

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

9% TAX CREDIT EXCHANGE PROGRAM NOTICE

UPDATED AUGUST 18, 2009

Background: As a part of the American Recovery and Reinvestment Act of 2009 (ARRA), the Michigan State Housing Development Authority has received funding under the United States Department of Treasury's Section 1602 Program. This program allows states to elect to receive cash grants from Treasury in lieu of awarding Low Income Housing Tax Credits (LIHTC).

On March 25, 2009, the Authority published a Preliminary Implementation Plan addressing its plan to use both Section 1602 Program (aka monetized credit) and Tax Credit Assistance Program (TCAP) funding from HUD to establish several state programs, including a "9% Tax Credit Exchange Program."

This memorandum, together with the attached application and exhibit checklist, is intended to formally announce the availability of funding for the 9% Tax Credit Exchange Program.

Program Outlook: Applicants should be aware that the Authority will re-underwrite all developments seeking funding from the 9% Tax Credit Exchange Program. Unlike the traditional 9% LIHTC program, ARRA imposes additional requirements on the Authority which create liabilities and public expectations that do not exist within the standing program.

The award of funds under the 9% Tax Credit Exchange Program will be at the Authority's sole discretion. The Authority will approach these applications in a manner consistent with its Direct Lending programs. This outlook varies from the traditional 9% allocations outlook in several regards:

- The review of development team capacity is more rigorous and takes into account all Authority dealings with development team members. Sponsors or development team members with recent or unresolved performance, compliance, or financial issues may cause denial of an application. This will include any issues that have developed since the original award of LIHTC was made to a specific project;
- Underwriting is more stringent. Because the Authority is being asked to materially participate in the direct funding of projects, our review may be less deferential to those completed by other funders in the project. Safe harbor cost allowances within the Qualified Allocation Plan (QAP), on operating costs for example, may be determined insufficient for purposes of the 9% Tax Credit Exchange Program; and
- As outlined in greater detail below, ongoing involvement from the Authority has increased. This includes interaction during the development construction and lease-up period as well as during the operational life of the project.

Like the 9% LIHTC program, however, the 9% Tax Credit Exchange Program has limited funding. Projects that are not viable within the maximum exchange program award—calculated based on the LIHTC reservation being returned—may be rejected.

There are several considerations that potential applicants should consider:

Application Deadline: All applications for the 9% Tax Credit Exchange Program are due no later than 5:00pm on Wednesday, July 8, 2009. Eligible applicants should also be aware that the Authority does not intend to provide further extensions to applicable commitment deadlines to sponsors holding 2007 or 2008 LIHTC reservations, and developers who ultimately return reservations after July 8th will not be eligible to apply to the exchange program.

Eligible Applicants: Only sponsors with a reservation of 9% Low Income Housing Tax Credits from 2007 or 2008 are eligible to apply. In order to apply for the 9% Tax Credit Exchange Program, sponsors MUST return and revoke their prior credit award. Sponsors that have previously returned awards of 2007 or 2008 credit are eligible to apply for the 9% Tax Credit Exchange Program ONLY IF they returned their credit reservations on or after March 25, 2009.

Eligible Recipients: In order to receive funding under the 9% Tax Credit Exchange Program, projects must be owned by an eligible borrower under the Authority's Act. In most cases this will require the establishment of a Limited Dividend Housing Association or a Non-Profit Housing Corporation as defined within the Authority's Act.

Source of Funding: While the Authority initially expects to fund the 9% Tax Credit Exchange Program with funding from the federal Section 1602 Program, the Authority specifically reserves the right to fund any application to the 9% Tax Credit Exchange Program with any source of funding available. To the extent the Authority determines another source of funding, such as the Neighborhood Stabilization Program or the federal Tax Credit Assistance Program, will be used to fund an application to the 9% Tax Credit Exchange Program, applicants will be required to submit documentation as may be needed by the Authority to comply with the requirements and regulations associated with any other funding source the Authority intends to use.

Maximum Funding: The Authority does not intend to award funding to individual developments in excess of the cash value of credit awards returned from those projects. For example, a returned credit award of \$200,000 in annual credit ceiling results in \$1.7 million in Section 1602 Program funding. The maximum award under the 9% Tax Credit Exchange Program in this example, therefore, is \$1.7 million. Furthermore, the Authority will not award funds that exceed those needed based on underwriting and gap analysis. In such cases, the maximum award may be less than the cash value of the returned tax credits.

Form of Assistance (Updated August 18, 2009): The Authority will provide Section 1602 Program funds to a development in the form of a mortgage loan, typically subordinate only to an amortizing permanent mortgage. Based upon recent guidance from Treasury,¹ the Authority expects loans to be interest free and deferred during the initial 15 year compliance

¹ Further updates from Treasury may require or result in additional changes. The Authority will consider extending the term of Section 1602 Program funded mortgages to 30 years to include the 15 year extended compliance period.

period. Provided no default or other recapture event has occurred, the mortgage will be forgivable at the end of the compliance period. The loan agreement along with associated documents may include, but may not be limited to, a regulatory agreement, a mortgage, and personal and/or corporate guarantees from the sponsor and/or underlying individual owners of the ownership entity. In the event the Authority elects to fund an application with other sources, funding generally will be provided in the form of a loan.

Limited Dividends (Added August 18, 2009): Because most 9% Tax Credit Exchange Program recipients will not have any LIHTC equity included in the transaction, standard policies surrounding calculating maximum owner return as a percentage of equity make little sense. Therefore, the Authority will calculate allowable distributions on a percentage of cash flow. On an annual basis, Limited Dividends will be capped at 50% of annual cash flow. The balance of any surplus cash shall be deposited into a Sustainability Reserve Account (SRA) which will be held, controlled, and invested by the Authority.

Applicability of Direct Lending Parameters and 2009 QAP: Applicants for the 9% Tax Credit Exchange Program will be subject to the requirements, underwriting standards, and parameters of both the 2009 Qualified Allocation Plan,² and the Authority's Direct Lending Parameters.³ Additionally, developments will be required to meet or exceed the commitments made in their original applications for Low Income Housing Tax Credits including income targeting, extended affordability, and other factors leading to points under the prior QAP.

Ongoing Oversight and Asset Management: It is important to note that ARRA specifically requires the Authority to "perform asset management functions to ensure compliance with section 42 ... and the long-term viability of buildings funded by [the Section 1602 Program]." In making such a requirement, Congress established specific expectations in excess of the compliance functions previously expected of the Authority as a LIHTC allocating agency. In developing this program, the Authority has determined that ARRA's expectations of "asset management" exceed even those traditionally fulfilled by the authority's Office of Asset Management (OAM). Ensuring the long-term viability of funded projects requires that the Authority perform functions such as design review, construction and disbursement oversight, and reviews of project financial feasibility.

Developments receiving assistance under the 9% Tax Credit Exchange Program, therefore, will be subject to a variety of oversight and asset management requirements of the Authority. Those include but may not be limited to design review, construction and disbursement oversight, and ongoing review by OAM. OAM oversight will be similar to that currently required of developments financed with an Authority permanent mortgage and will include submission of monthly income and expense reports, annual audits, annual budget reviews, and periodic capital needs assessments.

² This includes the 10% Permanent Supportive Housing set-aside requirements of the 2009 QAP even for projects that were not subject to this requirement under the 2005/2006 QAP.

³ Sections VI, Application Processing, and VII, Priority Selection Process, will not apply to developments seeking funding from the 9% Tax Credit Exchange Program; Sections I through V of the Direct Lending Parameters will apply.

Fees: The following fees will apply to all 9% Tax Credit Exchange Program applications and funded developments:

Application Fee:	None, but applicants will be responsible for any third-party costs incurred by the Authority associated with the review of a 9% Tax Credit Exchange Program proposal.
Initial Asset Management Fee:	2% of funding awarded under the 9% Tax Credit Exchange Program
Annual Asset Management Fee:	<i>TBD: For planning purposes at this point, sponsors should budget for \$10,000 per project per year, inflating at 3% annually. Developments with direct loans from the Authority are already subject to these asset management functions and therefore may budget a \$0 fee.</i>

Pursuant to the 2009 QAP, standard LIHTC compliance fees equal to \$450 per unit will also apply.

Development Timing: In order to satisfy disbursement requirements imposed by Treasury, developments seeking funding under the 9% Tax Credit Exchange Program must demonstrate to the Authority’s satisfaction that all Section 1602 Program funds awarded to a project may be properly incurred and reimbursed by the Authority prior to December 31, 2010. Any funds not disbursed by that date will be revoked. The Authority reserves the right to impose earlier deadlines and intends to award funds only to projects that can demonstrate an ability to properly expend all Section 1602 Program funding by September 30, 2010.

Competitive Selection Criteria: 9% Tax Credit Exchange Program applications will be selected for funding based on two primary threshold criteria: a) satisfactory underwriting viability of the project including acceptability of the development team and financial feasibility within maximum exchange program funding, and b) a determination by the Authority of a project’s readiness to proceed and ability to be completed within timeframes necessary for the Authority to comply with federal commitment and/or expenditure deadlines.

Failure to Syndicate: In order to award funds under the 9% Tax Credit Exchange Program, the Authority must determine that applicants returning a tax credit reservation have “made good faith efforts to obtain investment commitments for such credits.” The Authority will require that applicants provide a narrative description of the efforts they have made to syndicate their credit awards. Copies of correspondence, emails, meeting notes, or the like should be summarized and made available to the Authority to support the narrative.

In general, the Authority expects applicants to demonstrate that they have made commercially reasonable efforts to syndicate their credits. Applicants who, in the judgment

of the Authority, could sell or could have reasonably sold their credits and successfully completed the development will be expected to do so even if the proposed pricing was less than the 85 cent maximum exchange rate within ARRA. However, developers who reject offers to buy credits at a price that renders a development infeasible will be deemed to have acted in good faith.

Developer Fees: Developer fees will be recalculated based on revised project costs, but developer fees under the 9% Tax Credit Exchange Program generally may not exceed the fee anticipated under the original LIHTC reservation. However, for exchange program projects that choose to participate in tax exempt direct lending and syndicate 4% credits awarded to the development, the developer fee will be recalculated based on revised project costs and may increase. The maximum fee in such cases will be \$1.25 million.

Recovery Act Transparency, Accountability, and Reporting Requirements: ARRA contains new and unprecedented levels of oversight, scrutiny, and reporting. Applicants should be aware that the Authority is responsible for reporting on a variety of project features and outcomes including job creation and retention, development costs, projects awarded, and the like. While we are working to incorporate these data features into standard reporting processes such as the Authority's Equal Employment Opportunity Plans, federal requirements are still being developed and may not be fully available when funds are initially committed to projects. As a result, sponsors must agree to provide any data, reporting, and information needed by the Authority to comply with current or future, state or federal reporting requirements imposed as a result of the Recovery Act implementation.

Ongoing Implementation Flexibility: As with other aspects of implementing the ARRA provisions, the Authority recognizes the difficult environment for affordable multifamily housing development. We will continue to be as proactive and transparent as possible in the implementation of the 9% Tax Credit Exchange Program, but applicants should plan for continued changes, updates, and modifications to this and other ARRA related programs.

The Authority reserves the right to make program changes and waivers as needed to ensure that the 9% Tax Credit Exchange Program is quickly, efficiently, and effectively implemented. Developers with questions or concerns about the applicability of this program to their projects are encouraged to contact the Authority to discuss the specific status of their projects.

The Authority also intends to publish updates, addenda, and/or questions and answers related to the 9% Tax Credit Exchange Program in an effort to clarify remaining issues, respond to feedback, or otherwise communicate with the development community. Interested parties should monitor the Recovery Act portion of the Authority's website on a regular basis for more information (from the main page at www.michigan.gov/mshda click on the American Recovery and Reinvestment Act link).

Public Input and Feedback: Questions and comments on the 9% Tax Credit Exchange Program can be submitted via email to mshdarecovery@michigan.gov.

Attachments:

1. 9% Tax Credit Exchange Program Application
2. 9% Tax Credit Exchange Program Exhibit Checklist