



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 Hannah Gray's appeal of rent stabilization ordinance violations:

Memorandum replying to and rebutting Dominion's arguments in response to Ms. Gray's appeal.

Minutes of the June St. Paul HRA Board meeting with staff report laying out public assistance provided to Union Flats project in order to lower the project's required NOI.

Excel file permitting summation of the MNOI worksheet's rent schedules, showing discrepancies with Dominion'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 HANNAH GRAY'S APPEAL REGARDING RENT STABILIZATION VIOLATIONS AT UNION FLATS

There are two types of major problems with Dominion's response to Ms. Gray's appeal. First, the MNOI worksheet submitted fails to make sense and is internally contradictory. Second, the basis on which Dominion 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 most obvious error is that 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 five page attachment for page 18, following page 22 of the worksheet. For instance, the current year income calculation adds up to \$300,163, for an annual income of \$3,601,956. This is \$367,688 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 far 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.

The second problem with the worksheet is that the earliest occupancy shown in the five page attachment is May of 2019, with initial occupancies stretching at least into September 2019. 2019 was obviously not a full operating year and it's not reasonable to select it as the base year. Even if were reasonable to select it as the base year, the "gross scheduled rental income" has no relation to the actual rental income since none of the rents were charged or collected for a full year. But there is no indication where the other items of income or expense came from. Since they seem to be of the same order of magnitude as the items in the current year column, but were received or incurred over only part of 2019, they are likely purely hypothetical also. Under the ordinance, the landlord's right to exception rents depends completely on the base year net operating income. But in the Union Flats case, that is not a number which reflects actual project income and expenses.

The third problem with the worksheet is that the attachment for page 18 shows the initial occupancy of 120 units to be in 2019 and that in 89 of those cases, the actual initial rent was less than what Dominion shows as the base period rents. This applies to all of the units rented in the first month of occupancy. The discrepancy results in the purported base year rents exceeding the 2019 actual initial occupancy rents by \$116,316 annual income. See Columns I through L of the attached excel file.

This MNOI worksheet simply does not provide any basis for deciding what, if any, exception to the 3% limit Dominion is entitled to at Union Flats.

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. Dominion'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, Dominion 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.

First, Dominion'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. They obviously were not since they were the project's initial rents. In fact, as described above, the rents used as "Base Year" rents in the worksheet calculation were actually increased over the actual initial rents charged.

Second, Dominion's argument wholly ignores the need for "exceptional circumstances" as a precondition for inquiring about possible reduced rents. To fully understand why Dominion's demonstration of the need for an adjustment fails under the plain language of the Rules, 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: Minutes of the June 28, 2017 St. Paul Housing & Redevelopment Authority Board meeting, Item 3 and Report to the Commissioners describing the project):

*Federal Low Income Housing Tax Credits (LIHTC), in the amount of \$2,503,549 annually for ten years¹ and projected to be syndicated (sold to investors seeking tax

¹ See Exhibit A, submitted by Dominion, 4th page "Project Summary and Additional Restrictions," Item 15.

shelters) for \$22,668,568. See, LIHTC Tax Credit Equity on page 3 of Report to Commissioners.

- *Tax exempt bonds issued by the City in the amount of up to \$34,500,000 to provide initial financing for the project's development.

- *HUD insured permanent financing.

- *two Metropolitan Council grants of \$965,000 and \$413,365.

- *\$763,327 from Minnesota DEED.

- *and a \$225,000 Environmental Response Funds Grant from Ramsey.

The amount of the syndication of the tax credits, the fact that it was to investors seeking tax shelter rather than annual cash returns, and the additional subsidies all 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, Dominion is required to keep rent plus tenant paid utilities at under 60% of Area Median Income for at least 15 years.

Dominion claims that, despite the public largesse intended to permit the rents actually charged, and the NOI actually received, in the base year, the project should be treated under the Ordinance as if it were a market rate project. This ignores the plain language of the Rules. Dominion 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, or whatever alternative base year might be chosen. Rents, and the project's NOI, were exactly what Dominion bargained for when it received all of that public financing. The 2019 rents and NOI are neither exceptional nor unexpected nor disproportionately low.

Third, the market rate rents which Dominion 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, Dominion 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 Dominion 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 Dominion'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 Dominion's tax credit project in another fundamental way. Unlike equity investors in market rate rentals, Dominion's investment partners invested to get tax credits. The dramatic increase in NOI which Dominion's exception calculations represent would result in substantial taxable income – the exact opposite of the tax shelters which the investors in the project are actual seeking and thus would provide the opposite of a reasonable return on investment.

Sixth, Dominion 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 Dominion has secured long-term, fixed rate, HUD-insured mortgage financing substantially undercuts its “delicate balance” assertion. Further Dominion has apparently failed to notice that ensuring rent increases to match inflation is exactly what the City’s maintenance of NOI policies accomplishes. Dominion 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. Dominion’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.”

Dominion 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 Dominion proposes.

Finally, the quote above is an admission that the self-certifications for all eight of Dominion’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 Dominion 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.

Dominion’s “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, Dominion 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. 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 Dominion’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 Dominion'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 Dominion to charge exception rents for Ms. Gray:

1. Issue an order that permission for exception rents for all units at Union Flats 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 Dominion 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, Dominion 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 Dominion's 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.