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AMERICAN RECOVERY & REINVESTMENT ACT

PRELIMINARY IMPLEMENTATION PLAN MARCH 25, 2009

On February 17th, the President signed the American Recovery and Reinvestment Act (ARRA) in an effort to combat the recession, stimulate the economy, and begin systemic reinvestments in the nation's physical and economic infrastructure. The tools from ARRA, in combination with those provided by the 2008 Housing and Economic Recovery Act (HERA), provide the State of Michigan with powerful resources intended to combat national dislocations within the Low Income Housing Tax Credit (LIHTC) program, the nation's most substantial affordable housing production tool over the past two decades.

Michigan's affordable housing portfolio and industry are uniquely positioned, and the plans and programs outlined in this announcement are intended to deal with the specific challenges facing our state. Not only has Michigan been dramatically affected by the dislocations in the capital markets and the market for LIHTC equity, but the state faces significant challenges which predate the financial crisis that prompted ARRA.

Specifically, Michigan's economy has suffered from a prolonged period of stagnation coupled with substantial and ongoing job losses in the manufacturing and automotive sectors. Macroeconomic trends, including both year on year and inflation adjusted declines in income combined with population loss, have led to flat or declining rental revenues for many affordable housing developments. In contrast to Michigan's economic challenges, the national run up in housing activity drove increases in construction pricing (and therefore maintenance and capital improvement costs for existing developments) for much of the last decade while energy costs also increased dramatically. These factors have combined to put substantial pressure on operating budgets of existing affordable housing developments across the state.

Michigan has an exciting and historic opportunity to use ARRA's housing provisions to address these issues while simultaneously driving the state's economic recovery and the reinvigoration of its cities. The plans outlined in this announcement are driven by several priorities and policy determinations. Specifically, we seek to balance the need to:

- Maximize the value of these resources to the State of Michigan. ARRA has prompted a great deal of discussion within the affordable multifamily housing industry, and myriad suggestions on implementation. The Authority will implement policies that best support affordable housing in Michigan as a whole, taking into account leverage of other funds and overall efficiency of resource deployment, while specifically rejecting those that deflate the value of the resources made available through ARRA.



- Spur economic activity and employment by focusing on projects that can be implemented quickly. While not every project that has been stalled over the past 12-18 months will move forward, many can be quickly updated and restarted. Moreover, a focus on rehabilitation of existing housing will help provide job opportunities that are not as seasonal as new construction activity.
- Improve the quality, sustainability, and long term impact of projects developed with ARRA resources. These one-time funds create a special opportunity to structure transactions that can weather the difficult economic headwinds currently facing Michigan and, in better times, will provide housing which is at once more affordable and of higher quality than the standing LIHTC program has traditionally produced.
- Recognize and honestly address the economic and financial challenges ahead. While niche markets may exist in terms of both geography and tenant characteristics, on a macro level, the state does not need additional affordable housing units, but it demonstrably needs housing which is more affordable (i.e. at lower rents). State policies therefore should be oriented toward supporting reinvestment in the existing affordable housing stock by increasing its quality, marketability, energy efficiency, and continued viability. And, as demonstrated by the more conservative underwriting standards outlined in the 2009 Qualified Allocation Plan (QAP), developments will need to withstand significant stress testing to ensure their viability and to attract investment from the capital and equity markets.

At the same time, several caveats and notes of caution are in order.

- A great deal of uncertainty remains. The two most important features of ARRA, the ability to monetize portions of the state's LIHTC ceiling and new federal Tax Credit Assistance Program (TCAP) funding, will require regulatory guidance from both the United States Departments of Treasury and Housing and Urban Development (HUD). The Authority is keenly aware of the relative lack of clarity on the specific rules, regulations, and processes that will come with these funds, and while we believe the basic framework of this plan will remain intact, specific details will need to be updated, reconsidered, and changed as the federal requirements become clear.
- The backlog of projects from the past two years is too large for all stalled projects to move forward simultaneously. In spite of the need to speed economic activity, the public focus on "shovel ready" projects, and the extraordinary capacity of the state's affordable housing industry, it will take time to effectively and appropriately make use of the ARRA resources.
- The different funding opportunities provided by ARRA, along with the Neighborhood Stabilization Program (NSP) funding provided by HERA, each have specific commitment and expenditure timelines and varying eligibility and compliance requirements. In order to make efficient and full use of these resources, the Authority will explicitly reserve the ability to reappropriation funds and funding sources within and between the program categories described within this document.

In spite of these challenges, indeed in recognition of them, the Michigan State Housing Development Authority is committed to providing as much clarity to the public as possible of the direction, thinking, and planning efforts surrounding the implementation of provisions of ARRA. As a result, the Authority is pleased to announce plans for four key program areas:

1. **9% Tax Credit Assistance Program:** This program will provide funding support for applicants seeking awards of 2009 LIHTC ceiling;
2. **9% Tax Credit Exchange Program:** This program will allow sponsors with an unsyndicated 9% LIHTC award from 2007 or 2008 to return their credits and apply for direct funding from the Authority in lieu of syndication of those credit awards;
3. **4% Tax Credit Assistance Program:** This program will provide gap financing resources for proposals seeking 4% LIHTC and tax exempt financing from the Authority; and
4. **Michigan Affordable Housing Reinvestment and Innovation Program:** This program will, subject to compliance with federal regulations, provide funding to reinvest in existing affordable multifamily housing developments across the state whose viability is threatened, to invest in additional production under the three programs outlined above, or to invest in other innovative efforts to improve the viability of the state's affordable housing stock.

9% TAX CREDIT ASSISTANCE PROGRAM

With this announcement, the Authority is providing notice that applicants for 9% Low Income Housing Tax Credits under the 2009 Qualified Allocation Plan can request federal TCAP funding as a part of their applications in the upcoming 9% funding rounds without the need for a separate application. The Authority intends to tentatively set-aside up to \$34.5 Million in TCAP funding to support this initiative.

Applicants for 2009 9% LIHTC Awards will be allowed to request up to \$0.25 in federal TCAP per dollar of LIHTC. This is a maximum amount—actual awards will be based on need, consistent with an overall goal of creating as many sustainable, affordable units as possible with the available subsidy. At the maximum, the TCAP could therefore fill a gap created by a price decline of up to \$0.25 per dollar of LIHTC.

Further details will follow, but developers should be aware of several issues:

- The Authority believes that TCAP funds will ultimately trigger cross-cutting federal requirements similar in many ways to those applied to HOME funding. As a result, developers should assume that compliance with Davis Bacon & Related Acts (DBRA), the Uniform Relocation Act (URA), the National Environmental Protection Act (NEPA), and Uniform Federal Accessibility Standards (UFAS) will be required. The applicability of these standards has specific implications for any applicant seeking TCAP funds that will need to be addressed in planning, preparing, and submitting May 2009 LIHTC applications.
- At this time, the Authority intends to secure any TCAP investment with a mortgage loan and regulatory agreement. The terms of such mortgages will be outlined in greater detail over the next several weeks, but we currently expect to structure them as soft loans payable from a

percentage of cash flow with affordability requirements consistent with LIHTC and other restrictions already part of the property's development planning.

- Because of presumed recapture risk to the Authority and to encourage solid underwriting, applicants selected for 2009 LIHTC awards that have requested TCAP funding will be underwritten jointly by the Rental Development & Homeless Initiatives Division and the Tax Credit Allocations unit. The Authority's Direct Lending underwriting guidelines will be applied to any request for TCAP funding, including but not limited to expectations about reserve funding levels, income/expense inflation factors, debt coverage ratios, design review standards, and construction oversight.
- ARRA requires that states provide asset management oversight to developments receiving TCAP or Monetized Credit investments and further provides that reasonable annual fees can be charged to cover the cost of this function. At this time, the Authority initially intends to perform this function itself and to require some level of ongoing monthly income and expense reporting, annual budget and audit reviews, and periodic capital needs assessments similar to developments financed through the Authority's Direct Lending programs. Further details on the specifics of this process, how it can be coordinated with asset management oversight by LIHTC investors, and the annual fees that will be assessed will be released shortly.
- To encourage leveraging and to maximize the value of equity investments to the state, the Authority will apply additional scoring criteria to the previously published 2009 QAP Scoring Summary. The Authority intends to award additional points in an inverse relationship to the TCAP funding sought, so those applications seeking less than the maximum TCAP support—i.e. those that request less than \$0.25 per dollar of LIHTC—are advantaged. Specifically, for each \$0.01 less than the maximum \$0.25 of effective pricing support from TCAP requested, a development proposal will be awarded 2 additional points. For example, a development proposal seeking only TCAP funding equal to only \$0.20 per LIHTC will receive 10 additional points. Developments that are viable without TCAP funding will receive the maximum 50 points.

The Authority anticipates there will be requests for federal TCAP funds from developers that have either closed or are seeking to close on 2007 or 2008 tax credit awards but have funding gaps due to lower than expected pricing. Requests to provide gap financing to developments that have already closed are problematic on several fronts. Projects that have closed may not be able to meet the requirements for federal funding since most of the cross-cutting federal requirements must be satisfied prior to beginning a project. Additionally, developers that closed deals with a gap did so in full knowledge of the risks attendant in such an undertaking, and providing additional funding will, in general, not leverage additional investment into the state since the investment in the development has otherwise been made.

Sponsors seeking gap fillers to support credit pricing less than \$0.85 are encouraged to strongly consider the Tax Credit Exchange Program outlined below. In general, the Authority anticipates excess demand for ARRA resources, and providing TCAP funding to support pricing of credits below the federal exchange rate has both the direct cost of the TCAP investment and the

opportunity cost of credits that could have been exchanged at a higher rate. There may be limited circumstances where a modest investment of TCAP funding would accelerate the pace of a specific development or provide other indirect benefits that are worth considering. At this time, however, the Authority's primary focus for this program option is to support 2009 LIHTC applications.

9% TAX CREDIT EXCHANGE PROGRAM

With this announcement, the Authority is providing notice that sponsors with unsyndicated 9% LIHTC reservations from prior funding rounds will be afforded an opportunity to request an award of TCAP and/or awards of Monetized Credit in lieu of syndicating those credit awards. In order to apply for an award of such funding, sponsors will be required to return their reservation of credits to the Authority.

The Authority strongly urges sponsors with unsyndicated LIHTC awards from 2007 and 2008 to voluntarily return those awards quickly, to free up resources for affordable housing in Michigan. No penalty or stigma will be attached to an award voluntarily returned. Return of credit allocations simply recognizes that the economic environment has shifted radically since the award was made. However, sponsors who are eventually required to return unsyndicated LIHTC may be penalized.

The Authority intends to set aside funding generated through the federal exchange program, which as yet does not have formal guidance. Based on statute, the federal government will provide \$8.50 for each dollar of LIHTC exchanged—the up-front equivalent of \$0.85 pricing. Until developers return their credits, it is unclear exactly how much Michigan will have available through the exchange, but the Authority estimates that at least \$150 million of funding will be used in this manner.

Applicants for the Authority's 9% Credit Exchange Program will be required to submit refreshed underwriting materials including updated proforma projections. As with the 9% Credit Assistance Program described above, development proposals will be underwritten jointly by staff from the Rental Development & Homeless Initiatives Division and the Tax Credit Allocations unit. The Authority's Direct Lending underwriting guidelines will be applied to any request for TCAP funding, including but not limited to expectations about reserve funding levels, income/expense inflation factors, debt coverage ratios, design review standards, and construction oversight.

Further details will follow, but developers should be aware of several issues:

- Sponsors seeking to return their credits and apply for funding under the 9% Credit Exchange Program will be required to submit documentation satisfactory to the Authority that they have made good faith efforts to syndicate any returned credit reservations on reasonable terms. Developers who have been unable to attract equity investment at reasonable pricing and terms will be able to return their credits and apply for funding under this program.

- The Authority generally intends to award funding at the minimum level needed as determined by its underwriting. This amount is in no way dependent on the federal credit exchange amount or previous awards of LIHTC. It is a need-based gap filler, subject to project evaluation, underwriting, and available resources. The Authority is not, however, initially inclined to consider individual requests for exchange funding that exceed the monetized credit funding resulting from the return of a specific credit award.
- While details are still unclear, the Authority believes that Monetized Credit Investments may trigger DBRA requirements. Additionally, based on the commitment and expenditure deadlines associated with different funding sources, the Authority will seek to use TCAP funding for any 9% Credit Exchange Program proposals that also qualify for TCAP funding and will seek to process those proposals ahead of applications for Monetized Credit Investments. We believe TCAP funds will ultimately trigger cross-cutting federal requirements similar in many ways to those applied to HOME funding. As a result, developers should assume that compliance with DBRA, URA, NEPA, and UFAS will be required.
- At this time, the Authority intends to secure any TCAP or Monetized Credit investment with a mortgage loan and regulatory agreement. The terms of such a mortgage will be outlined in greater detail over the next several weeks, but we currently expect to structure them as soft loans payable from a percentage of cash flow.
- ARRA requires that states provide asset management oversight to developments receiving TCAP or Monetized Credit investments and further provides that reasonable annual fees can be charged to cover the cost of this function. At this time, the Authority intends to perform this function itself and to require some level of ongoing monthly income and expense reporting, periodic capital needs assessments, and annual budget and audit reviews similar to developments financed through the Authority's Direct Lending programs. Further details on the specifics of this process, how it can be coordinated with asset management oversight by LIHTC investors, and the annual fees that will be assessed will be released shortly.
- While participation will not be required and lack of participation will not be a factor in decisions to make awards under the 9% Credit Exchange Program, the Authority intends to make up to \$400 million in Tax Exempt Direct Lending financing available for construction and permanent loans for developments participating in the Tax Credit Exchange Program. Subject to compliance with the QAP and Section 42 rules, we believe this will qualify developments taking advantage of this special tax exempt financing program for 4% Low Income Housing Tax Credits. Developers seeking an award of 4% LIHTC will be able to either syndicate those credits or claim those credits for themselves. Credits claimed by the developer may be treated as (in present value terms) payment of developer fees for purposes of development sources and uses. This concept is preliminary only and may change at formal implementation.

4% TAX CREDIT ASSISTANCE PROGRAM

The Authority further intends to set-aside up to \$30 million in Monetized Credit and/or TCAP funding to support development proposals seeking tax exempt financing. These funds will be used to supplement existing soft funding resources the Authority has made available, including HOME, NSP, and MSHDA Preservation funds.

As noted in the 9% Credit Assistance and 9% Credit Exchange Programs above, sponsors should consider the implications of cross-cutting federal requirements to their proposals and assume that any assistance under the 4% Credit Assistance Program will trigger compliance with DBRA, URA, NEPA, and UFAS.

The Authority also intends to release technical bulletins shortly outlining revisions in the Direct Lending underwriting process and program parameters. These changes are intended to clarify and reconcile differences between the Direct Lending programs and the 2009 QAP, address a new system of awarding gap financing resources, update the Authority's underwriting outlook based upon recent economic and market trends, and otherwise provide clarity on the integration of these resources into the Authority's standing programs.

MICHIGAN AFFORDABLE HOUSING REINVESTMENT AND INNOVATION PROGRAM

The Authority intends to monetize 40% of the available 2009 credit ceiling and 40% of any 2009 national pool allocation it receives. It is estimated that this will produce \$75 million in Monetized Credits to invest in additional efforts to preserve and produce affordable housing. Subject to the regulatory guidance received from Treasury and HUD, the Authority intends to use these funds on efforts, prioritized in the order listed below, that:

1. Reinvest in existing developments that could, with appropriate infusion of rehabilitation funding, be preserved for at least 15 years without the need for a full preservation transaction.
2. Provide additional gap financing for tax exempt bond financed developments with actual equity commitments.
3. Provide additional gap financing to developments receiving 9% LIHTC awards from 2009.
4. Provide additional gap financing to development proposals in future 9% LIHTC funding rounds. Initial plans at this point call for the Authority to accept applications for 2010 9% LIHTC awards in the fourth quarter of calendar 2009.
5. Provide additional gap funding support to unique, innovative, or critical mission driven projects seeking resources in the other programs outlined above.

Some additional context may be in order, particularly as related to the first priority of reinvesting in developments without refinancing and resyndication. ARRA anticipates the award of Monetized Credit funds to "qualified low income buildings with *or without*" an allocation of tax credits (emphasis added). ARRA is silent, however, on the time period within which an assisted building must have received its allocation of tax credits, and it further limits a state's ability to provide such funds to buildings without a tax credit allocation to those situations in which the

state can “[determine] that such [an award] will increase the total funds available to the state to build and rehabilitate affordable housing.”

To make awards to developments that do not have tax credit allocations (or for which allocations are later deemed “too old” to qualify prima fascia under ARRA), MSHDA must determine that such awards will increase total funds to the state to fund affordable housing. In that context, the following should be noted:

- Weakness in the existing portfolio, demonstrated by weak and sometimes upside down debt-coverage ratios and increased economic vacancy, is a primary deterrent to private capital investment in housing production and preservation within the state. Anecdotally many industry observers have suggested direct relationships between an HFA’s ability and willingness to “stand behind” troubled projects in their decision to invest further in a state. Efforts to strengthen the existing portfolio can have a direct impact on the availability of equity investments needed to support the 2009 tax credits that will be awarded.
- Likewise, efforts to strengthen the Authority’s direct lending portfolio can sustain and improve its credit rating. Such efforts will increase the agency’s ability to access capital markets at favorable rates, increasing the availability of investment capital for affordable housing development across the state.
- The Authority’s intent is to design any such program to require matching capital investments from existing owners and to create competitive incentives which direct funds to developments that, all else being equal, provide the highest leveraging of additional investment.
- While not required by the LIHTC provisions of ARRA, such an effort will further other goals central to state and federal implementation of ARRA. Specifically, rehabilitation of existing housing can be done more quickly than development of new housing, speeding the economic impact of this capital investment. Rehabilitation is also “greener” than new construction in most cases and will be done in a manner to maximize cost effective energy efficiency, creating additional benefits to the nascent “green economy.”

PUBLIC INPUT SOUGHT & NEXT STEPS

This document is intended as a roadmap of the direction our implementation plans are likely to take, but specifics will undoubtedly change based on feedback from the public, the regulatory frameworks provided by the federal government, and ongoing changes in the economic environment. Put plainly, plans will change and evolve over the next weeks and months.

In the upcoming weeks, the Authority will provide additional guidance on the programs outlined above including parameters, application processes, and the like. Concurrent updates to other standing Authority programs and processes are likely as we seek to align these new resources with those we already manage.

In an effort to both seek public participation in the formation of these programs and policies and to keep industry participants informed of the status of expected updates, the Authority will take several steps, including:

- The Authority plans to hold a public listening and feedback session on April 13th in Lansing. Authority staff will facilitate the session, answer questions about specific provisions of this preliminary plan, and accept comments from members of the public. As soon as additional details of this session are available, they will be posted on the Authority's website at www.michigan.gov/mshda and distributed via any agency and industry means of electronic distribution that are readily available.
- Updates, new policies and procedures, and other relevant information will be provided via the agency's website. Additionally, a "frequently asked questions" section will be developed that seeks to respond publicly to questions about technical, implementation, and process issues in order to avoid confusion, duplication of efforts for both staff and industry members, and provide quicker turnaround to specific questions than a process that waits to incorporate all questions or comments into a single, unified document.
- The Authority will establish a special email address to collect written comments on this preliminary plan. Written comments on this preliminary plan are encouraged and should be directed to: mshdarecovery@michigan.gov (Note, this email address may not be active until Monday, March 30th.)

Alternatively, hard copies may be mailed to:

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