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MEMORANDUM

DATE: **November 26, 2019**

TO: **Michigan State Housing Development Authority**
c/o Gary Heidel, Mike Witt, and Chad Benson

FROM: **Ginosko Development Company**

RE: **2021-2022 Qualified Allocation Plan**

The recommendations below stem from the fundamental belief that Low Income Housing Tax Credits (LIHTC) for economically disadvantaged families have become increasingly scarce and more valuable, and the Michigan State Housing Development Authority (MSHDA) should structure the 2021-2022 QAP to leverage its 9% LIHTC allocation to the greatest extent possible. ***According to data acquired from MSHDA, there is solid evidence that the 2019-2020 QAP incentivizes INEFFICENCT use of the 9% LIHTC.*** Currently, Cost Reasonableness and Credit Efficiency only accounts for 2.73% of the total scoring criteria (1.95% for Supportive Service projects). To say it another way, as an Applicant submits a project with a higher Self-Score, the 9% LIHTC request per unit also increases. The problem with the current scoring method is that it doesn't incentivize "high scoring" projects to be efficient. If an Applicant has a Project that it believes will score well enough to receive an allocation, the Applicant is incentivized to make the deal less efficient from a LIHTC per unit perspective.

The following comments are consistent with an objective to create the EXACT OPPOSITE of the aforementioned result. The most efficient projects within each category (Preservation, Open, Permanent Supportive Housing, and Strategic) should have the greatest likelihood of receiving the highest score. This will inevitably:
1. Increase the supply of affordable housing in the State of Michigan.
2. Increase the number of full-time and part-time jobs in the State of Michigan.
3. Increase the number (and quality) of existing affordable housing units in the State of Michigan.
4. Force Applicants to be more creative and efficient in structuring their deals.

Cost Reasonableness & Credit Efficiency:
- While already addressed in the current 2019-2020 QAP, the 2021-2022 QAP should place substantially greater emphasis on Cost Reasonableness & Credit Efficiency.
  - Currently, only 5 points account for Credit Efficiency. In a comparison to all scoring criteria, this accounts for:

	2019-2020 QAP Scoring		
Cost Reasonableness & Credit Efficiency	**Score**	**Total %**	**Non-Supportive Service Deals %**
Credit Efficiency	5	1.95%	2.73%

  - The 2019-2020 QAP scoring currently indicates that Cost Reasonableness and Credit Efficiency, cumulatively, are equal to or less important than:
    - ***Evidence of*** Proper Zoning (all deals must be properly zoned)

        - ***Evidence of*** Site Plan Approval (all deals must have site plan approval)
        - Historic Rehabilitation Projects
        - QAP Green Policy
        - …many others on the list
- Prioritizing Cost Reasonableness and Credit Efficiency in the 2021-2022 QAP will reduce the instances of Applicants in a high-value, strong walk-score areas abusing the 2019-2020 QAP and being less efficient with their LIHTC request.
- **Credit Efficiency:**
    - To achieve MSHDA's purpose of providing quality affordable housing in the State of Michigan, Credit Efficiency must be the 2021-2022 QAP's single most important scoring criteria.
    - As set forth in the 2019-2020 QAP, we agree that Credit Efficiency should be calculated on a LIHTC per unit basis. We also agree with MSHDA's approach of giving greater weight to 3-bedroom units and less weight to studio units.
    - We have two (2) proposed solutions for the enhancement of Credit Efficiency:
        - ***SOLUTION #1: Keep everything the same, EXCEPT:***
            - (1) Multiply the "Positive Point Factor Per Dollar BELOW Safe Harbor" and the "Negative Point Factor Per Dollar ABOVE Safe Harbor" by a multiple of six (6)

	POINT FACTORS			
	CURRENT	PROPOSED	CURRENT	PROPOSED
	Positive Point Factor per $$ below safe harbor:	Positive Point Factor per $$ below safe harbor:	Negative Point Factor per $$ above safe harbor:	Negative Point Factor per $$ above safe harbor:
New Construction:	0.0012	0.0072	-0.0012	-0.0072
Preservation/Existing Development:	0.0025	0.0150	-0.0025	-0.0150
Vacant Rehab or Adaptive/Reuse:	0.0006	0.0036	-0.0006	-0.0036

            - **AND**
            - (2) Remove the cap on the total points awarded from the deviation from safe harbor Minimums and Maximums.

	POINT FACTORS	
	CURRENT	PROPOSED
	Possible Points for project type	Possible Points for project type
New Construction:	Capped at: +5 points or -5 points	No Cap (floor or ceiling)
Preservation/Existing Development:	Capped at: +5 points or -5 points	No Cap (floor or ceiling)
Vacant Rehab or Adaptive/Reuse:	Capped at: +5 points or -5 points	No Cap (floor or ceiling)

- **_SOLUTION #2: Award Sliding Scale Points on a Total Credit per Effective LIHTC Unit:_**
  - Solely using MSHDA's existing Total Credit per Effective LIHTC Unit calculation, we propose allocating 25 points based on as follows:
    - Projects with a LIHTC Request Per Unit of $5,000 or less receive 25 points.
    - Projects with a LIHTC Request Per Unit of $7,500 or less receive 20 points.
    - Projects with a LIHTC Request Per Unit of $10,000 or less receive 15 points
    - Projects with a LIHTC Request Per Unit of $12,500 or less receive 10 points.
    - Projects with a LIHTC Request Per Unit of $15,000 or less receive 5 points.
    - Projects with a LIHTC Request Per Unit of $21,231 or less receive 0 points.
    - Projects with a LIHTC Request Per Unit over $21,232 receive -5 points.

	2019-2020 QAP Scoring				2021-2022 Suggested QAP Scoring				
Cost Reasonableness & Credit Efficiency	Score	Total %	Non-Supportive Service Deals %		Suggested Change	Total %	Non-Supportive Service Deals %		Points Difference
Credit Efficiency	5	1.95%	2.73%		0	0.00%	0.00%		(5)
Total Credit Per Effective LIHTC Unit					25	9.77%	13.66%		25
Total	**5**	**1.95%**	**2.73%**		**25**	**9.77%**	**13.66%**		**25**

- At the very least, we believe the Cost Reasonableness and Credit Efficiency ratio should be at least 13.66% (25 points) of the overall 2021-2022 QAP score as set forth on the attached **Exhibit A**.
  - This does not have to "cheapen the product" if the 2021-2022 QAP implements certain _loose_ design standards on 9% deals, which will only force Applicants to more creatively structure a deal.
  - This also doesn't incentivize larger projects. Previous applications have proven that smaller deals have figured out a way to request less LIHTC's per unit than larger deals, but have unfortunately lost out due to scoring.
- **_MSDHA should also consider using the Strategic/Unreserved category to first fund the deals that have the lowest Total Credit Per Effective LIHTC Unit._** Once LIHTC's have been allocated to the highest scoring deals within each Category, instead of using the Strategic/Unreserved Category to fund the next highest deal, it should be used to fund the most efficient unallocated deals until the LIHTC allocation is exhausted.

- Additional Cost Reasonableness Items:
  - The 2021-2022 QAP should require cost certifications of the Tier 1 and Tier 2 subcontractors underneath the General Contractor, not just the General Contractor.
  - While more emphasis should be placed on Cost Reasonableness, we also believe the 2021-2022 QAP should be more detailed on cost disparities amongst various regions of the State.
    - High-value and high-density areas are put at an unfair disadvantage to the rest of the State due to higher labor rates and higher acquisition costs.
    - The 2021-2022 QAP should score projects on a cost per square foot based upon county averages as opposed to statewide averages.
    - This point is recently supported on page 16 of the updated report by "NCSHA's Recommended Practices in Housing Credit Administration" that states:
      - _"This process will produce a standard [of]…multiple limits that take into account disparities in costs due to project location, type of construction, population served, and potentially other project characteristics."_

Opportunity Criteria (Location):

- The disproportionate weight of the points allocated to location-based criteria in the 2019-2020 QAP basically says:
  - "We care more about _where_ 9% LIHTC's are utilized than _how many people and jobs_ 9% LIHTC's can serve."
  - "We don't even care about how efficient the 9% LIHTC's are being utilized."
  - "We would rather give 9% LIHTC's to a project that serves 20 low-income families but is 'close' to a bunch of ancillary services like a coffee shop, than 75 low-income families that live ½ mile further down the road."
- The question is, "Should the QAP choose a deal with a poor walk score, but services more people (by being hyper-efficient with the LIHTC's), than a deal that is more expensive, but services fewer people?"
  - Unlike the 2019-2020 QAP, we believe the answer should be "Yes".
- Location points should be more relevant for new construction properties only. The current weight of location based criteria points in the 2019-2020 QAP is hurting MSHDA (and its ability to repay its bond investors for preservation deals) by not giving incentives to recycle deals within MSHDA's debt portfolio.
- To assist in increasing points to Cost Reasonableness and Credit Efficiency, we believe LESS emphasis should be given to Location-Based Criteria and Development Characteristics, as reflected in **Exhibit A**.
- Currently, 30.60% of the total 2019-2020 QAP points are related to Location-Based Criteria.

- We believe that market efficiency should dictate where deals are done, and not the nine (9) sub-factors in the scoring criteria.
- As set forth on the attached **Exhibit A**, we recommend reducing this percentage from 30.60% to 23.50%

	2019-2020 QAP Scoring				2021-2022 Suggested QAP Scoring				
Opportunity Criteria (Location)	Score	Total %	Non-Supportive Service Deals %		Suggested Change	Total %	Non-Supportive Service Deals %		Points Difference
Total	56	21.88%	30.60%		43	16.80%	23.50%		(13)

  - This change alone would help with the Cost Reasonableness and Credit Efficiency recommendations above.

4%-9% Hybrid Deals:

- 4%-9% Hybrids transactions are the single most impactful way to create efficiencies of not only the 9% LIHTC, but the 4% LIHTC as well.
- Currently, the higher self-score an Applicant receives on a deal, the less likely that deal is to be efficient in its 9% LIHTC request.
- Under the 2021-2022 QAP:
  - A maxed out ($1,500,000) 9% LIHTC that is not paired with a 4% LIHTC deal should rarely beat out a 4%-9% Hybrid deal, especially if that 9% LIHTC deal has excess basis.
  - The 9% LIHTC phase of a 4%-9% Hybrid deal should rarely request the maximum 9% LIHTC allowable.
- Under the 2019-2020 QAP, it appears as though MSHDA is leaving a substantial amount of money and opportunity "on the table." Meaning, MSHDA has the potential to significantly increase its revenue streams by increasing its multi-family loan production (both for taxable bond and tax-exempt bond funded loans), while also producing/preserving more affordable units a year.
- In a 4%-9% Hybrid structure, MSHDA has the ability to increase the use of its taxable bond loan product, especially if it can capitalize on its ability to close quicker than HUD, or other loan products (which MSHDA can, seeing that you have all the information at the 4% Notice of Intent date).
- In increasing the use of the 4%-9% Hybrid structure, MSHDA will:
  1. Increase the efficiency of government resources.
  2. Increase the loan production of MSHDA.
  3. Increase the number of affordable housing units for the State of Michigan
  4. Increase the number of jobs in the State of Michigan
- Giving preferential points to existing Rural Deals in a 4%-9% Hybrid capacity can also help recapitalize existing deals in the MSHDA portfolio.
  - MSHDA should also consider allowing Applicants to pool rural deals together to absorb the debt. This is done in other states and allows rural deals to spread out the deal costs.

Development Characteristics:

- How many deals are *NOT* receiving points for Visitable and Barrier Free Units?
  - These lower point score items should simply be a mandated requirement for new construction, and a recommendation for preservation/rehab.
- LESS emphasis should be given to (1) Accessible Community Space and (2) Native American Housing.
  - Accessible Community Space:
    - If an existing project is 93%+ occupied without Community Space, then don't make us spend more money to get the 3 points.
    - Although not reflected in **Exhibit A,** we recommend eliminating this scoring criterion and simply mandate it for new construction projects.
  - Native American Housing.
    - Although Native American Housing is critically important, we believe even a 2-point advantage is more than enough for this criterion (although not reflected in **Exhibit A)**.

Development Team Characteristics:

- We believe there should NOT be any changes to the "Previous Experience of **Owner/Member**" criterion.
    - There seems to be a strong push for Consultants (or aspiring Consultants who once worked for a non-profit or for-profit development company) to receive points under the "Previous Experience of Owner/Member Points".
        - We believe this is a mistake due to the fact that Consultants do not:
            - assume any of the risk related to recapture, construction completion, liquidity, etc.,
            - provide the personal guarantees,
            - have organizational / institutional controls to help develop and actively manage, the deal throughout the 15-year compliance period, and
            - are not at risk of receiving a penalty for poor previous participation.
        - If this were implemented, organizations that 'buy' experience points by hiring consultants would not embody the same organizational commitment to a project that partnering with a truly experienced (and committed) Owner/Member.
- At the very least, Consultants should NOT be rewarded like Owner/Members unless the consulting entity itself ***has the same or greater risk on the project throughout the LIFE of the project***. Even though MSHDA currently requires some level of guaranties, there is currently opportunity for abuse by these entities as their length of guarantee in a project could be for a very limited time period.

Developer Fee:

- While it is easy to dismiss a for-profit development company advocating for a "graduated points scale" for developer fees, we believe this is consistent with the objective of maximizing the efficiency of the LIHTC.
- Like other state agencies, MSHDA should adopt a points system that gives more points to deals that defer the most amount of fee.
    - Deferred development fees have advantages, the primary one being tighter controls on the operational performance of a deal throughout the life of the deal.
        - Sophisticated Applicants are being disingenuous in claims that they do not place great emphasis on the "waterfall rules".
- Although not reflected in our **Exhibit A**, believe this should be a new section in the 2021-2022 QAP and should be heavily weighted at 15% to 20% of an Applicant's score.

Other Professional Fees:

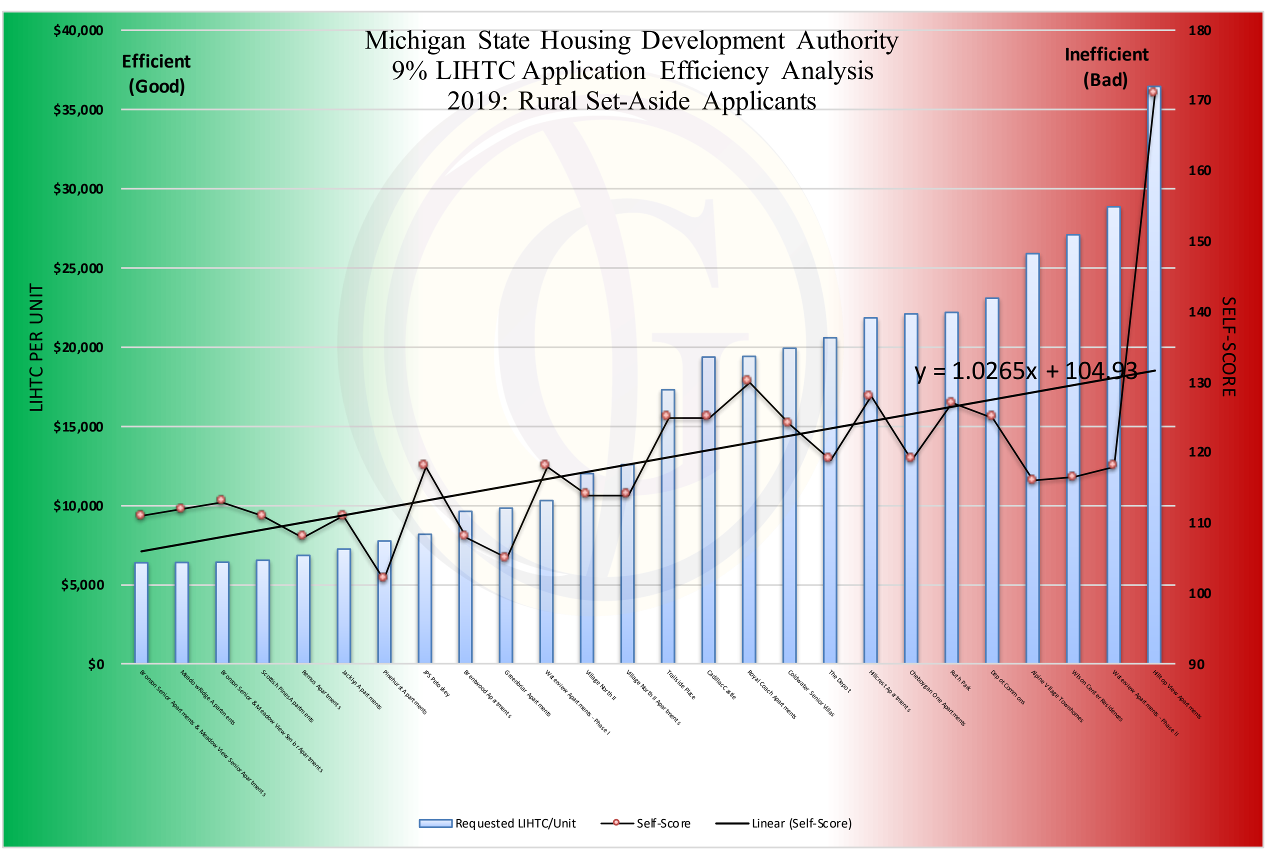
- Not only should the scoring system reward the deferment or reduction of developer's fee, there should be a preferential scoring system for other large professional services (General Contractor 6%, 2%, 6% fees, Architectural Fees, Financing Fees, etc)
    - We recommend a graduated point score for development team members that take a lesser fees based on the following:
        - General Contractor
            - 0 Points = 6%, 2%, 6% (14% Total)
            - 2 Points = 5%, 1.5%, 5% (12% Total)
            - 4 Points = 4%, 1%, 4% (9% Total)
            - At very least, incentivize points to the General Contractor that exchanges a portion of their overall fee for an equity position in the deal or a deferred fee based on future cash flow.
        - Architect:
            - 0 Points = 6% of Construction Contract
            - 1 Point = 5% of Construction Contract
            - 2 Points = 4% of Construction Contract
            - 3 Points = 3% of Construction Contract
            - 4 Points = 2% of Construction Contract
            - At very least, incentivize points to the Architect that exchanges a portion of their overall fee for an equity position in the deal or a deferred fee based on futured cash flow.
        - Lender & Equity Financing Fees
            - In prior years, MSHDA has not required the transparency of LIHTC equity load structures between the syndicators and their underlying investors.
            - Points should be given to deals that are at least willing to share the internal rates of return required by the syndicator or direct investor.

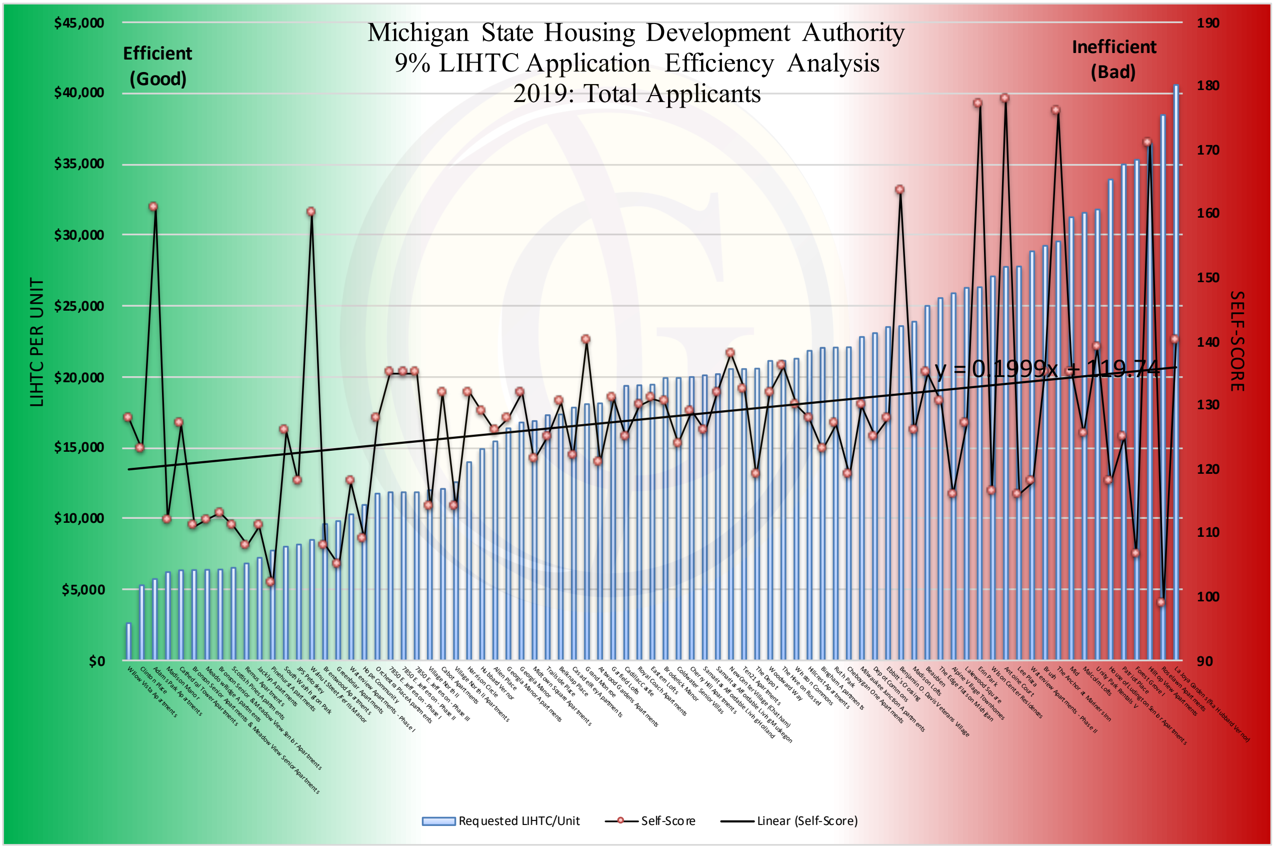
ADDENDUM III: Supportive Service Deals

- All real estate deals should be able service debt for normal operations.
  - Debt service payments (or a lack thereof) should not be used to fund permanent supportive housing (PSH) operations.
  - PSH services should be paid from subsidies above and beyond real estate underwriting fundamentals, and/or excess cash flows above debt service payments.
- The real goal for PSH projects should be to utilize long term, non-housing related programs for the services they provide with a reliance on creative real estate underwriting fundamentals.
  - Not a situation where you choose to forego a first mortgage because you want to use what would have been a loan payment as a funding source for the services.
- In lieu of giving points to Applicants with PSH experience, provide points to PSH deals that utilize collateralized debt (since most PSH developers underwrite supportive service deals without any debt).
  - Underwriting without debt clearly shows a lack of respect to real estate fundamentals, especially for affordable housing.
    - PSH owners are essentially saying: "I'd rather be inefficient with precious federal resources by choosing NOT to put a loan on the deal, rather than be creative and raise additional resources specifically designated for the supportive services I'm trying to provide."
- The key is to have the right team together, which is borne out between:
  - a seasoned Applicant that is willing to creatively use market debt, coupled with
  - an experienced lead agency that has the proven track record of creatively finding other non-housing resources to fund their services, and
  - a strong management agent,
- Therefore, we recommend:
  - Mandating that PSH Projects have a first mortgage loan no greater than a 1.35 debt-service coverage ratio.
  - Apply the same point emphasis to successful PSH outcomes that apply to other deals.

<u>Other Miscellaneous Information:</u>

The following graphs clearly show how Applicants with a higher Self-Score tend to request more LIHTC's per unit. This is something the 2021-2022 QAP should vehemently counteract. For example, in the following graphs, MSHDA would review the highest self-scored Applicants first, therefore it is highly likely that the most efficient deals would ***<u>never</u>*** be reviewed because the funding would have already run out.





In conclusion, we believe there is an opportunity for the 2021-2022 QAP to properly reflect the significant changes in macro-policy. We do not believe that 69.95% of the total QAP points should be focused solely on Opportunity Criteria (Location) and Development Characteristics; when only 2.73% is focused on Cost Reasonableness and Credit Efficiency. The aforementioned recommendations help to not only (1) mitigate any anticipated loss in affordable housing production, but also (2) maximize the efficiency of the LIHTC.

We would welcome the opportunity to discuss these proposed amendments in person should you see fit.

Thank you.

EXHIBIT A

QUICK REFERENCE SHEET	2019-2020 QAP Scoring			2021-2022 Suggested QAP Scoring			
	Score	Total %	Non-Supportive Service Deals %	Suggested Change	Total %	Non-Supportive Service Deals %	Points Difference
A. Opportunity Criteria							
1. Proximity to Transportation	5	1.95%	2.73%	5	1.95%	2.73%	0
2. Proximity to Amenities	12	4.69%	6.56%	6	2.34%	3.28%	(6)
3. Education, Health and Well-Being, Economic Security, and Jobs, Goods, & Services	4	1.56%	2.19%	4	1.56%	2.19%	0
4. Developments near Downtowns or Corridors	12	4.69%	6.56%	8	3.13%	4.37%	(4)
5. Developments near an Employment Center	5	1.95%	2.73%	5	1.95%	2.73%	0
6. Neighborhood Investment Activity Areas	10	3.91%	5.46%	7	2.73%	3.83%	(3)
7. Affordable/Market Rent Differential	5	1.95%	2.73%	5	1.95%	2.73%	0
8. Developments in Opportunity Zones or Rising Tide Communities	3	1.17%	1.64%	3	1.17%	1.64%	0
	56	21.88%	30.60%	**43**	16.80%	23.50%	**(13)**
B. Development Characteristics							
1. Historic Rehabilitation Projects	5	1.95%	2.73%	5	1.95%	2.73%	0
2. Native American Housing	5	1.95%	2.73%	5	1.95%	2.73%	0
3. Affordable Assisted Living	5	1.95%	2.73%	5	1.95%	2.73%	0
4. Low Income Targeting	20	7.81%	10.93%	20	7.81%	10.93%	0
5. Affordability Commitment	5	1.95%	2.73%	5	1.95%	2.73%	0
6. Tenant Ownership	1	0.39%	0.55%	0	0.00%	0.00%	(1)
7. Mixed Income Development	2	0.78%	1.09%	2	0.78%	1.09%	0
8. Accessible Community Space	3	1.17%	1.64%	3	1.17%	1.64%	0
9. QAP Green Policy Points	10	3.91%	5.46%	5	1.95%	2.73%	(5)
10. Evidence of Proper Zoning	5	1.95%	2.73%	2	0.78%	1.09%	(3)
11. Evidence of Site Plan Approval	5	1.95%	2.73%	2	0.78%	1.09%	(3)
12. Visitable Units	3	1.17%	1.64%	3	1.17%	1.64%	0
13. Barrier-Free/Fully-Adaptable-to-Barrier-Free Units	3	1.17%	1.64%	3	1.17%	1.64%	0
	72	28.13%	39.34%	**60**	23.44%	32.79%	**(12)**
C. Development Team Characteristics							
1. Previous Experience of GP/Member	10	3.91%	5.46%	10	3.91%	5.46%	0
2. Previous Experience of Management Agent	10	3.91%	5.46%	10	3.91%	5.46%	0
3. Temporary Point Reduction	-5	0.00%	-2.73%	-5	0.00%	-2.73%	0
4. Poor Previous Participation of Applicant	-20	0.00%	-10.93%	-20	0.00%	-10.93%	0
5. Poor Previous Participation of Management Agent	-20	0.00%	-10.93%	-20	0.00%	-10.93%	0
tal:	**20**	7.81%	10.93%	**20**	7.81%	10.93%	**0**
D. Development Financing							
1. 4% / 9% Developments	10	3.91%	5.46%	15	5.86%	8.20%	5
2. Replacement/Redevelopment of Public Housing	5	1.95%	2.73%	5	1.95%	2.73%	0
3. RHS Section 515 Property	5	1.95%	2.73%	5	1.95%	2.73%	0
4. Project-Based Tenant Subsidies	5	1.95%	2.73%	5	1.95%	2.73%	0
5. Tax Abatement	5	1.95%	2.73%	5	1.95%	2.73%	0
	30	11.72%	16.39%	**35**	13.67%	19.13%	**5**
E. Permanent Supportive Housing Developments							
1. Supportive Service Coordination	6	2.34%		6	2.34%		0
2. Service Funding Commitments	5	1.95%		5	1.95%		0
3. Targeted Supportive Housing Populations	15	5.86%		15	5.86%		0
4. Developing in a High Need Area	8	3.13%		8	3.13%		0
5. Experienced Supportive Housing Development Team	9	3.52%		9	3.52%		0
6. Successful PSH Outcomes	6	2.34%		6	2.34%		0
7. Medicaid Experience	5	1.95%		5	1.95%		0
8. Specific On-Site Services	4	1.56%		4	1.56%		0
9. Inclusive Tenant Selection Plan	5	1.95%		5	1.95%		0
10. Coordinated Entry System	5	1.95%		5	1.95%		0
11. Recovery Housing Developments	5	1.95%		5	1.95%		0
	73	28.52%		**73**	28.52%		**0**
F. Cost Reasonableness & Credit Efficiency							
1. Credit Efficiency	5	1.95%	2.73%	0	0.00%	0.00%	(5)
2. Total Credit Per Effective LIHTC Unit				25	9.77%	13.66%	25
Total:	**5**	1.95%	2.73%	**25**	9.77%	13.66%	**20**
GRAND TOTAL:	256	100.00%		256	100.00%		0
Non-Supportive Services Grand Total:	183		100.00%	183		100.00%	0

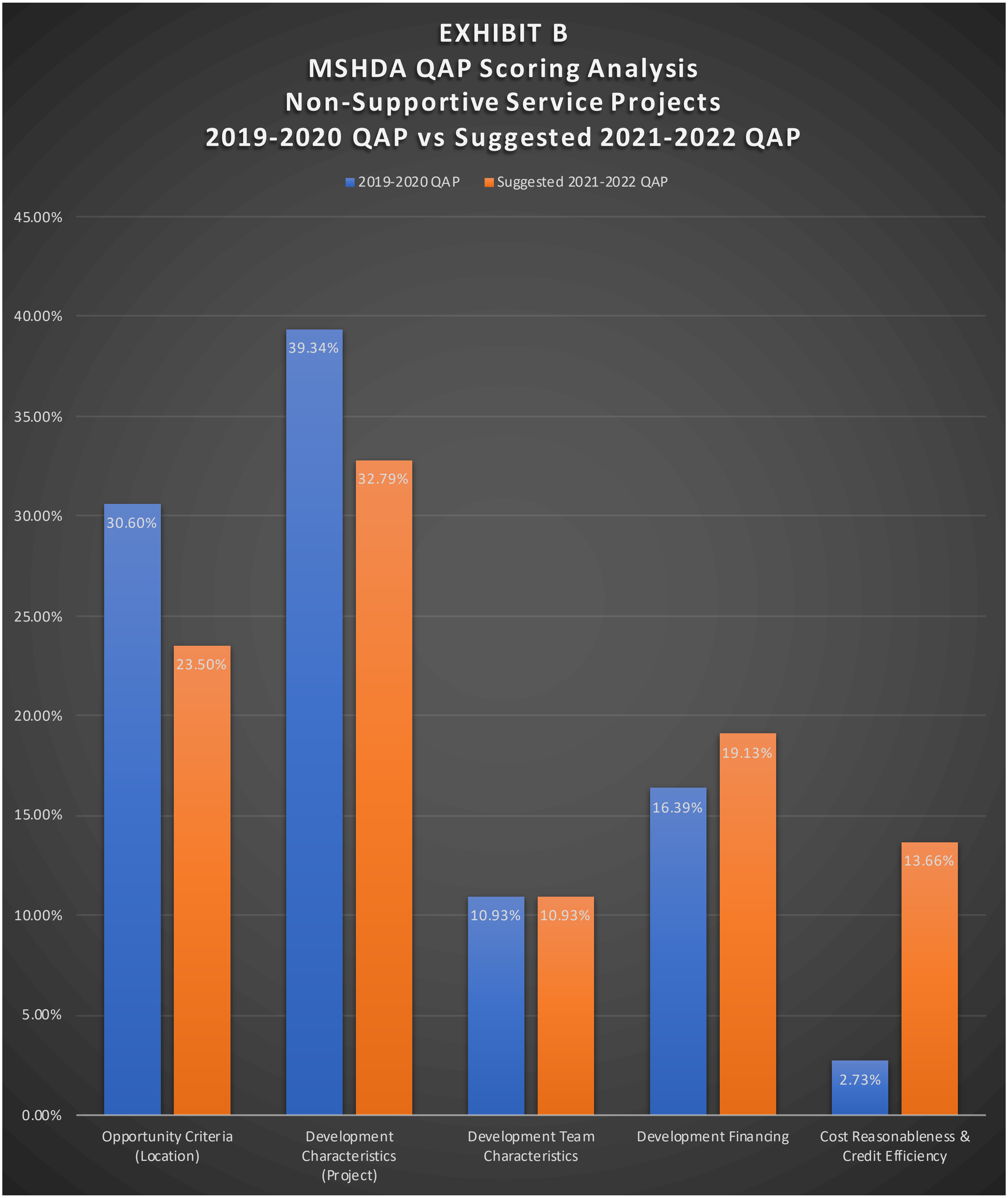


EXHIBIT B
MSHDA QAP Scoring Analysis
Non-Supportive Service Projects
2019-2020 QAP vs Suggested 2021-2022 QAP
2019-2020 QAP
Suggested 2021-2022 QAP
45.00%
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
30.60%
23.50%
39.34%
32.79%
10.93%
10.93%
16.39%
19.13%
2.73%
13.66%
Opportunity Criteria (Location)
Development Characteristics (Project)
Development Team Characteristics
Development Financing
Cost Reasonableness & Credit Efficiency