June 22, 2011

MSHDA 2012 Qualified Allocation Plan
Staff Report

Using this document

MSHDA is issuing this Staff Report to enable all stakeholders to better understand the draft 2012 Qualified Allocation Plan ("QAP"). This Staff Report is intended as a guide to the QAP being issued simultaneously herewith, and as such it should be read alongside the QAP. However:

- This Staff Report is not the QAP and is qualified in its entirety by reference to the QAP. It does not purport to be a comprehensive summary of every change in the QAP, only those MSHDA believes may be of most interest to stakeholders.
- This Staff Report has no legal force and in no way modifies, amends, or contradicts the QAP.
- Participants should neither rely upon nor use this Staff Report when preparing applications.

The QAP and the accompanying policy bulletins and other guidance are the sole authoritative source for the LIHTC allocation process in Michigan.

1. Introduction

A QAP being a device whereby the state seeks to make best use of the LIHTC resource for benefit of the citizens of Michigan, it is incumbent upon MSHDA to change the QAP to reflect shifting policy priorities as these are influenced by events, including experience with the previous QAP, macroeconomic developments in the state of Michigan, and economic and policy changes throughout the nation as a whole. We begin with a review of the past year's events relating to housing policy, as a basis for identifying what areas MSHDA elected to change, and which the Authority sought to continue.

1. A. The changing housing-finance environment since 2010

During 2010, the LIHTC equity market rebounded strongly. Despite the permanent absence of Fannie Mae and Freddie Mac as potential LIHTC buyers, buyers returned to LIHTC equity, some motivated by continuing CRA interest, others as purely economic investors. As a result, and unlike the fraught conditions of 2008 and 2009, virtually all 2010 LIHTC equity was successfully placed, although with a wide range of nationally reported prices.

Meanwhile, the temporary ARRA-related pipeline-protection measures, the soft debt TCAP program, and the Exchange – have expired, which eliminates that distraction and thus serves also to concentrate sponsor, lender, and investor attention on the LIHTC.

If there is a consensus of investor opinion, it is that 2011 and 2012 will be a continuation of the solid LIHTC demand and that the disruption of 2008 and 2009 is now, thankfully, behind us. However, as a result of the economic challenges of recent prior years, strengthening communities and creating jobs must be a priority of Michigan's housing policy.

As state governments are generally under financial stress and resources are constrained (even more so after the expiration of ARRA-funded support for state and local governments) policy demands even greater accountability and efficiency in use of taxpayer money.

1. B. Key principles of this 2012 QAP

The 2011 QAP, which modified the 2009 QAP, was generally well received by participants, with applications strong: activity during the 2010 allocation cycle was well oversubscribed, with applications representing 260% of the total LIHTC MSHDA had available to award. Given the state of the current economic and housing market as well experience gained from recent prior QAPs, the 2012 QAP is guided by several key principles that are reflected throughout the QAP:

- *Continue to make Michigan LIHTC an attractive investment*, for sponsors, lenders, and investors. This includes streamlining processes, encouraging new and capable sponsors/partnerships, and maintaining a portfolio approach to the allocation.
- *Strengthen Michigan's economies and jobs base*, so as to build the economic base that can support quality housing in quality communities. This includes emphasis on central cities and their economic redevelopment, focus on preservation as an anchor to neighborhoods, and emphasizing communities.
- *Make MSHDA's money go further*, with emphasis on cost containment and cost effectiveness, encouraging appropriate planning among sponsors through competitive scoring rules, and rewarding lower-cost development.
- *Build on what works*, by making Permanent Supportive Housing continue as a viable tenure configuration; using Target Percentages (and a new Category approach as well) to assure diversity of location, property types, and tenancies; and pursuing sensible green improvements.

These are expanded upon below, and this Staff Report also includes a section highlighting areas of evolving practice, to encourage stakeholders to provide insights that may help MSHDA shape future policy.

2. Continue to make Michigan LIHTC an attractive investment

While Michigan developers have shown commendable loyalty to the state's priorities, without an equity investor properties cannot proceed, and LIHTC equity investment is a national phenomenon. MSHDA therefore seeks to make Michigan LIHTC attractive to equity investors by providing an allocation process that is rational, transparent, fair, efficient, sequential, and straightforward to navigate.

2. A. Streamline processes wherever possible

1. Equity investor commitments and closing. In 2009, when the LIHTC markets were disrupted, MSHDA required a 'hard letter' from a LIHTC equity investor, and gave substantial points to properties that were ready to close. Now that the markets have recovered, MSHDA has followed stakeholder recommendations and eliminated the hard equity letter requirements and replaced it with an easier-to-satisfy equity investor letter. See Section VII.A.17 of the QAP.

MSHDA's goal remains that of receiving applications for projects that are highly likely to receive equity investment, and of weeding out those that are not, while minimizing the additional effort required to demonstrate that likelihood. MSHDA now requires an equity investor letter by an investor/syndicator, with sufficient detail of price and terms to demonstrate that the capital provider has performed a level of review and due diligence that shows serious interest in a property. This level of review is higher than an 'expression of interest' but less than a binding commitment. MSHDA has also eased related requirements, setting a 180-day deadline for properties to close on equity and all other sources of financing, and eliminating the requirement that the 6% fee be submitted with the application.

2. Elimination of rolling round. Eliminating the requirement for hard equity eliminates the need for a rolling allocation round, especially as in MSHDA’s experience, the rolling-round was fully subscribed the first day it was open.

Accordingly, the proposal for the 2012 QAP is to have two separate competitive rounds, each for 50% of the 2012 credit ceiling. The dates for these rounds are August 15, 2011 and February 15, 2012.

3. Not impose MSHDA underwriting standards if they are redundant and MSHDA is not at risk. Stakeholders observed that in some cases, MSHDA is merely allocating LIHTC, not debt or other resources, and that third parties are providing hard debt, soft debt, and equity, using underwriting standards that those parties think suitable for placing their money at risk. While MSHDA remains every bit as concerned about property viability as if MSHDA had a lending role in the property, MSHDA has no wish to constrain market innovation. Hence MSHDA will accept a debt and/or equity provider’s underwriting standards *if* the applicant submits acceptable written documentation from both the lender and equity provider, indicating what the alternative standards are and how they are being used. See Section IX.G of the QAP.

4. Allow 'anticipatory funding' to be considered available if it has a later funding cycle than MSHDA's. Stakeholders rightly observed that many properties capture other resources – leverage that MSHDA seeks to encourage – but that these other entities have funding rounds that do not coincide with MSHDA's. Examples of such funds include City of Detroit HOME funding and Federal Home Loan Bank funding, both of which are awarded on their own competitive cycles.

MSHDA strongly encourages use of such resources, and accordingly, has modified the QAP to give projects the flexibility to pursue other sources of funding which are also awarded on a funding round basis. Specifically, applicants may indicate that they are *potential* recipients of such funds, and MSHDA will consider that potential provided that the applicant has submitted, and currently has pending, a valid application for the identified funding source prior to making an award of credit. Naturally the applicant will then be required, after award, to maintain the application and secure a funding commitment within 90-days of the LIHTC award or MSHDA may reclaim the award. See Section VII.A.7 of the QAP and Section B.2 of the Scoring Summary.

5. Use external green standards chosen by the applicant. Greening MSHDA properties remains a priority that stakeholders largely endorsed, while raising many practical concerns about achieving green certification. Green standards are continuously changing and national construction methods and specifications are constantly improving. Criteria that have been in place for years may be out of step with more current, recognizable standards, a changing landscape that is difficult for MSHDA staff to monitor.

Accordingly, MSHDA has elected to adopt recognized national standards of LEED and Enterprise Green Communities as its basis for its Green Policy. Applicants can receive points for implementing either of these methods, or simply incorporate the new MSHDA green affordable housing criteria, depending on what works best for their specific deal type.

The MSHDA criteria seek to set a common-sense baseline approach which is reasonable and advisable for projects to incorporate – both for the environment and the bottom line. MSHDA's criteria consist of items which are generally less costly and easier to incorporate.

For 2012, applicants will be required to incorporate one of the green criteria – MSHDA, LEED, or Enterprise Green Communities – into their development. Incorporation of either the LEED or Green Communities will earn a project points, while incorporation of the basic MSHDA criteria will not. See Section VII.A.18 of the QAP and the Green Policy.

6. Post-award followup and interim closing milestones. With the deadline for a project to close on its equity and financing set at 180 days, it is important to have an interim step after the Reservation is issued for projects to demonstrate they are making progress toward closing. This allows projects that have secured the appropriate financing commitments to move forward, while also giving MSHDA the ability to reclaim credit from projects that are not able to secure these commitments and allocate it to another project. MSHDA has therefore established a 90-day progress update, by which time awardees will be required to show substantive progress on funding, namely (a) a term sheet for each debt source, including evidence of the ability to close within 90 further days; (b) a Letter of Intent for all equity sources, which confirms the existence of a committed investor, again with a demonstration of ability to close within 90 further days; and (c) certification that a site visit has been conducted by the investor or syndicator.

In addition, language in the administrative guidance memo issued early in 2011 describing MSHDA's project review at various stages will be incorporated into the QAP. While MSHDA will underwrite a property at initial award to determine whether or not an award of credit will be made, MSHDA will review the project underwriting again at the 10% Certification and when the project is placed in service, but these interim underwriting reviews will not be used to hold up progress or Form 8609 issuance. MSHDA's primary objective at the two latter stages will be to ensure that we are not allocating more credit to the project than is necessary for financial feasibility. See Sections XI and XII of the QAP.

2. B. Encourage new and capable sponsors

Though MSHDA awards LIHTC to properties, properties are developed by sponsors, so MSHDA has a continuing interest in maintaining within and for the State of Michigan a large and robust population of sponsors that are diversified by scale, mission orientation, expertise, geography, and property specialties. A robust sponsor population also assures healthy competition for MSHDA's LIHTC and a continuing improvement of LIHTC development. For this, therefore, MSHDA has a policy interest in seeing new sponsors enter the LIHTC business, compete for and win awards, and develop successful properties.

At the same time that it is encouraging innovation, however, MSHDA has a duty to pick the strongest properties, many of which are delivered by the strongest sponsors, many of whom are also the most experienced. As a result MSHDA has to balance between encouraging newcomers without lowering its standards to do so, while not penalizing experienced developers simply because they are successful.

1. Experience bonus points reduced from 30 to 20. Total points available for both the general partner and the management agent have been decreased from 30 to 20. Those with more experience will still receive more points, but not as much as before, which is part of an effort to balance this scoring criterion with the total points available overall. See Section D.1 of the Scoring Summary.

2. Performance period to qualify for experience points reduced from 5 years to 3. In discussions over the last several years, stakeholders have returned several times to the principle that some developers have done fewer properties of high quality and should not be permanently disadvantaged vis-à-vis those whose experience goes back decades. Stakeholders suggested that 3 years is sufficient to cover the period including initial lease-up and stabilization. MSHDA concurs, and has reduced from 5 years down to 3 years the period that a property, to be counted as positive experience, must be in service (or, in the case of a management company, under that company's management). See Section D.2 of the Scoring Summary.

3. Points are scored not for *any* experience, but solely for *positive* experience. Stakeholders expressed general endorsement of MSHDA's emphasis on development team experience but raised logical and valid concerns about the specifics, and in particular the difference between any experience and *positive* experience. While this should be self-evident, the principle is worth memorializing in the QAP text. Thus, when listing the properties that comprise their experience, applicants must now indicate for those properties any negative events, which include whether a property has materially defaulted on any obligation (including foreclosure or bankruptcy) or has any uncorrected 8823's outstanding more than 6 months. Properties so flagged will not count toward the applicant's experience points. See Section VII.A.22 of the QAP and Sections D.1 and D.2 of the Scoring Summary.

4. Sponsors must disclose *all* negative experience, including non-MSHDA affordable properties. While MSHDA is a distinct entity, other affordable housing programs (such as those run by HUD, RHS, or other states) draw on the same core skills and corporate values as those MSHDA supports, and as a result performance in those properties is relevant to evaluating a sponsor's capacity. Thus, similar to the previous point, MSHDA has added a certification to the application materials, requiring applicants to disclose their prior participation in any affordable programs, not just MSHDA's. The certification encompasses removal from an ownership entity, HUD Previous Participation (Form 2530) violations, violations or citations by the Rural Housing Service (RHS) which operates the §515 program, HOME program violations, and regulatory or mortgage defaults.

In addition, as a courtesy to applicants, MSHDA will offer to give any applicant a pre-application Previous Participation review. Applicants that contact MSHDA staff at least 30 days before a funding round will be advised in advance of any outstanding issues, which could lead to a potential negative point assessment in a LIHTC funding round, and hence have an opportunity to take action. See Section VII.C of the QAP, and Sections D.3 and D.4 of the Scoring Summary.

5. All sponsors, including non-profits, must provide financial statements. Stakeholders suggested generally that non-profit developers should be held to the same financial-capacity standards as for-profits. Upon consideration, MSHDA agrees, and has added conforming language to the requirements in Policy Bulletin #7 relating to the financial capacity of nonprofit entities designed to align them with the requirements which apply to for-profit entities. See Section VII.A.11 of the QAP, Section D.5 of the Scoring Summary, and Policy Bulletin #7.

2. C. Maintain a 'portfolio' approach to the allocation

MSHDA is interested not only in individual properties, but also in a portfolio approach to the state as a whole. Encouraging diversity of location, tenancy and use, configuration, and other attributes not only assures that the state serves different aspects of affordable housing demand, but also provides MSHDA and sponsors with a continuing rich source of examples that can serve as innovation models for other properties and pilots for potential future QAP priorities. Stakeholders, particularly sponsors, likewise develop specialties and quite understandably seek encouragement that properties suitable for their areas of expertise will capture some portion of the state's overall LIHTC resources. Thus, Michigan's LIHTC has set-aside mandates (established in both the §42 statute itself and the MSHDA Act) and MSHDA has adopted Target Percentages (which are not mandatory but represent allocation priorities apart from strict total score). In an effort to improve this, MSHDA is adding another attribute, the Categories, that operates similarly to target percentages, but address a different dimension of diversity, configuration.

1. The Category approach: Preservation, PSH, and Open. For many years, Michigan has made Preservation (which helps stabilize communities) and Permanent Supportive Housing (which assists one of the state's most vulnerable populations) priorities within the QAP. To encourage diversity among property types, the QAP adds a Category applicable to each property. Under the proposed QAP, all properties must self-identify as one and only one of Preservation (first test), PSH (second test), or Open (all other properties). A property that is both Preservation and PSH will be assigned to the PSH category. Then MSHDA has added a category allocation to assure that all three categories are represented in the allocations. All properties will be scored and ranked relative to others in the same category. In a manner similar to Target Percentages, MSHDA will select properties, based on scores, so a minimum of 25% of credits will go to Preservation properties, 25% to PSH, and 25% to Open properties. Because these category percentages total only 75% of the credits, the final distribution could be 25-50% Preservation, 25-50% PSH, and 25-50% Open properties, unless there is a shortage of projects applying in any one category.

Although MSHDA will be using three screens – set-asides, target percentages, and categories – there is minimal risk of failing to fill the requirements, because (a) only the set-asides are mandatory, and (b) every property has a tenancy, a location, and a configuration, so some properties will satisfy all three dimensions, some two or one or zero. This is summarized schematically below.

	Set-asides	*Target Percentages*	*Categories*
Where specified	§42 statute/MSHDA Act	MSHDA QAP	MSHDA QAP
Are they mandatory?	Yes	No	No
Principal attribute	Tenancy and use	Location type	Configuration type

See Section VI of the QAP.

3. Strengthen Michigan's economy and jobs base

Affordable housing is where lower-income wage-earners reside, so it is only natural that MSHDA's affordable housing policy must be cognizant of the state's economic challenges. In view of these evolving state priorities, the QAP includes these large-scale changes:

- Strengthen the jobs base, via the Central Cities Target Percentage (Section VI of the QAP).
- Modification of preservation priorities, (Section VII.B.1 of the QAP and Section F of the Scoring Summary).

3. A. Create a "Central Cities" Target Percentage

Stakeholders observed that Target Percentages did not include an emphasis on Michigan's downtowns and urban core areas, where economic development and job creation are important state priorities. Accordingly, MSHDA has created a new Target Percentage, 20% for "Central Cities." A "Central City" location is defined as being located within a traditional downtown or commercial center with a block group employee to resident ratio of 1.0 or more. MSHDA developed this method, so as to provide an objective and measurable standard on which stakeholders can make decisions with confidence. MSHDA Marketing Staff will be available to assist applicants in determining whether or not they qualify for this Target Percentage. Alternatively, applicants may also use an online web application MSHDA is developing to determine if they are eligible for this Target Percentage or the points available to projects in these locations by using their project's address. See Section VI of the QAP.

In addition to the Central Cities Target Percentage, properties in locations of this type can earn up to 10 additional scoring points determined on a sliding scale using the project's Walk Score which applicants can find at www.walkscore.com. See Section A.5 of the Scoring Summary.

3. B. Refine and sharpen the Preservation category

1. Preservation points have been lowered. MSHDA has carefully reviewed all categories and levels of points available, and has made point-scaling adjustments (reflected in Section F of the Scoring Summary) whose aggregate effect is to reduce the potential advantages of

Preservation properties. While they are still preferred, the proposed new scoring system does not weigh this category as heavily as was done previously.

2. Points added for a Preservation sub-priority – very old Section 236 properties. As an active leader in affordable housing during the early 1970's, the State of Michigan developed a portfolio of properties under HUD's Section 236 interest reduction subsidy program (IRP). These assets have aged significantly, require major rehabilitation, and have almost fully amortized their original loans. Should the properties complete full loan repayment without a transaction, then under current Federal law their residents would lose eligibility for 'enhanced vouchers'. Aside from the potential loss of affordable housing stock, this could result in the loss of approximately 5,000 vouchers otherwise available to the State of Michigan, and would have a devastating impact on the ability of these people to live in quality housing. Thus, these assets are a rising priority for MSHDA.

Accordingly, up to 9 additional preservation points spread across three different categories have been added for the rehab of a Section 236 property nearing its original mortgage maturity. Owners that can secure an award of project-based rental assistance from a local PHA will receive additional points, which make up 3 of the 9 available points for these projects. MSHDA has also awarded more points to properties closer to their full loan amortization, since these are the projects that must be prioritized first. See Section F of the Scoring Summary.

3. C. Focus on communities

Like the updated Green Policy referenced above, site criteria are an important objective for MSHDA to achieve but in a manner that allows flexibility to developers in meeting the goals. The 2012 QAP utilizes the Walk Score methodology found at www.walkscore.com to determine the walkability and proximity of site amenities and other positive attributes to the proposed project. All projects will then have the opportunity to earn up to 10 points determined on a sliding scale using the project Walk Score.

Similarly, MSHDA has renewed the points for Michigan business, so as to keep development and construction jobs at home. See Section C. 6 and D.1 – D.3 of the Scoring Summary.

4. Make MSHDA's money go further

For the state and for MSHDA, money is tight and will get tighter. MSDHA and all its stakeholders must demonstrate, not just to ourselves but to Michigan's leadership and taxpayers, that we are making best uses of resources entrusted to us. The 2012 QAP thus includes several new cost-containment measures.

4. A. Cost containment scoring

MSHDA has heard stakeholder concerns that total development costs (TDCs) for properties may be rising above levels that are sound policy as being necessary to create quality developments. MSHDA shares that view. Accordingly, MSHDA has added bonus points for properties that achieve their objectives at a lower TDC, which should ultimately mean the use of less credit per project. As construction types vary, MSHDA will rank all submissions on credit usage per affordable square foot by construction type (Historic and Adaptive Re-use, New

Construction, Preservation), and then award bonus points only to the highest-ranked properties within each construction type.

Because the ranking is comparative, not absolute, applicants will therefore not know whether they will receive the points or not when they apply. This seeks to encourage applicants to consider all possible credit/cost containment approaches. Additionally, by having like projects compete against one another for these points, MSHDA intends to account for variances in inherent construction costs. Using per-square-foot accounts for different bedroom sizes (and discourages targeting smaller units for containment measures). Market-rate apartments and non-residential space will be eliminated from the psf calculation. See Section I of the Scoring Summary.

MSDHA expects this component to continue evolving in future QAPs as we gain more experience.

4. B. Acquisition cost points

As a further encouragement to cost containment, MSHDA will award 3 points for acquisition-rehab Preservation properties where the acquisition cost is less than 40% of the Total Development Cost (TDC). See Section F.3 of the Scoring Summary.

4. C. Eliminate additional credit option

In the 2011 QAP, MSHDA gave priority, in new LIHTC allocations, to properties that had received previous LIHTC allocations and were returning for additional credits. This was intended as a safety valve for properties experiencing cost increases due to circumstances entirely beyond their control. Nevertheless, MSHDA's experience with the additional-credit has been insufficiently positive to warrant its continuation, particularly in view of the perverse incentives that could be created by awarding points for cost containment in one year, then allowing those that had previously won awards to return later for a higher LIHTC (and hence higher TDC). Accordingly, MSHDA has eliminated the additional-credit option.

5. Build on what works

Two areas that had attracted attention in previous QAPs, Permanent Supportive Housing and green improvements, have proven successful in practice and are being kept largely unchanged.

5. A. Continue current Permanent Supportive Housing rules

Ever since 2008, Permanent Supportive Housing has been featured prominently in the QAPs, both as a concentrated use category of properties, and in the requirement that 10% of every non-elderly property be available for PSH residents. During the QAP comment process, stakeholders commented extensively about both aspects. Significantly, none of the commenters offered demonstrable evidence that either PSH requirement was leading to property infeasibility. MSHDA's experience is likewise that PSH, although a more complicated form of tenure than a normal rental, is viable in both purpose-built and deconcentrated properties.

MSHDA has concluded that the 10% PSH requirement is feasible and does not impair property operational viability, and hence is making no change in the requirement's substance. However, to facilitate successful implementation and operation, MSHDA has simplified and clarified the requirements, focusing on four key areas: 1) the safety valve provision; 2) what is expected when a funding shortfall for service provision occurs; 3) voucher availability for PSH units in a project; and 4) the MOU/Inclusion Plan deadlines and expectations. These changes should simplify this requirement for applicants and their investors, thereby alleviating many stakeholder concerns expressed. See Section VII.A.1 of the QAP for the PSH threshold, Section VI of the QAP for the PSH category, and Addendum VI for the 10% PSH requirements.

5. B. Keep green requirements but streamline them where possible

Green Policy and walkability have been retained, not as administrative requirements but instead as attributes that can earn points. See Section VII.A.18 of the QAP and (Sections A.4 and A.5 of the Scoring Summary.

6. Areas of future consideration

In several areas, MSHDA elected to make no change despite conducting extensive review. We flag these for stakeholder awareness, as they may be changed in the future.

6. A. Continuing to refine Permanent Supportive Housing

As described in Section 5.A above, Permanent Supportive Housing remains a priority for the state and for MSHDA, and is substantively unchanged in this QAP. Nevertheless, there are continuing practical challenges to making PSH work, both as stand-alone properties and as a portion of normal rental properties. MSHDA appreciates the lively commentary its stakeholders have provided regarding PSH, and expects to receive further insights and suggestions that will help us improve our allocations to PSH properties and their success as homes and investments. Additionally, one of MSHDA’s priorities includes having a working group that is focused on determining how well this process works, which should provide factual evidence that will help inform future policy direction. See Sections VI and VII.A.1 of the QAP.

6. B. Housing as part of economic revitalization

Although affordable housing is a community asset in its own right, recent economic challenges in Michigan have demonstrated that its development or renovation can stimulate the local economy and strengthen local communities. MSHDA must always consider the economic and community impact of properties financed using LIHTC resources, and invites continuing stakeholder input as to how these objectives can be better aligned.