

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

AFFORDABLE HOUSING REINVESTMENT & INNOVATION PROGRAM NOTICE

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 an "Affordable Housing Reinvestment and Innovation Program."

This memorandum, together with the attached application and exhibit checklist, is intended to formally announce the availability of funding for the Reinvestment Program.

Program Outlook: The Reinvestment Program is built around the premise that it is quicker, more cost effective, and ultimately better to make modest investments in existing affordable housing developments to extend their physical and economic lifespan than to force every project that is struggling through a full-scale refinancing and resyndication. As such, the Reinvestment Program can be seen as a preventive medicine strategy versus major surgery, and in that way it is also a program that will not adequately address every challenge facing every potentially eligible transaction.

Applicants should also be aware that the Authority will re-underwrite all developments seeking funding from the Reinvestment Program. Underwriting will generally be based on the currently achievable rents and current operating figures (adjusted as appropriate based on projected savings resulting from a comprehensive rehabilitation) and must demonstrate breakeven and cash flow positive operations through 15 years.

The award of funds under the Reinvestment Program will be at the Authority's sole discretion. Owners (including the underlying general partner or managing member) must be in good standing and demonstrate they have acceptable plans in place to address other troubled or at-risk projects in their portfolio.

There are several considerations that potential applicants should consider:

Application Deadline: September 18, 2009

Eligible Applicants: Owners of state or federally regulated affordable housing developments that have previously received a direct investment of Authority funding—including participation in one of the Authority's Direct Lending Programs, receipt of HOME or Authority Funding, or receipt of Authority administered Project Based Vouchers.

Developments must be no less than 8 years old and must have at least 15 years remaining on their Authority mortgage or federally required affordability period. If projects receiving Section 1602 Program funds are not already subject to an extended low-income housing commitment, enforceable by a Regulatory Agreement, under the LIHTC program, they will have to execute such an agreement with a minimum term of 30 years (equating to a 15 year federal compliance period followed by a 15 year extended use restriction). If projects are already subject to such a commitment, its term will be extended to 30 years following the date upon which the rehabilitation expenditures are placed in service for purposes of the LIHTC program.

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

Eligible Uses: Reinvestment Program funds may be used for any Authority-approved project costs, including but not necessarily limited to hard rehabilitation costs, required reserve deposits, and a developer fee as described below. However, as outlined below, maximum program funding is calculated based on costs which are attributable to depreciable rehabilitation costs that otherwise constitute eligible basis for purposes of LIHTC.

Source of Funding: While the Authority initially expects to fund the Reinvestment Program with funding from the federal Section 1602 Program, the Authority specifically reserves the right to fund any application to the Reinvestment Program with any source of funding available. To the extent the Authority determines another source of funding, such as the HOME Program, will be used to fund an application to the Reinvestment 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.

Scope of Work: The Scope of Work must be consistent with the Authority's Preservation Design Review Requirements and should include all items needed to ensure the long term viability of the project and must take into account the results of a Preservation Capital Needs Assessment (CNA) obtained through the Authority and an Energy Audit. The CNA must demonstrate that upon completion of the scope of work that a) at least \$700 per unit will remain in the development's Replacement Reserve Account and b) that the development's projected annual contributions, beginning at no less than \$300 per unit per year following the rehabilitation, are adequate to extend the life of the development through 20 years or full amortization whichever occurs first.

Energy/Green Audit: Owners have two options relevant to the required Energy/Green Audit. MSHDA's current CNA provider, On-Site Insight, provides a "Green Capital Needs Assessment" that combines its standard CNA with an Energy Audit and other recommendations on "green" rehabilitation and maintenance alternatives that can reduce energy usage, improve indoor air quality, and provide lower life-cycle costs than replacement

in kind options. More information on this option is provided as an exhibit to this program statement.

Alternatively, owners may, as part of their application, suggest another professional be contracted to complete the Energy/Green Audit (note, this option is not available for the CNA). At the time of application, owners wishing to use an alternative provider may provide a copy of that provider's bid, a resume/company profile outlining the proposed provider's qualifications, and an example report completed by the provider in the last 12 months. Any such alternative Energy/Green Audit must, at a minimum, make recommendations related to energy efficiency improvements, water usage, building envelope sealing, and indoor air quality. Approval of another provider is in the sole discretion of the Authority, and such requests will be reviewed within 2 weeks of receiving the owner's initial application.

Minimum Investment: An Authority approved CNA and Scope of Work must demonstrate the need for investment totaling at least a) 20% of the owner's adjusted basis or b) \$6,000 per unit, whichever is greater, and that level of rehabilitation must be achieved within a 24-month period prior to completion of the rehabilitation expenditures – as further described herein and explained in the award agreement.

Maximum Funding: The Authority generally expects Reinvestment Program awards of no more than \$20,000 per affordable unit. Additionally, in no case will the Reinvestment Program investment exceed 110% of the "eligible basis" associated with a Reinvestment project.¹

Form of Assistance: 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 and/or other Authority loans. Based upon recent guidance from Treasury, the Authority expects the Reinvestment Program loan to be interest free and deferred during the initial 15 year compliance period after which it will be forgiven if no default exists. 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. Limited Dividend regulations specific to developments funded with Section 1602 Program funds are being considered by the Authority. In the event that the Authority elects to fund an application with other sources, funding will be provided in the form of a repayable loan and may be provided under different terms consistent with the funding source used.

Owners will further be required to waive any right to prepay any existing Authority mortgage without the Authority's prior consent and must enter into a new regulatory agreement that may include Reinvestment Program specific revisions to the calculation and definition of allowable limited dividends.

Applicability of Direct Lending Parameters and 2009 QAP: Generally, applicants for the Reinvestment Program will be subject to the requirements, underwriting standards, and

¹ Treasury has indicated that maximum funding under the Section 1602 can equal up to 85% of eligible basis, which can further be boosted by 30% at the Authority's discretion, resulting in this maximum funding level.

parameters of the Authority’s Direct Lending Parameters.² This will include the establishment of appropriate reserve levels, including Replacement Reserves as noted above and an Operating Assurance Reserve (OAR). An OAR must be established and/or replenished by the owner sized on the re-underwritten operating expenses and held by the Authority for 15 years based on the closing date of the Reinvestment Program loan.

Additionally, for developments that do not present cash flow projections resulting in a Debt Coverage Ratio of at least 1.15 in the first year following completion of the rehabilitation, the Authority may require an OAR equal to six (6) months of projected operating expenses, reserve and escrow deposits, and debt service.

Ongoing Oversight and Asset Management: As noted in other associated program notices, 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 [TCAP].” 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 additional functions such as design review, construction and disbursement oversight, and reviews of project financial feasibility.

Developments receiving assistance under the Reinvestment Program, therefore, will be subject to a variety of oversight and asset management requirements of the Authority’s Direct Lending programs including but not limited to design review, construction and disbursement oversight, and ongoing review by OAM. Ongoing OAM oversight of developments financed with an Authority permanent mortgage includes submission of monthly income and expense reports, annual audits, annual budget reviews, and periodic CNAs.

Fees: The following fees will apply to all Reinvestment 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 Reinvestment Program proposal, including the cost of completing a Preservation Capital Needs Assessment.
Initial Asset Management Fee:	2% of funding awarded under the Reinvestment Program, which shall be used by the Authority to defray the actual costs of asset management functions as outlined above.
Annual Asset Management Fee:	<i>TBD: For planning purposes at this point, sponsors</i>

² Sections VI, Application Processing, and VII, Priority Selection Process, will not apply to developments seeking funding from the Affordable Housing Reinvestment and Innovation Program; Sections I through V of the Direct Lending Parameters will apply.

	<p><i>should budget for asset management fees based upon actual costs of \$10,000 per project per year, inflating at 3% annually. Developments with existing bond-financed direct loans from the Authority are already subject to these asset management functions and therefore may budget a \$0 fee.</i></p>
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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 Reinvestment 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. Projects awarded Section 1602 Program funds in 2009 must be placed in service, within the meaning of the LIHTC program, no later than the end of 2011. (See further explanation below.)

Competitive Selection Criteria: Reinvestment Program applications must meet two primary threshold criteria:

- a) Satisfactory underwriting viability of the project including acceptability of the development team and financial feasibility within maximum program funding, and
- b) 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.

The Authority will rank applications meeting the threshold criteria based on the following competitive criteria:

- a) Leveraged funds from non-Authority sources, measured as a percentage of total project costs;
- b) Percentage of units in the development that are affordable within LIHTC definitions;³
- c) Highest projected Debt Coverage Ratio after 15 years as determined by the Authority’s underwriting analysis; and
- d) Material participation by a nonprofit as defined by the QAP.⁴

Should there be funds remaining after the competitive selection round, the Authority may evaluate additional applications on a first-come, first-served basis. Such applications must meet the primary threshold criteria.

³ Unlike standard LIHTC awards, Reinvestment Program funding can be used to directly support the rehabilitation of “market” rate units in a development.

⁴ Current Treasury guidance applies Section 42’s nonprofit set aside requirement to the Authority’s combined total of 9% LIHTC and Section 1602 Program funding awarded in 2009.

Developer Fees: The Reinvestment Program includes a developer fee of up to 10% of hard rehabilitation costs, not to exceed \$250,000 per development. Additionally, owners should note that developments participating in the Reinvestment program will increase the likelihood of positive cash flow during the compliance period and can generally be expected to have more equity in the project as a result of further amortization during the 15 year initial compliance period.

Failure to Syndicate/Obtain Capital Investment: In order to award funds under the Reinvestment Program, Treasury rules require that the Authority determine that applicants receiving Section 1602 Program funds 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 seek investment capital for the needed rehabilitation, either from existing limited partners or from a refinancing transaction. Those efforts should include inquiries as to whether, if an LIHTC allocation were made available for the rehabilitation of the project involved, sufficient equity would be available to provide adequate funding for that rehabilitation. Copies of correspondence, emails, meeting notes, or the like should be summarized and made available to the Authority to support the narrative. The Authority recognizes that under current market conditions, when combined with development specific conditions, there may be no reasonable opportunity to obtain investment via credit syndication and/or refinancing and does not intend to require extraordinary efforts by the owner to do so.

In general, the Authority expects applicants to demonstrate that they have made commercially reasonable efforts to position the development to obtain LIHTC equity. Applicants who, in the judgment of the Authority, could sell or could reasonably be expected to refinance and sell new credit awards adequate to preserve the development will do so. However, developers who are unable to identify realistic strategies to complete needed repairs via infusions of additional LIHTC equity despite reasonable efforts to do so will be deemed to have acted in good faith.

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.

Regulatory Basis: As originally noted in the Authority’s Preliminary Implementation Plan, the premise of the proposed Affordable Housing Reinvestment Program is that the Authority can best leverage available ARRA funding by extending the physical and economic viability of

existing low to moderate income housing projects and thereby preserving the properties for further use by low to moderate income individuals and families.

Per the provisions of Section 42(e)(4)(A), rehabilitation expenditures are aggregated and treated as a separate new building which are considered placed in service at the close of any 24-month period. This placed in service date applies even if the building is occupied during the rehabilitation period.

The term “rehabilitation expenditures” generally refers to eligible basis cost amounts incurred in connection with the rehabilitation of an existing building. As provided in Section 42(e)(2), these costs must be chargeable to a capital account and incurred for property (or additions or improvements to property) that is subject to depreciation. Excluded costs would be those costs that are generally not included in eligible basis.

Pursuant to Section 42(e)(1), “rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.” In order to qualify as a separate new building under Section 42(e)(1), Section 42(e)(3) says that such expenditures must exceed the greater of 20% of the taxpayer’s adjusted basis of the building, or \$6,000 per unit.

If a project incurs enough hard rehabilitation costs to meet the minimum expenditure test described above, the project would be eligible for an award of credits related to these expenditures. Therefore, the project would also be eligible to receive an allocation of Section 1602 Program funds on the “new building” as long as it met the requirements of Section 42(h)(1)(B) of the Internal Revenue Code, which requires that the allocation of Section 1602 funding is made in either the year prior to or the same year as the “new building” is placed in service.

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 Reinvestment 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 Reinvestment 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 Reinvestment 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 Reinvestment Program can be submitted via email to mshdarecovery@michigan.gov.

Tentative Program Timeline: The Authority has established the following timeline for processing application and closing on Reinvestment Program awards. While there will undoubtedly be changes over the next several months, Authority staff will work to keep applicants and other interested parties informed of ongoing progress and timing projections.

1. Posted draft program notice for public comment by Friday, July 31st.
2. Comments were due to MSHDA by Friday, August 7th.
3. Final Program Notice and Application Materials posted by Tuesday, August 18th.
4. Applications due by Friday, September 18th.
5. Initial Triage of applications completed by Office of Asset Management staff (including completion of proforma analysis, owner/development team standing, and review of MSHDA perspective on any development performance issues) by Tuesday, September 29th.
6. CNAs ordered by Thursday, October 1st.
7. CNAs delivered by OSI beginning Monday, November 2nd and continuing throughout November.
8. Updated Scope of Work, Bids, etc and final CNA analysis from owners and approved by MSHDA within two weeks of CNA delivery by OSI.
9. Loan Committee reviews and approves Reinvestment Program applications recommended by OAM beginning around December 1st and continuing throughout December
10. Deals close during January, giving approximately 12 months to complete project.

Attachments:

1. Reinvestment Program Application
2. Reinvestment Program Exhibit Checklist
3. On-Site Insight Green CNA description and pricing list