to which projects selected to receive EDHC funds met each individual preference listed in statutes and rules. In 2017, some EDHC preferences were combined with one another or mixed with other considerations within the threshold and selection criteria used to score applications. For example, statutes and rules require that MHFA give preference to projects that include cost reductions resulting from regulatory changes, incentives, or waivers.[18] In addition, rules require the agency to give preference to projects that include contributions from local governments, area employers, or charitable or nonprofit organizations.[19] MHFA staff combined these two preferences when calculating a project's score in one criterion, called "Federal/Local/Philanthropic Contributions."[20] This combination made it difficult to determine the *number* of statutory preferences that projects met and whether the agency has selected projects that met the "greatest number" of preferences.

**Based on our review, the Minnesota Housing Finance Agency has collected most types of required information from applicants.**

In addition to specifying preferences that MHFA must consider in the award process, rules stipulate the types of information the agency must review when selecting awardees. Rules require applicants to provide 11 specific types of information, including detailed budgets and project staff qualifications, as listed in the box on the next page.[21] Based on our file review, we determined that MHFA collected 9 of the 11 required types of information for most (at least 15 of 18) applications that received EDHC funding.[22] For example, MHFA collected detailed development and operating budgets and data on average or median rents in the area.

[16] *Minnesota Rules*, 4900.3650, published electronically June 11, 2008.

[17] *Minnesota Rules*, 4900.3620, published electronically June 11, 2008.

[18] *Minnesota Statutes* 2018, 462A.33, subd. 1(b); and *Minnesota Rules*, 4900.3650, K, published electronically June 11, 2008.

[19] *Minnesota Rules*, 4900.3650, A, published electronically June 11, 2008.

[20] This selection criterion takes other factors into account as well.

[21] *Minnesota Rules*, 4900.3642, published electronically June 11, 2008. Rules also state that eligible applications must include documentation that allows MHFA to evaluate whether the applications meet requirements in rules.

[22] While we defined "most" as 15 of 18 applications, 1 of the 11 types of information we reviewed was required for only certain projects. Projects that did not involve temporary displacement or relocation of residents did not have to submit a plan for minimizing the effect of those actions on residents.

**Types of information required of eligible rental project applications:**

- Description of how housing will be developed and managed
- Development staff's qualifications
- Management staff's qualifications
- Detailed development budget
- Detailed operations budget
- Description of temporary or permanent displacement or relocation of residents
- Description of local area
- Average, median, or fair market rent
- Description of development, operations, and management of common space
- Specific wage data
- Description of goals and objectives

*Minnesota Rules,* 4900.3642, published electronically June 11, 2008.

However, there were some instances in which applicants did not submit certain types of application materials required by rules. For example, MHFA did not require applicants to describe the "goals and objectives in meeting the area's need for the type of housing proposed," as required.[23] As a result, most applicants did not explicitly provide this information. In addition, only one of the applications we reviewed contained all of the types of wage data required by rules, although 16 of 18 contained at least one type.[24] We discuss these issues further in Chapter 4.

# Award Requirements

We explained in Chapter 1 that statutes lay out a broad purpose for the EDHC program and direct MHFA to construe statutes liberally to effect the agency's purpose.

In our file review, we analyzed each project's application materials to determine whether the project showed evidence that it met the broad purpose listed in statutes. We looked for evidence that the project (1) met a locally identified housing need, (2) supported job creation or job retention, or (3) supported economic development and redevelopment.[25]

**The Minnesota Housing Finance Agency awarded Economic Development and Housing Challenge funds to projects that fit within the broad purpose of the program.**

All files we reviewed contained evidence that the projects fulfilled at least one component of the statutory purpose of the program. All 18 projects demonstrated that they planned to address locally identified housing needs. Applicants provided evidence of local need through letters of support from local employers or government officials, cooperatively developed plans, city resolutions, or other materials. For example, the application for Cherokee Place, a project proposed for the city of North Branch and selected in 2017, included a cooperatively developed plan. The plan, which was developed in cooperation with the city of North Branch, Chisago County, and other organizations, stated that the rental vacancy rate for comparable units was below 1 percent and that the county had gained 1,000 jobs in the past five years.[26] The application also included numerous letters of support from local officials and employers.

In our file review, we also found evidence that most projects were located in areas experiencing job growth or retention or areas where the proposed housing development

[23] *Minnesota Rules*, 4900.3642, A, published electronically June 11, 2008.

[24] Rules state that all applications must contain average or hourly wage data related to "jobs being created or retained in the local area, the fastest growing jobs in the local area, the jobs with the most openings in the local area, and the wages of the work force employed by organizations making contributions" to the project. *Minnesota Rules*, 4900.3642, G(2), published electronically June 11, 2008.

[25] EDHC statutes and rules do not define "redevelopment." We looked for evidence that the project was located in an area targeted for renovation, removal of substandard structures, or other revitalization activities. Projects must also "meet the needs of the local work force." We discuss this further in Chapter 4.

[26] MHFA reviews local rental vacancies to determine whether they are below 4 percent, indicating a shortage of rental housing.

would support economic development or redevelopment goals. Of the 18 projects, 14 were located in MHFA-designated "job-growth areas," and 3 additional projects provided evidence of current or anticipated job growth from employers, local governments, or other sources.[27] Six applicants also provided local plans that indicated housing was a part of broader economic development or revitalization efforts. For example, the application for Grand Terrace Apartments in the city of Worthington contained a local plan that showed the housing would be located in an area targeted for redevelopment by the city.

**Based on our review, the Minnesota Housing Finance Agency generally followed key legal requirements when awarding Economic Development and Housing Challenge funds.**

We examined MHFA's compliance with the 11 legal requirements governing EDHC awards that are shown in Exhibit 1.1. Based on our review, MHFA generally complied with these requirements. For example, as shown in the table on the right, MHFA funded projects that proposed eligible activities.[28] In addition, MHFA selected organizations that were eligible for EDHC awards from 2015 through 2017—eight awardees were nonprofit organizations, seven were private developers, two were city housing authorities, and one was a tribal housing authority.[29]

**MHFA awarded EDHC funds for eligible activities in 2013-2017.**

| Activity | Number of Projects |
|---|---|
| New Construction | 29 |
| Acquisition | 11 |
| Rehabilitation | 7 |
| Demolition | 3 |
| Refinance | 2 |

NOTE: A total of 35 projects received EDHC funds; some projects involved more than one activity.

MHFA complied with statutory limits on incomes of households served by the program for projects selected for funding from 2013 through 2017. Statutes state that EDHC funds must be used to benefit renters with incomes that do not exceed 80 percent of the state or area median income, whichever is higher.[30] For example, a household in Minneapolis in 2018, regardless of its size, could earn no more than $75,500 to be eligible to live in housing funded with EDHC.[31] Based on our review, close to one-third of projects awarded EDHC funds from 2013 through 2017 committed to renting units to households with incomes no higher than the statutory limit. Most other projects committed to renting to households that

[27] MHFA research staff identify "job-growth areas" by analyzing employment data from the Minnesota Department of Employment and Economic Development and determining which communities experienced job growth over a five-year period. MHFA defines job-growth areas as communities in the Twin Cities metropolitan area that have experienced a net increase of at least 500 jobs over a five-year period, or communities outside the metropolitan area with at least 2,000 jobs that have seen net growth of at least 100 jobs over a five-year period. Six of the 14 projects designated as being in job-growth areas also provided evidence from employers or other local sources of current or expected job growth.

[28] *Minnesota Statutes* 2018, 462A.33, 1(a), states that EDHC funds may be used for construction, acquisition, rehabilitation, demolition, construction financing, permanent financing, interest-rate reduction, refinancing, and gap financing.

[29] *Minnesota Statutes* 2018, 462A.33, subd. 2, allows MHFA to award EDHC funds to a city, a federally recognized American Indian tribe or subdivision located in Minnesota, a tribal housing corporation, a private developer, a nonprofit organization, or the owner of the housing, including an individual.

[30] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[31] Residents of the Twin Cities metropolitan area are held to the area median income standard, which is higher than the state median income standard. The state median income limit was $67,400 in 2018.

met income standards for the Low-Income Housing Tax Credit program; for most households, tax credit income standards are lower than EDHC limits.[32]

**Site Visit: Supportive Housing Development**

**City:** Minneapolis

**Units completed:** 36 studio apartments

**EDHC award amount:** $420,000; 2 percent interest, 30-year deferred loan

**Local housing need identified:** The development provides supportive housing to people with disabilities, many of whom were homeless or at risk of being homeless. Seven units are reserved for people experiencing long-term homelessness. The organization that developed this building is part of a cooperative effort to increase the supply of safe, affordable housing for people with disabilities. The development was constructed in an area targeted by the community for redevelopment.

# Monitoring

Once rental projects that receive EDHC funds have completed construction, rehabilitation, or other planned activities, MHFA monitors them to ensure they meet program requirements. Properties funded with EDHC must restrict the rents charged. They also must serve households with incomes no higher than limits established in law. These restrictions must remain in place for the life of the deferred loan or a minimum of 15 years if the award recipient pays the loan back early.[33] All rental developments must also meet construction standards established by MHFA.

MHFA provides information about its monitoring and reporting expectations to project administrators via a formal program guide.[34] The guide states that the agency actively monitors renters' incomes, rents, affirmative action and equal opportunity requirements, and year-end operating reports. EDHC recipients must verify and document the incomes of all new renters. MHFA staff review this documentation annually. The program guide also states that projects are subject to periodic physical inspections. These inspections should

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[32] Tax credit program income limits increase as household sizes increase, while income limits for EDHC do not. We reviewed the tax credit income limits and found that, up to a household size of eight, tax credit income limits are lower than EDHC limits. For larger households, they may be higher. However, in our review of program data, we did not find that any households of more than eight individuals moved into projects funded with EDHC from 2013 through 2017.

[33] *Minnesota Rules*, 4900.3646, subp. 2, F(2), published electronically June 11, 2008.

[34] Minnesota Housing Finance Agency, *Economic Development and Housing Challenge Program Guide* (St. Paul, 2018).

occur every two years for EDHC loans totaling $500,000 or more, every five years for loans totaling $100,000 to $499,999, and every ten years for loans totaling less than $100,000.[35]

An MHFA official told us that when properties receive other types of funding—such as MHFA-financed first mortgages or Low-Income Housing Tax Credits—in addition to EDHC funds, the agency may use other programs' procedures and schedules to monitor them. For example, MHFA uses tax credit compliance requirements to monitor properties that receive both EDHC funds and Low-Income Housing Tax Credits. MHFA's "Housing Tax Credit Program Compliance Manual" states that the agency inspects these developments at least once every three years.[36] During inspections, MHFA officials review documentation of renters' incomes for at least 20 percent of the development's income-restricted units. In addition, agency staff inspect the development to ensure it meets federal requirements for "decent, safe and sanitary condition."[37]

**Based on our review, the agency followed its monitoring procedures for nearly all projects that received Economic Development and Housing Challenge funds.**

MHFA requires EDHC recipients to use an online tool to report details about renters' incomes, rents charged, and other information. Each year, recipients must submit to MHFA through the online tool a certification that they have complied with program requirements. Of the housing developments that received EDHC funds from 2008 through 2017, 70 were completed at the time of our review. Records indicate that from January 2014 to June 2018, the agency monitored the annual certification of all but 3 of these 70 developments. For two of the developments, MHFA stopped monitoring the developments' compliance with EDHC program requirements before 15 years had passed—the minimum amount of time that rent and income restrictions must remain in place, according to state rules.[38] For the third development, MHFA had not monitored its EDHC program compliance because the agency had failed to input the development into its monitoring database. Records indicate that MHFA appropriately monitored the remaining developments annually.

Likewise, except for those three cases, we found that MHFA or its partners conducted physical inspections of developments according to its inspection schedules. For the two developments in which MHFA failed to monitor EDHC compliance for a minimum of 15 years, the agency did inspect them for compliance with other agency programs. For the third development, though, we found that MHFA had not inspected it since it received funds in 2009.[39]

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[35] This inspection schedule is for projects that received MHFA deferred loans and did not receive funds from certain other programs.

[36] Minnesota Housing Finance Agency, *Housing Tax Credit Program Compliance Manual* (St. Paul, 2016), 24. MHFA signed a memorandum of understanding with the U.S. Department of Agriculture, Rural Housing Service (RHS) in which the two agencies agreed that RHS would share results of inspections it conducts with MHFA. MHFA generally does not inspect properties inspected by RHS.

[37] *Ibid*., 25.

[38] Although MHFA has not monitored the developments' compliance with EDHC requirements, it has annually reviewed their compliance with other programs' requirements. *Minnesota Rules*, 4900.3646, subp. 2, F(2), published electronically June 11, 2008.

[39] An MHFA official told us the development should have been inspected for the first time in 2014, but the agency will instead inspect it for the first time in 2019.

We also found that MHFA failed to document some inspections properly. Developments funded through the consolidated application process often receive funding from multiple sources with varied requirements. In some cases, in order not to duplicate inspection efforts, MHFA staff rely on reports of inspections performed by partners, rather than performing every inspection themselves. MHFA staff then follow-up with property owners directly if partners report serious issues found during their inspections. We found that the agency failed to document some inspections performed by its partners in its monitoring database. We also found that MHFA did not have quality-control measures in place to ensure that its partners were inspecting properties according to the agency's required schedules.

When MHFA staff or its partners physically inspect housing developments or review EDHC recipients' files, they issue violations if recipients are not in compliance with program requirements.[40] We reviewed the violations cited against 70 completed housing developments that received EDHC funds over the last ten years. In 2017, MHFA or its partners cited violations against 15 developments for failing to comply with EDHC program requirements.[41] That year, the most common violation related to the habitability or physical conditions of the properties (84 percent of total violations). The remaining violations were related to property owners (1) failing to report information about renters, such as their incomes; (2) failing to provide required paperwork; or (3) charging rents that exceeded program limits.

Program data showed that property owners eventually corrected all instances of noncompliance. For example, they performed maintenance activities, such as fixing broken windows or installing smoke detectors. They also submitted missing paperwork. Although neither EDHC statutes nor rules specify how quickly property owners must correct violations, MHFA requires resolution within 30 days. However, agency officials told us that, for various reasons, it can often take property owners longer to address certain issues. For example, property owners may not be able to address certain maintenance issues during winter months. As a result, the agency may offer property owners a grace period to correct issues. Program data showed that property owners corrected only 16 percent of violations within 30 days.[42] However, they corrected nearly all (96 percent) within 60 days.

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[40] In this context, a housing "development" refers to a single project. It could involve just one building, or multiple buildings. When MHFA issues a violation, it may issue it against the entire development, just one building in the development, or just one unit within a building.

[41] MHFA and its partners do not inspect every development each year. For about 12 percent of the violations that inspectors cited in 2017, property owners provided evidence showing that a violation did not actually occur, such as providing missing paperwork. Our analysis did not account for all violations cited by MHFA's partners during inspections they conducted. Partners report only serious, uncorrected violations to MHFA.

[42] This figure represents only those violations that property owners corrected. It does not include instances in which property owners provided additional evidence to show that a violation did not occur.

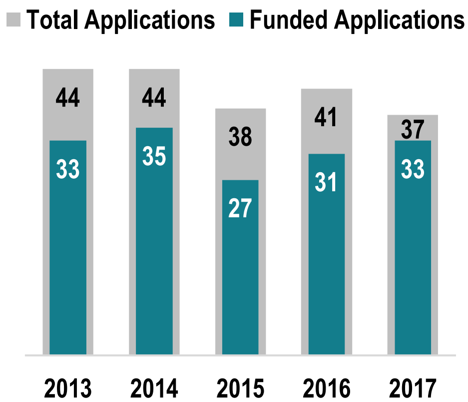
# Chapter 3: Owner-Occupied Housing Projects

In this chapter, we focus on owner-occupied housing projects funded by the Economic Development and Housing Challenge (EDHC) program.[1] We describe the award process both in terms of how the Minnesota Housing Finance Agency (MHFA) administers it and how applicants experience it during the application, selection, and post-award monitoring phases. We also describe legal requirements related to the EDHC program and evaluate MHFA's compliance with those requirements. In addition, we provide information about two owner-occupied projects that we visited as part of our evaluation.

Despite owner-occupied housing projects and rental housing projects having separate award processes, many of our conclusions about those processes are similar. We found that the application process for owner-occupied housing projects was complicated for some applicants and that the agency has supported applicants well throughout it. We also found that the selection process has not been entirely transparent at times. Overall, we found that all of the projects that MHFA selected for funding met the EDHC program's broad purpose and that MHFA generally followed legal requirements in its award process.

## Award Process

The number of funded applications compared to the total number of applications between 2013 and 2017




MHFA awards EDHC funds to owner-occupied housing projects through an annual consolidated application process, as we explained in Chapter 1. Through the consolidated application, organizations may request grants, interim loans, or deferred loan funds from MHFA or its funding partners, such as the Metropolitan Council.[2]

**The majority of applications submitted through the consolidated funding process for owner-occupied projects in recent years have received funding.**

MHFA received an average of 41 applications for owner-occupied housing projects each year from 2013 through 2017. Seventy-eight percent of the applications submitted during that period received funding, although not all applications received the amount of funding requested.

MHFA made an average of 32 awards each year from 2013 through 2017, totaling an average of $7.5 million. All applications that MHFA funded through the consolidated

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[1] MHFA refers to the two types of housing as "multifamily" and "single family" housing, rather than rental and owner-occupied. We chose to use the terms stated in *Minnesota Rules*, 4900.3600 to 4900.3652, published electronically June 11, 2008.

[2] See the Glossary of Terms for definitions of certain terms, including deferred and interim loans. In 2017, funding partners included the Greater Minnesota Housing Fund and the Metropolitan Council.

process received some EDHC funds.[3] Over the five-year period, the average EDHC award grew by 36 percent, from $205,000 in 2013 to $280,000 in 2017.[4] Agency officials told us that the average award size can vary based on the types of activities proposed by applicants, the number of housing units proposed, and other factors.

**Site Visit: Green Homes North**

**Developer:** City of Minneapolis Department of Community Planning and Economic Development

**City:** Minneapolis (North)

**Units completed:** 11 single family houses

**EDHC award amount:** $416,670 grant

**Local housing need identified:** Green Homes North is part of a community development plan focused on foreclosure recovery efforts in north Minneapolis. The developer told us there would have been little new construction in these neighborhoods without the Green Homes North project. Therefore, according to the developer, it served to stabilize the housing market. The grant was used to fill the difference between the total construction costs of homes and the fair market sales prices of the homes. The program proposed to serve households with incomes up to 115 percent of the area median income.

SOURCE: City of Minneapolis Department of Community Planning and Economic Development.

As we discussed in Chapter 1, EDHC awards can fund a variety of activities, including construction of new properties or rehabilitation of existing ones. More than half of owner-occupied projects awarded EDHC funds from 2013 through 2017 involved rehabilitation.

## Application Process

As was the case for rental projects, applicants for owner-occupied projects generally cannot request a specific source of funding through the consolidated application.[5] But, applicants can request a specific type of funding, such as a grant or loan, based on the type of activity they propose.[6] We reviewed files for a sample of owner-occupied housing projects from calendar years 2015, 2016, and 2017 to determine whether the application process was efficient and whether MHFA followed legal requirements.[7]

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[3] Appendix C lists owner-occupied projects that MHFA selected to receive EDHC awards from 2015 through 2017.

[4] These amounts are not adjusted for inflation.

[5] Applicants may specifically request funds from Housing Infrastructure Bonds or certain agency funding partners as the source of their award.

[6] Rules allow MHFA to award funding as grants only to cover value gaps, or in some other special circumstances. *Minnesota Rules*, 4900.3634, subp. 3, published electronically June 11, 2008.

[7] We selected a random sample of 27 single family projects—9 each from calendar years 2015, 2016, and 2017—that were selected to receive EDHC funding. In addition, we purposively selected 2 projects that received funds set aside for housing projects for American Indians, for a total of 29 projects. We reviewed application materials, scoring and evaluation documentation, funding contracts, and monitoring documentation, when available.

### The consolidated application for owner-occupied housing project funding was complicated for some applicants.

The application for owner-occupied projects involves numerous components, albeit fewer than the rental application. Applicants for owner-occupied project funding must submit narratives about their experience as housing developers and the needs of their local communities, among other things. In addition to narrative responses, applicants must provide data about their projects' funding and costs, as well as details about previous projects they administered that received MHFA funding. Finally, applicants must provide a number of supporting documents, such as maps and plans for advertising the developed housing to eligible buyers.

> I struggle with the amount of time the [application] process takes each time I apply. …. The overall breadth [and] number of documents that are needed to apply is intensive....
>
> **— 2017 Applicant**

The application is labor intensive for some owner-occupied funding applicants, although again, less so than the rental application. We surveyed all 26 organizations that submitted owner-occupied project applications in 2017 to learn about their experiences.[8] Respondents estimated spending a median of 45 hours on their applications, with applicants' answers ranging from 15 hours to more than 200. Two-thirds of respondents described various ways in which the process was burdensome. One common complaint involved the work of completing the many complex documents. Two stakeholders that we spoke with—despite having many years of experience with the application—indicated that the application was complicated and time intensive, with one noting that this was especially true in recent years. One developer said that the stack of required application materials has grown exponentially.

Although some survey respondents described ways in which the application was burdensome, most (17 of 21 respondents) described positive aspects of the application process in their open-ended responses. About half of respondents praised the agency's clear expectations or communication. About one-fifth of respondents described the ability to submit the application electronically positively. We also heard positive sentiments about the application process from some of MHFA's funding partners that we interviewed.

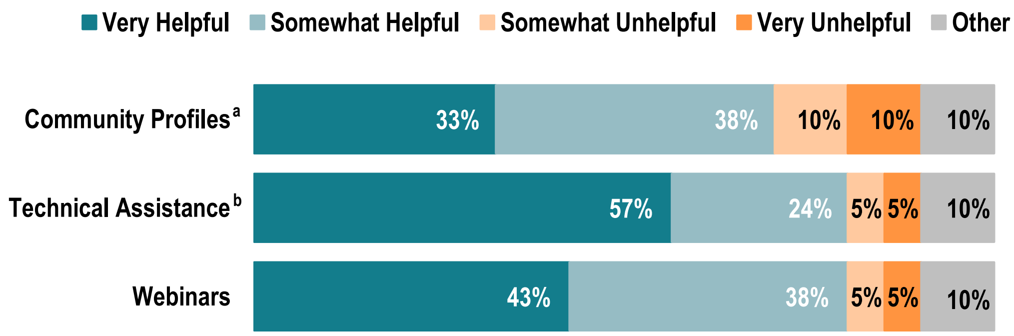
### Most survey respondents indicated that the Minnesota Housing Finance Agency's guidance was helpful during the application process.

> The [MHFA owner-occupied] housing team was very helpful when we had questions.
>
> **— 2017 Applicant**

We asked applicants about the clarity or helpfulness of MHFA's guidance for completing the application, including its webinars, application instructions, and technical assistance. Similar to rental applicants, more than three-quarters of survey respondents that submitted owner-occupied housing project applications replied that application instructions were "somewhat clear" or "very clear." Additionally, most respondents replied that MHFA's assistance was "somewhat helpful" or "very helpful," as shown in Exhibit 3.1.

[8] Of the 26 organizations we surveyed, 21 responded for an 81 percent response rate. Some organizations submitted applications for more than one project in a single year; we surveyed those organizations only once regarding the owner-occupied application process.

**Exhibit 3.1: Most survey respondents replied that the agency's guidance was helpful while completing their 2017 owner-occupied project applications.**




NOTES: We asked applicants how helpful or unhelpful each of the types of assistance listed above were while completing their 2017 consolidated applications for funding. The "Other" category includes "Don't Know" and "Not Applicable" responses, as well as nonresponses.

[a] Community Profiles, prepared by Minnesota Housing Finance Agency (MHFA) staff, contain data on economic and geographic factors that are intended to assist applicants in preparing their proposals. These factors include unemployment rates, rental vacancy rates, and median household incomes.

[b] Technical assistance includes meeting with MHFA staff to discuss project specifics, such as project goals and targeted populations.

SOURCE: Office of the Legislative Auditor, survey of applicants to the 2017 consolidated funding application for owner-occupied housing projects.

Despite generally positive feedback, a few applicants noted in their open-ended responses that the guidance provided by MHFA could still be better. One of these respondents indicated that MHFA could do a better job reaching out to applicants with more frequent notices. Another told us that they found some information inconsistently written across multiple documents. We discuss issues with the application process further in Chapter 4.

## Selection Process

MHFA selects owner-occupied projects to fund using a process that is more straightforward than the process used to select rental projects. Staff score applications using two types of criteria: threshold and selection criteria.[9] Projects must achieve a minimum score for each of the three threshold criteria to receive funding.[10] The three threshold criteria are: organizational capacity, project feasibility, and community need. Projects do not need to achieve a minimum score for any of the selection criteria, which are outlined in Exhibit 3.2, to be considered for funding.

[9] MHFA uses the terms "selection standards" and "funding priorities" in application materials; however, we refer to them as "threshold criteria" and "selection criteria," respectively.

[10] These threshold criteria are different from the threshold criteria used to evaluate rental project applications.

## Exhibit 3.2: The Minnesota Housing Finance Agency scored 2017 applications for owner-occupied housing projects using numerous criteria.

| 2017 Threshold Criteria and Possible Points (Projects must receive at least 5.5 points in each category to receive funding.) | |
|---|---|
| Community need (10)<br>Organizational capacity (10) | Project feasibility (10) |
| **2017 Selection Criteria and Possible Points** | |
| Financial leverage (9)<br>Location efficiency[a] (6)<br>Underserved populations (6)<br>Economic integration[b] (5)<br>Efficient use of land (5)<br>Rural/Tribal designation (4)<br>Workforce housing (4)<br>Long-term affordability (3) | Community recovery[c] (2)<br>Cooperatively developed plan (1)<br>Foreclosure (1)<br>Large family housing (1)<br>Regulatory incentives[d] (1)<br>Senior housing (1)<br>Unique financial or credit issues (1)<br>Universal design/accessibility (1) |

NOTES: This exhibit displays criteria and total points available for each criterion (in parenthesis). Projects were not eligible for points in all criteria shown; the total number of points for which a project was eligible depended upon the type of proposed project, the geographic location of the project, and other factors.

[a] Projects received points for location efficiency if they had access to public transit or were within walking distance of schools, grocery stores, and other services.

[b] Projects qualified for economic integration points if the proposed housing was located in higher-income areas and near job centers.

[c] In their consolidated application guide, the Minnesota Housing Finance Agency (MHFA) designated communities with "lower median household incomes, older housing stock, and higher than average declines in home sales prices" as areas in need of "community recovery." Only areas designated by MHFA were eligible for points.

[d] Projects could receive up to one point for obtaining regulatory incentives, such as fee waivers, that resulted in cost savings.

SOURCE: Minnesota Housing Finance Agency, *2017 Single Family Request for Proposals Scoring Criteria* (St. Paul, 2017).

After staff score applications, senior agency officials perform a second review. Program staff compose a brief summary of each project for these officials, which include the commissioner, deputy commissioners, and others, to use during their review. The senior agency officials score each application on the threshold criteria. Staff average the initial reviewers' and the officials' scores, and use the average scores to rank the applications. Unlike the complicated process used to select rental projects, whether owner-occupied housing projects are funded or not depends entirely on their ranking and ability to achieve a minimum score in each of the threshold criteria.

However, the *amount* of funding that each successful owner-occupied housing project receives is not based on its application score or ranking. Instead, agency staff review applicants' past performance (including the size of projects they have completed previously and their history in meeting MHFA project requirements) to determine how much funding to provide.

**While the Minnesota Housing Finance Agency has established procedures to promote consistent reviews, some aspects of the selection process have not been fully transparent.**

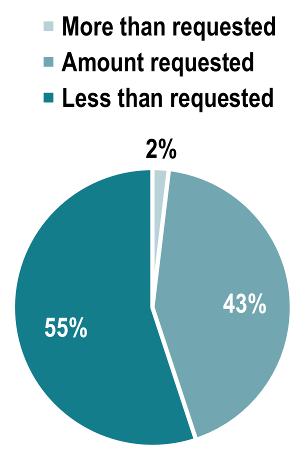
MHFA has promoted consistency in its selection process for owner-occupied projects using several of the same methods used for selecting rental projects. For example, it developed a scoring template with explicit instructions on how to score applications on selection criteria. Staff have received annual training on how to use the template, among other things. In addition, during the review process, staff have met on a weekly basis to ensure consistency and to discuss any questions.

We asked owner-occupied project applicants from 2017 about the clarity of certain aspects of MHFA's selection process, and the majority of survey respondents replied that those aspects were clear. For example, we asked applicants about the criteria that the agency used to select projects; most applicants responded that the criteria were "somewhat clear" or "very clear." Only a few applicants indicated that criteria were unclear or described concerns with the scoring criteria in their open-ended comments. For example, one applicant described the scoring system as "less than transparent."

In our own review, we found that the agency has not clearly communicated some aspects of the selection process. For example, MHFA has not provided applicants with detailed information about how the agency scored certain threshold and selection criteria. MHFA has posted on its website brief descriptions of the application threshold and selection criteria, along with the maximum points available for each criterion. However, the agency has not clearly explained what is required to achieve the maximum number of points. Application materials have not indicated, for example, how a project could earn the full five points available under the criterion "Efficient Land Use." In addition, the agency has not provided applicants with their applications' final scores. We discuss this point further in Chapter 4.

The application materials also have not indicated how MHFA determined the amount of funding to provide to a proposed project. An MHFA official told us that the agency has not established firm guidelines to determine the amount of funding a project receives; rather, it expects reviewers to use their judgment based on information provided in the application and the applicant's performance on past awards. We analyzed program data from 2013 through 2017 and found that the majority of awardees did not receive the amount of funding they requested, as shown in the chart to the right. Despite our findings, the great majority of survey respondents indicated that the reason for the amount of funding they received was clear.

**Fifty-five percent of awardees received less funding than the amount they had requested.**



# Compliance

MHFA must follow many requirements specified in statutes and rules when awarding program funds. As part of our evaluation, we determined whether MHFA followed key legal requirements in its award process, and we discuss the agency's compliance with these requirements below.

## Application Selection Requirements

As we noted in chapters 1 and 2, statutes and rules require MHFA to consider numerous preferences when evaluating applications for EDHC funds. We analyzed the threshold and selection criteria used to score the 2017 owner-occupied housing consolidated applications for funding and determined whether MHFA incorporated required preferences in its selection process.[11]

**The criteria that the agency used to evaluate owner-occupied project applications in 2017 aligned closely with requirements in statutes and rules.**

MHFA included all required preferences in its selection process for owner-occupied project applications, just as it did for rental project applications. We noted in Chapter 2 that MHFA has some flexibility to evaluate applications for EDHC funds against additional criteria. Of the 19 criteria used to score owner-occupied funding applications, 16 corresponded directly to preferences or requirements specified in EDHC statutes or rules.[12] The three criteria that did not correspond directly to EDHC preferences were worth a total of only four points, which represented a small share of the total points possible for an application.[13] (See Exhibit 3.2 for a comprehensive list of all criteria and their point values from 2017.)

We also explained in Chapter 2 that rules require MHFA to (1) give priority to projects that "best address the greatest number" of preferences *and* (2) distribute funds in accordance with the agency's affordable housing plan.[14] Similar to the selection process for rental projects, MHFA assigned varying point values to individual criteria used to score owner-occupied applications. Therefore, applications' scores reflected the weight the agency had given each criterion, rather than a tally of the preferences that had been met. Given the two directives, it is unclear whether the agency complied with rules related to preferences, which we discuss further in Chapter 4.

[11] An MHFA official told us agency staff review criteria each year and make changes as needed. We chose to review the criteria from the most recently completed application cycle at the time of our evaluation (2017).

[12] See Exhibit 1.2 for a list of EDHC preferences in statutes and rules.

[13] These criteria were: large family housing, senior housing, and unique financial or credit issues. Like rental applications, owner-occupied funding applications are eligible to receive points in only certain criteria based on the type of activity proposed and other factors.

[14] *Minnesota Rules*, 4900.3620 and 4900.3650, published electronically June 11, 2008.

**For the files we reviewed, the Minnesota Housing Finance Agency collected most required information from applicants.**

Rules list information that applications must contain to be eligible for EDHC funding.[15] As part of our file review, we determined whether applications contained certain required information, such as development staff qualifications and the projects' budgets for developing the proposed housing. Based on our review, MHFA collected 8 of 10 types of required information from the majority of applicants (24 or more of the 29 files we reviewed).[16] For example, 26 of the 29 applications contained information on development staff qualifications and 28 contained marketing plans, both of which are required by rules.[17]

However, MHFA did not ensure that applicants provided some required information. For example, rules require applications to include four types of specific data about local wages, but MHFA did not require applicants for owner-occupied projects to provide any wage data.[18] None of the applications we reviewed contained all required types of wage data, although most applications contained at least one type. Rules also require applications to include a description of the proposed projects' goals and objectives in meeting local housing needs.[19] MHFA asked applicants in 2015 to provide this information, but did not explicitly request it in 2016 or 2017. We found that only 17 of the 29 applications that we reviewed contained goals or objectives statements, as required. We discuss this further in Chapter 4.

# Award Requirements

As we explained in Chapter 1, statutes state that the purpose of the EDHC program is "to support economic development and redevelopment activities or job creation or job preservation…by meeting locally identified housing needs."[20] Through our file review, we determined whether applications for owner-occupied housing showed evidence that the proposed projects would address any of the components of the program's statutory purpose, just as we did for rental projects. We looked for evidence that the project demonstrated (1) locally identified housing needs, (2) job growth or retention, or (3) economic development or redevelopment needs.

**All of the owner-occupied housing projects that we reviewed fit within the Economic Development and Housing Challenge program's broad statutory purpose.**

Based on our review, all projects demonstrated a locally identified need. Statutes do not indicate how MHFA should determine whether a need was "locally identified." In the absence of statutory guidance, the agency has reviewed multiple facets of an application when making this determination, including the submission of plans with relevant housing

[15] *Minnesota Rules*, 4900.3642, published electronically June 11, 2008.

[16] Some application requirements are different for owner-occupied housing projects and rental housing projects.

[17] *Minnesota Rules*, 4900.3642, C and I, published electronically June 11, 2008.

[18] *Minnesota Rules*, 4900.3642, G(2), published electronically June 11, 2008.

[19] *Minnesota Rules*, 4900.3642, A, published electronically June 11, 2008.

[20] *Minnesota Statutes* 2018, 462A.33, subd. 1(a).

goals or data supporting a local need. We determined that a need had been locally identified if an applicant provided evidence of a cooperatively developed plan; a local housing study that supported a need for the project; or letters of support from a local government, business, or nonprofit organization.[21] We also determined that a project was locally identified if a local government or local nonprofit organization submitted information in their applications that supported a local housing need.[22] We found that 23 of the 29 applications included one or more of the documents listed above; the remaining 6 applications were submitted by local governments or nonprofit organizations. Although we ultimately determined that all projects demonstrated a locally identified need, in some cases this was a difficult determination to make. We discuss this issue further in Chapter 4.

In addition to meeting locally identified needs, many applications contained evidence that the proposed projects may have supported job growth or retention by being located in areas experiencing job growth. Of the 29 projects that we reviewed, 21 were located in MHFA-designated job-growth areas.[23] One other applicant provided data that indicated there had been local job growth in their application.

Finally, some applications contained evidence that the proposed projects intended to support the economic development or redevelopment goals of a local community. We found that 7 of the 29 applications indicated that the proposed owner-occupied housing projects were located in areas that had developed plans for coordinated economic development or revitalization efforts.

**Based on our review, the Minnesota Housing Finance Agency generally complied with key legal requirements in its use of program funds.**

MHFA generally awarded EDHC funds in accordance with the requirements detailed in Exhibit 1.1, based on our review of program data, project files, and agency documents.[24] For example, MHFA awarded EDHC funds to eligible types of entities from 2013 through 2017, with most awards going to nonprofit organizations, as shown in the chart on the next page.[25]

[21] A "cooperatively developed plan" is a plan developed in cooperation with a city, county, or regional government unit, and other organizations that addresses local housing and other needs.

[22] Many local governments and mission-based nonprofit organizations submitting funding applications were already providing services in the area targeted for the owner-occupied housing project, familiarizing them with local housing needs.

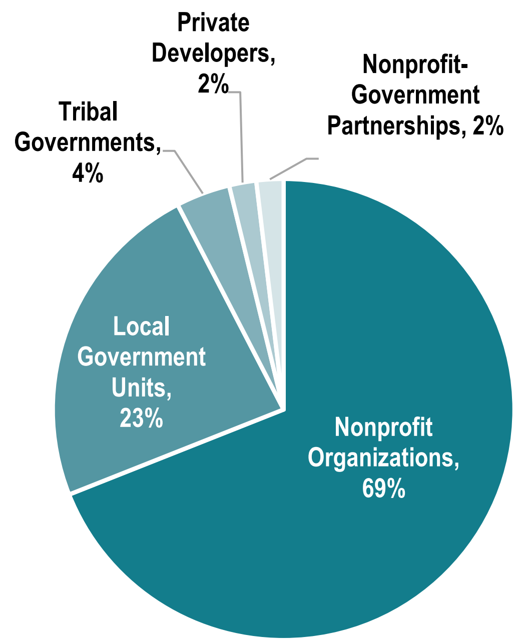
[23] MHFA research staff identify "job-growth areas" by analyzing employment data from the Minnesota Department of Employment and Economic Development and determining which communities experienced job growth over a five-year period. MHFA defines job-growth areas as communities in the Twin Cities metropolitan area that have experienced a net increase of at least 500 jobs over a five-year period, or communities outside the metropolitan area with at least 2,000 jobs that have seen a net growth of at least 100 jobs over a five-year period.

[24] We reviewed data from 2013 through 2017 and application files from 2015 through 2017 to determine whether MHFA complied with requirements.

[25] *Minnesota Statutes* 2018, 462A.33, subd. 2, allows MHFA to award EDHC funds to a city, a federally recognized American Indian tribe or subdivision located in Minnesota, a tribal housing corporation, a private developer, a nonprofit organization, or the owner of the housing, including an individual.

Additionally, MHFA awarded EDHC funds to applicants that committed to serving households that met income limits, as required by statutes. Statutes require that homeowners' incomes be no more than 115 percent of the state or area median income (whichever is greater).[26] This would require a household living in Minneapolis in 2018 to earn less than $108,445. For the files we reviewed, applicants committed to serving homeowners with incomes up to the statutory limit in 8 of 29 projects. Other applicants committed to serving homeowners with lower incomes—some as low as 50 percent of the state or area median income.[27]

**Between 2013 and 2017, all owner-occupied project awards went to eligible recipients.**




Finally, MHFA complied with statutory requirements regarding the geographic distribution of units financed with EDHC. Statutes require MHFA to finance an "approximately equal number of housing units" in the Twin Cities metropolitan area and the nonmetropolitan area—but only to "the extent practicable."[28] MHFA financed more units in the Twin Cities metropolitan area than in the nonmetropolitan area from 2013 through 2017. Of the roughly 3,200 units the agency supported with EDHC funds during this time period, 60 percent were located in the Twin Cities metropolitan area, while 40 percent were located in the nonmetropolitan area. The fact that MHFA financed more units in the Twin Cities metropolitan area likely reflects the fact that it also received more applications for projects located there. From 2013 through 2017, 59 percent of applications came from the Twin Cities metropolitan area, while only 41 percent came from the nonmetropolitan area. This may have limited the practicality of funding units evenly between the two areas.[29]

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[26] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[27] Nineteen of the 29 projects we reviewed committed to serving households with incomes of 80 percent of the area median income or less; two projects did not have signed funding awards.

[28] *Minnesota Statutes* 2018, 462A.33, subd. 2.

[29] Statutes do not make a distinction between the number of rental and owner-occupied units that must be supported in the Twin Cities metropolitan area versus the nonmetropolitan area. We, therefore, analyzed the total number of units supported with EDHC funds.

**Site Visit: Housing Resource Connection 2015**

**Developer:** One Roof Community Housing

**Cities:** Duluth, Proctor, and Hermantown

**Units funded:** 14 single family houses

**EDHC award amount:** $355,000 grant and $120,000 deferred loan

**Local housing need identified:** One Roof Community Housing has worked with 24 other public, nonprofit, and neighborhood organizations to revitalize certain neighborhoods in Duluth. Most of the houses acquired for rehabilitation or newly constructed as a part of this project provided permanently affordable housing for households earning up to 80 percent of area median income through a community land trust model. In this model, One Roof Community Housing retains ownership of the land on which homes are constructed or rehabilitated, sells the homes for a significantly reduced price, and leases the land to homeowners for a small fee. When homeowners sell their homes, they must sell them at below-market prices to income-qualified households. These houses are located in several Duluth neighborhoods and in two nearby cities. MHFA provided the EDHC grant to bridge the gap between the cost of constructing or rehabilitating homes and the fair market sales prices of those homes (which were lower). The MHFA deferred loan was awarded to provide deferred loans to multiple homebuyers who, without the loan, would be unable to afford the homes.

NOTE: Because this project was ongoing at the time of our review, we listed the number of units that the project received funds to complete, rather than the number completed.

SOURCE: One Roof Community Housing.

# Monitoring

An MHFA official told us that organizations that are selected to receive EDHC funding for owner-occupied housing projects typically sign funding contracts with MHFA within three months of being selected for an EDHC award. MHFA then monitors these organizations' performance implementing the projects to ensure they comply with numerous EDHC requirements. MHFA requires awardees to submit annual reports to MHFA by the end of January each year. These reports must update MHFA on the status of awardees' projects, including addresses of homes sold or rehabilitated and the names of homebuyers. Based on the projects that we reviewed, we found 84 percent (16 of 19) of the 2015 and 2016 awardees submitted annual reports, as required.[30]

**Examples of required documentation**

- Revenues and expenditures
- Contractor information and contracts[a]
- Site survey[a]
- Appraisal by a qualified third party[a]
- Mortgage documents[a]
- Copy of the deed
- Household income verification
- Household demographic information

[a] These documents are required only for certain projects.

In addition to requiring annual reports, MHFA periodically reviews a sample of project files maintained by awardees to ensure they comply with the agency's requirements. Awardees must ensure that their project files include all required documentation, such as household demographics, proof of income for the

[30] Projects selected for funding in 2017 were not yet required to submit an annual report at the time of our evaluation.

homeowners, and an appraisal, among other things. MHFA has listed required program documentation in its procedural manual, which is available on the agency's website. A partial list of required documents is shown in the box on the previous page. An agency official said agency staff may visit a sample of units in a given project, but the agency expects awardees to handle physical inspections themselves and properly document the results in their projects' files. The official told us agency staff work with the awardees to remedy any issues the agency identifies.

**The majority of owner-occupied projects that received Economic Development and Housing Challenge funding from 2013 through 2015 were not completed within the timeframe established in rules.**

Rules state that to be eligible for EDHC funds, proposed projects must be "able to be completed" within 20 months of signing a loan or grant contract.[31] In its program guide, MHFA states that a project is completed when it has finished all activities for which it received funding or returned remaining funds to MHFA, and the developer has submitted all required reports and other documents to the agency.

Although MHFA typically drafted its initial contracts with 20-month terms, it issued contract extensions for 70 percent of the 94 awards that it issued from 2013 through 2015.[32] An agency official told us that the agency usually offers extensions when a developer needs additional time to sell the units that it has developed and to collect and report household information about the buyers. A few EDHC recipients said it was difficult to complete all required activities within this 20-month timeframe. We discuss this issue further in Chapter 4.

**The majority of awardees met or exceeded the number of owner-occupied units they planned to support with their award funds, but more than one-quarter did not.**

MHFA specifies the number of units that awardees must complete in its funding contracts. Of the 158 projects that received funding from 2013 through 2017, 72 had been completed at the time of our review. We analyzed whether those projects had constructed, rehabilitated, or otherwise supported the number of units for which they received funding.

Most projects completed at least the number of units stated in their contracts. Of the 72 finished projects, 27 completed exactly the number of units for which they were awarded funding, resulting in 227 units.

**The number of owner-occupied projects completed between 2013 and 2017 that served:**

| | Number of Projects |
|---|---|
| More units than stated | 25 |
| The stated number of units | 27 |
| Fewer units than stated | 20 |

Of the 72 projects, another 25 completed more units than agreed upon in their MHFA contracts. These projects completed 61 more units than planned (an increase of 24 percent). They were able to do this for several

[31] *Minnesota Rules*, 4900.3646, subp. 1D, published electronically June 11, 2008.

[32] Some contracts awarded in 2016 and 2017 were not yet due at the time of our review, so they would not have needed contract extensions.

reasons. First, under certain conditions, awardees may "revolve" their award funds. According to rules, EDHC awardees may retain the proceeds of their loans and use them for the same purpose for which they received them at the same location identified in their application within two years of the original award.[33] Second, some projects received additional "incentive" funds. In 2015, the MHFA board adopted a resolution allowing the agency to issue incentive funding to ongoing projects that had met certain benchmarks.[34] Officials told us the agency provides these funds so awardees can quickly scale up their efforts without having to wait for the next consolidated application. MHFA awarded a total of $405,000 in EDHC incentive funds to eight projects to build an additional 25 units. Third, agency officials told us that a number of projects were able to stretch their dollars by spending fewer dollars per unit than planned.

Of the 72 completed projects, the remaining 20 projects completed fewer units than planned. Most of those projects (15 of 20) did not receive their full awards. MHFA's funding contracts allow MHFA to discontinue disbursing funds or require awardees to return funds when contract requirements are not met. The remaining five projects that did not complete all of their planned units *did* receive and use all of their awarded funds. Agency officials told us the costs of development for these cases were higher than expected and the agency approved the changes.

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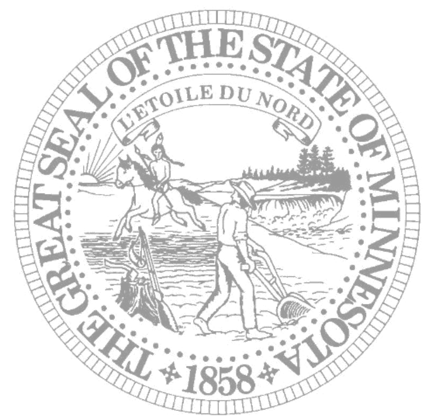
[33] One of the 72 projects revolved its EDHC funds using program rules, *Minnesota Rules,* 4900.3634, subp. 4B, published electronically June 11, 2008. Some projects that received other funds in addition to EDHC also revolved those funds.

[34] Minnesota Housing Finance Agency, Minnesota Housing Board Meeting, "Resolution No. MHFA 15-034 Board Delegation No. 017: Resolution Delegating Authority to the Commissioner Regarding Community Homeownership Impact Fund Award Modifications," July 23, 2015.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# Chapter 4: Discussion

In the previous two chapters, we outlined the processes that the Minnesota Housing Finance Agency (MHFA) has used for awarding Economic Development and Housing Challenge (EDHC) program funds to rental and owner-occupied housing projects. We also reviewed the extent to which the agency has complied with the program's key legal requirements and discussed how projects selected for EDHC funding fit within the program's purpose.

Overall, we determined that MHFA has appropriately administered the program and that all of the projects we reviewed fit within the program's purpose. However, in the previous two chapters we identified some cross-cutting issues that we discuss here. This chapter further evaluates the broad use of EDHC funds and the complexity of the program's legal requirements and application processes. In this chapter, we offer three recommendations about these issues for the agency and Legislature to consider.

## Program Use

Statutes establish that the purpose of the EDHC program is to "support economic development and redevelopment activities or job creation or job preservation within a community or region by meeting locally identified housing needs."[1] Statutes also state that EDHC funds must be used for projects that "address the housing needs of the local workforce."[2]

As we explained in the introduction to this report, EDHC is not plainly an economic development program. Its purpose is not to *spur* economic development or to *create* jobs, but rather to "support" those activities "by meeting locally identified housing needs." In addition, statutes state that the chapter governing the agency's activities "shall be liberally construed to effect its purpose" because those activities are "necessary for the welfare of the state of Minnesota and its inhabitants."[3]

**The Economic Development and Housing Challenge program is so broad and flexible that we found it difficult to determine that a project did *not* fit within its purpose.**

Ultimately, we determined that all of the EDHC-funded projects that we reviewed from 2015 through 2017 fit within the program's statutory purpose. But, these determinations were not always easy to make.

According to MHFA's 2018 affordable housing plan, the agency uses the EDHC program to address workforce housing needs wherein employers in some communities, particularly in greater Minnesota, "struggle to recruit a skilled workforce because employees cannot

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[1] *Minnesota Statutes* 2018, 462A.33, subd. 1(a).

[2] *Minnesota Statutes* 2018, 462A.33, subd. 3.

[3] *Minnesota Statutes* 2018, 462A.24.

find housing."[4] This suggests a rather narrow purpose for the program. We visited one EDHC-funded project in the north-central city of Perham that clearly addressed this type of workforce housing need, as we illustrated in Chapter 2.

However, MHFA has also used EDHC funds in a much broader way. For example, in the absence of a statutory definition for "workforce," the agency has individually determined whether each proposed project would address the needs of the local workforce based on the project area's unique economic development and employment needs, among other factors. We think the agency is operating within its broad statutory authority by evaluating projects in this way.

MHFA's broad approach to addressing workforce needs has allowed the agency to fund projects for households with a wide variety of needs. For example, in 2015, MHFA awarded EDHC funds to a nonprofit organization that constructed studio apartments for individuals living with HIV/AIDS. The project did not solely house current members of the workforce, but MHFA staff determined that it qualified for EDHC funds because it was part of planned community rehabilitation efforts and had rents that were affordable to the local workforce, among other factors. As another example, in 2016, the agency funded a sober, supportive rental housing project for men, many of whom were expected to be homeless or leaving treatment or correctional facilities. Some renters were expected to be employed; others were expected to receive services to help them find work while living in sober housing. We reviewed the characteristics of each project in our file review and, like MHFA, determined that they fit within the program's purpose as it is broadly set forth in statute and interpreted by the agency.

In our review of project files, we also found that MHFA has applied broad parameters when determining whether the housing needs described in applications were "locally identified."[5] MHFA officials told us they consider needs to be locally identified if, for example, an applicant provides evidence of support from a local employer; a financial contribution to the project from a local government, including regulatory waivers; or data from a locally based foundation or other organization, among other things. Most of the project files we reviewed contained such evidence. However, a few did not. For example, in 2017, MHFA awarded EDHC funds to a project that helped persons purchase homes within four resident-owned manufactured home communities.[6] A Minneapolis-based nonprofit organization—rather than entities within the four communities—applied for the funds. While the files contained data supporting a *local need* for housing, they did not contain evidence that the need was *locally identified*—that the impetus for the project arose from within those communities. Nevertheless, we were wary to fault MHFA for funding an organization that helped communities that may have had limited capacity to address their housing needs on their own.

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[4] Minnesota Housing Finance Agency, *Affordable Housing Plan: October 2017-September 2018* (St. Paul, 2017), 11.

[5] In our review of application files, we determined that a housing need had been locally identified if (1) the need was identified in a local government's or community's plan, a locally sponsored market study, a letter from an employer or other organization, or other relevant support; or (2) the project was proposed by a local government, a tribal government, a private-government partnership, or a local nonprofit with knowledge of the targeted community and supported by information demonstrating a local housing need.

[6] Manufactured homes are a type of factory-built housing that are subject to regulations set forth by the U.S. Department of Housing and Urban Development. The manufactured home communities were located within the cities of Clarks Grove, Fairmont, Lindstrom, and Madelia.

The agency's broad interpretation of statutes, as well as the statutes' already broad parameters, make the EDHC program extremely flexible. It can, for example, be used to award funds to several types of organizations. It can also fund a wide range of activities, from new construction to rehabilitation to refinancing. And, even though the program has income limits, it can generally serve households with higher incomes than some other key funding programs, such as the Low-Income Housing Tax Credit program.[7]

> Annually, these resources are what get projects done….
>
> **— 2017 Applicant**

In addition, MHFA has used the program's flexibility to address financing gaps left by other programs, private investment, or market conditions. For example, agency officials told us that, after federal lawmakers began proposing cuts to the corporate tax rate in 2016, some investors began paying less for Low-Income Housing Tax Credits, or stopped investing altogether. In some cases, MHFA used EDHC funds to fill gaps left by those investors. Many survey respondents took the time to write to us about the value of the program's flexibility. For example, one wrote: "EDHC is flexible, and as such, can be used to support a varying array of community priorities and economic development needs. This flexibility allows housing to be developed outside of a one-size fits all approach." Another stated, "The ability of those funds to address a wide range of housing needs is a major benefit of EDHC, since there is such a dearth of funds that can address needs across the affordable housing spectrum."

## RECOMMENDATION

**The Legislature should review the Economic Development and Housing Challenge program statutes to determine whether the program's broad purpose and flexibility accurately reflect legislative priorities.**

Agency officials told us the EDHC program was designed to be applied in a broad, flexible manner. If, however, the Legislature intends for MHFA to use the program in a more targeted way, then it should adjust statutory language to clarify the purpose of the program or define key terms.

> EDHC funds play a key role in preserving needed affordable housing across Minnesota.
>
> **— 2017 Applicant**

On the other hand, if the Legislature intends for the EDHC program to function as it has been, then statutory changes to the program may not be needed. Numerous stakeholders described the flexibility of the program as one of its most positive aspects. In their open-ended comments to our survey, many applicants told us that the EDHC program provides a critical source of funding—in large part because of its flexibility.

[7] For example, a family of four living in Willmar could earn up to $67,400 in 2018 and qualify for EDHC-funded housing, while it could earn only up to $41,700 to qualify for tax credit-funded housing. (These are upper limits; income limits can be set lower for either program.) Tax credit program income limits increase as household sizes increase, while income limits for EDHC do not. We reviewed the tax credit income limits and found that, up to a household size of eight, tax credit income limits are lower than EDHC limits. However, for larger households, they may be higher. As we noted in Chapter 2, in our review of program data, we did not find that any household of more than eight individuals moved into projects funded with EDHC in 2013 through 2017.

# Measuring Impact

In addition to determining whether EDHC-funded projects fit within the program's purpose, we also explored ways to measure the program's impact.

**It is difficult to measure and isolate the impact of the Economic Development and Housing Challenge program.**

The EDHC program's impact proved challenging to evaluate for several reasons. First, the program does not have clear benchmarks against which to evaluate it. The Legislature did not identify benchmarks in the program's enabling statute, and MHFA establishes agency-wide strategic priorities, rather than program-specific goals. Furthermore, because the program is not intended to directly spur economic development, it does not make sense to measure its impact using economic indicators, such as numbers of jobs or businesses created.

Second, it was difficult to isolate the program's impact because it is integrated with some of the agency's other funding programs. Rental projects, in particular, are often made possible by several MHFA funding programs, not just EDHC. Along with other MHFA programs and funding from outside sources, the EDHC program funded projects that constructed or rehabilitated about 1,540 rental units from 2013 through 2017. EDHC funds accounted for only about 20 percent of the dollars MHFA awarded to these projects. EDHC funds made up a larger share of the funding that MHFA awarded to owner-occupied projects. Along with other agency resources, the program supported around 1,750 owner-occupied housing units from 2013 through 2017. EDHC funds accounted for about 80 percent of the dollars MHFA awarded to these projects.

Third, we cannot compare the program's impacts against what would have occurred in its absence. Statutes prohibit MHFA from making certain types of loans if a private lender could have offered one with equivalent terms and conditions.[8] However, we cannot know for certain whether EDHC funding crowded out private funding. We did not conduct an exhaustive review of the agency's underwriting standards or investigate the extent to which program applicants sought funding from private lenders or contributions from nonstate entities. Nevertheless, we did find evidence in our review of project files that MHFA turned down several projects that staff determined did not need state funds.

Lastly, the magnitude of the program's impact depends on the context in which it is measured. For example, the program's impact may seem low when comparing the number of housing units the program has supported in recent years against the size of the state's affordable housing shortage for the lowest-income residents, as reported by MHFA. However, the impact of EDHC's investment in an individual community or neighborhood may be felt more deeply. Agency officials and stakeholders provided us with some anecdotal evidence of this impact. For example, agency officials told us that, after the foreclosure crisis of the previous decade, MHFA strategically invested in distressed properties in north Minneapolis over a period of several years to help raise values for entire neighborhoods over time. Similarly, one survey respondent told us:

[8] *Minnesota Statutes* 2018, 462A.05, subds. 2, 3, and 3c.

> Funding through this program has impact far beyond the creation of a housing unit. For example, having a consistent pipeline of projects has assisted some of our small contractors [to] grow.

Another wrote:

> In our case this activity isn't just about building housing, it's one piece of a comprehensive neighborhood revitalization community development effort….

In addition, the impact of the program on an individual household may be felt even more deeply. For example, one survey respondent explained that the program provides "an opportunity for lower-income households to have lower housing costs [which has] created opportunities to explore income-improving jobs or advancing education." A developer also told us that providing affordable rental housing allows renters to save money, creating a path to homeownership.

# Administration

## Overall Performance

In chapters 2 and 3, we described MHFA's application and selection processes for the EDHC program. We also described how the agency monitors housing projects after they are completed.

**Generally, the agency has administered the Economic Development and Housing Challenge program well.**

Overall, we think MHFA practices good grant and loan administration. As we noted in previous chapters, MHFA has established various quality control measures in its application review processes, including annual training for staff that review applications and clear scoring guides. Based on our review, the agency also generally followed key best practices for awarding funds.[9] For example, as required by the state's Office of Grants Management, MHFA reviewed proposals using a standardized scoring system that it published in its application materials.[10] In addition, the agency has used a national best practice to award funds by utilizing a consolidated application process to distribute funds for numerous programs.[11] Agency staff also analyzed important information during the selection process,

[9] We evaluated the agency's owner-occupied project award process procedures against key Office of Grants Management policies related to grant-making, reviewing grant proposals, and publicizing funding opportunities. We evaluated the agency's rental award process procedures against key practices recommended by the National Council of State Housing Agencies.

[10] *Minnesota Statutes* 2018, 16B.97, subd. 2. Minnesota Department of Administration, Office of Grants Management, "Policy 08-02: Policy on Rating Criteria for Competitive Grant Review," Revised September 15, 2017.

[11] The National Council of State Housing Agencies (NCSHA) recommends that state agencies, like MHFA, that administer the federal Low-Income Housing Tax Credit program consolidate the funding cycles for different sources of funding to the extent practical.

such as the reasonableness of projects' proposed development and operating costs, another best practice.[12]

MHFA has also shown a commitment to protecting state funds. For example, in our review of project files, we found evidence that the agency performed extensive due diligence to ensure that rental projects would be viable into the future. We also found that MHFA used several methods to ensure rental development costs were contained. For example, the agency rejected one proposal because the interest rate of the proposal's private mortgage was higher than the organization could have obtained from MHFA.

> …[MHFA] staff are generally very helpful and very good to work with.
>
> **— 2017 Applicant**

We also received a large amount of positive feedback from stakeholders about the agency's performance. In their open-ended comments, more than a dozen survey respondents took the time to praise agency staff for the support they provided.[13] Several stakeholders mentioned that staff were responsive and helpful during the application process. Some also said the agency has done a good job maximizing limited state resources. Even when citing problems, stakeholders we spoke with were often sympathetic to the agency's efforts. For example, representatives from two organizations noted that MHFA takes a long time to process applications; yet, they were quick to acknowledge that it has good reasons for taking so long, such as its extensive due-diligence activities.

Finally, we found that MHFA complied with most of the EDHC program's legal requirements. For example, as we discussed in previous chapters, MHFA funded the types of activities allowed in law, used the types of funding mechanisms permitted by law, and imposed the income limits required by law.

# Application Issues

Although MHFA has generally administered the program well, we identified some areas for improvement, as outlined in chapters 2 and 3. One issue that stakeholders frequently cited related to the agency's complex application processes.

**The agency's funding application processes have become unwieldy.**

Stakeholders told us that, since the program's inception, MHFA has increased the amount of information that it has required of applicants. Agency officials noted that the consolidated applications must provide MHFA with the information necessary to meet the agency's legal and fiduciary obligations. In addition, an official told us the agency's application requirements better allow agency staff to compare competing projects, thereby increasing fairness and transparency within the application process.

Although we applaud the agency's efforts to create comprehensive and transparent processes, they have resulted in significant complexity—especially on the rental side. Two separate individuals we interviewed described the rental application as "arduous." One applicant described the application processes as "dizzying." Another complained about the

[12] NCSHA also recommends state agencies limit development costs to reasonable levels and require applicants to include realistic, itemized proposed operating expenses in their applications.

[13] We surveyed all 66 organizations that submitted consolidated applications for funding in 2017 and received 52 responses (a 79 percent response rate).

"vast quantities" of exhibits and attachments that applicants must submit. Some stakeholders indicated the requirements have become very prescriptive.

> Reduce the number of manuals and guides. It seems like as soon as I find one guide that will be helpful regarding one part of the process, it refers me to another guide, and another guide. Could they be combined into one larger guide (or at least fewer guides), that someone (or a team of someones) have combed through for inconsistencies?
>
> **— 2017 Applicant**

Applicants described certain aspects of the application as particularly cumbersome. For example, MHFA has developed a data tool to score certain aspects of the consolidated applications and assist applicants with quantifying their local housing needs. MHFA officials said this tool helps the agency more clearly and objectively evaluate housing needs in the areas where proposed projects are located. However, some applicants indicated that this tool was difficult to use. Other applicants described various inconsistencies and redundancies in the lengthy application.

Although some experienced organizations struggle with the application, it may be even more daunting for new applicants and smaller communities with limited financial or staffing resources. An agency official and stakeholders told us that new applicants often have to apply for funds multiple times before they receive an award. Some city officials told us they thought the process may not be feasible for many small communities.

Besides being complicated, the application process can be expensive for applicants. Applicant organizations must dedicate staff time to complete numerous application forms, or hire a consultant to complete them. On average, rental and owner-occupied housing project applicants that we surveyed reported that their staff spent approximately 128 hours on the application. In addition, 31 percent of applicants said they hired a consultant to help with the application. Rental applicants also must pay MHFA appraisal fees as part of their applications, and some may have to pay for market studies or attorneys' fees.

## RECOMMENDATION

**The Minnesota Housing Finance Agency should increase its efforts to work with stakeholders to streamline its funding application processes.**

The complexity and cost of applying for EDHC funds may be creating barriers for certain applicants. The current processes may be reducing competition and reducing access to funds for new applicants and smaller communities. Most of the applications MHFA has received in recent years have come from repeat applicants. About 48 percent of rental and almost 66 percent of owner-occupied housing project applicants applied for funds in more than one year between 2013 and 2017.

> While the process has been streamlined significantly in the past several years… [it is still] somewhat redundant.
>
> **— 2017 Applicant**

MHFA should increase its efforts to reach out to stakeholders to discuss how to better streamline its applications. MHFA officials told us that the agency already internally evaluates its application processes each year and makes adjustments as needed. For example, an official told us that in recent years the agency stopped asking for applicants to provide project schedules. In fact, several stakeholders praised improvements the agency has made over the years.

The agency has reached out to stakeholders in *rental* housing development to solicit feedback on various aspects of the application process. This was part of an ongoing effort to improve the rental application process and resulted in the agency moving the consolidated application for rental housing funding online. However, given the volume of negative feedback that we received and the complex application processes that we observed, we think the agency still has work to do. MHFA should regularly and systematically reach out to stakeholders for recommendations—particularly for owner-occupied housing projects. An MHFA official told us the agency has not solicited formal feedback from owner-occupied housing stakeholders on the application process in recent years.

As the agency streamlines its application processes, it should ensure that it clearly explains the selection processes in its applications materials. Certain aspects of MHFA's selection processes have not been entirely transparent, as we explained in chapters 2 and 3. We believe some flexibility is necessary in the processes and that MHFA's approach is reasonable. However, MHFA should more clearly explain the processes so that all applicants can understand how the agency will score their applications and select projects for funding.

# Legal Requirements

As we mentioned in previous chapters, the EDHC program is subject to a number of legal requirements.

**Based on our review, the agency followed most legal requirements in awarding program funds, but the value of some of the requirements was questionable.**

Based on our review of data from 2013 through 2017 and project files from 2015 through 2017, MHFA adhered to most legal requirements; however, it has not strictly complied with some others. For example, statutes require housing supported by EDHC to be "affordable to the local workforce."[14] Rules stipulate that rent or house payments are affordable if they "do not exceed 30 percent of the wages being paid in the local area as the wages are described in the application" by applicants for EDHC.[15] But, in our review of owner-occupied housing project files, we found that MHFA did not require applicants to provide the wage data required by rules that would be necessary to make this determination.[16] Instead, an agency official told us that MHFA uses 30 percent of state or area median income as its benchmark for determining whether a house payment for a proposed housing project would be affordable to the local workforce.

As another example, rules state that owner-occupied housing project proposals may be eligible for funds only if they can be completed within 20 months of signing a contract for loan or grant funds.[17] However, as we explained in Chapter 3, the agency has issued contract extensions beyond the 20-month requirement for the majority of owner-occupied project contracts in recent years.

In another case, it was difficult to determine whether the agency had complied with rules because the rules themselves were unclear. Rules state that MHFA must give priority to

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[14] *Minnesota Statutes* 2018, 462A.33, subd. 5.

[15] *Minnesota Rules,* 4900.3610, subp. 2, published electronically June 11, 2008.

[16] *Minnesota Rules,* 4900.3642, G(2), published electronically June 11, 2008. Rules state that applicants must include data on four specific types of wages in their applications, including jobs being created or retained in the area and the fastest growing jobs in the area.

[17] *Minnesota Rules,* 4900.3646, subp. 1D, published electronically June 11, 2008.

applications that "best address the greatest number" of preferences outlined in rule.[18] This suggests that all preferences listed in rule are equally important. However, MHFA has prioritized among the many selection criteria by providing higher point values for certain criteria and lower point values for others (in both the rental and owner-occupied award processes). For example, in 2017, MHFA provided a maximum of 30 points to rental applications that proposed preserving existing affordable housing, but only 6 points to projects proposed in communities with workforce housing needs. Therefore, under this point system, a proposed project's total score would not reflect the *number* of preferences met, but rather, the sum of the values that MHFA has assigned each preference that was met.

However, in addition to this requirement, rules indicate that MHFA should award EDHC funds according to the agency's affordable housing plan.[19] MHFA has updated the plan annually. The plan establishes broad "principles" to guide the agency's work over the coming year. For example, in 2017, the plan stated that the agency should be "flexible and responsive to meet changing housing needs across the state."[20] It is unclear how the agency should apply these two rules to the award process. For instance, if the agency determines that in order to be responsive to changing needs in the state, it must assign certain criteria higher point values than others, it is unclear whether this principle articulated in the affordable housing plan can override the direction in rule to give priority to the applications that "best address the greatest number" of preferences. It is therefore also unclear whether the agency's scoring system complies with rules.

MHFA should follow rules as they are written; however, rules should also reflect useful public policy. We questioned how much value certain legal requirements added to the EDHC program. For example, it was unclear to us whether MHFA staff really need to calculate affordability based on wage data provided by applicants, especially when agency staff can access similar information from other sources. Similarly, an agency official told us that, for various reasons, it is not practical for some owner-occupied housing projects to be completed within 20 months, as required by rules. And finally, an application scoring system in which MHFA simply counted the number of statutory preferences each application met may not allow the agency to make the best funding decisions.

## RECOMMENDATION

**The Minnesota Housing Finance Agency should review the requirements it has established in Economic Development and Housing Challenge program rules.**

The EDHC program's current rules were promulgated by MHFA in 2008, ten years ago. We noted that some rules lack clarity and others may not contribute to an effective application process. If MHFA officials think certain rules are no longer necessary for the agency to administer an effective and efficient award process, then they should update them to reflect this fact. Given the feedback we received from stakeholders and the complexity of the application processes we observed, the program may benefit from a reexamination of the rules. If, however, agency officials think current rules are appropriate, they should ensure the agency follows them as written.

[18] *Minnesota Rules,* 4900.3650, published electronically June 11, 2008.

[19] *Minnesota Rules,* 4900.3620, published electronically June 11, 2008.

[20] Minnesota Housing Finance Agency, *2017 Affordable Housing Plan* (St. Paul, 2017), 6.

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# List of Recommendations

- The Legislature should review the Economic Development and Housing Challenge program statutes to determine whether the program's broad purpose and flexibility accurately reflect legislative priorities. (p. 49)

- The Minnesota Housing Finance Agency should increase its efforts to work with stakeholders to streamline its funding application processes. (p. 53)

- The Minnesota Housing Finance Agency should review the requirements it has established in Economic Development and Housing Challenge program rules. (p. 55)

# Glossary of Terms

**Affordability gap:** A funding gap that occurs when the price of a property exceeds the borrowing limit of an eligible borrower.[1]

**Affordable housing plan:** A plan adopted by the board members of the Minnesota Housing Finance Agency that plans how the agency's resources will be invested over the biennium.[2]

**Amortizing loan:** A loan in which the principal and interest are repaid on a payment schedule throughout the loan term.

**Construction loan:** See "interim loan."

**Cooperatively developed plan:** A plan developed in cooperation with a city, county, or regional government unit, and other organizations that addresses local housing and other needs.[3]

**Deferred loan:** A loan in which the principal and/or interest are not repaid until the end of the loan term.[4]

**Developer:** An individual, nonprofit organization, for-profit entity, or cooperative housing corporation that develops housing.

**Economic integration:** The integration of housing units with a range of income levels within a community, neighborhood, or building.

**Eligible homebuyer:** A household with an income that does not exceed 115 percent of the state or area median income, whichever is greater.[5]

**First mortgage:** The original and primary amortizing loan that pays for a piece of real estate and that has priority over all other claims on it.

**Flexible Financing for Capital Costs (FFCC):** An MHFA program that provides deferred loans with no or low interest to reduce the interest rate of developments receiving LMIR loans. FFCC loans are available through the consolidated rental application and on a pipeline basis.

**Grant:** Funds awarded that do not require repayment as long as the grantee meets the terms of the grant agreement.

**Historic preservation:** The preservation of a property with historic significance.

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[1] *Minnesota Statutes* 2018, 462A.33, subd. 1(a)(2).

[2] *Minnesota Rules*, 4900.3610, subp. 15, published electronically June 11, 2008.

[3] *Minnesota Rules*, 4900.3610, subp. 7, published electronically June 11, 2008.

[4] *Minnesota Rules*, 4900.3610, subp. 8, published electronically June 11, 2008.

[5] *Minnesota Statutes* 2018, 462A.33, subd. 5.

**Housing unit:** The residence of a single household, such as an apartment unit or a single owner-occupied house.

**Housing Infrastructure Bonds:** A type of bond authorized by the Legislature and paid for through legislative appropriations that supports some housing programs administered by the Minnesota Housing Finance Agency (MHFA).[6]

**Interim loan:** A loan used to finance a project for a short period of time, such as while a borrower waits for permanent, long-term financing or during a construction period.[7]

**Location efficiency:** A criterion that MHFA uses to evaluate the extent to which proposed housing projects are within walking distance to key amenities, such as transit stops, schools, or grocery stores.

**Low and Moderate Income Rental (LMIR) program:** An MHFA program that provides long-term amortizing mortgages to develop or finance rental housing for low- and moderate-income residents. LMIR mortgages are available through the consolidated rental application and on a pipeline basis.

**LMIR Bridge Loan:** A short-term loan provided through MHFA's LMIR program to finance a rental project during the construction period.

**Low-Income Housing Tax Credit program:** A program administered by the federal Internal Revenue Service (IRS) that provides funds to develop rental housing for low-income households. MHFA receives a limited number of tax credits from the IRS each year, which it awards to rental housing developers. Those developers sell the tax credits to private investors to raise funds for their housing projects. The sale of tax credits is called "syndication."

**Mortgage:** A type of amortizing loan used to purchase real estate, in which the real estate serves as collateral.

**Multifamily housing:** See "rental housing."

**Permanent financing:** A long-term loan, such as a first mortgage, that may replace prior interim financing (also called an "end loan").

**Preservation:** The practice of preserving and rehabilitating existing housing, rather than demolishing it to build new housing, to maintain its affordability.

**Redevelopment:** The construction of new buildings or rehabilitation of old buildings on sites with preexisting uses.

**Refinancing:** The revision of the terms of a loan agreement, such as changes to the interest rate, payment schedule, or other terms.

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[6] *Minnesota Statutes* 2018, 462A.37.

[7] *Minnesota Rules*, 4900.3610, subp. 13, published electronically June 11, 2008.

**Rental housing:** Housing with a minimum of four units used to accommodate persons or families on a rental basis, excluding hotels or other establishments used on a transient basis, and referred to by MHFA as "multifamily housing."[8]

**Owner-occupied housing:** Housing that is the principal place of residence for the owner and the owner's household, referred to by MHFA as "single-family housing."[9]

**Single-family housing:** See "owner-occupied housing."

**Supportive housing:** Housing that provides services for a specific population, such as sober housing for people with chemical dependencies.

**Underwriting:** A process used by MHFA and other financial institutions to assess the ability of potential borrowers to repay a loan.

**Universal design:** Design standards that ensure buildings are accessible to persons of all ages and those with disabilities.

**Value gap:** A funding gap that occurs when the cost to build or rehabilitate a house exceeds its market value.[10]

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[8] *Minnesota Rules*, 4900.3610, subp. 19, published electronically June 11, 2008.

[9] *Minnesota Rules*, 4900.3610, subp. 16, published electronically June 11, 2008.

[10] *Minnesota Statutes* 2018, 462A.33, subd. 1(a)(1).

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# Types of Funding Awarded through the Minnesota Housing Finance Agency's Consolidated Applications in 2017

# APPENDIX A

## Exhibit A.1: Consolidated Rental Housing Application, 2017

| Program | Purpose | Funding Mechanism | Funding Source |
|---|---|---|---|
| Economic Development and Housing Challenge (EDHC) Program | To support economic development, redevelopment, job creation, or job preservation within a community or region by meeting locally identified housing needs | 30-year, deferred, no- or low-interest loans to rental housing developers or owners | State appropriations |
| Flexible Financing for Capital Costs (FFCC) Program[a] | To reduce interest rates in rental housing development; typically used with the LMIR program (described below) | Low- or no-interest deferred loans to rental housing developers or owners | MHFA-generated resources |
| Housing Infrastructure Bonds (HIB) | To finance the development of affordable housing that involves foreclosed or abandoned properties, supportive housing, senior housing, or federally assisted rental housing | Low- or no-interest deferred loans | Bond proceeds |
| Low and Moderate Income Rental (LMIR) Program | To construct new affordable rental properties, stabilize existing ones, and preserve federally assisted rental housing | Permanent, amortizing first mortgages to rental housing developers or owners | MHFA-generated resources |
| Low and Moderate Income Rental (LMIR) Bridge Program | To finance construction and allow a proposed housing project to qualify for 4 percent tax credits | Short-term loans | MHFA-issued bonds |
| Low-Income Housing Tax Credits (LIHTC)—4 percent[a] | To distribute federal tax credits to housing developers so they can raise capital by selling the credits to private investors who use them to reduce their tax liability for a period of ten years | Allocation of tax credits | Federal funds |
| Low-Income Housing Tax Credits (LIHTC)—9 percent[b] | To distribute federal tax credits to housing developers so they can raise capital by selling the credits to private investors who use them to reduce their tax liability for a period of ten years | Allocation of tax credits | Federal funds |
| Multifamily Accelerated Processing (MAP) Programs (Also known as sections 221(d) and 223(f))[c] | To provide consistent, expedited federal mortgage insurance application processing | Amortizing mortgage | MHFA-generated resources, including bond proceeds |
| National Housing Trust Fund (NHTF)[c] | To increase or preserve the supply of rental housing for low-income families (including homeless families) by financing operating costs, new construction, acquisition, or rehabilitation of rental housing | Grants for operating subsidies; no-interest deferred construction or end loans for other activities to rental housing developers or owners | Fannie Mae and Freddie Mac (federally sponsored) |
| Preservation Affordable Rental Investment Fund (PARIF)[a] | To rehabilitate, acquire, or restructure the debt of supportive housing or federally assisted rental housing at risk of aging out of a federal program | Deferred loans to rental housing developers or owners | State appropriations |
| Section 811[c] | To expand the supply of supportive housing that facilitates community integration for persons with significant and long-term disabilities | Monthly reimbursements to rental housing owners for a period of 20 years | Federal funds |

See footnotes next page.

# Exhibit A.2: Consolidated Owner-Occupied Housing Application, 2017

| Program | Purpose | Funding Mechanism | Funding Source |
|---|---|---|---|
| Economic Development and Housing Challenge (EDHC) Program | To support economic development, redevelopment, job creation, or job preservation within a community or region by meeting locally identified housing needs | Grants; interim deferred loans; no-interest, 30-year, permanent, deferred loans | State appropriations |
| Housing Infrastructure Bonds (HIB) | To finance the development of affordable housing that involves infrastructure for manufactured home parks or the acquisition of property for community land trusts | Loans | Bond proceeds |
| Interim Construction Loans | To assist in acquiring, demolishing, rehabilitating, or constructing housing | Interim loan | MHFA-generated resources (also known as "Pool 2") |

NOTES: This appendix shows funding offered by Minnesota Housing Finance Agency (MHFA) programs and MHFA-administered federal programs through MHFA's consolidated applications in 2017. In addition to these programs, several other entities also offered funding through the agency's consolidated *rental* housing application in 2017, including: the Greater Minnesota Housing Fund, the Metropolitan Council, and the Minnesota Department of Employment and Economic Development. Similarly, that year the Greater Minnesota Housing Funding and the Metropolitan Council also offered funding through MHFA's consolidated *owner-occupied* housing application.

[a] These funds are available year-round, on a pipeline basis, in addition to being available through the consolidated applications.

[b] MHFA distributes 9 percent tax credits through the consolidated application as well as through another competitive process offered at a different time of year. MHFA's sub-allocators also distribute 9 percent tax credits.

[c] This is a federal program that is administered by MHFA.

SOURCE: Minnesota Housing Finance Agency.

# Rental Projects Selected for Economic Development and Housing Challenge Program Awards from 2015 through 2017

## APPENDIX B

| Project Title | Applicant/Developer | City | Units Planned[a] | EDHC Funds Awarded[b] |
|---|---|---|---|---|
| **2015** | | | | |
| Ivy Manor Apartments | Arrowhead Economic Opportunity Agency | Virginia | 41 | $ 438,000 |
| Bois Forte Homes III | Bois Forte Housing Department | Tower | 20 | 263,971 |
| Marshall Flats | Clare Housing | Minneapolis | 36 | 420,000 |
| 1st Avenue Flats | Joseph Development | Rochester | 68 | 3,960,000 |
| The Meadows Townhomes | D.W. Jones, Inc. | Perham | 24 | 2,503,140 |
| Grand Terrace Apartments | Southwest Minnesota Housing Partnership | Worthington | 48 | 4,743,544 |
| **2016** | | | | |
| White Pine Apartments | Cloquet Housing and Redevelopment Authority | Cloquet | 35 | $ 712,506 |
| Dublin Crossing | CommonBond Communities | Mankato | 50 | 5,641,781 |
| Indian Neighborhood Club Expansion | Indian Neighborhood Club on Alcohol and Drugs | Minneapolis | 20 | 554,220 |
| Valleyhigh Flats | Joseph Development | Rochester | 60 | 1,121,049 |
| Main Street Flats | Metro Plains, LLC | Cambridge | 28 | 1,673,269 |
| Minnehaha Townhomes | Minneapolis Public Housing Authority | Minneapolis | 16 | 1,170,475 |
| Fox Pointe Townhomes | Three Rivers Community Action, Inc. | Austin | 38 | 121,600 |
| Agassiz Townhomes | Tri-Valley Opportunity Council, Inc. | Crookston | 30 | 315,000 |
| **2017** | | | | |
| West Birch Estates | Central Minnesota Housing Partnership, Inc. | Princeton | 40 | $ 1,777,808 |
| Cherokee Place | Commonwealth Development Corporation | North Branch | 48 | 3,873,508 |
| Apex Townhomes | D.W. Jones, Inc. | Detroit Lakes | 30 | 3,486,000 |
| Boulevard | MWF Properties | Mounds View | 60 | 1,736,000 |
| **Total, 2015-2017** | | | 692 | $34,511,871 |

NOTES: This table shows all rental projects that were selected for Economic Development and Housing Challenge (EDHC) program awards from 2015 through 2017. It only shows projects that used EDHC appropriations; it does not show projects that used EDHC rules but did not also use the program's appropriations.

[a] These figures represent the number of units for which the project was awarded funding to develop or serve. Some projects had not yet completed all of their units or finalized their contracts with the Minnesota Housing Finance Agency at the time of our evaluation.

[b] These figures represent only the funds awarded from the EDHC program. All of these rental projects were awarded at least one other type of funding, such as first mortgages, through the consolidated funding process.

SOURCE: Office of the Legislative Auditor, analysis of EDHC program data provided by the Minnesota Housing Finance Agency.

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# Owner-Occupied Housing Projects Selected for Economic Development and Housing Challenge Program Awards from 2015 through 2017

## APPENDIX C

| Project Title | Applicant | Intended Service Area | Units Completed or Planned[a] | EDHC Funds Awarded |
|---|---|---|---|---|
| **2015** | | | | |
| Northeast Minnesota Community Impact Project–Owner-Occupied Rehabilitation[b, c] | Arrowhead Economic Opportunity Agency | Virginia | 1 | $ 205,000 |
| Family Stabilization Plan[e] | Build Wealth Minnesota, Inc. | Minneapolis, Brooklyn Park, Brooklyn Center, and St. Paul | 16 | 190,000 |
| New Construction[b, c] | City of Big Lake | Big Lake | 2 | 100,000 |
| Homebuyer Initiated Program | City of Lakes Community Land Trust | Minneapolis | 15 | 540,000 |
| Green Homes North Round 5[b] | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 11 | 416,670 |
| Rehabilitation Support Program | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 20 | 280,000 |
| Thief River Falls Building a Better Neighborhood—Phase 2 | City of Thief River Falls | Thief River Falls | 10 | 217,000 |
| New Construction of Four-Bedroom Homes[d] | Construction Consultant Minneapolis Metro, Inc. | Minneapolis | 2 | 109,250 |
| Suburban Fix-Up Incentive Program[b, c] | Greater Metropolitan Housing Corporation | Brooklyn Center, Crystal, and Richfield | 26 | 171,975 |
| Impact Fund #3[b] | Habitat for Humanity of Minnesota | 53 counties | 23 | 345,000 |
| Scattered Site New Construction | Habitat for Humanity Twin Cities | Blaine, Bloomington, Hugo, Prior Lake, Minneapolis, and greater east side | 34 | 988,680 |
| Owner-Occupied Rehabilitation | Headwaters Regional Development Commission | Beltrami, Clearwater, Hubbard, Lake of the Woods, Mahnomen | 11 | 100,000 |
| Home Accessibility Ramps Program[b] | Hennepin County Housing and Redevelopment Authority | Ramsey and Hennepin counties | 39 | 174,600 |
| Tax Forfeit to Affordable Homeownership | Hennepin County Housing and Redevelopment Authority | Minneapolis and suburban Hennepin County | 2 | 210,000 |
| Deferred Loan Program[d] | Lakes and Pines Community Action Council | Cloquet, Moose Lake, Mora, Princeton | 9 | 139,500 |

Continued next page.

| Project Title | Applicant | Intended Service Area | Units Completed or Planned[a] | EDHC Funds Awarded |
|---|---|---|---|---|
| **2015 (continued)** | | | | |
| Ash Avenue Restoration[b, c] | Midwest Minnesota Community Development Corporation | Frazee | 2 | $ 131,200 |
| Community Keys[b] | NeighborWorks Home Partners | St. Paul | 12 | 80,000 |
| Homeownership Program[b] | Northside Home, LLC | Minneapolis | 9 | 180,000 |
| Housing Resource Connection—Acquisition, Rehabilitation, Resale, and New Construction[e] | One Roof Community Housing | Duluth, Proctor, and Hermantown | 14 | 475,000 |
| Housing Resource Connection—Owner-Occupied Rehabilitation Community Fix-Up Loan Write-Down | One Roof Community Housing | Duluth | 12 | 50,000 |
| Foreclosure Recovery V—Acquisition, Rehabilitation, Resale and New Construction[b, c, e] | Powderhorn Residence Group | Minneapolis | 7 | 225,000 |
| Critical Repair Projects for Low-Income Homeowners[b] | Rebuilding Together Twin Cities | Minneapolis, St. Paul, Brooklyn Park, and Brooklyn Center | 12 | 80,000 |
| Southwest Regional Rehabilitation Pool[b, c] | Southwest Minnesota Housing Partnership | Redwood, Nobles, Murray, Lyon, Cottonwood, Jackson, Lincoln, Pipestone, and Rock counties | 6 | 165,000 |
| Emerging Markets Gap Financing[b] | Three Rivers Community Action | 20 counties | 14 | 120,000 |
| Home Fund Project Area Part 3 | Twin Cities Community Land Bank, LLC | St. Paul | 6 | 300,000 |
| Homes Within Reach[b] | West Hennepin Affordable Housing Land Trust | Bloomington, Brooklyn Park, Crystal, Deephaven, Edina, Eden Prairie, Golden Valley, Maple Grove, Minnetonka, New Hope, Richfield, St. Louis Park, and Wayzata | 6 | 114,000 |
| **2016** | | | | |
| Community Fix-Up Project[d] | Arrowhead Economic Development Agency | Virginia, Chisholm, Buhl | 10 | 42,000 |
| New Construction | City of Lakes Community Land Trust | Minneapolis | 2 | 140,000 |
| Organization-Initiated Acquisition-Rehabilitation Program | City of Lakes Community Land Trust | Minneapolis | 10 | 525,000 |
| Homebuyer-Initiated Program and Development | City of Lakes Community Land Trust | Minneapolis | 15 | 937,500 |
| Rehabilitation Support Program | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 45 | 236,842 |
| Vacant Housing Recycling Program | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 15 | 45,000 |

Continued next page.

| Project Title | Applicant | Intended Service Area | Units Completed or Planned[a] | EDHC Funds Awarded |
|---|---|---|---|---|
| **2016 (continued)** | | | | |
| Green Homes North/Infill Housing Development | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 12 | $ 500,000 |
| Inspiring Communities Program | City of St Paul Housing and Redevelopment Authority | St. Paul | 14 | 400,000 |
| Village on Rivoli | Daytons Bluff Neighborhood Housing Services | St. Paul | 4 | 248,020 |
| Impact Fund #4 | Habitat for Humanity of Minnesota | Minneapolis | 17 | 255,000 |
| Scattered-Site New Construction | Habitat for Humanity Twin Cities | Seven-county Twin Cities metropolitan area | 26 | 606,900 |
| 2016 Affordability Gap Categories 4 and 5 | Habitat for Humanity Twin Cities | Seven-county Twin Cities metropolitan area | 32 | 660,896 |
| Owner-Occupied Rehabilitation | Headwaters Regional Development Commission | Bemidji | 35 | 300,000 |
| Tax Forfeit to Affordable Homeownership[c] | Hennepin County Housing and Redevelopment Authority | Minneapolis | 2 | 105,000 |
| Healthy Homes Assistance Project | Hennepin County Housing and Redevelopment Authority | Minneapolis | 13 | 75,000 |
| Down Payment Assistance[d] | Housing and Redevelopment Authority of Perham | Perham | 8 | 56,000 |
| Owner-Occupied Rehabilitation Loan Program | Hutchinson Housing and Redevelopment Authority | Hutchinson | 10 | 73,878 |
| Home Ownership Initiative Phase IIIB—Acquisition, Rehabilitation, Resale, and New Construction | Lower Sioux Indian Community | Morton | 6 | 1,050,000 |
| Frazee Ash Avenue Restoration | Midwest Minnesota Community Development Corporation | Detroit Lakes | 2 | 120,500 |
| City of Mankato Mobile Home Replacement Pilot Programe[e] | Minnesota Valley Action Council | Mankato | 5 | 131,750 |
| Northside Home  Homeownership Program | Northside Home, LLC | Minneapolis | 10 | 250,000 |
| Grand Marais | One Roof Community Housing | Duluth and Grand Marais | 4 | 200,000 |
| Housing Resource Connection Owner-Occupied Rehabilitation | One Roof Community Housing | Duluth | 20 | 350,000 |
| Housing Resource Connection Acquisition-Rehabilitation | One Roof Community Housing | Duluth | 11 | 495,000 |
| Neighborhood Stabilization—Acquisition, Rehabilitation, Resale, and New Construction | Powderhorn Residence Group | Minneapolis | 6 | 210,000 |
| Critical Repair Projects for Low-Income Homeowners | Rebuilding Together Twin Cities | Minneapolis and St. Paul | 20 | 160,000 |
| Foreclosure Recovery[c] | Robert Engstrom Capital Management, LLC | Bloomington | 10 | 150,000 |
| Homeowner Affordability Gap[d] | Southwest Minnesota Housing Partnership | Slayton and St. Peter | 6 | 100,000 |

Continued next page.

| Project Title | Applicant | Intended Service Area | Units Completed or Planned[a] | EDHC Funds Awarded |
|---|---|---|---|---|
| **2016 (continued)** | | | | |
| Emerging Markets Gap Financing | Three Rivers Community Action | Zumbrota | 20 | $ 200,000 |
| Marshall Parkway II Home Ownership Program | United Community Action Partnership, Inc. | Marshall | 5 | 250,000 |
| Homes Within Reach | West Hennepin Affordable Housing Land Trust | Minnetonka | 9 | 115,000 |
| **2017** | | | | |
| Community Land Trust Expansion | Carver County Community Development Agency | Waconia | 5 | 50,000 |
| Homebuyer Initiated Program | City of Lakes Community Land Trust | Minneapolis | 20 | 900,000 |
| Minneapolis Homes Development Assistance | City of Minneapolis Department of Community Planning and Economic Development | Minneapolis | 20 | 750,000 |
| East-Central Neighborhood Revitalization Program | City of Winona | Winona | 13 | 291,200 |
| Village on Rivoli Phase II | Daytons Bluff Neighborhood Housing Services | St. Paul | 4 | 185,460 |
| Impact Fund #5 | Habitat for Humanity of Minnesota | Statewide | 25 | 375,000 |
| Scattered Acquisition, Rehabilitation, Resale | Habitat for Humanity Twin Cities | Minneapolis, St. Paul, Blaine, Plymouth, and Bloomington | 20 | 517,200 |
| Scattered-Site New Construction | Habitat for Humanity Twin Cities | Minneapolis, St. Paul, Blaine, W. St. Paul, Maple Grove, Prior Lake, Bayport, and Hugo | 29 | 1,264,845 |
| Baudette Single Family Project | Headwaters Housing Development Corporation | Baudette | 2 | 50,000 |
| Home Accessibility Ramps Program | Hennepin County Housing and Redevelopment Authority | Hennepin and Ramsey counties | 51 | 250,000 |
| Single Family Owner-Occupied Rehabilitation Program | Housing and Redevelopment Authority of Duluth | Duluth | 20 | 280,000 |
| City Home Improvement Loan Program | Hutchinson Housing and Redevelopment Authority | Hutchinson | 8 | 80,000 |
| Tiwahe Rehabilitation Loan Project | Lower Sioux Indian Community | Lower Sioux Indian Community Reservation | 15 | 532,500 |
| Oakdale Avenue Development | Neighborhood Development Alliance | St. Paul | 3 | 126,000 |
| Community Keys | NeighborWorks Home Partners | St. Paul | 10 | 100,000 |
| Facelift Program | NeighborWorks Home Partners | St. Paul | 12 | 186,000 |
| NEST Homes Value Gap Program | Northcountry Cooperative Foundation | Clarks Grove, Fairmont, Lindstrom, and Madelia | 10 | 180,000 |
| Northside Home | Northside Home, LLC | Minneapolis | 8 | 200,000 |
| Acquisition, Rehabilitation, and Resale | One Roof Community Housing | Duluth, Cloquet, Proctor | 8 | 310,000 |
| New Construction #1 | One Roof Community Housing | Grand Marais | 7 | 252,000 |
| New Construction #2 | One Roof Community Housing | Duluth | 3 | 150,000 |
| Moving On Pilot | Powderhorn Residence Group | Minneapolis | 5 | 75,000 |

Continued next page.

| Project Title | Applicant | Intended Service Area | Units Completed or Planned[a] | EDHC Funds Awarded |
|---|---|---|---|---|
| **2017 (continued)** | | | | |
| Neighborhood Stabilization II—Acquisition, Rehabilitation, Resale | Powderhorn Residence Group | Minneapolis | 3 | $ 75,000 |
| Neighborhood Stabilization II—New Construction | Powderhorn Residence Group | Minneapolis | 4 | 180,000 |
| Greenbelt Homes | Project for Pride in Living | Minneapolis | 9 | 450,000 |
| Critical Repair Projects for Low-Income Homeowners | Rebuilding Together Twin Cities | Minneapolis and St. Paul | 20 | 160,000 |
| Microhouse Prototype Project | Robert Engstrom Capital Management, LLC | St. Paul | 5 | 275,000 |
| Regional Rehabilitation Pool | Southwest Minnesota Housing Partnership | LeSueur, New Prague, Olivia, St. James, and Windom | 5 | 75,000 |
| Affordability Gap Financing Program | Three Rivers Community Action | Southeastern Minnesota | 10 | 100,000 |
| Northside Home | Urban Homeworks | Minneapolis | 8 | 280,000 |
| Down Payment Assistance Program | Washington County Community Development Agency | Washington County | 7 | 73,500 |
| Homes Within Reach | West Hennepin Affordable Housing Land Trust | Bloomington, Brooklyn Park, Deephaven, Eden Prairie, Edina, Golden Valley, Maple Grove, Minnetonka, New Hope, Richfield, St. Louis Park, and Wayzata | 8 | 200,000 |
| White Earth Housing Homeowner Rehabilitation Project | White Earth Reservation | White Earth Reservation | 12 | 250,000 |
| **Total, 2015-2017** | | | 1,114 | $24,320,866 |

NOTES: This table shows all owner-occupied housing projects that were selected for Economic Development and Housing Challenge (EDHC) program awards from 2015 through 2017. It only shows projects that used EDHC appropriations; it does not show projects that used EDHC rules but did not also use the program's appropriations.

[a] For projects that have been completed, these figures represent the actual number of units completed. For projects that are still in progress, these figures represent the number of units the project received funding to develop.

[b] This project was completed at the time of our review (at least before June 2018).

[c] This completed project did not spend a portion of the funds that it was awarded; any unspent funds were returned to the Minnesota Housing Finance Agency (MHFA) or were never disbursed. The original award figures are shown here.

[d] This completed project did not spend any of the funds that it was awarded; unspent funds were returned to MHFA or were never disbursed. The original award figures are shown here.

[e] This project received incentive funds from the EDHC program to complete units in addition to those for which it initially received funding.

SOURCE: Office of the Legislative Auditor, analysis of EDHC program data provided by the Minnesota Housing Finance Agency.

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February 4, 2019

James Nobles, Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles,

After reviewing the Office of the Legislative Auditor's evaluation of the Economic Development and Housing Challenge (EDHC) program, I am pleased that your thorough evaluation concluded that we administer the program well and appreciate insights and recommendations to improve the program.

Minnesota needs more housing that is affordable and the Challenge Program is the state's only housing development program appropriated by the Legislature. We believe homes are the foundation for strong communities and are critical to maintain our competitive edge. The recent Housing Task Force identified the need to build an additional 10,000 homes each year to meet demand and as the evaluation noted, demand exceeds funding for the program. Per the evaluation we are only able to fund 40% of the rental developments requests we've received the past five years.

As the evaluation highlights, the program's flexibility provides the opportunity to serve various and evolving housing needs in communities across the state. This flexibility has allowed the program to serve both rental and homeownership needs in communities in the metro and all corners of the state. Understanding that communities have a range of needs -- from building new homes to preserving existing homes -- and this program can do both. That flexibility is appreciated by our partners, and as the report states, "Stakeholders told us that the flexibility of the EDHC program is one of its most positive aspects."

Minnesota Housing has increased our technical support and guidance around our application process, but agree that we have more work to do to make the application process less complex. We will work to remove barriers for communities and developers to access these critical resources while also ensuring projects are built on time, within budget and meet all legal requirements, be well-managed and financially viable for 30 or more years.

Finally, housing is critical to economic development. Of the 18 rental projects that the evaluators examined, 14 were located in areas with job growth or long commutes, while the others provided evidence of current or anticipated job growth. If not for the Challenge program, these communities would have fewer housing opportunities for their workers and residents.

Thank you for the recommendations, the opportunity to comment on the evaluation and for the dedicated work of your staff.

Sincerely,

Jennifer Ho, Commissioner
Minnesota Housing

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## Forthcoming OLA Evaluations

*Debt Service Equalization for School Facilities*
*MnDOT Measures of Financial Effectiveness*
*Office of Minnesota Information Technology Services (MNIT)*

## Recent OLA Evaluations

Agriculture
*Agricultural Utilization Research Institute (AURI)*, May 2016
*Agricultural Commodity Councils*, March 2014
*"Green Acres" and Agricultural Land Preservation Programs*, February 2008
*Pesticide Regulation*, March 2006

Criminal Justice
*Guardian ad Litem Program*, March 2018
*Mental Health Services in County Jails*, March 2016
*Health Services in State Correctional Facilities*, February 2014
*Law Enforcement's Use of State Databases,* February 2013
*Public Defender System*, February 2010

Economic Development
*Minnesota Investment Fund*, February 2018
*Minnesota Research Tax Credit*, February 2017
*Iron Range Resources and Rehabilitation Board (IRRRB)*, March 2016
*JOBZ Program*, February 2008

Education, K-12 and Preschool
*Early Childhood Programs*, April 2018
*Minnesota State High School League*, April 2017
*Standardized Student Testing*, March 2017
*Perpich Center for Arts Education*, January 2017
*Minnesota Teacher Licensure*, March 2016
*Special Education*, February 2013

Education, Postsecondary
*Preventive Maintenance for University of Minnesota Buildings,* June 2012
*MnSCU System Office*, February 2010
*MnSCU Occupational Programs*, March 2009

Energy
*Renewable Energy Development Fund*, October 2010
*Biofuel Policies and Programs*, April 2009
*Energy Conservation Improvement Program*, January 2005

Environment and Natural Resources
*Public Facilities Authority: Wastewater Infrastructure Programs*, January 2019
*Clean Water Fund Outcomes*, March 2017
*Department of Natural Resources: Deer Population Management*, May 2016
*Recycling and Waste Reduction*, February 2015
*DNR Forest Management*, August 2014
*Sustainable Forest Incentive Program*, November 2013

Government Operations
*Mineral Taxation*, April 2015
*Minnesota Board of Nursing: Complaint Resolution Process*, March 2015
*Councils on Asian-Pacific Minnesotans, Black Minnesotans, Chicano/Latino People, and Indian Affairs*, March 2014
*Helping Communities Recover from Natural Disasters,* March 2012
*Fiscal Notes*, February 2012

Health
*Office of Health Facility Complaints*, March 2018
*Minnesota Department of Health Oversight of HMO Complaint Resolution*, February 2016
*Minnesota Health Insurance Exchange (MNsure)*, February 2015
*Financial Management of Health Care Programs*, February 2008

Human Services
*Home- and Community-Based Services: Financial Oversight*, February 2017
*Managed Care Organizations' Administrative Expenses*, March 2015
*Medical Assistance Payment Rates for Dental Services,* March 2013
*State-Operated Human Services,* February 2013
*Child Protection Screening*, February 2012
*Civil Commitment of Sex Offenders*, March 2011
*Medical Nonemergency Transportation*, February 2011

Housing and Local Government
*Economic Development and Housing Challenge Program*, February 2019
*Consolidation of Local Governments,* April 2012

Jobs, Training, and Labor
*State Protections for Meatpacking Workers*, 2015
*State Employee Union Fair Share Fee Calculations*, July 2013
*Workforce Programs*, February 2010
*E-Verify*, June 2009
*Oversight of Workers' Compensation*, February 2009

Miscellaneous
*Minnesota State Arts Board Grant Administration*, February 2019
*Board of Animal Health's Oversight of Deer and Elk Farms*, April 2018
*Voter Registration*, March 2018
*Minnesota Film and TV Board*, April 2015
*The Legacy Amendment*, November 2011
*Public Libraries*, March 2010

Transportation
*MnDOT Highway Project Selection*, March 2016
*MnDOT Selection of Pavement Surface for Road Preservation*, March 2014
*MnDOT Noise Barriers*, October 2013
*Governance of Transit in the Twin Cities Region*, January 2011

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