

2017-2018 QUALIFIED ALLOCATION PLAN

STAFF REPORT

INTRODUCTION

As is the case with any policy document, certain modifications need to be made to further refine policies and to address changes in legislative and market conditions. To accomplish these modifications in the 2017-2018 Qualified Allocation Plan (“QAP”), MSHDA has worked closely with stakeholders in various focus groups, meetings, and conversations. Based on these many discussions, MSHDA has determined that there should be three general areas of focus for the redevelopment of the QAP for 2017-2018:

- 1) Make improvements to existing key policies
- 2) Create policies that leverage the programmatic flexibility created by the fixed 9% rate and the currently strong equity markets
- 3) Continue to ensure that affordable housing is being provided for Michigan residents in areas of opportunity.

To accomplish these objectives, several changes have been made throughout the QAP, Scoring Criteria, and accompanying program documents. Following is a list of some of the more significant revisions to the 2017-2018 Qualified Allocation Plan, Scoring Criteria, and other related policies. This is not intended to be an all-encompassing list. Therefore, in addition to reviewing this list, stakeholders are encouraged to review all of the program documents in their entirety to gain a full understanding of the policies and program requirements contained within them.

IMPROVEMENTS TO EXISTING POLICIES

The key policy areas in the 2015-2016 QAP were a reflection of the priorities for affordable housing in the State of Michigan. The priorities that were key areas of focus at that time remain the key areas of focus in the 2017-2018 QAP. However, changes have been made to iterate on and enhance the effectiveness of those policies. The key policy areas within the 2017-2018 QAP and some of the more significant adjustments that have been made since the previous QAP are listed below.

PLACEMAKING

“Placemaking” is centered around the concept that people choose to live in places that offer the amenities, resources, and opportunities to support thriving lifestyles. In an effort to revitalize communities across the state, the various funding programs that are available should take into account the types of places where workers, entrepreneurs, and businesses want to locate, invest and expand. Further, as it relates to affordable housing, these same characteristics of locations are often critical to the success of any housing development.

The previous QAP contained much of the place-based criteria that is involved in strategic placemaking. In the 2017-2018 QAP, further improvements in this area were needed. Some of the more significant modifications are as follows:

Location-Based Points

Location is one of the primary components of placemaking. Because of this, the 2017-2018 QAP Scoring Criteria continues to place heavy weight on a project's location as was the case in the prior QAP. As one component of assessing the strength of a project's location, the competitive scoring criteria will continue to use a project's Walk Score, and will continue to give priority to those locations that are in close proximity to transportation. Adjustments to these criteria have been made to better notify Applicants of the ability they have to engage in the process of determining a project's accurate Walk Score as well as to give Applicants a better understanding of what may or may not qualify for transportation points.

Developments near an Employment Center

Not only are there many areas throughout the state that provide strong, walkable locations for affordable housing, but there are also many benefits from locating developments in areas that are proximate to employment centers. Doing so provides residents with access to potential employment that otherwise may not be available in certain areas and a potential added stability for the local economy. Additionally, these institutions often provide ancillary amenities within a neighborhood that can also create significant benefits for residents. With that in mind, an item has been added to the scoring criteria that prioritizes areas that are near an employer with a significant amount of full-time, year-round employment in one location.

Affordable/Market Rent Differential

The availability of affordable housing units provide a significant benefit in housing markets where the actual cost to rent market-rate units far exceeds the ability lower income tenants have to pay those market rents. These are areas where there is a demonstrated need for affordable units due to the fact that the rents that can be charged by the LIHTC program can be significantly less than the units that are otherwise available in these kinds of housing markets. The 2017-2018 QAP creates a scoring incentive for developments that are located in areas where the market-rate rent of unassisted units is at least 20% higher than the 60% AMI LIHTC rents on comparable units.

PREVIOUS EXPERIENCE OF GP/MEMBER

Previous experience continues to be a significant factor in determining with whom investors should invest their resources. With that in mind, the 2017-2018 QAP continues to place a strong focus on ensuring that the state's most valuable affordable housing resource is allocated to experienced owners who will put it to use in an efficient and expeditious manner.

This is an area of the QAP that has historically been frequently iterated on and has been an area of interest for many stakeholders. After a significant amount of discussion with Michigan's affordable housing development community, the 2017-2018 QAP reflects an understanding that prior experience with all affordable housing programs, where previous rental developments were successfully completed that are similar in scope and complexity to the LIHTC program, should count as a part of an owner's prior experience. Owners will now be able to count the experience gained using other programs toward their overall experience scoring assessment, where previously only LIHTC experience was considered as part of the analysis.

COST REASONABLENESS & CREDIT EFFICIENCY

Nationally, an effort to contain costs has been a recent significant policy objective to ensure that the resources available to produce affordable housing are being used efficiently. A good cost reasonableness policy should strike a balance between keeping applicants conscious of the goal of cost-effectiveness, while also keeping general real estate principles in tact that seek to ensure that developments are built to last in a quality manner. With this in mind, the cost reasonableness policy within the QAP has been revamped to meet those goals, but at the same time, allows other important QAP policy objectives to be meaningful in the award process. The cost reasonableness and credit efficiency policy within the 2017-2018 QAP has been enhanced in a few ways.

First, to allow the safe harbor metrics to be more in line with current costs by factoring in the use of inflation data from national cost indices, as opposed to simply relying on historical data that may be outdated. Second, the 2017-2018 QAP iterates on that policy by limiting the amount of penalty any one project can receive for having higher costs, but also establishes an upper cost limit in the QAP to prevent those very high cost outlier projects from being funded. This revised policy allows higher cost projects to compete, but only to the extent that they can meet a significant amount of other QAP objectives that would essentially outweigh the higher costs of completing the project.

Finally, a new element of the cost reasonableness policy within the 2017-2018 QAP rests in placing arguably the most significant penalty in the hands of the applicant. Applicants that experience significant increases in total development costs prior to closing and beginning construction will be given the option to either (1) continue forward with their project, but be penalized in future funding rounds, or (2) return the credit and be free and clear of future penalty. A similar assessment will be conducted upon project completion. This new policy will encourage developers to be mindful when assembling their development cost budget for their initial application to avoid being forced to decide between future penalty or returning the credits on their project.

GREEN POLICY

One of the significant policy goals that the QAP has held over the recent previous years is the encouragement of healthy, green, and sustainable building practices. MSHDA continues to believe that connecting to national green standards allows the QAP to rely on proven systems that are current and

verifiable to deliver good results. As more green building standards become available for developments to utilize, it stands to reason that the policy will evolve to allow for connection to those standards. In the 2017-2018 QAP, the Home Innovations Lab National Green Building Standard has been added to the list of available national green standards that Applicants can utilize to achieve green policy objectives.

PERMANENT SUPPORTIVE HOUSING

Permanent Supportive Housing has and continues to be a high priority for MSHDA as an agency and specifically within the QAP. Permanent Supportive Housing requires a tremendous amount of successful coordination and collaboration between agencies, companies, and resources for it to be successful. Enhancements have been made throughout the Permanent Supportive Housing criteria to better focus developments in areas having the greatest need, those tenant populations having a great need, to provide for a higher level of financing commitments from other funding sources, and to adjust criteria that measures prior successful PSH outcomes of the development team.

MSHDA GAP FINANCING PROGRAM LEVEL 1 REVIEW

After four funding rounds of the MSHDA Gap Financing Program Level 1 Review process being applied to potential 9% LIHTC preservation projects, MSHDA has gained valuable insight into certain improvements that can be made. The 2017-2018 QAP implements some enhancements to (1) reduce the scope of projects that now need to undergo this Level 1 Review and (2) to provide some further clarification to applicants regarding MSHDA's administration of the process. In the 2017-2018 QAP, developments that are 49 units or less and that are financed by the United State Department of Agriculture Rural Development will not be required to submit an application for the Level 1 Review prior to submitting under the 9% Preservation Category. Due to various inherent project characteristics, developments of this type and size have found it very difficult to be competitive under the MSHDA Gap Financing Program and are therefore being exempted from the Level 1 Review process to alleviate some of the administrative time involved for MSHDA and developers alike. Additionally, some clarifications have been provided related to what would typically be considered to be a competitive application for the Gap Financing Program, and to identify which areas of the application must stay materially the same between submissions.

DEVELOPMENT FEE

As identified throughout the QAP and various program documents, a key priority for MSHDA is ensuring that the resources available are being used as efficiently as possible. One of ways the QAP attempts to accomplish that goal is by trying to direct projects that can be completed with 4% credit to use the available 4% credit program, instead of applying for the more valuable and more limited 9% credit. In that context, and as an additional way to incentivize developers to use the 4% credit program where possible, MSHDA has modified the allowable development fee on projects being funded with tax-exempt bonds and 4% LIHTC. As opposed to having a maximum of \$2,100,000 that could previously be earned on these transactions, the maximum allowable development fee will now simply be limited to a calculation of 7.5% of acquisition costs and reserves, plus 15% (or 20% for projects of 49 units or fewer) of all other

project costs. It is worth noting that tax-exempt bond financed projects seeking gap financing from MSHDA will be eligible to receive a maximum developer fee based on the calculations above. However, for purposes of sizing the amount of gap financing that the project is eligible to receive, the maximum developer fee will be based on the lesser of the applicable calculation outlined above or \$2,100,000.

RURAL COMMUNITIES LIST

After a significant amount of discussion with development community stakeholders, it became clear that some modifications were needed to the list of rural locations that qualify under Michigan's statutory QAP rural set-aside. The 2017-2018 QAP contains a revised list of communities that is more reflective of the communities that are characteristically rural within the state.

SECTION 811 PROGRAM

MSHDA was fortunate to recently receive a significant amount of subsidy in the form of HUD Section 811 Rental Assistance that it will be responsible for administering. The intent of the Section 811 Rental Assistance is to allow persons with disabilities to live as independently as possible in an integrated setting. The LIHTC program is the largest generator of affordable housing within the state and creating a link between the HUD Section 811 Program and the QAP is necessary to ensure efficient use of resources. With that in mind, projects will be eligible to apply for HUD Section 811 Rental Assistance and, if selected, will be eligible for points in the 2017-2018 QAP for having Project-Based Rental Assistance. This is a limited opportunity to utilize vouchers and have access to points that many projects previously did not have access to.

LEVERAGING PROGRAMMATIC FLEXIBILITY

The LIHTC program is currently in a unique position not only in the state of Michigan, but also nationwide. The combination of a healthy market for LIHTC equity investment and legislative changes that have taken place to modify the LIHTC program has given the LIHTC program the ability to be even more transformative than it historically has been. The blend of these characteristics creates some unique opportunities, but also creates the need to ensure appropriate parameters are in place to maintain the efficiency of the program. With that in mind, below are some areas where the 2017-2018 QAP has been modified to achieve new policy objectives with the available resources, while also making sure credit is being allocated efficiently.

MIXED INCOME DEVELOPMENT

Historically, the QAP has given some priority to mixed-income developments consisting of a mix of affordable units and market-rate units. The benefits that this structure of housing creates are numerous. However, there are significant challenges to creating mixed-income housing, largely associated with securing the necessary funding to allow a mixed-income project to be viable. The combination of healthy

equity markets and the fixed 9% credit rate creates a foundation for mixed-income development to be possible if located in the right areas.

The 2017-2018 QAP expands on the mixed-income concept by allowing projects to earn varying levels of points for having units reserved for market-rate tenants. However, due to the challenges of structuring a financially feasible mixed-income project, the QAP requires projects to be in an area that has true market rents (see Affordable/Market Rent Differential section above) to be able to earn points for having a greater number of units targeted for market-rate tenants. Doing this aligns the incentives within the 2017-2018 QAP to ensure that developments that are devoting a significant amount of their units for market-rate purposes will be located in areas where market-rents are significantly higher than the affordable rents and make a significant contribution to the financial viability of the mixed-income development. This policy also creates a substantial benefit for creating or preserving integrated housing.

APPLICATION OF BASIS BOOST

Since 2008, the basis boost has been expanded in the LIHTC program to allow states to use the basis boost as a way of achieving specific policy objectives and as an additional tool to help make project financially viable. The 2017-2018 QAP continues to utilize the basis boost to incentivize various project characteristics, but with some modifications based on current market conditions.

The combination of healthy LIHTC equity markets and the fixed 9% credit rate has allowed for a significant amount of funding to be available to projects that previously was unavailable. As discussed above, this creates a valuable opportunity to incentivize policy goals that previously were unattainable; however, it also creates the challenge of continuing to ensure that the LIHTC resources are allocated efficiently. To accomplish that, the 2017-2018 QAP lowers the maximum basis boost that any 9% LIHTC project can receive to up to 10% for some projects and up to 20% for other projects. In the current market, a 10% basis boost is approximately equivalent to a 30% basis boost prior to the 9% credit rate being fixed and, therefore, will be more widely available. The 20% basis boost is being reserved for only those projects that have certain unique characteristics and that may need the additional credit to be feasible (e.g. historic rehabilitation projects, mixed income projects, projects targeting lower income levels). In doing this, the 2017-2018 QAP strikes an appropriate balance between using the basis boost to achieve desirable policy objectives while also placing a clear focus on overall resource efficiency.

PROJECT FEASIBILITY

Since the previous QAP was approved, changes within the equity market and the tax credit program, as previously discussed, has allowed the program to be very versatile and valuable to the creation of affordable housing. With that in mind, the 2017-2018 QAP contains policies that recognize this great opportunity while also recognizing the increased need to ensure program efficiency. Along those lines, the 2017-2018 highlights the fact that applicants will continue to be held to the same standards as has previously been the case related to ensuring that developments only are allocated a level of LIHTC resources that is enough to make the development financially feasible. To achieve this, it will require

applicants to secure debt and/or other funding sources to be paired with the LIHTC when appropriate and possible in order to ensure the continued efficient administration of the LIHTC program in Michigan.

HOUSING IN AREAS OF OPPORTUNITY

As has been outlined in greater detail above, many of the policies that are in place within the 2017-2018 QAP are designed to ensure that affordable housing is available in areas of high opportunity. To accomplish this, the 2017-2018 QAP places a great amount of emphasis on the strength of a project's location by considering many factors as further highlighted below. It is the intention of these policies to develop and revitalize housing in areas that have a significant quantity of community amenities, offer tenants access to mobility and jobs, and that will be a focal point for further future investment.

The following are key criteria within the QAP that have a direct correlation to creating and/or preserving affordable housing and allowing lower income residents to live in areas of greater opportunity:

1. Proximity to Transportation/Walk Score
2. Developments Near An Employment Center
3. Neighborhood Investment Activity Areas
4. Affordable/Market Rent Differential
5. Mixed Income Development
6. Rural Set-Aside

The QAP has a heavy emphasis on location because strong locations that are proximate to a large amount of amenities can have significant benefits for residents. Among them are the potential for enhanced quality of life and reduced transportation costs associated with living in walkable areas. All residents of the state of Michigan deserve not only safe and quality-built housing, but also housing that provides them with access to employment and recreational opportunities in locations that are vibrant and growing through public and private investment and reinvestment. The QAP accomplishes that goal by targeting locations that are close to significant employers and that are proven areas of focus by being attractive to recent and ongoing private and public investment. The QAP also targets affordable housing units to areas where rent levels are significantly higher than a typical lower income resident will be able to afford without being severely rent over-burdened, which should allow lower income residents to have access to the same quality housing and opportunities as higher income residents.

The overall rental market is steadily trending toward vibrant, walkable areas with many amenities and opportunities for employment and recreation. Residents desire to live and work in locations where there is a high quality of life and where there are a multitude of opportunities to continue to better their current situation. Residents that are in need of affordable housing are no different in what they desire and affordable housing should be no different in what it offers them. It is for these reasons that the QAP focuses on areas of opportunity.