July 14, 2022

Mai Vang
City Council Office of Legislative Hearing
By email to: mai.vang@ci.stpaul.mn.us

Dear Ms. Vang:

Pleased find attached to this email the following relating to Katherine Banbury's appeal of rent stabilization ordinance violations:

Memorandum replying to and rebutting Dominium's arguments in response to Ms. Banbury's appeal.

Minutes of the Feb. 25,2015 St. Paul HRA Board meeting with staff report laying out public assistance provided to the Cambric project in order to lower the project's required NOI.

Excel file permitting summation of the MNOI worksheet's rent schedules, showing discrepancies with Dominium's base year and current year "Gross scheduled rental income."

Yours truly,

Jack Cann

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Dedicated to expanding and preserving the supply of affordable housing in Minnesota and nationwide

REPLY TO DOMINIUM'S RESPONSE TO MS. BANBURY'S APPEAL OF RENT STABILIZATION VIOLATIONS AT THE CAMBRIC

There are two types of major problems with Dominium's response to Ms. Banbury's appeal. First, the MNOI worksheet submitted fails to make sense and is internally contradictory. Second, the basis on which Dominium claims a right to the exemption from the 3% cap on rent increases is, for a number of reasons, wrong, both legally and logically.

Errors in the MNOI Worksheet

The "Gross scheduled rental incomes" set out on row 1 of Section VIII do not accurately reflect the rents for the "base period rent year" and the "Rent used in current year income calculation." These rents are set out in the three page attachment for page 18, following page 22 of the worksheet. For instance, the current year income calculation adds up to $135,397, for an annual gross scheduled rental income of $1,624,764. This is $114,324 more than the "Current Year" rent shown on line 1 of part VIII of the worksheet. The NOI for the current year calculated on part XVI of the worksheet is thus too low. See the excel spreadsheet "MNOI worksheet page 15 project rents" submitted with this memorandum. In the spreadsheet, above the list of rents for all units submitted as "Rent Used in Current Year Income Calculation" is the sum of all rents and the annual income generated.

Legal Errors

The City's rent stabilization ordinance requires that the city establish a procedure by which owners can request an exception to the 3% rent increase limit "based on the right to a reasonable return on investment." §193A.05(a). The Ordinance also requires that such exceptions be made "only when the landlord **demonstrates** that such adjustments are necessary to provide the landlord with a fair return on investment." § 193A.05(b); emphasis added. Dominium's attempt to make the demonstration of necessity, in compliance with the City's Rent Stabilization Rules, falls short for several reasons set out below.

First, Dominium mischaracterizes the basis for granting exceptions under the City Rules. The City Rules have adopted a "maintenance of net operating income (MNOI) reasonable return standard." The rules are set out to assure that a project's net operating income (gross rental income minus operating expenses) keeps up with inflation and have four provisions relevant here. They provide:

1) a presumption that the 2019 NOI provided a reasonable return. § A.1;

2) that an owner has a right to that NOI increased by the annual percentage increase in the Consumer Price Index; § A.2.;

3) that the landlord may present evidence to rebut the presumption that the base year NOI provided a reasonable return by showing "exceptional circumstances in the

base year," that is, that the gross income in the base year was "disproportionately low due to exceptional circumstances;" § A.4.b; and

4) that, one "exceptional circumstance" is that "the gross income in the base year was lower than it might have been because some residents were charged reduced rent." §A.4.b.i.

Dominium's argument is that the project's rents are somehow "reduced rents." If the 2019 rents were "reduced" then they would have been higher at some time in the past. That's what "reduced" means. But there is no indication of actual Cambric rents reduced in 2019.

Second, Dominium's argument wholly ignores the need for "exceptional circumstances" as a precondition for inquiring about possible reduced rents. To fully understand why Dominium's demonstration fails under these provisions it is necessary to understand the nature of the financing of the project. The project was built with multiple forms of public subsidies and assistance (see Attachment: Feb. 25, 2015 Minutes of the St. Paul Housing & Redevelopment Authority with Report to the Commissioners):

*Federal Low Income Housing Tax Credits (LIHTC), in the amount of $1,034,988 annually for ten years[1] and projected to be syndicated (sold to investors seeking tax shelters) for $10,403,848.

*Tax exempt bonds issued by the City in the amount of up to $14,850,000 to provide initial financing for the project's development.

*HUD insured permanent financing at 4.5% interest with a 42 year term.

*A St. Paul STAR loan of $200,000 at 2% interest for 42 years.

*$2,291,000 of pay-as-you-go tax increment financing. The City pays tax increment to the developer over time, instead of at the start of the project, as if it were repaying a loan in that amount from the developer at 4.5% interest.

*$975,000 of the City's federal HOME funds, loaned to the project at 1% interest for a 42 year term.

*$1,030,000 of proceeds of the City's sale of public land to the developer, deferred until the project is sold or refinanced.

*an 482,720 Grant from Ramsey County for soil remediation.

The amount of the syndication of the tax credits, the fact that it was to investors seeking tax shelter rather than annual cash retrns, and the additional subsidies and far-below-market interest rate loans very substantially wrote down the cost of the project which would otherwise have to be financed by mortgage debt at market interest rates and relatively short terms and by equity investors demanding cash returns. In return, under the federal LIHTC statute, Dominium is required to keep rent plus tenant paid utilities at under 60% of Area Median Income for at least 15 years.

Dominium claims that, despite public largesse intended to permit the rents actually charged, and the NOI actually received, in the 2019 base year, the project should be treated under the Ordinance as if it were a market rate project. This ignores the plain

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[1] See Exhibit A, submitted by Dominium, at page 11, Item 15.

language of the Rules. Dominium has presented no evidence of "exceptional circumstances in the base year." The rents charged were not "disproportionately low due to exceptional circumstances." There were no "exceptional circumstances" in 2019 and rents, and the project's NOI, were exactly what Dominium bargained for when it all of that public financing. The 2019 rents and NOI are neither exceptional or unexpected or disproportionately low.

Third, the market rate rents which Dominium proposes as comparable in order to adjust the base year NOI would represent an enormous cash windfall rather than a reasonable return, because, unlike the market-rate projects which charge those rents, Dominium has financing, which must be paid from the NOI, that has been dramatically reduced by federal and local subsidies.

Fourth, for that reason, those projects are not even remotely "comparable" to the Dominium project. The City rules use a maintenance of net operating income standard to assure a reasonable return. The net operating incomes needed to assure a reasonable return on the market rate projects is not at all comparable to that required to assure a reasonable return on Dominium's tax credit projects because the market rate projects did not receive millions in public subsidies to write down the development cost of the project and thus the amount of project debt required.

Fifth, the market rate projects differ from Dominium's tax credit project in another fundamental way. Unlike equity investors in market rate rentals, Dominium's investment partners invested to get tax credits. The dramatic increase in NOI which Dominium's exception calculations represent would result in substantial taxable income – the exact opposite of what the people who actually made the investments in the project are seeking and thus provide the opposite of a reasonable return on investment.

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Sixth, Dominium argues that rent control has disrupted a "delicate balance" struck in the financing of LIHTC properties because they were "designed to ensure rent increases were sufficient to match inflation in operating costs." The fact that Dominium has secured long-term, fixed rate, HUD-insured mortgage financing substantially undercuts its "delicate balance" assertion. Further Dominium has apparently failed to notice that ensuring rent increases to match inflation is exactly what the City's maintenance of NOI policies accomplishes. Dominium is, in fact, not attempting to

ensure rent keeps up with operating costs, it is attempting to exempt, as a practical matter, all of its eight LIHTC properties from rent regulation by the City. Dominium's "Response to Appeal" states that:

> Therefore, all such properties inherently satisfy the exception provided for in Section A(4)(b)(i). Accordingly for all such LIHTC properties, 2019 baseline NOI would be eligible to be adjusted for all years during their LURA compliance period because residents "were charged reduced rent."

Dominium is attempting to secure with this argument what amounts to an exception from coverage of the rent stabilization ordinance for all LIHTC projects. But the ordinance permits, at § 193A.06, only two exceptions and LIHTC projects are not included. The ordinance may not be significantly amended for a year after adoption by the voters and thus the City Rules are not permitted to allow the sort of result Dominium proposes.

Finally, the quote above is an admission that the self-certifications for all eight of Dominium's LIHTC properties in St. Paul were based on the same attempt to portray the 2019 base year as some "exceptional circumstance" rather than exactly what Dominium bargained for when it accepted tens of millions of public subsidies which were provided specifically to reduce the NOI required to provide a reasonable return on investment.

The "Response" also states that "Units that were vacant prior to May 1st implementation of the ordinance were properly adjusted to the new HUD allowable rent level." So, apparently, in all of its eight St. Paul LIHTC projects, Dominium has increased rents on such units and they are now being rented at the maximum permitted by HUD, an 11.89% increase over what same-size units were charged as of May 1. For example, see unit 101 in the "Proposed Adjustment Worksheet," following page 22 on the MNOI form. It is being offered for rent at $1,621 rather than the $1,440 for similar, occupied units. This ignores the plain language of the Ordinance which applies the 3% limit to any "rent increase within a 12 month period." § 193A.03 The ordinance further provides that the 3% limit applies "regardless of change of occupancy in a residential unit.." § 193A.04. So except, perhaps, in the highly unlikely case that a unit was vacant for an entire year prior to May 1, rent was charged for these units at some point in the 12 months preceding Dominium's current rent increases and rents on that unit are therefore subject to exactly the same rules as all of the others in the building, regardless of whether they were vacant at some point in that 12 month period.

On the basis of Dominium's admissions regarding its multiple violations of the ordinance and the Rules, currently and in the future, the City needs to take the following steps in addition to retracting any permission for Dominium to charge exception rents for Ms. Banbury:

1. Issue an order that permission for exception rents for all units at 720 E. 7th is immediately retracted and issue an order that rents must instead be set according to the Ordinance and Rules
2. Issue an order that permission for exception rents for all units at all of the other Dominium LIHTC buildings in St. Paul is immediately retracted and rents must be set according to the Ordinance and Rules and that, to be granted an exception, Dominium must submit MNOI worksheets meeting the standards set out in the Rules.
3. Issue an order that, regardless of any vacancy status prior to May 1, 2022, the rent limitations in the ordinance and rules apply and any rents contrary to the ordinance and rules must be immediately brought into compliance.
4. Order that, in light of Dominium's frivolous attempts to avoid the plain language of the ordinance and rules, Dominion shall not be permitted any future self-certifications, and any application for exceptions will be required to be supported by audits.

Dominium has not attempted to justify an exception based the NOI calculation on pages 6,7, and 15 of the MNOI Worksheet. Two things are worth noting however. First the percent annual percentage increase in the CPI shown on page 15 is incorrect. As Table A of Exhibit 2 submitted with Ms Banbury's appeal clearly shows, the percentage CPI for Minneapolis-St.Paul-Bloomington for all urban consumers increased by 1.2% in March of 2020 over that in March of 2019 and by 3.0% in March of 2021 over that in March 2020. That is a 4.2% increase between the 2019 base year and the 2021 current year, defined by the rule as the most recent full calendar year. Dominium uses instead, on page 15, a 6.05% increase and its calculation of permitted average allowable rent increase is therefore too high.[2] This 6.05% CPI increase is built into the City's worksheet, which states that it is based on "annual average CPI" numbers from some unnamed source. The use of some "average annual" CPI in the MNOI worksheet is clearly contradicted by paragraph 5 of the worksheet's "introductory Information" which defines the CPI to be used as "for the twelve-month period ending as of March." Moreover, the CPI increase from 201 to 2021 is 4.2% using the correct CPI for the worksheet. See, Table A of Exhibit 2 attached to Ms. Banbury's appeal. It's understandable that Dominium used the 6.05% CPI increase, but that does not make it less wrong under the plain language of the Worksheet instructions and it improperly inflates any exception sought by Dominium.

The second point is that Dominium's purported cost increase from 2019 to 2021 was 17.1% while the CPI rose only 4.2%. This level of cost increase is highly suspect, especially in light of Dominium's other misleading statements and arguments set out

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[2] Ms. Banbury's appeal, to be conservative and in order to illustrate what seemed the obviously overstated nature of the justification for an exception, used the March 2022 CPI, rather than the March 2021 CPI. It is the 2021 CPI that is required by the City rules to be used.

above. For that reason, these numbers, if they are re-submitted by Dominium or should Dominium attempt to use them as justification in this appeal proceeding, should be accepted only if supported by an audit.