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CONSULTING

DISTRESSED PROPERTY DATA PROJECT

PHASE 1 RESEARCH FINDINGS – QUALITATIVE INTERVIEWS

MEMO I: EXECUTIVE SUMMARY

Prepared for:

Family Housing Fund
Greater Minnesota Housing Fund

September 2024

Distressed Property Data Project
Phase 1 Research Findings – Qualitative Interviews

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Project Background

The Minnesota Housing Stability Coalition ("the Coalition") assembled 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 sharp rise in inflation, dramatic increases in interest rates, elevated operating and security costs, and reductions in rent collection since the COVID-19 pandemic. The Coalition is comprised of roughly 40 statewide housing providers and funders.

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") to better understand the current state of distressed at regulated affordable housing in Minnesota. FHF commissioned Thomas O'Neil of O'Neil Consulting to complete the work. The first phase of research involved interviews with housing provider organizations, who collectively own roughly 19,000 units across Minnesota, and industry professionals.

Mr. O'Neil interviewed 34 individuals, divided into two groups: 1) staff at affordable multifamily housing provider organizations across the State, and 2) professionals working as consultants, lenders, vendors, policy analysts, and advocates. Based on interview comments, Mr. O'Neil made judgments about the apparent prevalence of each distress factor within the regulated housing system.

Broad Findings

- **In the current environment, public policy goals for service provision in housing are proving very difficult to achieve for most non-profit providers.** Objectives for service provision may focus on outcomes that cannot be delivered cost effectively in this highly stressed environment, especially with regard to housing that offers services for very specific challenges around mental health, addiction, disability, homelessness, and other conditions or situations.

- **Non-profit affordable housing operators report higher levels of distress than for-profit organizations.** This is due to: a) organizational missions that allow tenants repeated opportunities to recover from mistakes without putting their housing in jeopardy, b) an organizational focus on low- and very low-income residents, who were disproportionately harmed by the pandemic, and c) higher reliance on donations, grants, and services funding, all of which vary in amount from year-to-year.

SPECIFIC AREAS OF DISTRESS: PROPERTY OPERATIONS

Rent Collection Loss: *Present across much of the regulated supply but greatly heightened among Permanent Supportive Housing (PSH) and units target to households with incomes at or below 30% of Area Median Income (AMI).*

- Since the start of COVID-19, housing operators report lower payments received from tenants, more tenants having difficulty paying rent, and higher levels of rent non-payment, reflected in part by incomes of very low-income tenants falling further behind the significant rise in the cost of living.

Vacancy and Bad Debt: *Present across much of the regulated supply; presumably lower among newer properties rented at 60% AMI under the Low-Income Housing Tax Credit (LIHTC) program, and most age-restricted properties.*

- Post eviction moratoria, many operators became saddled with a large inventory of vacant units. Bringing units online proved costly, took longer than expected, and required intense staff effort.
- Providers continue to report a lack of staff to prepare and release units to new tenants, depressed occupancy in higher-crime areas, and delays filling units through the Coordinated Entry System.
- Operators absorbed higher bad debt costs as evictions proceeded after the end of the moratoria.
- Operators report increased bad debt among units serving formerly homeless individuals who are given multiple chances to succeed rather than face eviction.

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

- Greatly increased labor costs, higher turnover, and insufficient funds to keep pace with competitive wage offers has led to staff shortages and the loss of operational knowledge at many properties.

Repair and Maintenance: Staffing: *Pervasive across the regulated housing supply.*

- Operators report being perpetually short on maintenance staff. Rising salaries and finding qualified workers are the two main underlying stressors.

Repair and Maintenance: Vendors / Suppliers and Supplies: *Present across much of the regulated supply but greatly heightened among Permanent Supportive Housing (PSH) and units priced at or below 30% AMI.*

- Third-party services that require labor are far higher in cost now than pre-COVID. All types of supplies increased substantially in cost, with appliances, doors, and windows doubling in price according to several interviewees.

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

- Insurance is reported by both operators and lenders as one of the most significant and unpredictable expenses across all property types.

- Numerous interviewees cited increases of 70%, 100%, and higher in insurance costs since COVID began, with higher policy premiums and deductibles, cost increases for hail and wind coverages, and the elimination of certain coverages such as terrorism acts.
- Some affordable properties are lucky to get coverage of any type as industry contraction has shrunk the pool of national insurers.

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

- Turnover cost, widely cited as a significant point of stress that has escalated in the last two years, is reflected in increased staff time, rent loss, and direct costs to repair units.
- This issue remains a key stressor in 2024 for several reasons: inflated costs for supplies, more staff involvement, and vendor issues (lack of availability and higher costs).

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

- The number of evictions spiked after the expiration of eviction moratoria in 2022, but operators serving residents at or below 30% AMI reported higher levels still in 2024.
- 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 units and units priced at or below 30% AMI.*

- Security issues are most acute in both downtowns, the Lake Street corridor, and along the Green Line in St. Paul, as reported by operators.
- Several operators cited crime and neighborhood instability as external factors out of their control but requiring a strong response.

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

- Compliance reporting has increased in volume and cost due to higher amounts of unit/resident turnover at PSH properties since eviction moratoria expired.

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

- Operators cited system backlogs, eligibility determination, difficulties in matching tenants with appropriate units, and overall process complications that create extensive delays in leasing units.

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

- Operators report stagnant or declining services funding, but significant increases in the number of residents needing assistance who they work to serve.

Reserve Accounts: *Pervasive across the system but worse among properties with units priced at or below 30% AMI and/or PSH units, at older properties, or those with significant deferred maintenance.*

- Property-level reserve accounts have been drawn down at many properties across the industry since COVID began, leaving them with fewer financial assets to withstand additional stress.

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

- Projects are becoming sale candidates due to persistent operating losses, 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.
- 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: *All interviewees discussed issues related to funding programs and processes across a variety of sources.*

- Several interviewees cited tension that arises when underwriting assumptions or projections do not match the reality of the operating environment, and affordable rental housing providers, who are limited in gaining additional revenue, are left to manage with insufficient funds.
- 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.
- QAP scoring incentivizes housing providers seeking preservation funding to add set aside units for special needs populations. In the experience of many providers, claiming these scoring points is necessary for securing funding. This is perceived by many operators as an "unfunded mandate" because the scoring criteria is not accompanied with supportive services funding.

DISTRESS AMONG PROPERTY SUBGROUPS

Interviewees provided extensive details about operational distress within like-kind property subgroups. The groupings below are not exclusive to one another, as a given property may overlap with two or more listed subgroups. 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

- The PSH property subgroup is suffering far more distress than any other subgroup. 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 – such as insurance cost increases or staffing shortages – have become magnified in the housing + services provider community and property subgroup.
- PSH properties come in two main types: buildings where 100% of the units offer PSH services, and those with only a small number of PSH units (often 5-10) integrated into a larger affordable building that otherwise offers limited services ("integrated PSH"). Integrated PSH lacks economies of scale for cost-effective and timely delivery of services to residents, adding further operating stress.

30% AMI Units with No Services and Section 8 Units (Project-Based and Housing Choice Vouchers)

- 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.
- Property management duties have become more challenging with more frequent unit turnover, an increased need to meet with tenants on rent issues or payment, and new marketing efforts to fill vacancies (not typically needed in the past).

Central-City Districts with Greater Public Safety Needs

- Downtown Minneapolis, Uptown / the Lake Street corridor, Downtown Saint Paul, and the Green Line LRT corridor in St. Paul were all cited as areas with higher distress from crime, heightened drug use, and market perceptions of insecurity.
- Owners have reported high costs for third-party security, much higher costs to repair damage when turning units, and higher staff turnover. Higher vacancy rates have become the norm.

Properties in Greater Minnesota

- Buildings in Greater Minnesota often have smaller unit counts (typically 20-50), leading to a lack of economies of scale in maintenance and general staffing costs.
- For more complicated projects or populations, there often isn't enough revenue to pay third-party property managers, forcing operators into self-management.
- 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.
- Some small towns have limited employment and no in-migration. Projects in these situations report a struggle to keep full.
- Many buildings in rural areas are often in need of repairs and upgrades but lack available funding.

50 to 60% LIHTC with no Services

- 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.
- 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)

- Many older NOAH buildings are in substantial need of repairs and upgrades, but the property reserves are limited, and refinancing options cannot pay off existing debt and fund repairs.
- 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.
- There are reportedly fewer buyers for NOAH properties given higher interest rates and deferred maintenance needs at many properties.

Projects with Mixed Populations and Senior Buildings

- Tenants in 30% AMI, LTH, or HPH units integrated into a market-rate or 60% AMI rent building are difficult to serve effectively for providers. This can present challenges to tenant safety and security.
- 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.