

OVERVIEW

Properties financed by the United States Department of Agriculture (USDA) Rural Development (RD) 515 Loan Program provide affordable homes to more than 9,550 households in Minnesota, primarily seniors, individuals with disabilities, and families with extremely low incomes. Most of the RD housing stock was built in the 1970s and 1980s, with funding provided by USDA in the form of a first mortgage (515 mortgage) paired with federal project-based rental assistance. RD buildings are scattered throughout Minnesota and are an important part of the affordable housing continuum in the state – in large part because of the project-based rental assistance associated with the 515 mortgage and the vulnerable populations that are served. In addition, these projects are usually in smaller sized towns where they are one of a few, if not the only, rental housing option (refer to attached USDA RD Portfolio Number of Units). These aging buildings are often owned and operated by individual borrowers who have limited capacity to address deferred maintenance issues. Rents in these buildings are low, and due to the break-even budgeting approach required by the 515 loan program, many properties have not built up reserves sufficient to address needed improvements and larger capital items.

In order to preserve this essential federally subsidized housing, it is important to address both the critical physical needs of these projects and build the capacity of borrowers throughout the state. To that end, Minnesota Housing established the Rental Rehabilitation Deferred Loan (RRDL) Pilot Program in the fall of 2011 to repair and preserve smaller scale rental housing stock with federal project-based rental assistance (e.g., Section 8, RD rental assistance) or permanent rental housing that is naturally affordable to the local workforce and convenient to jobs, transportation, and essential services. The Minnesota Legislature typically appropriates \$3-4 million each year to the RRDL program. The program was designed to address the needs of modest-sized rural buildings, generally containing between 12-30 units total, that have not competed well for other state resources such as low income housing tax credits. Recently, Minnesota Housing streamlined the RRDL program and launched a special request for proposals (RFP) in partnership with the local USDA office to focus specifically on the preservation of USDA RD projects with RD 515 mortgages and rental assistance.

This RFP – the RRDL RD RFP – was designed to build on the success of previous state funding efforts and the partnership with the Minnesota USDA RD state office to preserve USDA RD housing. RRDL resources were made available to any owner of RD buildings of eight or more units in the form of a 20-year deferred loan up to \$500,000 (or \$35,000/unit maximum) with 10% forgiveness at the end of the loan term. USDA RD staff partnered with Minnesota Housing staff and agreed to reamortize applicants' remaining RD 515 mortgages to be co-terminous with the RRDL loan term – thus preserving the valuable rental assistance attached to the 515 mortgage and implementing much needed capital improvements.

INNOVATION

The RFP involved a unique partnership with USDA RD staff and a new streamlined application process to make it easier for borrowers who have limited capacity. By sharing data and analysis between the two agencies and collaboratively assessing a number of USDA buildings, the partnership was able to achieve economies of scale that resulted in a more efficient application review and a streamlined application process for project owners.

The RFP was carefully designed to balance the capacity of RD owners with reasonable application requirements. From past experience, we know that application requirements can dissuade owners from applying. The newly developed application process required a minimal number of items needing to be submitted (only eight), which included preliminary construction and development costs and a form allowing RD to share information with us. This data sharing enabled RD to provide us with previous operating reports, budgets, and inspection reports for each property. Applicants were also required to

connect with Minnesota Housing staff for technical assistance so that staff could proactively offer guidance applicants might not otherwise seek out. This technical assistance is provided at no cost to help them submit the most robust application possible.

Once applications were submitted, Minnesota Housing's RRDL staff worked closely with Minnesota's USDA RD housing director and multifamily housing specialist to review each development's historic and future rents, operating expenses, balance sheets, rental assistance, and mortgage maturity dates. By leveraging our relationship with USDA RD, we were able to remove a lot of the uncertainty surrounding future operations of the recommended properties, which in turn helped mitigate our lending risk.

REPLICABILITY

The issues facing RD projects are not unique to Minnesota. Many states have RD buildings with deferred maintenance and limited ownership capacity and are looking for creative ways to preserve the housing and the valuable rental assistance associated with it. The partnership that we have formed with the state USDA RD office to preserve these important housing assets could be replicated in other areas. Since the RFP launched, we have already been approached by other states asking for assistance in establishing similar programs.

We are fortunate in Minnesota to have state appropriated funds dedicated to the needs of rural affordable housing. This is due in large part to strong partnerships throughout the state that successfully and collectively advocate for housing resources at the state capitol. In addition, Minnesota has an Interagency Stabilization Group (ISG), which is a coalition of funding agencies that works to identify properties in need of preservation across the state and advocates for preservation resources. The ISG has been instrumental in understanding the particular needs of existing RD housing in Minnesota and successfully conveying that information to key stakeholders.

RESPOND TO AN IMPORTANT STATE HOUSING NEED

Preserving housing with federally based rental assistance is an important priority for Minnesota. There are 456 RD buildings in the state, providing 9,550 units of housing for extremely low income individuals and households. In the last 10 years, the state has lost 47 RD projects (totaling 673 units) due to mortgage maturity (refer to attached USDA RD Portfolio Mortgage Maturation Date) and has made a concerted effort to prevent loss of more units when possible. In addition, more than 76% of RD buildings in Minnesota are more than 30 years old, with limited access to funding for repairs.

Since 2012, Minnesota has successfully preserved 32 RD projects with 633 units using the RRDL program. In addition, through Minnesota Housing's annual Consolidated RFP, we have preserved an additional 19 USDA properties having 577 units.

Through the special RRDL RD RFP, we have now been able to preserve an additional 21 projects at one time – encompassing 544 units (refer to attached RRDL Recommended Selections). By pairing this rehab resource with the requirement of borrowers to reamortize their RD mortgages for a longer term, borrowers are able to keep the rental assistance attached to the RD 515 mortgage – benefitting both the property and residents. Because RRDL is a state appropriation, we anticipate similar RFPs in the future, which will allow us to preserve even more units.

DEMONSTRATE MEASURABLE BENEFITS TO TARGETED CUSTOMERS

This program addresses the needs of RD borrowers who have limited capacity to repair aging buildings. In this special RFP, we have been able to fund 21 RD projects, with a total of 544 units. Measurable benefits to residents are improved quality of the buildings and units in which they live and preserved rental assistance attached to their units for a minimum of an additional 20 years. Residents of RD 515

housing are extremely low income – with an average income of \$13,551 across the state; 65.2% of the residents in RD projects are elderly and/or disabled.

PROVEN TRACK RECORD OF SUCCESS IN THE MARKETPLACE

The RRDL program has a proven track record of success with RD properties in Minnesota. Since 2012, RRDL has helped Minnesota successfully preserve 32 RD projects having over 633 units. These projects ranged in size from eight to 36 units, and each project was able to complete significant repairs with the RRDL loans. The RRDL RD RFP builds on this success by enabling the preservation and stabilization of 21 more RD projects with 544 units.

PROGRAM BENEFITS THAT OUTWEIGH COSTS

Reamortizing the RD 515 mortgages to extend their term is an important strategy to preserve the rental assistance in RD projects. By working with RD to ensure that the 515 mortgages were extended to match the term of the RRDL funding, we were able to address both deferred maintenance and keep the rental assistance in the projects. The RRDL RD RFP provided \$9.6 million to 21 projects. A conservative calculation of the present value of the rental assistance shows it to be more than twice the amount of the funding provided through the RFP, far outweighing Minnesota Housing's costs.

DEMONSTRATE EFFECTIVE USE OF RESOURCES

The RRDL RD RFP demonstrated an effective use of both staff and financial resources. By partnering with RD staff that have a deep knowledge of the applicants and properties, we were able to reduce hours spent on review and feasibility assessments of the projects. In addition, for every dollar spent in RRDL funds, we were able to preserve two times that amount in recaptured federal rental assistance.

EFFECTIVELY EMPLOY PARTNERSHIPS

We worked closely with USDA RD staff on application review, initial scoring, analysis of owner capacity, and ranking of the RFP applications. Our partnership with USDA RD effectively allowed both agencies the opportunity to better position these developments for the long term by:

- Addressing critical deferred maintenance issues and stabilizing aging buildings
- Strengthening the overall position of each development's day-to-day operations
- Facilitating the reamortization of USDA RD 515 mortgages nearing maturity so that developments are able to keep their rental assistance through the USDA RD program
- Adding additional rental assisted units to buildings that are partially assisted

The RFP has also been able to strengthen partnerships with RD property owners and management companies by providing easier access to funding, and guidance and technical assistance during the application and post selection due diligence processes to ensure success.

ACHIEVE STRATEGIC OBJECTIVES

The RRDL program underscores one of Minnesota Housing's Strategic Goals, which is to "Preserve the Condition and Affordability of Existing Housing." The RRDL RD RFP helped us achieve this objective by preserving 21 projects of existing RD housing in a way that better aligns program expectations, outcomes, and risk with the needs in the communities served.

In addition, USDA RD staff emphasizes the importance of sharing Minnesota Housing's goals for long-term preservation: *"The partnership with Minnesota Housing and USDA RD will help households throughout greater Minnesota and further each agency's mission of providing affordable housing. The RRDL program is providing much needed rehab to rural rental housing and ensures these properties will be around for at least another 20 years."*