SFA BILL ANALYSIS

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Senate Bill 326 (as passed by the Senate)
Sponsor: Senator John M. Engler
Committee: Finance
Date Completed: 6-16-87

RATIONALE

Recent Federal tax changes have combined to discourage investments in low income housing. The 1986 Federal Tax Reform Act eliminated many of the tax incentives for private developers, who have traditionally invested in housing for tax shelter, cash flow, and capital appreciation purposes. In low-income housing with reduced or eliminated Federal rent subsidies, cash flow is minimal and appreciation of the property may not be as great as in market-rate developments. Although a Federal tax credit program for low-income housing is available, there are those who claim that it won't be enough of an incentive to attract developers. Since the need for low income housing is continuing and critical, especially in economically depressed areas, it has been suggested that modified Michigan State Housing Development Authority (MSHDA) programs be combined with the Federal tax credits to provide incentives for developers and investors.

CONTENT

The bill would amend the State Housing Development Authority Act to require the Michigan State Housing Development Authority (MSHDA) under certain conditions to make loans to housing cooperatives for multi-family housing projects in eligible distressed areas, to allocate Federal housing credits to applicants developing housing projects, and to extend the June 30, 1987, sunsets on certain MSHDA loan programs. The bill also would allow MSHDA to make loans, under certain conditions, to public bodies or agencies and housing cooperatives, corporations and associations, for projects developed with special considerations for elderly and handicapped residents. Following is a detailed description of the bill.

MSHDA Loans: Terms and Conditions

The bill would require MSHDA to make loans to limited dividend housing corporations, consumer housing cooperatives, and nonprofit housing corporations for construction, rehabilitation, operation, or long-term financing of multi-family housing projects in "eligible distressed areas". The Authority would have to set a goal of financing, yearly, at least 1,000 housing units through loans as required in the bill. The Authority could not make a loan under the bill after June 30, 1989.

The bill would require MSHDA to publish a notice in the Michigan Register to solicit proposals for the projects, and send a copy of the notice by mail to every limited dividend housing corporation, consumer housing cooperative, and nonprofit housing corporation that had received financing for a multi-family project from the Authority. If MSHDA received a proposal to construct a project that conformed to the bill's requirements, the Authority would have to accept the proposal and finance the project. The Authority would not be required to finance the project if, within 60 days of when the project was determined to be feasible, MSHDA received written documentation from the bond underwriters that the interest rate on the project's bonds would exceed 9%.

To finance a project, MSHDA would be required to loan an amount equal to 90% of a project's cost at an annual rate of interest not to exceed 6%. Included in a project's cost would be a builder's fee of 5% of the amount of the construction contract, developer overhead of 2% of the project cost, sponsor's risk allowance of 10% of the project cost, marketing and working capital expenses, and cost of furnishings. The Authority could charge up to .5% of a project's cost as an application, processing, and financing fee.

If the cash flow of a project were insufficient to pay the principal and interest of the loan, the interest would be deferred, although the Authority could limit deferral of interest to the first five years after a project was placed in service. Deferred interest would be repaid as a first priority from cash flow generated from operations, refinancing, or money derived from the sale of the project or syndication. If the owner of a project sold or refinanced the project for an amount exceeding the original project cost, plus the cost of the sale or refinancing including a 3% disposition to the owner, the excess would have to be applied against outstanding indebtedness; 25% of the balance of the excess would be distributed to the Authority and the seller or borrower would return the remainder.

If the payments of principal and interest for a project were current, and no deferred interest had accrued, a limited dividend housing cooperation borrower for that project would be allowed distributions equal to a 12% return on the borrower's risk allowance plus any additional sponsor investment in the project for the first 12 months of operation following completion. The return would be increased by 1% for each 12-month period after the first 12 months, with a maximum allowable return of 25% for the project.

The Authority would be required to dedicate at least $1 million of its reserves to award "seed loans" to consumer housing cooperatives and nonprofit housing corporations to cover proposal and start-up expenses for multi-family projects.

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Income Requirements and Subsidies
For 15 years, after housing units in a project were ready for use, a project would have to contain at least 25% of households with incomes of 50% or less of the area median gross income, as determined under the Federal Internal Revenue Code. After 15 years a project owner could prepay the MSHDA loan. Upon prepayment, all MSHDA regulations on the project would terminate.

The Authority would have to pay to the owner of a project, each year, an amount equal to the difference between the annual rent for the required low-income units and the annual rent for those units based on the initial underwritten market rate for the project. The payment to the owner would have to be adjusted annually to reflect changes in the budget expenses for the project. The owner and MSHDA could enter into an agreement under which the Authority would pay the owner an amount not to exceed the difference between the annual rent and the market rate, for an agreed number of units.

Housing Credits
The bill would require MSHDA, within 30 days of the bill's effective date, to provide a form for project applicants to apply for Federal low-income housing credits, as allowed under Section 42 of the Internal Revenue Code. (The Code allows the State to allocate a certain number of low-income housing credits on a yearly basis.) Within 45 days of receiving an application MSHDA would allocate the credits to the applicant; however, if it did not allocate the credits, the Authority would have to provide the applicant, in writing, the reasons for denial.

The State's credit dollar amount would be allocated in the following manner: qualified nonprofit organizations, 10%; farmers home projects, 10%; housing projects in eligible distressed areas, 30%; and all other projects on a first-come, first-serve basis, 50%. Except for the credits allocated to nonprofit organizations, if credits were not allocated before November 1 of the year in which that credit amount was authorized under the Internal Revenue Code, the Authority could reapportion unallocated credits in "a reasonable manner so as to maximize the allocation of the State low-income housing credit dollar amount".

An applicant would have to forfeit credits by November 1 of the year allocated unless the applicant verified before November 1 that a housing project would be in service on or before December 31. The Authority would reallocate forfeited credits to other applicants.

Eligible Distressed Area
An "eligible distressed area" is defined in the Act as: 1) An area located in a city with a population of at least 10,000 that is designated either as a "blighted area" or as vacant because of clearance of blight; and where market demand has outstripped the supply of safe housing and the city has obtained approval for elimination of income limits for authority loans; or 2) a municipality that had a negative population change from 1970 to 1980, an overall increase in the State equalized value of real and personal property of less than the statewide average increase since 1972, a poverty rate greater than the statewide average, is eligible for the Federal Urban Development Action Grant Program, and has had an unemployment rate higher than the statewide average for three of the last five years; or 3) an area in a city of more than 20,000 population that is located within the boundaries of a downtown development authority.

The bill would add to the definition of eligible distressed area any other area, as determined by MSHDA, that would meet the "balanced low-income housing needs" of the State.

Elderly and Handicapper Projects
The bill would allow the Authority to make loans for construction, rehabilitation, and long-term financing of housing projects to any nonprofit housing corporation, consumer housing cooperative, limited dividend housing corporation, limited dividend housing association, mobile home park association, mobile home park corporation, or public body or agency. A project would have to provide the following:

- A system of support services that "promote and preserve the independent living of handicappers, the elderly, or other persons at risk of institutionalization".
- Readily accessible social, recreational, medical, and shopping facilities for residents who cannot provide their own transportation.
- For elderly and handicapped residents unable to transport themselves, an "affordable, daily demand actuated transportation system".

Extend Loan and Bond Deadlines
The bill also would extend from June 30, 1987, to June 30, 1989, the deadline for extending loans to nonprofit housing corporations, consumer housing cooperatives, limited dividend housing corporations and associations, mobile home park corporations and associations, and public bodies or agencies that construct or rehabilitate certain types of low and moderate income housing. The deadline for the use of those note or bond proceeds secured by revenues and property obtained in connection with housing projects would be similarly extended from June 30, 1987, to June 30, 1989.

The deadline on the requirement that the limitation on the aggregate principal amount of notes and bonds in the MSHDA capital reserve fund be reduced from $3 billion to $1.8 billion would also be extended from June 30, 1987, to June 30, 1989. The bill specifies that not more than $100 million could be used to finance multi-family housing projects under the bill.

The Internal Revenue Code limits the amount of certain types of bonds that may be issued in a state in a calendar year. The bill would allocate to MSHDA, for 1988, $150 million of the amount that this State may issue in bonds, and would require that any portion of the MSHDA allocation not issued as "private activity bonds" (as defined in Executive Order 1986-6) by October 15, 1988, be reallocated by the State Treasurer to municipalities whose allocation requests had not been fulfilled.

Tie-Bar
The bill is tie-barred to House Bill 4505, which would extend from June 30, 1987, to June 30, 1989, sunsets on certain MSHDA loan programs.

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FISCAL IMPACT

No General Fund or local unit dollars are at risk under Senate Bill 326. The additional subsidy provided private developers would be funded from current MSHDA reserves. The Authority's reserves are earnings from the repayment and arbitrage of past bond obligations.

MORE

ARGUMENTS

Supporting Argument

There is a continuing need for housing for persons with low and moderate incomes. Because recent Federal tax changes drastically reduced or eliminated housing subsidies and tax benefits for housing projects, developers and investors in the housing industry have had to re-evaluate the profit potential of proposed housing projects. The Authority has reported difficulty lately in getting developers to show solid interest in projects, even when using additional rent subsidies. Because lagging interest in creating low and moderate income housing will only exacerbate an already severe problem by decreasing the number of housing units, something must be done to spur development. The bill would provide significant incentives for private sector development by combining MSHDA's traditional role as low-interest lender with Federal housing tax credits. By requiring MSHDA to provide about 2,000 apartments over a two-year period in distressed areas, the bill would not totally solve housing problems in the State but would be a positive step in that direction.

Supporting Argument

Extending the sunsets on the Authority's debt ceiling and on the income limits in its multi-family direct loan and pass through loan programs would enhance the economic feasibility of development and ensure that there is an increasing supply of affordable rental housing for low and moderate income households, and, at the same time, would stimulate growth. Every MSHDA development has an economic impact on the community it is located in. Contractors and management companies are engaged to construct and manage these facilities. When the developments are fully operational wages are paid to employees, vendor services are contracted, and taxes, or service fees in lieu of taxes, are paid to local governments. A $5 million mortgage loan from the Authority will create approximately 100 jobs and pay $1.7 million in wages. After completion it will employ at least three people and expend an average of $145,000 in vendor services per year.

Opposing Argument

Federal tax reform eliminated important financing tools that MSHDA traditionally used to finance multi-family rental developments for low and moderate income households. In an effort to make MSHDA's multi-family rental programs more attractive, the Authority is using additional reserves to subsidize rents. Even with these additional incentives, MSHDA does not believe that there will be a significant resurgence of private sector interest in creating housing for low and moderate income households, and consequently, that there will be a decrease in the number of such units. The Authority would continue to finance developments through its multi-family direct loan and pass through loan programs under the bill, however, the bill should also allow MSHDA to develop and own housing developments (as House Bill 4505 allowed, as passed by the House). This would create a third multi-family program ensuring continued development of housing for low and moderate income households, while at the same time allowing MSHDA to maintain its economic stability. The bill, by requiring MSHDA to finance a project if it qualified under the bill's provisions, could prove costly to the Authority and drain the Authority's reserves.

Response: The idea of allowing MSHDA to be an owner and developer of projects is a radical departure from its traditional role, and puts it in direct competition with the private sector. The proposal developed in House Bill 4505 brings up a fundamental philosophical question: should private interest or a public entity own and operate a housing project? Many people feel the State has no business directly competing with the private sector. A program allowing a housing authority the power to lend money to itself has been tried before in New York, with disastrous financial results. It is vital the MSHDA remain at arms length from the transaction and be the underwriter and lender and not the developer.

As for the contention that the bill could cause MSHDA's reserves to dwindle, the bill contains a clause that allows the Authority to opt out of a project if the projected interest rate on its bonds would exceed 9%.

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