Dominium Housing's Owen Metz & Paula Prahl

Use tax-exempt bonds, federal tax credits to maximize production of affordable housing

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Affordable housing developer Dominium Housing Vice Presidents Owen Metz and Paula Prahl discuss the Federal Government's Low-Income Housing Tax Credit (LIHTC) program. They describe how the program works with tax-exempt bonds to help finance the development of affordable housing by nonprofit and for-profit developers. They explain why they think Minnesota is not maximizing the amount of new housing development that it could through the LIHTC program. They point to policies of the Minnesota Housing Agency that need to change in order to build more affordable housing in the state. And they discuss the best ways to help people who are homeless.

Present

John Adams, Steve Anderson, Janis Clay (executive director), Pat Davies, Paul Gilje, Pahoua Yang Hoffman, Owen Metz, Paula Prahl, Dana Schroeder (associate director), Clarence Shallbetter, T. Williams. By phone: Paul Ostrow (chair).

Summary

According to affordable housing developer Dominium Housing Vice Presidents Owen Metz and Paula Prahl, the three most important things people need to know about housing in Minnesota are the following:

1. We're not producing enough housing.

2. We're not using the free money the federal government provides to efficiently maximize production of affordable housing.

3. We're not investing enough of our own state resources in affordable housing production.

Metz says the Minnesota Housing Agency and the Legislature are barriers to getting more affordable housing built. He says Minnesota Housing uses the affordable housing tax-exempt bonds they are allocated by the Federal Government to purchase single-family housing mortgages, at the expense of developing more rental housing. Use of those same bonds for housing development, he says, would trigger federal resources in the form of tax credits to supply equity to projects. He says using the federal affordable housing tax-exempt bonds the way Minnesota Housing uses them leaves federal resources unused for housing.

Metz also says it's clear that most legislators don't understand the intricacies of the affordable housing tax-exempt bond program or the Low-Income Housing Tax Credit (LIHTC) program. Consequently, he says, they don't fully understand the amount of federal resources Minnesota is not accessing because of outdated policies, many of which were written in very different economic times.

Metz and Prahl explain the LIHTC program, how the nine-percent and four-percent tax credits differ and how nonprofit and for-profit developers can use the credits to help finance the production of affordable housing. Metz says a number of states are doing more than Minnesota to support affordable housing, mainly by exempting such developments from some or all property taxes.

Metz says the two best ways to help the homeless are (1) by increasing the supply of housing and (2) by expanding-through state funding-the voucher program for people who can't afford their rent.

Biographies

Owen Metz is vice president and project partner at Dominium. He is responsible for all facets of new project development, acquisition and financing. His daily responsibilities include analyzing new acquisition opportunities, determining project feasibility, overseeing design and construction, structuring partnerships and negotiating with lenders, investors and third-party vendors.

Since joining Dominium in 2006, Metz has worked on the acquisition, construction and renovation of numerous apartment communities across the country. He has been involved in Dominium becoming the replacement general partner on several properties. In aggregate, he has helped add more than 4,000 apartment units to the Dominium portfolio.

Metz played a major role in Dominium's entrance into the Texas multifamily market with the acquisition and extensive renovation of 390 units in the Beaumont and Houston areas.

More recently, he played a lead role in the successful completion of the two largest historic redevelopments completed in Minnesota using state and federal historic tax credits: the Schmidt Brewery in Saint Paul and the Pillsbury A-Mill in Minneapolis. Schmidt Artist Lofts and A-Mill Artist Lofts are now home to more than 500 low-income artists and their families at rents significantly below market rates.

Over his tenure at Dominium, Metz has placed more than $200 million in permanent financing, more than $250 million in construction and bridge financing, and over $300 million in tax-credit equity, while working on a variety of different project types. He is a founding contributor to the Dominium Foundation, which contributes to housing and social service organizations in the communities where Dominium operates.

Metz is a graduate of the University of Wisconsin School of Business, with a B.B.A. in both real estate and finance. His professional affiliations include the UW Real Estate Alumni and the Urban Land Institute.

Paula Prahl is vice president of public affairs for Dominium, a post she has held since December 2018. She aims to develop a program to ensure effective and consistent interactions with governments and other key external stakeholders. The establishment of this role is critical to Dominium's growth plan of owning 40,000 units by 2025.

Prahl most recently served as managing director of communications and public affairs at Varde Partners, a hedge, real estate and private-equity fund based in Minneapolis. Previously, she served over a decade as senior vice president of communications, public affairs and corporate responsibility at Best Buy. She served nearly a decade as vice president for government and community relations at Honeywell. Prahl began her public-policy career as director of public policy at the Minnesota Business Partnership.

She holds a B.A. from Smith College and an M.A. from the Humphrey School of Public Affairs at the University of Minnesota.

Background

Since November 2018, the Civic Caucus has been undertaking a review of the issue of affordable housing in Minnesota. The Caucus interviewed Owen Metz and Paula Prahl of

Dominium Housing to learn about the role of private developers in producing affordable housing and how that production is financed.

To see all of the previous Civic Caucus interviews on affordable housing, go to the Civic Caucus website . The notes of our May 31, 2019, interview with Minnesota Housing Commissioner Jennifer Ho might be of special interest to readers of these Metz and Prahl interview notes.

About Dominium. Headquartered in Plymouth, Minnesota, Dominium is one of the nation's largest affordable housing development and management companies. By 2025, the company expects to be the country's preeminent private developer, owner and property manager of affordable housing, with over 40,000 apartment homes totaling $4 billion in assets.

Dominium, which was founded in 1972 as a Section 8 developer (the Federal Government's affordable housing voucher program), is currently the nation's largest provider of affordable housing. It manages more than 30,000 apartments in 22 states and owns properties worth over $3 billion. It owns 8,706 housing units in Minnesota at 63 sites.

In 2018, one-half of the households living in Dominium housing earned less than $20,000 per year. Half of those made less than $12,000 per year.

Discussion

Dominium has been around affordable housing for 47 years and has changed as housing programs have changed. Paula Prahl, vice president of public affairs for Dominium, said the private developer used to be focused on federal Section 8 housing vouchers, which pay a portion of a household's rent. She said 1986 was a watershed year for change, when the Federal Tax Act created LIHTC.

She said Dominium only does affordable housing aimed at households earning 60 percent or less of area median income (AMI). Its housing does not include any services.

Around the country, 7,000 households living in Dominium's 35,000 rental units use federal Section 8 housing vouchers to help pay their rent. Owen Metz,Dominium vice president and project partner, said 1,500 to 2,000 of the company's rental households in Minnesota use Section 8 vouchers.

As of January 2019, Dominium is the fourth largest affordable housing organization in the country by number of units-among government, for-profit and nonprofit organizations. Prahl cited a chart showing that as of May 2019, Dominium owned 222 rental sites and 32,886 units across the country. Minnesota is home to the largest number of Dominium rental units-8,706 units at 63 sites. She said Dominium is focused on long-term value. The company owns its projects through the life of the low-income housing tax credits attached to each project, she said.

What about management of the buildings? An interviewer asked that question and also asked what assurance Dominium gives to investors that projects will be well run. Prahl responded that the federal Department of Housing and Urban Development (HUD) inspects the properties.

Metz said every development and every landlord is different. The costs of management might affect rent levels in a development, he said. He pointed out that Dominium cannot rent to violent offenders. He said most of Dominium's community managers do not live in the buildings they manage.

The Low-Income Housing Tax Credit (LIHTC) program was created by the Tax Law of 1986. The program includes two types of tax credits: the nine-percent and the four-percent credits. (For a more detailed explanation of the LIHTC program and the challenges it faces, see the Addendum at the end of these interview notes.)

The Nine-Percent Low-Income Housing Tax Credit (LIHTC) program is used most often by nonprofits to build extremely low-income housing-that is, for people earning 30 percent or less of area median income (AMI). These federal tax credits are awarded by state housing agencies through a competitive process. Metz said there are six applications for every project that gets funded, both in Minnesota and nationally.

He said the nonprofit organizations that are awarded tax credits to build housing through the nine-percent LIHTC program are also trying to solve other social and economic problems of their tenants. "I would argue that if we go back to 1986, when the tax-credit program was started, the program was not set up for supportive housing," Metz said. "Do we want to focus on housing production or on solving other problems?"

The volume of nine-percent LIHTC projects in any state is limited by the number of tax credits allocated annually to that state by the Federal Government.

The other part of the LIHTC program is the Four-Percent Tax Credit program, in which projects that receive at least 50 percent of their funding through tax-exempt bonds are eligible for four-percent tax credits. Metz said typically, a public agency, such as a city, issues tax-exempt bonds to fund a private development. "When we go to borrow money," he said, "the interest we pay is tax exempt for the lender. Under federal law, the local agency is a pass-through and the private developer has the obligation to repay the bonds. They're very different from general-obligation bonds."

The tax-exempt bonds, if they provide 50 percent of a project's funding, come with four-percent federal LIHTC tax credits. Metz said the four-percent tax credits, which-like the nine-percent credits-last for 10 years, cover a smaller percentage of a project's cost than the nine-percent credits. "But we're serving different people," Metz said, primarily those earning 60 percent or lower of AMI, so the rents can be higher.

He noted that if a project rents to people who are above the income guidelines, the investors can lose their tax credits. "There's very little fraud and misuse," Metz said. "The program is over 30 years old."

Minnesota Management and Budget (MMB) is the agency that allocates tax-exempt bonds to a local issuer. For example, Metz said, if Dominium applies to Columbia Heights for tax-exempt bonds, the city then applies to MMB for an allocation of the bonds. "We can't get the tax credits without the bonds," he said. If the project gets enough tax-exempt bonds to finance 50 percent of its costs, it's supposed to automatically get the four-percent tax credits for the project, he said. But, he said, in Minnesota, the developer must apply to Minnesota Housing to get approval for those tax credits.

Metz said in most states, once a project gets the required amount of tax-exempt bonds, it automatically gets the four-percent federal tax credits. But, he said, Minnesota Housing, along with a few other state housing agencies, has added on minimum requirements beyond those required by building codes (such as for energy efficiency) or for locating in areas with better school districts. If a project does not meet those requirements, it might not get approved for tax credits. "That effectively limits where affordable housing can be located," he said. While Dominium is still busy in Minnesota, he said, the company is now doing more business in states that "aren't trying to proscribe where affordable housing can be built."

Three out of every four of Dominium's affordable housing projects in Minnesota use tax-increment financing (TIF). Metz said in Minnesota, TIF is the primary way cities offer assistance to affordable housing projects. He stressed that using TIF is a local decision.

Cities can use TIF to help pay some of the costs of redevelopment or new development. Under TIF, property taxes on a district including the project's property are frozen at their current level over a certain number of years, 15 or 25 years, for example. The frozen property taxes include not only city taxes, but also those for any other local taxing districts in which the property is located-such as counties, school districts and special taxing districts.

Over the term of the TIF agreement, the revenue from any increase in property taxes due to increases in the property's value-the tax increment-are not paid to the city or other local taxing districts. Instead, the tax increment is used to pay for various costs of the new development, such as roads and sewers or environmental remediation.

Meanwhile, the city and other local taxing districts do not benefit from increased property taxes on the project until the TIF agreement expires.

Dominium plans to develop 20,000 units of affordable housing across the country in the next five years. "If we could do 1,000 a year or more in Minnesota, we would do it," said Metz. "The market here would support 5,000 units or more per year in four-percent tax credit housing. Minnesota gets enough bonds from the federal government to build about 5,000 to 6,000 units of affordable housing a year, using just the four-percent program and private-activity bonds."

Minnesota Housing focuses its tax-exempt bonds on single-family housing at the expense of rental housing. Metz said starting back in 1986-and even before that with Section 8 housing-housing agencies were set up and funded their operations with income from the rental properties. He said the eligible uses of private-activity bonds are to fund the production of affordable rental housing with LIHTC or to purchase single-family-mortgage revenue bonds.

What Minnesota Housing has chosen to do, he said, with the roughly $250 million per year in tax-exempt bonds allocated to the agency by the Legislature, is to borrow money with tax-exempt bonds at, say, three percent interest and use the money to buy a pool of single-family mortgages that have already been issued. That pool of mortgages might be paying four percent interest, Metz said, so the agency takes that one percent difference and uses it to fund some of its programs. "What that doesn't do," Metz said, "is build a single unit of housing."

Minnesota Housing and the Legislature are barriers to getting more affordable housing built. Metz made that statement and said, "Minnesota Housing is effectively a bank first. They're going to focus on how to protect their balance sheet and self-sufficiency, so they don't have to go ask the Legislature for appropriations."

He said Minnesota Housing gets allocated a certain percentage of federal tax-exempt bonds under state law. "We don't think it's in the state's best interest to use this federal resource to earn a little bit of money, especially when that practice curtails the amount of federal funding for housing development available to the state," he said. "Currently, there is only a very marginal difference between borrowing through taxable bonds and through tax-free bonds. But Minnesota Housing can use those bonds however it wants."

Metz said in 1990, the housing agency's board decided it wouldn't use bonds for new housing production. The policy, he said, is that the agency will focus on Section 8 preservation only and will not allow new housing. "That policy could change tomorrow," he said.

Metz said when Dominium or its lobbyists speak to legislators about the problem, it's clear many don't understand the complicated tax-exempt bond program or the LIHTC program. "The bonds are often confused with General Obligation bonds issued by the state," he said, "which increase the indebtedness of the state. In the LIHTC program, in contrast, the bond debt is assumed by the developer, not the state."

"Also," Metz continued, "few legislators realize that the four-percent federal tax credits are only available if the bonds are issued for housing development. If the bonds are used for other purposes, no tax credits-which are essentially federal resources for housing development-are issued. Every tax-exempt bond that is used for something other than housing leaves federal funding on the table."

"We think it's important for Minnesota Housing to allow the four-percent tax credit bond program to go back to a production program, which is what it originally was," he said. "This is a huge factor in us doing more housing production in other states. The opportunity cost is too high for us in Minnesota."

Minnesota Housing is a semi-autonomous organization. Prahl made that statement and said the housing agency has more autonomy than a typical state agency would have. She said Minnesota Housing has focused on funding single-family housing, not rental housing production. "The housing crisis is a supply-and-demand issue," she said. "We don't have enough supply." In an era when low interest rates make housing production so effective, she said, and in which there is little gain in mortgage-rate arbitrage, it makes little sense to forgo the federal funding that comes through the LIHTC program.

A number of states are doing more than Minnesota to support the development of affordable housing. Metz said that some other states do things that are more automatic, rather than left up to the decision of a city council to allow TIF, as in Minnesota. He listed the following examples:

- In California, affordable housing doesn't pay any property taxes.
- In Colorado, if developers partner with a local housing authority, which is easy to do, their affordable housing projects don't have to pay property taxes.
- Florida has a program that gives a 50 percent exemption on property taxes once an affordable housing property has remained affordable for 15 years.
- Texas has a 50-percent exemption on property taxes that's automatic in smaller communities.
- Georgia has a state multi-housing tax credit that mirrors the federal program.

"A lot of states are investing a significant amount of resources into affordable housing production," Metz said. "Chances of the federal program being expanded are low, so states are supplementing that and local cities are supplementing it to increase affordable housing production. Minnesota does almost nothing as a percentage of its budget and compared to other states that have similar challenges to ours in producing affordable housing. What we fund in Minnesota is very, very low. It's a challenge in Minnesota to get people to invest in building affordable housing. That's where other states have made different policy decisions."

When developers build affordable housing in a community, the new units open up the rental housing market there. Metz said building the new affordable housing is also economic development and redevelopment for communities.

The nine-percent program could produce 1,000 to 1,500 units per year in Minnesota, Metz said, while the four-percent program could produce 5,000 units per year.

Zoning is a huge constraint to expanding market-rate housing, which could free up older units that might be more affordable. Metz pointed to Houston, Texas, which has no zoning, making land costs less expensive.He said most land sites in Minnesota are not zoned for density. He cited the example of Woodbury, which has a maximum of 15 units per acre.

Metz said Dominium could build easily up to 30 and or even 70 units an acre, if cities would allow it. That would bring land costs down and the costs of production down.

A lot of Minnesota communities are much more interested in investing in affordable housing than the state is. Metz said many suburban communities realize how important it is to provide affordable housing for their workers. The City of Minnetonka, he said, wrote a check to help secure an affordable housing project. Other cities approve TIF districts for affordable housing, he said.

What are three critical things people need to understand about housing in Minnesota? An interviewer asked that question and Metz responded:

1. We're not producing enough housing.
2. We're not using the free money the federal government provides efficiently to maximize production.
3. We're not investing enough of our own state resources.

Many legislators and even the housing advocates don't understand tax-exempt bonds and the tax-credit programs and ways to increase the production of affordable housing. Metz saidMinnesota Housing says we need to work on single-family housing, because that's the way to accumulate wealth and it's the American dream. "It's very hard for us to combat that," he said, "and to say, 'It's a tradeoff, but you're not really producing housing when you do it that way.'"

Metz said we're leaving free money on the table as a state. "We're not producing as much housing as we could that would cost us zero and, if anything, would produce more revenue for the state," he said. "People you would think would be most interested in producing affordable housing aren't."

The reality is that we are careening toward a place where we won't have enough places to put bodies. Prahl made that statement and Metz added that we're not keeping up, so the gap is getting greater every year.

Prahl said building independent living units for seniors opens up single-family homes to people who can start developing wealth through home ownership.

An interviewer asked a question about supportive housing, which includes services to tenants for issues like addiction and other problems. Metz said the nine-percent tax credit program reflects a focus on solving other social issues that aren't housing. "There's not currently a focus on the production side," he said. "We've converted a production program to a social-service program." He said the nine-percent program is not about efficiency, because building a 30-unit to 40-unit project is not cost-efficient. A project must include 300 to 400 units to be cost-efficient, he said.

Metz said Dominium's cost per unit of affordable housing is about $170,000 to $175,000, the same as market-rate housing.

The best way to help the homeless is to build housing for everybody. An interviewer made that statement and Metz agreed. Increasing the supply of housing and expanding the voucher program for people who can't afford rent are the two important things we must do, Metz said. "Rental assistance is something the state needs to spend money on, because increases won't come from the federal government," he said.

Addendum

Further details about the Low-Income Housing Tax Credit (LIHTC) Program and the challenges it faces. According to a July 2018 Urban Institute report, *The Low-Income Housing Tax Credit: How It Works and Who It Serves*, LIHTC is the most critical method of producing and preserving affordable rental housing. Between 1987 and 2015, 45,905 projects and 2.97 million housing units were developed using LIHTC. It is the longest-running national affordable housing program for producing new units. The report says LIHTC's longevity comes from bipartisan support in Congress, homebuilder support and a history of strong program performance.

LIHTC operates through the federal tax code and was authorized by the Tax Reform Act of 1986. It gives private investors a federal income-tax credit as an incentive to make equity investments in affordable rental housing. These investments reduce the need for costlier methods of financing, such as bank loans, making it possible to charge lower, affordable rents.

Under LIHTC, a housing unit is considered affordable if a household is paying no more than 30 percent of its income for housing costs. Originally, the LHITC program required that a minimum of 20 percent of the units in the property be affordable to households earning 50 percent or below of area median income (AMI) or that a minimum of 40 percent of the units be affordable to households earning 60 percent or below of AMI.

In 2018, Congress amended the LIHTC income standard for residents. Now, households earning up to 80 percent of AMI are allowed in LHITC-assisted units as long as the average income of all households in assisted units in the project is 60 percent of AMI or below.

LHITC properties are required to comply with investment regulations for 15 years and meet affordable rent requirements for at least 30 years. Some states require longer affordability periods.

The LHITC program offers two types of tax credits: a nine-percent tax credit and a four-percent tax credit. The programs have different processes for awarding credits, different benefits for investors and different financing structures. Under both, investors claim their tax credits over a 10-year period and are subject to a 15-year compliance period.

The nine-percent tax credits are allocated to states annually by the IRS to distribute to eligible projects through a competitive process administered by state housing finance agencies. States with larger populations get the most tax credits to allocate.

In 2018, Congress increased the amount of nine-percent credits available to states: for each year through 2021, all states and territories will receive at least $3,105,000 of nine-percent credits or $2.70 per capita, whichever is higher. Each state housing finance agency must allocate 10 percent of its tax credits to nonprofit developers.

In the Four-Percent Tax Credit program, projects that receive at least 50 percent of their funding through tax-exempt bonds are eligible for four-percent tax credits. The bond transactions add to the project's costs (and related debt structure) and the after-tax yield for investors is lower. There is no limit on the total amount of four-percent tax credits available in a given year, but the number of tax-exempt bonds is limited, providing a cap on the number of projects in a given year.

The Urban Institute report lists several challenges facing the LHITC program, including the following:

- Units are not required to be permanently affordable beyond 30 years. But the IRS can only recapture the tax credits during the initial 15-year compliance period. To extend affordability beyond the 15 years, additional funds are necessary: federal, state and local subsidies or new LHITC investments in the same exact property.
- LIHTC does not serve the lowest-income households well on its own. Because of the program's requirements, LIHTC properties often serve households earning an average of 60 percent of AMI. The program has struggled to meet the needs of extremely low-income households, those earning 30 percent or less of AMI, without depending on additional federal rental-assistance programs. This rental assistance is in such short supply that only one out of every five eligible households receives it.
- LIHTC is an economically inefficient method for producing affordable rental housing, as transaction costs associated with the tax credits and bond programs are significant.
- Studies have found that other programs, such as vouchers that pay a portion of a household's rent, are cheaper per unit over time than using LHITC.
- LIHTC can promote concentration of affordable rental units in poor areas and can exacerbate racial segregation. (Dominium's Paula Prahl contested that conclusion from the report. She said in comparison to public housing, LIHTC program developments are much more welcome in communities and therefore serve to extend affordable housing beyond economically challenged areas.)