O'NEIL CONSULTING

DISTRESSED PROPERTY DATA PROJECT

RESEARCH FINDINGS – QUALITATIVE INTERVIEWS

REPORT I: DISTRESS INDICATORS - OPERATIONS AND PROPERTY SUBGROUPS

September 2024

CONTENTS

I. INTRODUCTION

Affordable Housing in Distress: Exacerbated by the Pandemic

Entering 2024, the national multifamily sector had absorbed four years of extraordinary turmoil with many providers of regulated affordable housing hit unusually hard. In Minnesota, the Legislature and the Walz administration provided $50 million in emergency relief funds to 43 affordable housing providers across the State. Without this support, tens of thousands of affordable multifamily units could have been lost from the regulated supply due to owner insolvency.

While many believe that distress in the regulated housing sector peaked in 2023, housing operators still cite problems persisting at unsustainable levels. Rent collection loss remains a primary issue, notably for projects offering permanent supportive housing (PSH) and units serving renters at and below the 30% to 50% AMI income level.

Rent collection problems have had a multi-year impact on property operations. Eviction moratoria programs expired in the second half of 2022 and housing providers faced continued rent loss and a marked increase in eviction filings over the next year. In 2023, bad debt filtered through property finances and unit turnover costs rose considerably as evictions moved forward. After tenants moved out, many operators cited extensive damage to units, some as costly as $15,000 to repair.

Higher interest rates and lower property valuations will ensure that difficult situations remain for operators who have projects needing near-term refinancing or requiring sale to stem financial losses. And while inflation has cooled, operating costs –especially for labor– have stabilized at a much higher level.

Per the National Institutes of Health (NIH), the COVID-19 pandemic "collided" with the national drug overdose and addiction crisis, with social isolation, stress, and increased rates of drug use exacerbated by the societal response. Regulated housing operators focused on protecting the safety of residents through these converging challenges, but the heightened task put substantial pressure on property staff and daily challenges persist.

Finally, there is a larger preservation story that underlies the pool of LIHTC properties throughout the State. The first LIHTC-funded apartments in Minnesota were delivered in 1988 and at least 30,000 new units have been placed in service since then. Nearly 8,000 units are 20 years or older and in need of rehabilitation. Unfortunately, few resources exist to help recapitalize much of this vital housing supply, as State and local preservation efforts focus on pre-LIHTC housing with federal operating subsidy contracts.

About the Distressed Property Data Project

The Minnesota Housing Stability Coalition ("the Coalition") came together in the fall of 2023 to address the significant threats to the stability of low-income residents, individual rent-restricted properties, and entire affordable housing portfolios that resulted from the historic rise in inflation, dramatic increases in interest rates, elevated operating and security costs, and reductions in rent collection since the COVID-19 pandemic.

The process began with two large in-person convenings in the fall, followed by twelve smaller work group meetings over the course of three months to develop and solidify a set of legislative priorities. During the 2024 legislative session, the Coalition met weekly to receive updates about legislative progress and advise on strategy and priorities. More than 70 people from 36 organizations statewide contributed to these recommendations. Planning for the 2025 legislative session by the Coalition is ongoing.

To support the Coalition, the Family Housing Fund (FHF) and the Greater Minnesota Housing Fund (GMHF) initiated the Distressed Property Data Project ("the data project"), aimed at fully understanding the current state of distressed regulated affordable housing in Minnesota.

The data project is being completed in phases, beginning with qualitative interviews with housing providers and other stakeholders in June and July 2024 and finishing with quantitative analysis of operational and financial data in the summer and fall. During the project, Mr. O'Neil will occasionally provide written summaries or briefings to inform the legislative process, the ISG, and the Task Force on Long-Term Sustainability of Affordable Housing (the "Task Force"), which is convening from August 2024 through January 2025.

Mr. O'Neil will keep opinions and data collected from interviewees confidential and he will report research findings in an aggregated or summary format. Mr. O'Neil will work with data that has been assembled by housing operators, governmental agencies, and/or portfolio monitoring organizations under terms outlined by each data provider.

Data Project Objectives

1. **Collect and analyze project level data to help the ISG develop recommendations for prioritization of recapitalization and other resources, administrative changes, and potential project-, portfolio-, enterprise-, and industry-level solutions.** To the extent possible, the project will consider a broad range of distressed properties in different subgroups, as indicated by funding source, operator type, tenant population, supportive services, location, and other important characteristics.

2. **Make the conditions of the affordable housing system (or a subset thereof) visible.** Understand the broad landscape of distressed regulated housing: identify trends, common

issues, and common problems to better understand the current landscape and identify system improvements to address challenges ("We can't solve what we can't see"). To the extent possible, we will consider the following issues:

a. Funder priority of deeply affordable housing with services, and the lack of long-term supportive service funding support
b. The confluence of supportive services costs not accurately modeled at project approval and funding with the unexpected increase in operating costs
c. The universal challenges in all regulated affordable housing related to increased operating costs and the discrepancy between the costs modeled in underwriting and the actual costs experienced by housing operators
d. Ability to analyze data based on different criteria, including, but not limited to: supportive housing and use of coordinated entry systems, funding source, etc.
e. Identifying qualitative data of urgency that may require more immediate prioritization

3. **Use data and analysis to inform the broader public policy discussion with the nuance and delicacy it deserves**, from the industry perspective, and identify appropriate solutions to address the problems.

4. **Coordinate on-going data collection processes and identify resource needs to monitor the health of regulated affordable housing over time**, across a variety of housing provider organizations throughout Minnesota.

Data Project Timeline

Month	**Distressed Property Data Project**
June 2024	Phase 1: Qualitative interviews
July	Phase 1: Qualitative interviews
August - October	Phase 2: Interview summary report delivered mid-August Phases 3 and 4: Quantitative data collection and analysis
November	Phase 5: Draft report with qualitative and quantitative research findings and recommendations delivered by November 11th
December 2024	Phase 6: Deliver final report by December 16th

II. SCOPE OF INTERVIEWS / BROADER INDICATORS OF DISTRESS

Scope of Interviews

Mr. O'Neil conducted face-to-face interviews with 34 individuals across Minnesota, divided into two groups: 1) affordable multifamily housing provider organizations, and 2) professionals working as consultants, lenders, vendors, policy analysts, and advocates.

The interviewees held roles in 17 or more disciplines / functional areas. Five of the housing provider organizations conducted interviews in groups of two to four staffers, enabling distress topics to be discussed in a multidisciplinary manner.

Exhibit 1:
Data Project Interviewees by Industry Role

Housing Provider Organizations	No. Interviewed
Executive Director/CEO	6
Operations/Asset Mgmnt./Property Mgmnt.	6
Finance	3
Development / Portfolio Strategy	3
Policy and Service Partnerships	1
	19
Industry Professionals	
Compliance / Tax Credits / Devel. Consulting	4
Private Lender	3
Public Funder	3
Finance, Valuation, Investment	3
Advocacy and Public Policy	2
	15
17+ Roles, 34 Interviewees	

The eight housing provider organizations included in the interview process collectively owned roughly 19,000 regulated multifamily units in Minnesota at the start of 2024. This group was selected to be a representative sample, not an exhaustive one, of the regulated multifamily housing industry in Minnesota.

Mr. O'Neil asked interviewees to:

- provide **detailed information on causes of distress** at properties, within property subgroups, and at the organizational / enterprise level.
- offer thoughts on **what is needed immediately to provide help** to operators of portfolios in critical distress, and what could be done to provide **long-term solutions** to any of the factors underlying specific areas of distress.
- identify **data sources and research paths** to quantify specific areas of distress in the next phase of the data project.

Mr. O'Neil also attended six industry events where issues and policies were discussed by a wide variety of affordable housing stakeholders. Appendix Exhibit 1 presents the list of interviewees and industry meetings involved in the qualitative interview phase of the data project.

Broad Indicators of Distress

Many interviewees cited broader indicators of distress at the property, property subgroup (like-kind), and parent organization levels. These comments provide a valuable, principal framework for understanding the specific, line-item points of distress that are addressed in the next sections.

Distress Indications: Property and/or Property Subgroup Levels

- Operations that produce **negative cash flow** or fall well below budget.
- **High, sustained vacancy or steadily rising vacancy**.
- The presence of **permanent supportive housing, (PSH) units**, especially those integrated in smaller numbers into a larger affordable property ("integrated PSH").
- **Negative operational issues not deemed to be one-time events** (e.g., problematic rates of crime and vandalism in the neighborhood requiring 3rd party security contracts).
- **Continually high staff turnover** or **persistent staffing shortages**.
- **Deferred maintenance with insufficient funds** to do the work.
- **Difficulties passing physical inspections** that are required by funding sources. This often signals units in poor condition for tenants. Repeated failure of a property to pass inspections may also jeopardize vital rent subsidy payments to the operator.
- **Debt-service coverage ratio (DSCR) below 1.0**, signifying an inability to pay a mortgage obligation.
- **An older building with high repair needs.**
- Buildings with **a history of damages and high insurance deductibles**.
- Locations in **areas with security concerns and crime issues**.
- Locations in **rural communities with stagnant or declining populations**.
- **Depleted reserves**, or **strict lender requirements** denying access to them.
- **Near-term maturing debt** that cannot be **refinanced without a loss in mortgage proceeds** or will **produce a loss to the operator upon sale**.

Distress Indications: Parent Organization Level

- A **bleeding REO schedule**; the schedule of owned properties reveals negative financial indicators for the parent such as cash flow problems or difficulties paying hard debt.
- **Big drops in liquidity**; cash reserve accounts drop to very low levels, reducing flexibility of corporate responses to new stressors.
- **Using corporate staff to fill in** for staff inadequacies at the property level.
- **Property-level management fees not paid to the corporate office**. Parent companies may rely on fees from individual properties to fund central office functions or resident services.
- **Organizational debt guarantees** for projects in significant or great distress.

How Public Policy Priorities Intersect at the Housing Provider Level

Public policy objectives guide organizations serving individuals facing significant barriers to housing. Housing providers work within policy and regulatory frameworks to realize important goals for all types of individuals, across a wide range of needs and situations. In theory, the system leaves no one behind. However, while necessary, public policy objectives can also focus on outcomes that are impossible to deliver cost effectively in the current environment, especially with regard to housing that offers services for very specific challenges around mental health, addiction, disability, homelessness, and other conditions or situations.

Post COVID-19, housing providers across Minnesota have been facing a number of overwhelming challenges in fulfilling policy objectives. For example, the coordinated entry system (CES) throughout the State asks organizations to provide housing to a growing number of individuals who need an increasing array of services, yet funding systems have stagnated. As a result, more individuals are living in housing untethered from the support they need to be successful. Untreated mental health or addiction issues in many cases have escalated to problematic behavior affecting the health and safety of the tenant, other residents of the building, and on-site staff.

Another example comes from public financing underwriting policies. Underwriting methods utilize moment-in-time assumptions or projections about property operations to determine appropriate investment levels. Public institutions prioritize wise stewardship of taxpayer resources and are thereby careful not to "over subsidize" any individual project in order to make public funds stretch as far as possible. While this is a good philosophy in theory, it can also have the opposite effect: stretching organizational budgets beyond what is sustainable and thereby putting the taxpayer dollars that have been invested into that project at risk. This has become particularly noticeable in the recent high-inflation period where costs quickly jumped, and wage rates often doubled. Affordable rental housing providers, who are limited in gathering additional revenue, are left to manage with insufficient funds to keep the operating budget in balance. While public agencies can provide some financial relief, the path for such relief is perceived by providers as slow or insufficient to meet the financial pressures of the moment.

General Observations on Non-Profits Providers, Especially Those with Service Missions

Non-profit affordable housing providers report higher levels of distress than for-profit organizations for a few key reasons:

- Many non-profit housing providers **follow a mission that puts high priority on serving the needs of people**. Integral to this mission are decisions and programs that allow tenants repeated opportunities to recover from mistakes without putting their housing in jeopardy. This adds significant cost.
- Non-profits often **provide tenants with services in addition to housing**. Service delivery requires a unique organizational infrastructure for funding and delivery.
- Negative economic, health, and social **effects of the pandemic disproportionately affected low-income community members**, the same broader population that is served by many non-profit housing providers.
- Non-profits are more **likely to rely on donations and grants**, which vary in amount from year-to-year and require additional staff to oversee.

III. SPECIFIC AREAS OF DISTRESS: PROPERTY OPERATIONS

Introduction

Points of distress at regulated affordable properties are shown below by the frequency of comments by interviewees.

The apparent prevalence of the distress factor within the regulated housing system is listed next to each factor in italics. This represents a judgment by Mr. O'Neil from interview comments. Underlying causes and important details for each distress factor follow in bullet format. It is important to note that these bulleted lists are not necessarily exhaustive. They are intended to help stakeholders understand important nuances and complexities correlated to distress factors.

Employing data to quantify the magnitude of impact of distress factors will come in phases 3 and 4 of the data project (Quantitative Data Collection and Analysis).

Rent Collection Loss: *Present across much of the regulated supply but greatly heightened among PSH and 30% AMI units*.

- Many operators report a substantial change in tenant payment patterns since pre-COVID:
    - Lower actual payments received from tenants.
    - More tenants having difficulty paying rent.
    - Higher levels of rent non-payment. This may, in part, reflect incomes for very low-income tenants falling further behind the significant rises in the cost of living.
- Among PSH Properties:
    - Rent collection loss is the top issue across the country driving PSH property loans into the high-risk category, per one affordable lender with a national portfolio.
    - One larger PSH operator in the Twin Cities cited a 14% drop in average collections in 2023, with the situation no different thus far in 2024.
- Eviction backlogs in the court system have exacerbated rent loss from eviction.
- Rent Subsidy Payments, Vouchers, and Emergency Assistance Examples:
    - HUD's maximum 1%-3% annual increase in the rent payment standard has not kept up with the much higher increases in property expenses. Operators may raise rents to current market levels by engaging an appraiser for a rent comparability study (RCS), but the RCS can only be undertaken on each fifth-year anniversary of the HAP contract renewal (years 5, 10, 15, etc.).
    - Certain programs have not kept up with payment standards or inflation; older McKinney Vento vouchers are one example.
    - Delays in income-certifying tenants under the Housing Choice Voucher program have exacerbated rent loss for some providers, as rental assistance payments are suspended until the certification is complete.

Vacancy and Bad Debt: *Present across much of the regulated supply; presumably lower among newer 60% AMI LIHTC properties and most age-restricted properties.*

- Eviction Issues:
  - With the expiration of eviction moratoria, many operators became saddled with a large inventory of vacant units. Bringing units back online proved costly, took longer than expected, and required intense effort by staff.
  - Providers continue to report a lack of staff to prepare and release units to new tenants after eviction, extending the vacancy period.
- Heightened Vacancy Among PSH Properties:
  - Vacancy is a significant distress factor among PSH units. In one extreme example, an operator cited a vacancy rate of nearly 25% (several dozen units) at one project, driven by compounding factors: neighborhood security issues, more evictions, slow unit turns, staffing shortages, and delays in screening / selecting new tenants.
  - Lease-up delays related to the Coordinated Entry System were reported by all Twin Cities PSH providers as a critical issue creating vacancies and rent loss.
- Crime and Neighborhood Perception:
  - Occupancy rates are down in areas with higher crime rates.
  - Some tenants have moved out from central city districts once they saw local crime occurring.
- Programmatic Issues:
  - Local funding requirements that require occupancy by a very narrow target group of supportive housing tenants can lead to extended vacancies as operators attempt to find “unicorn” candidates.
  - Matching tenant needs with appropriate housing and services can take significant time and leaves units vacant for longer than is forecast in project budgets.
- Labor Market Forces:
  - Many types of regulated housing, including LIHTC projects in the Twin Cities suburbs and PSH units in Greater Minnesota, report a lack of qualified subcontractors to complete repair work, increasing vacancy periods.
  - In many Greater Minnesota counties, wages are rising faster than LIHTC AMIs, effectively lowering the pool of eligible renters.
    - Aitken County example: the 60% AMI only went up 3.9% (2022-2023), but wages at entry level jobs nearly doubled.
- Bad Debt:
  - Operators absorbed higher costs from bad debt in 2023 as evictions proceeded after the expiration of eviction moratoria.
  - There is reportedly higher bad debt write-off with long term homeless (LTH) and high-priority homeless (HPH) units as operators provide multiple opportunities for vulnerable tenants to succeed in recovery rather than face eviction.

Property Management and On-site Staffing: *Pervasive across the regulated housing supply.*

- Staff cost increase is the most critical issue cited by one large operator. Many others report it as a top problem.
- Non-profits often lack the funds to keep pace with competitive wage offers by other companies/other industries.
- Local wages are increasing in rural counties far above programmatic rent increases.
- Site Manager Labor Costs:
  - Site manager costs have risen dramatically. For one Greater Minnesota operator with smaller size properties, site manager hourly wages have doubled in the past 2-3 years, consuming valuable cash flow in razor-thin financial operations.
  - Property staff wages, per one Twin Cities operator, are still considerably below market in 2024, leaving organizations vulnerable to further staff losses.
- Staff Shortages and Turnover:
  - Many operators report being perpetually short-staffed in property management. Salaries and retention are the two primary issues.
  - There is a loss of institutional knowledge with staff turnover. What one experienced staffer could do now might require two or more inexperienced staffers to do.
- Stress on Staff:
  - Many providers report an increase in difficult interactions with tenants compared to pre-Covid. Numerous interviewees stated that this factor has contributed to increased staff turnover, and the greater need to recruit new employees.
  - The tasks of on-site staff changed significantly in response to health and safety concerns during COVID. Staff had to switch to online tools for leasing and tenant relations, employ new processes for purchasing supplies and managing vendors, follow new security procedures, and more. One executive stated the job changes were extremely consequential in nature.
- Permanent Supportive Housing Complexities:
  - The property manager's role at PSH properties requires extensive contact with tenants at move-in, and to ensure ongoing service provision. Increased evictions and greater turnover of tenants over the past two years has intensified these tasks.
  - PSH operators often provide tenant services directly with staff and also through independent partners. Managing both adds complexity and cost.

Repair and Maintenance: Staffing: This category includes a broad range of staff activities including groundskeeping, janitorial/cleaning, and repairs and maintenance of building systems and components. *Pervasive across the regulated housing supply.*

- Operators report being perpetually short on maintenance staff. Rising wages and finding qualified workers are the two underlying stressors.
- Salaries for maintenance staff are a particularly significant cost issue for many operators.

    - One operator cited a rise in general labor costs from $15/hour to $27/hour in a 2- to 3-year span.
- Loss of key personnel drains a property of vital operational knowledge. Staff losses may also deplete critical concentrations of workers needed to complete tasks in a timely manner.

Repair and Maintenance: Vendors / Suppliers and Supplies: *Pervasive across the regulated housing supply.*

- Any third-party service that requires labor is far higher in cost now than pre-COVID.
- All types of supplies are now more expensive. Costs have gone "through the roof," per one interviewee.
- New components and appliances have greatly risen in cost since pre-COVID.
    - One operator's examples: refrigerators have increased from $400 to $900, and doors from $200 to $900.
- Vendor Constraints:
    - Vendors indicate that they have also lost staff as the labor market has become more volatile since COVID began.
    - Vendors cannot undertake as many projects as they did a few years ago, a sign of lower capacity in the industry.
    - Vendors now take longer to provide repair bids and longer to complete the work.
    - An operator reported waiting 8 months for the replacement of one window at an older property, among other delay examples.
- Operators often lack reserve funds to pay premium rates to expedite vendor work orders.
- Operators with properties in the central cities report significant increases in vandalism, with much higher spending in the past few years on new doors, locks, and windows.

Insurance: *Pervasive across the regulated housing supply, but more pronounced at older buildings, projects that regularly incur more damage from neighborhood crime and vandalism, or projects where units are more regularly damaged.*

- Insurance is a critical expense issue across nearly all properties per operators and lenders.
- Numerous interviewees cited rises of 70%, 100%, and higher in insurance costs:
    - Higher policy premiums in general.
    - Higher deductibles in general.
    - Cost increases for hail and wind coverages and the elimination of certain coverages like terrorism acts.
- Industry Contraction and Changes to Risk Models:
    - Some affordable properties are lucky to get coverage of any type as industry contraction has shrunk the pool of national insurers.
    - Some providers have been denied access to the Housing Partnership Insurance Exchange, an important national insurance program serving affordable providers.

- Key Cost Drivers:
  - Building age: Claims are higher with older NOAH properties with aging components, especially plumbing systems.
  - Several operators reported more water events within units as a leading cause of claims; sprinkler set-offs, clogged/overflowing toilets.
  - Claims for one large operator are split 50-50 between building age issues and damage to units, with the latter cause being more frequent since COVID began.
- Deductibles:
  - Wind and hail damage deductibles are increasing to 2 to 4% of property values.
  - Owners with reserve money don't need to submit small claims and can manage a $25,000 deductible.
  - Owners without reserve money are forced to submit small claims or leave repairs undone.
  - Example: a burst pipe flooding two floors would have cost $5,000 out of pocket a few years ago with the rest covered by insurance. A similar event now would cost $50,000 to $100,000 out of pocket prior to insurance payment.
- To save overall costs, one operator with a large portfolio is considering segregating its market rate projects into a pool that is self-insured by the parent organization. The affordable properties would stay with third-party insurers.

Unit Turnover: *Most pronounced among PSH units and those serving units at or below 50% AMI, particularly at or below 30% AMI.*

- The turnover of units was widely cited among interviewees as a significant point of distress that has escalated in the past two years.
- Turnover cost is reflected in increased staff time, rent loss, and direct costs to repair units.
  - One larger operator stated that "operational disruption" and actual dollar losses from turnover represent the second biggest problem for the organization.
- This issue remains prominent in 2024 for several reasons: high supply costs, more staff involvement, and vendor issues (lack of availability and higher costs).
- Several operators reported that unit "downtime" is longer than pre-COVID, meaning rent loss is higher.
- Repair Cost Testimonials:
  - Turnover costs have risen from $1,000/unit to $6,000 to $7,000 in many cases.
  - Unit turns formerly cost $750/unit but now are between $3,000 and $4,000 typically, with $5,000/unit being a "don't blink" figure, and some hitting $10,000 to $11,000.
  - Factoring the direct cost to turn a unit plus the economic vacancy can total $15,000 to turn one unit.

- Costs for carpets and appliances have been notable cost stressors at smaller and/or rural projects, per one operator. Carpet replacement has increased from $1,500 to $3,000 per unit, and new ranges have gone up from $400 to $800.
- Damage to just two units at a 30-unit rural project that is only five years old wiped out the year's cash flow for the property.

- One operator with 20+ properties prioritizes units they can turn and re-tenant within 60 days ("minimizing" annual rent loss to 17% for that unit).
  - Some units will take up to six months to get back online.
  - Units that are heavily damaged are continually put "at the back of the line" and are ignored "again and again" in favor of units that can be turned more quickly.

Evictions: *Most pronounced among PSH units and those serving units at or below 50% AMI, particularly at or below 30% AMI.*

- The number of evictions spiked after the expiration of eviction moratoria in later 2022, but several operators serving residents at or below 30% AMI reported higher levels still in 2024.
- Evictions produce higher costs in several operational areas: legal fees, unit vacancy and rent loss, repairs / unit turns, and administrative staff time.
- PSH operators provide repeated opportunities for a tenant to recover from mistakes, and evictions at PSH units often only occur when the operator determines it can provide no other options. This extended commitment to vulnerable residents increases costs.

Security: *Much more focused on properties in central city districts with higher crime and negative neighborhood perceptions; also higher among PSH and 30% AMI units.*

- Security expenses were one of the top issues in 2024 in decisions to downgrade loan ratings at nearly 20 PSH properties nationally, per one lender with a large portfolio.
- Security issues are most acute in both downtowns, the Lake Street corridor, and along the Green Line in St. Paul, as reported by two larger providers.
- Several operators cited crime and neighborhood instability as external factors out of their control but requiring a strong response.
- Security Cost Testimonials:
  - The third largest problem for one large, complex provider is tenant security/safety.
  - One provider has hired a private security firm and a security consultant for a large project in a high-crime area.
  - A newly rehabbed project in a central city district cycled through five property managers in 18 months due to security problems in the neighborhood.
  - Security costs have become a critical issue for a suburban-focused provider, even in senior buildings, where the provider has installed cameras and additional locks.

Compliance: *Most pronounced for PSH providers, but also for projects funded with many different development sources.*

- Compliance reporting has increased in volume due to higher amounts of unit/resident turnover at PSH properties since eviction moratoria expired.
- The compliance function has been highly complex for PSH operators historically, but higher amounts of staff turnover in recent years have left many providers with less experienced staff to conduct highly detailed processes.
    - One Greater Minnesota PSH provider with a large portfolio cited compliance reporting as a serious point of distress for its operations, and a more acute problem in recent years.
- Examples of Compliance Complexity:
    - One medium-size provider of PSH manages 20 unique sources of funds for housing and services across 13 properties. Each source has unique program requirements, specific tenant selection criteria, and distinct reporting requirements. (See Appendix Exhibit 2.)

Coordinated Entry System (CES): *Pervasive across the PSH system.*

- Lease-up delays related to CES were reported by all Twin Cities PSH providers as a critical issue compounding vacancies and rent loss.
- Operators cited system backlogs, eligibility determination, difficulties in matching tenants with appropriate units, and overall process complications that create extensive delays. (See Appendix Exhibit 3 for an example of the complexity of tenant placement in one HIV housing option.)
- Several operators cited a lack of funding increases to match the rising need for mental health services provision.

Supportive Services Funding: *Pervasive across the PSH system.*

- One operator stated: “It’s getting harder to find sources. We are always writing grants.”
- Housing with Supports for Adults with Serious Mental Illness (HASAMI) grants are facing more competition.
- Priorities of Funders Change:
    - Housing providers chase funding sources and ramp-up to serve a specific group, then the funding sources dry-up.
    - Example per one provider: Housing chronic alcoholics was a high priority with funders a few years ago, but now that interest has waned in favor of other groups.

Reserve Accounts: *Pervasive across the system but worse among properties serving 30% AMI rent levels and PSH tenants, at older properties, or those with much deferred maintenance.*

- Property-level reserve accounts have been drawn down at many properties across the industry since COVID began.
- Some operators gained approvals from lenders to use project reserves to fund property cash shortfalls in 2020 through 2023, but now have depleted reserves at certain properties.
- Some operators tried to maintain property reserve balances by subsidizing building operations with corporate funds or corporate staff time over the past few years. However, lenders have become reluctant in many cases to now release reserves funds to shore up operations, even though some properties have significant reserve fund balances.

Difficult Environment for Restructuring and Recapitalization: *Pervasive across the entire regulated housing system.*

- Operators are placing regulated and NOAH properties on the sale market to stem losses.
- Projects are becoming sale candidates due to maturing debt and/or unfunded repair needs. However, higher interest rates are yielding lower mortgage amounts, presenting a cash loss for the operator at sale. (See Appendix Exhibit 4.)
- Maturing debt is a critical event that is increasingly driving projects to lender loan watch lists, per two lenders with national portfolios.
- The level of deferred maintenance is higher at many LIHTC properties than assumed in original 15-year proformas. This is exacerbating refinance or sale challenges.
- Valuation Issues:
  - Poor historical operating incomes from 2020-2023 translate to lower property valuations, and in turn lower supportable mortgage amounts.
  - Comparable-project analyses in appraisals also reflect lower project incomes and thus lower comparable valuations.
- Projects with many financing sources and regulatory covenants must renegotiate disposition terms individually with each partner in a difficult and protracted process.
- At year 15, an owner may want to keep subordinate debt in place with a refinance or sale, but some funders will require repayment instead of term extension or debt resubordination.
- One finance executive stated that, without recapitalization funds for LIHTC projects at year 15, many will leave the regulated system, and will become unregulated NOAH with deferred maintenance.
- There are reportedly fewer buyers for NOAH properties given higher interest rates and many properties with significant amounts of deferred maintenance.
- When a project fails to qualify for preservation funds, owners frequently continue to operate the property with little capital investment, leaving poorer quality housing for residents.

Public Funding Sources and Processes: *Nearly all interviewees discussed issues related to funding programs and processes across a variety of sources.*

- Underwriting methods utilize moment-in-time assumptions or projections about property operations to determine appropriate investment levels. However, tension arises when the underwriting assumptions or projections do not match the reality of the operating environment, and affordable rental housing providers, who are limited in gathering additional revenue, are left to manage with insufficient funds. While public agencies can provide some financial relief, the path for such relief is perceived by providers as slow or insufficient to meet the financial pressures of the moment.
- Since late 2021, housing providers have been unable to use first mortgage multifamily loan products from FHA/HUD on transactions that seek secondary gap funds from Minnesota Housing. HUD introduced a revised form of Subordination Agreement, effective September 2021, which included provisions that run counter to Minnesota Housing's stance on subordinating funds to Federal sources. Minnesota Housing and HUD have been working to find a solution but have not come to an agreement thus far.
- Although Housing Infrastructure Bonds (HIBs) do not allow the funding of operating and capital reserves, there nonetheless remains a need among providers for such funds. Reserves become vital sources for projects that need cash infusions in periods of distress.
- QAP scoring incentivizes regulated housing providers seeking preservation funding to add set aside units to serve special needs populations. In the experience of many providers, claiming these scoring points is necessary to be successful in securing funding. This is perceived by many operators as an "unfunded mandate" to access preservation funding because it is not accompanied with supportive services funding.
- Several operators expressed frustration that some public funders fail to recognize the negative operational outcomes that stemmed from public funder underwriting requirements and assumptions –including the availability of service funding, and growth assumptions about revenues and operating costs– that did not bear out as projected.

IV. DISTRESS AMONG PROPERTY SUBGROUPS

Introduction

Interviewees provided extensive details about operational distress within like-kind property subgroups. This section touches on many of the key distress points discussed in the previous section, but through the subgroup lens. This perspective may help in the development of scalable solutions across broader property groups.

The groupings below are not exclusive to one another. A given property may overlap with two or more listed subgroups, an example being a mixed-population Section 8 property in Greater Minnesota. This schema intends to simplify for the reader a complex universe of regulated housing types.

Housing with Services: Permanent Supportive Housing (PSH) and LTH / HPH Units:

No property subgroup presents the myriad distress factors as those faced by housing with supportive services. This stems from the complex task of providing tailored services to tenants with specific challenges in a variety of settings and building types. Forces that distress other property subgroups – items such as insurance cost increases or staffing shortages – have become magnified in the housing + services provider community and property subgroup.

Within the larger PSH category, there are two main types of properties: buildings where 100% of the units offer PSH services, and buildings with just a small number of PSH units (often 5-10) integrated within a larger affordable building that otherwise offers limited services ("integrated PSH"). Integrated PSH presents great challenges for effective service delivery to residents.

Causes of Distress:

- Pervasive income loss from increased vacancies, frequent and drawn-out evictions, lower tenant payments, coordinated entry delays, and "hard turns" that keep units vacant for extended periods.
- Much higher demand for services but stagnant funding:
  - Many more high-acuity mental health conditions reported now over pre-COVID.
  - Increased drug use at properties and in neighborhoods.
- Much higher costs for staff of all types, especially property management and maintenance.
- Persistent staff turnover due to job stress, or higher wage opportunities elsewhere.
- Higher costs for supplies and purchased services of all types.
- Severe insurance problems: costlier premiums and deductibles triggered by a greater number of claims and increased levels of property damage.
- Heightened security costs per a variety of factors, but often driven by neighborhood instability.

- Limited or negative cash flow and depleted reserves, creating burdens on the parent organization.
- Specific Challenges with Integrated PSH:
    - A lack of economies of scale with serving a handful of tenants in a building that otherwise offers no services.
    - No 24-hour onsite staff for quick response to tenants in mental health crisis.
    - Extended periods of crisis for a tenant can go unnoticed by the operator, possibly affecting neighbors and leading to legal issues, tenant trauma, or unit damage.

30% AMI Units with No Services and Section 8

Causes of Distress:

- More tenants with high-acuity mental health conditions now occupy units without services due to the backlog of PSH unit availability and services funding shortfalls.
- Higher reported drug use among tenants, and in some cases, among residents of the neighborhood.
- Property management duties have become more challenging; more frequent unit turnover, increased need to meet with tenants on rent issues or payment, new marketing efforts to fill vacancies (not previously needed).
- Higher costs for labor, supplies, and services as with other property subgroups.
- More likely to be located in a central city area where chances are higher for crime, producing higher costs for security, repairs, and insurance.

Central-City Districts with Greater Public Safety Needs

Causes of Distress:

- Downtown Minneapolis, Downtown Saint Paul, the Green Line LRT corridor in St. Paul, and Uptown / the Lake Street corridor were all cited as areas with higher distress from crime, heightened drug use, and market perceptions of insecurity.
- Crime and disruption at some projects have become "intractable," putting heavy stress on property-level operations, with staff turnover a critical issue.
- Owners have reported high costs for third-party security, and much higher costs to repair damage when turning units.
- Staff in certain high-crime areas have experienced stress due to safety and security concerns, which creates staff turnover.
- Higher vacancy rates have become the norm in the past few years, with rent reductions not necessarily successful at attracting new tenants.
- Some properties have difficulty gaining insurance coverage, or coverage is very costly.

Properties in Greater Minnesota

Causes of Distress:

- Problems Related to Small Scale:
    - Cashflow is particularly lean at RD-funded projects, which typically only earn about $2,000 in net income per year, per one interviewee.
    - Buildings with fewer than 50-75 units lack economies of scale in maintenance and general staffing costs.
    - A narrow range of problems can cause outsized harm to rural projects, which invariably have fewer units.
    - For more complicated projects or populations, there often isn't enough revenue to pay third-party property managers, forcing operators into self-management.
- Difficulty with Service Provision:
    - The pool of service providers for PSH/LTH/HPH units in close proximity to any given community in Greater Minnesota is small. There is usually only one choice of provider for a given project or area.
    - Long commutes across extensive rural land leaves providers with less time to work with individual residents.
    - Many buildings only have a few tenants who need services.
- Smaller Pool of Renters:
    - Senior project-based Section 8 projects in some communities need waivers for age and income to keep full.
    - Some small towns have limited employment and no in-migration. Projects in these situations report a struggle to keep full.
    - Local wages are going up far faster than HUD AMIs in various places. This lowers the pool of eligible renters for affordable properties.
- Income and Rent Standards:
    - The LIHTC income restrictions are often below RD restrictions, so there are renters who qualify for LIHTC, but not RD.
    - There may be a significant difference in LIHTC rents, RD rents, and HUD FMR's.
- Many buildings in rural communities are greatly in need of repairs and upgrades.

50 to 60% LIHTC with no Services

Causes of Distress:

- Many LIHTC properties approaching their 15-year compliance period or 30-year extended use period have deferred maintenance but have been unsuccessful with large-scale recapitalizations through Minnesota Housing's consolidated RFP.
- Several years of increased expenses have depressed operating income, creating difficulties for properties seeking to refinance debt or to be sold to a new owner.

- Some operators report that they have many supportive housing candidates who are living in 50% or 60% LIHTC units without services.

Naturally Occurring Affordable Housing (NOAH)

Causes of Distress:

- Many older NOAH buildings are in substantial need of repairs and upgrades.
- NOAH properties have suffered from the same cost inflation on staff, supplies, and vendors as other property subgroups have.
- There are reportedly fewer buyers for NOAH properties given higher interest rates and deferred maintenance needs at many properties.
- Many owners are selling at a loss.
- Typical mortgage balloon maturities on NOAH property loans are between 7 and 10 years, under more favorable interest rates than current rates. This creates refinance challenges.

Projects with Mixed Populations and Senior Buildings

Causes of Distress:

- Mixed Populations:
    - Tenants in 30% AMI, LTH, or HPH units integrated in an otherwise market-rate or 60% AMI rent building are difficult to serve effectively for providers. This can present challenges to tenant safety and security.
    - Federally funded, age-restricted (62+) buildings also serve non-senior tenants with disabilities. One investor deeply familiar with Section 8 properties reports that seniors have moved out from several rural properties due to “lifestyle differences” in these properties.
- 100% Section 8 senior projects needing repairs –especially those in rural Minnesota– report being unsuccessful in securing funding through the framework of the current QAP.

V. RECOMMENDED READING

Priority Reading List

- The Whole Industry Could Collapse: D.C.'s Housing Providers Face An Existential Crisis (BisNow)
  - Highlights the collapse of Neighborhood Development Co as a symptom of a larger housing crisis in which 80% of low-income housing properties aren't bringing in enough rental income to cover mortgage and maintenance costs.
- A Note from Priya: Making Preservation a Priority (National Housing Trust)
  - National Housing Trust's CEO describes the industry-wide financial threat that could mean lost affordable housing across the nation.
- Talking Toilets, Taxes, and Tenants: Challenges Mount for Apartment Owners in Twin Cities Area (Federal Reserve Bank of Minneapolis)
  - Summarizes findings from interviews with leaders of Twin Cities affordable housing providers and describes the steep cost increases that are threatening these buildings' financial sustainability.
- The Dundry - A Case Study in how Soaring Security Costs are Threatening Affordable Housing (Star Tribune)
  - Chronicles the loss of 25 units of deeply affordable housing for people exiting homelessness and the costs that proved higher to demolish than it would have been to save, had any preservation funding source been available.
- The High Cost of Maintaining Affordable Housing (Finance & Commerce)
  - Describes the significant financial hardships nonprofit housing providers are facing, given rapidly rising operating costs over recent years.
- Affordable Housing Preservation Strategy Framework: 2023 (Oregon Housing & Community Services)
  - A statewide policy framework developed through a community engagement process that identified a set of values and priorities for preserving public investments in affordable housing.
- Impediments in the Affordable Housing Insurance Marketplace (Fairview Housing Partners)
  - 14-page background brief articulates the factors that are contributing to rapidly increasing - and even inaccessible - insurance premiums for affordable housing providers.

Additional Resources

- 2024 Legislative Changes
  - Tracked changes document showing the legislative changes that were passed during the last session.

- Race Place Policy Podcast: State of Affordable Housing (Project for Pride in Living)
  - Twin Cities housing leaders Paul Williams (PPL), Deidre Schmidt (CommonBond Communities), and Chris LaTondresse (Beacon Interfaith Housing) discuss the wide-ranging challenges facing their organizations and the sector at-large.

- Affordable Housing Credit Study Report (Cohn Reznick)
  - Broad marketplace overview of Low-Income Housing Tax Credit (LIHTC) properties across the nation, including recent performance, current risks, and future projection.

VI. APPENDICES

1. List of Interviewees and Information Sources for Phase 1
2. Exhibit: Heavy Staffing Burden: Housing and Services Funding Complexities for Supportive Housing
3. Exhibit: Hennepin County Descriptions of One Path of the HIV Housing Referral Process, July 2022
4. Exhibit: Lending Challenges: Decline in Mortgage Proceeds for FHA Multifamily Mortgages

1. List of Interviewees and Information Sources for Phase 1: Distressed Property Data Project

Housing Provider Organizations (19 Interviewees)

Name	Organization	Title
Caroline Horton	Aeon	Chief Financial Officer
Tyler Parette	Aeon	Chief Policy & Partnerships Officer
Laura Russ	Aeon	Chief Real Estate Officer
Nancy Cashman	Center City Housing Corp.	Executive Director
Coleen Cole	Center City Housing Corp.	Director of Property Management
Deidre Schmidt	CommonBond Communities	President and CEO
Henry Parker	CommonBond Communities	Director of Asset Management
Skip Duchesneau	D.W. Jones, Inc.	Owner
Tony Shertler	Dakota County CDA	Executive Director
Kari Gill	Dakota County CDA	Deputy Executive Director
Katherine Kugel	Dakota County CDA	Housing Finance Program Coordinator
James Archer	Matrix Development, LLC	Owner
Scott Cordes	Project for Pride in Living	Chief Financial Officer/ SVP of Operations
Rashida Jackson	Project for Pride in Living	Vice President of Housing Operations
Leslie Seaberg	Project for Pride in Living	Director of Asset Management
Barb McQuillan	Twin Cities Hsg. Dev. Corp.	Executive Director
Ken Isaacson	Twin Cities Hsg. Dev. Corp.	Development Manager
Debra Palmquist	Twin Cities Hsg. Dev. Corp.	Senior Asset Manager
Margaret Metzdorff	Twin Cities Hsg. Dev. Corp.	Senior Asset Manager

Affordable Multifamily Lenders, Funders, Vendors, Consultants, Policy / Advocacy (15)

Name	Organization	Title and Area of Expertise
Lyn Burton	Afford. Housing Connections	Executive Director; Compliance
Mike Bisanz	Colliers Mortgage	SVP and COO, HUD/FHA; Private Lending
Anthony Schulze	Colliers Mortgage	Assistant Vice President; Private Lending
Mary Tingerthal	Tingerthal Group	President; Finance and Policy Consulting
Julia Welle Ayers	Hennepin County HRA	Housing Development and Finance Director
Sarah Larson	Landon Group	Principal; Tax Credit Dev. & Finance Consulting
Louise Zawojski	Landon Group	Principal; Tax Credit Dev. & Finance Consulting
Peter McLaughlin	Local Initiatives Support Corp.	Exec. Dir.; Housing & Community Investment
John Patterson	Minnesota Housing	Director of Planning, Research and Evaluation
Eric Thiewes	Minnesota Housing	Multifamily Portfolio Manager; Public Funding
Doug Wageman	Nicollet Partners	Multifamily Appraiser / Valuation
Andrea Ponsor	Stewards of Affordable Housing for the Future	President and CEO; Affordable Housing Policy

Affordable Multifamily Lenders, Funders, Vendors, Consultants, Policy / Advocacy (15) ***(cont.)***

Name	Organization	Title and Role
Nicole Manchester	Stewards of Affordable Housing for the Future	Director, Data & Analytics; Affordable Housing Policy
Donovan Walsh	The Financial Services Consulting Group	Executive Management Consultant; Housing Finance
Dan Smith	USBank	Director of Business Dev.; Lending/LIHTC

Discussion Groups and Industry Conferences That Provided Additional Information (6)

Affordable Housing Summit	May 9, 2024
Distressed Property Data Project Advisory Group Meeting	May 20, 2024
MN Housing Stability Coalition: End-of-Session Meeting	May 30, 2024
MHP 2024 Legislative Session Wrap-Up	June 4, 2024
MN Housing 2026-27 QAP Online Presentation	June 18, 2024
QAP 2026-27 Discussion with MN Housing Staff and Industry Stakeholders	June 20, 2024

2. Heavy Staffing Burden: Housing and Services Funding Complexities for Supportive Housing

(Sources: Minnesota Department of Human Services and a Greater Minnesota Housing Provider)

HOUSING REVENUE SOURCES BY TENANT - 11 Shown

- Self-pay/tenant portion
- Income Supplements
  - Housing Support (formerly Group Residential Housing)
  - Housing Support-Supplemental Service Rate (SSR)
  - Minnesota Supplemental Aid (MSA) Housing Assistance
- Vouchers
  - Section 8 Housing Choice Voucher
  - Bridges and Bridges Regional Treatment Center (RTC)
  - Housing Trust Fund Rental Assistance
  - Family Unification Program
- Project-based
  - Section 8
  - HUD Homeless Programs
  - Housing Trust Fund Rental Assistance

→ Detailed Eligibility Rules, Specific Application Processes, Unique Compliance Formats →

SERVICES REVENUE SOURCES BY TENANT - 12 Shown

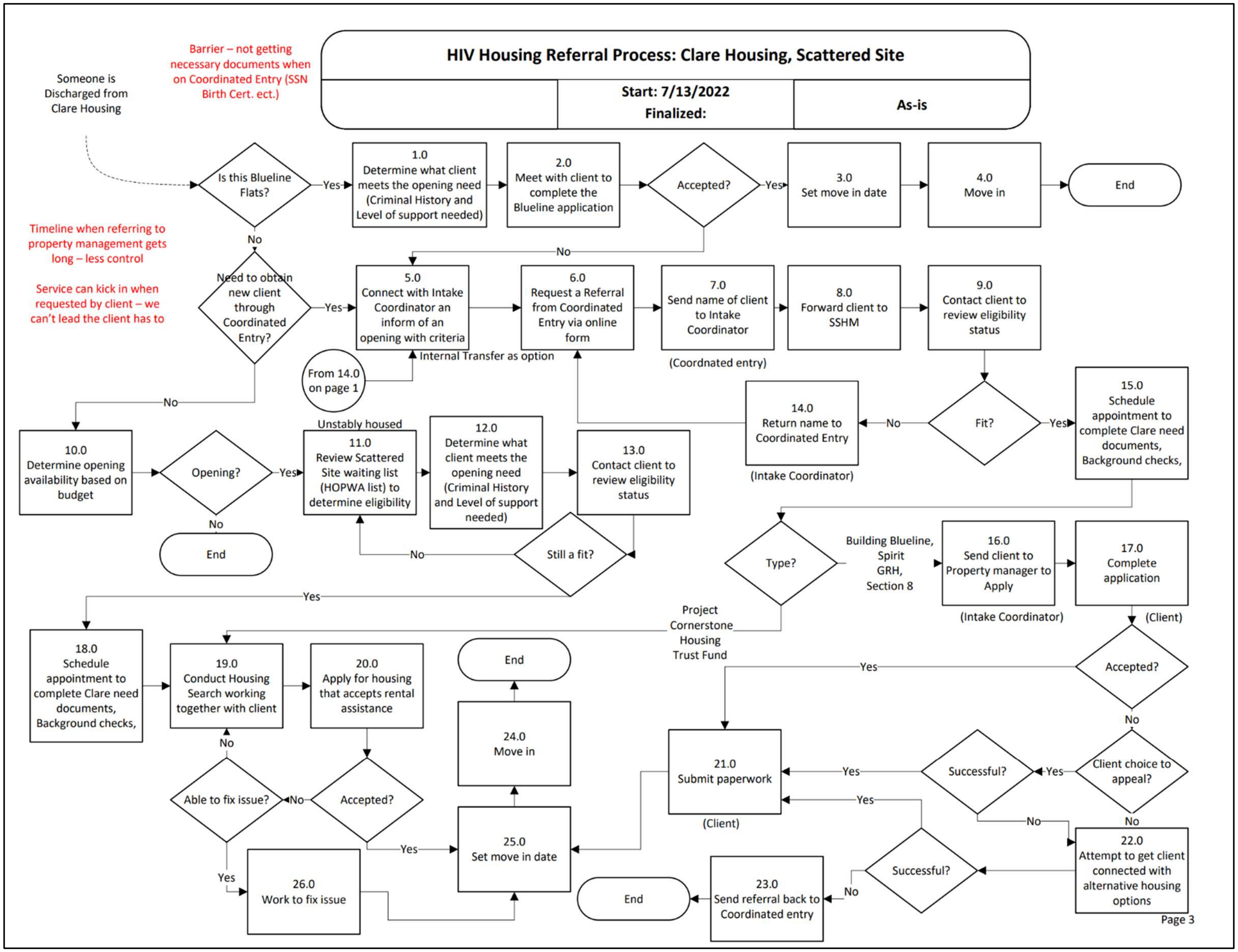
- Supportive Housing
  - Long-term Housing Services and Supports (LTHSS)-State Funds
  - HUD Homeless Programs (Continuums of Care)
  - Housing Support Supplemental Services (LTH and non-LTH)
- Personal Care Assistant (PCA)
- Waiver Programs
- Mental Health
  - Targeted Case Management
  - Assertive Community Treatment
  - Adult Rehabilitative Mental Health Services (ARMHS)
  - Grants-Projects for Assist. in Transition from Homelessness (PATH)
  - Grants-Housing with Supports for Adults w/ Serious M-I (HSASMI)
- Housing Stabilization Services (Medicaid Benefit-Seniors & Disability)
- County Funds (e.g. St. Louis County for staff costs)

→ Detailed Eligibility Rules, Specific Application Processes, Unique Compliance Formats →

PERMANENT SUPPORTIVE HOUSING PROVIDERS

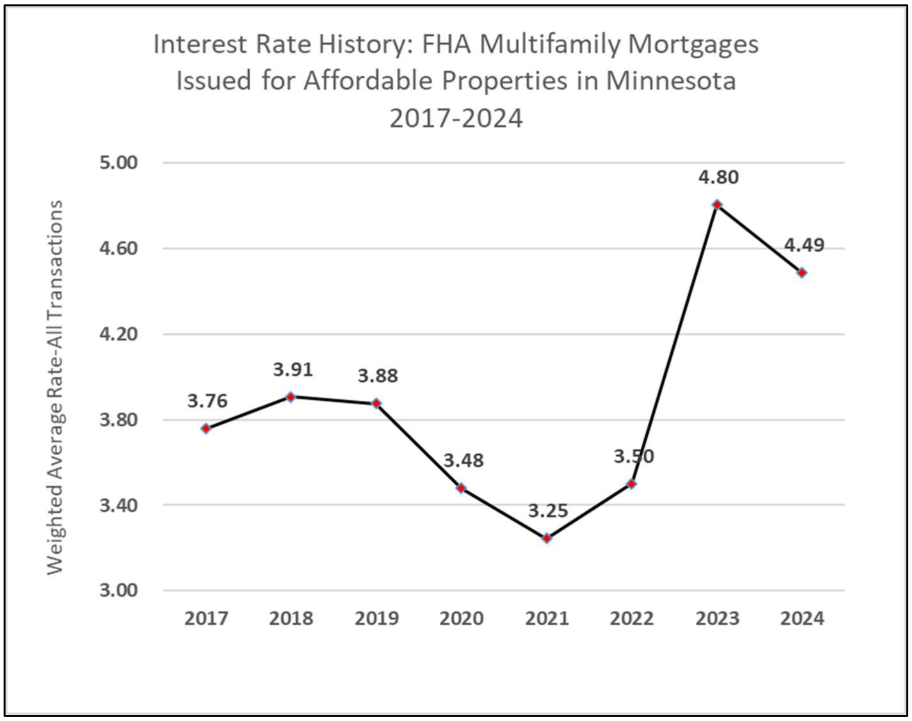
Note: The chart above does not necessarily show all possible housing and services revenue sources that may be associated with a given tenant in Minnesota.

3. Hennepin County Descriptions of One Path of the HIV Housing Referral Process, July 2022



4. Lending Challenges: Rising Interest Rates and the Decline in Mortgage Proceeds for FHA Multifamily Mortgages, 2017-2024

(Sources: Housing and Urban Development, O'Neil Consulting)



Pressure From Rising Interest Rates:
Declining Mortgage Proceeds as Rates Increase
FHA-Insured Multifamily Affordable Mortgages
2017-2024

Assumed NOI	Mortgage Proceeds: Period Low Rate* 3.25% (2021)	Mortgage Proceeds: Period High Rate* 4.80% (2023)	Difference in Proceeds: High Rate vs. Low Rate
$ 50,000	$ 1,118,000	$ 888,000	$ (230,000)
$ 100,000	$ 2,236,000	$ 1,776,000	$ (460,000)
$ 200,000	$ 4,473,000	$ 3,553,000	$ (920,000)
$ 400,000	$ 8,947,000	$ 7,106,000	$ (1,841,000)
$ 500,000	$ 11,184,000	$ 8,883,000	$ (2,301,000)

*Weighted average rate for properties financed during the year.
Note: The average mortgage issued on affordable properties in MN during 2017-2024 (5/31) was $7.99 million, with an assumed NOI of roughly $360,000 to $450,000. 108 affordable properties with 9,491 units are covered by this data.

Source: Active Multifamily Insured Mortgages, HUD, 5/31/24