Approved April 30, 1992
Date

MINUTES OF THE Senate COMMITTEE ON Economic Development.

The meeting was called to order by Senator Dave Kerr at
Chairperson

8:00 a.m./XXX. on April 8, 1992 in room 123-S of the Capitol.

All members were present XXXXXX

Committee staff present:

Lynne Holt, Legislative Research Department
Bill Edds, Revisor of Statutes' Office
LaVonne Mumert, Committee Secretary

Conferees appearing before the committee:

Bill Caton, Kansas Development Finance Authority
Noelle St. Clair, Kansas National Association of Housing and Redevelopment Officials
Dennis Shockley, Chief of Housing, Department of Commerce
Jeffrey Sonnich, Kansas-Nebraska League of Savings Institutions
Gary Reser, Governor's Office
Representative Tom Bishop
Dale Higgs, Rural Rental Housing Association of Kansas
Bill Tschudy, Kansas Securities Industry Association
Nancy LeGrande, Pittsburg State University
Harold Stones, Kansas Bankers Association
Marty Bloomquist, Kansas Development Finance Authority

HB 2918 - KDFA; Issuance of bonds for moderate income family housing

Bill Caton gave an explanation of and testimony in support of HB 2918 (Attachment 1). The bill would change the enabling legislation of the Kansas Development Finance Authority (KDFA) to allow the issuance of bonds for moderate income housing in addition to the current authority to issue bonds for low-income and elderly housing. Mr. Caton referred to two post audit reports: "Examining Mortgage Assistance Programs at the Department of Commerce" (Attachment 2) and "Reviewing the Department of Commerce's 1992 Bond Allocations" (Attachment 3). He said these reports indicate that competitive selection of financial services on bond issues lowers bond issuance costs and that Kansas as a whole is not well served by the current structure. He noted that Kansas is the only state that does not have statewide issuance authority.

Noelle St. Clair spoke in favor of the bill (Attachment 4). She said the legislation would give a new resource of funding and allow those funds to be used as leverage for additional funds.

Dennis Shockley spoke in support of HB 2918 (Attachment 5). He said that the current system primarily benefits only a few counties and that buyers pay higher fees than in other states. Mr. Shockley mentioned that program fees accruing to the issuer could be used to match federal funds under the HOME program.

Jeffrey Sonnich testified in favor of the bill (Attachment 6). He described the revenue bond program in Nebraska and said a similar program would allow greater availability throughout the state in addition to providing consumer cost savings.

Gary Reser urged favorable consideration of HB 2918 (Attachment 7).

Representative Tom Bishop spoke in favor of HB 2918 (Attachment 8). He noted that Kansas had the lowest percentage of first-time home buyers in the nation in 1991. He said this bill will result in reduced costs for home buyers.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE Senate COMMITTEE ON Economic Development,

room 123-S, Statehouse, at 8:00 a.m./~~p.m.~~ on April 8, 1992.

Representative Bishop also provided: a copy of a letter from Curtis Krizek (Attachment 9); a report on the Mortgage Credit Certificate Program done by Kirk McClure of the University of Kansas (Attachment 10) and testimony from Christopher Imming, Federal Home Loan Bank (Attachment 11).

Dale Higgs spoke in favor of the bill and said that rural communities are not being served by the present system.

The Committee also received testimony in support of the bill sent by Kirk McClure, University of Kansas (Attachment 12).

Bill Tschudy testified in opposition to the bill. He said that housing agencies in other states have reserve funds gained through arbitrage, but arbitrage was eliminated in 1986 and Kansas has no such reserve fund to use. Mr. Tschudy referred to the allocation process and noted that banks have been consolidated and savings and loans have gone out of business. He said that KDFA would have to use the same lenders as are now used and there is no program unless the lenders put up funds.

In response to questions from Senator Feleciano, Marty Bloomquist (KDFA) said that it is necessary to be very, very careful in developing this type of program and also to keep in mind that yield restrictions may be a factor. Ms. Bloomquist mentioned that other states are developing new ways to try to keep seeding their funds and to deal with yield restriction problems.

The Committee received testimony in opposition to the bill from Nancy Ziekle, City of Kansas City, Kansas (Attachment 13).

HB 3163 - Economic development, standby loan participation program, "gap" financing assistance for Kansas businesses

Nancy LeGrande explained and testified in support of HB 3163 (Attachment 14). Ms. LeGrande described problems of small businesses, especially service, retail and small manufacturers, in obtaining financing. The program in this legislation would provide "gap financing" of the difference between the borrower's equity and the amount loaned by a lender. She noted that the Small Business Administration would typically require $30,000 in equity for a $100,000 project. Ms. LeGrande said a revolving fund would be established by participating firms placing 2% of net sales in an escrow account on a quarterly basis.

Harold Stones spoke in favor of the bill and said his association would assist in an education program if the bill is passed.

Marty Bloomquist testified in favor of HB 3163 (Attachment 15).

Senator Vidricksen moved that the minutes of March 27 and 31 and April 3 be approved. Senator Moran seconded the motion, and the motion carried.

Senator Feleciano moved that HB 2918 be recommended favorably. Senator Petty seconded the motion, and the motion failed on a 3-4 vote.

Senator Feleciano made a motion that HB 3163 be recommended favorably. The motion died for lack of a second.

The meeting adjourned at 9:00 a.m. There are no further meetings of the Committee scheduled at this time.

Date 4/8/

SENATE ECONOMIC DEVELOPMENT
VISITOR SHEET

(Please sign)

Name/Company	Name/Company
JEFF SONNICH / KNCSI	
Noelle St. Clair KS NAHRO	
Whitney Damron / McGill & Associates	
JOHN C. BOTTENBERG - Ks City	
Doug Bach - KS City KS	
Steve Kelly Topeka KDOC	
Carole Morgan KDOC	
DENNIS SHOCKLEY	KDOC
Nancy Le Grande PSU	
Marty Bloomquist	KDFA
Gary Reser	GOVERNOR
George Wingert	Gov.
Kathy Peterson	McGill
BILL TSCHUDY /	
Harold Stones	KBR
Diane A. Gjerstad	House of Rep.
Jim Maag	KBA
Jerry Ferguson	KDOC
Richard D. Higgs	President Rural Rental Housing Association of Kansas
Roger Franzke	Ks Credit Consulting

KANSAS

KANSAS DEVELOPMENT FINANCE AUTHORITY

Joan Finney
Governor

Wm. F. Caton
President

TESTIMONY ON HOUSE BILL 2918 TO THE SENATE ECONOMIC DEVELOPMENT COMMITTEE

My name is Bill Caton, Acting President for the Kansas Development Finance Authority. Thank you for the opportunity to testify before you this morning. I will be brief and get right to the testimony.

This legislation provides the Authority for the KDFA to issue Mortgage Revenue Bonds (MRBs) to moderate income families. This legislation has been requested by the Governor in conjunction with her housing plan to provide affordable housing to the working class of Kansas.

This bill deals with some very serious problems addressed in two legislative post audit reports regarding the issuance of bonds and mortgage assistance programs in Kansas. These reports clearly state that the cost of bond issuance is extremely high in Kansas and that cost is being passed on to the home buyers.

One report concluded that competitive selecting financial services on bond issues has been successful in lowering bond issuance costs. KDFA has been very successful in lowering costs on bonds it has issued by issuing request for proposals (RFPs). Free enterprise thrives on competition, and lack of competitive bidding for financial services appears to have significantly increased the cost of money.

The other audit report concludes that the state as a whole is <u>not</u> well served by the current structure of the Mortgage Revenue Bond and Mortgage Credit Certificate programs. It also recommends that the Legislature should direct a state entity to take over the administration or operation of the programs. This report also indicated that savings as a result of local refundings and restructuring of bonds has supported general activities and not been reinvested in housing. It also shows that the issuance cost of Mortgage Credit Certificates is <u>4 to 5 times higher</u> than other states, another gross inequity of the non-competitive process.

Kansas is the <u>only</u> state that does <u>not</u> have statewide issuance authority for MRBs and MCCs, and this legislation does not prohibit localities from issuance of MRBs. If the localities display the ability to properly administer the program, I am sure they will be considered to receive sufficient allocation from the Department of Commerce.

If the real reason why there is opposition to this bill is that the KDFA takes money away from financial service providers by requiring a competitive selection process, then we are guilty. If you are told that there is nothing wrong with the system, then I submit to you these reports issued by your Legislative Post Audit Committee.

The KDFA is proud of its record in providing top quality services in the issuance of bonds and serving all Kansans.

* Note - Legislative Post Audit Reports referred to are numbers 92-25 and 92-33 dated December 1991

Attachment 1
4/8/92
Sen. Ec. Dev.

700 S.W. JACKSON, SUITE 1000 / TOPEKA, KANSAS 66603 / (913) 296-6747 FAX (913) 296-6810

PERFORMANCE AUDIT REPORT

EXAMINING MORTGAGE ASSISTANCE PROGRAMS AT THE DEPARTMENT OF COMMERCE

OBTAINING AUDIT INFORMATION

This audit was conducted by Cindy Lash and Jim Davis, Senior Auditors, and Murlene Priest and Rick Riggs, Auditors, of the Division's staff. If you need any additional information about the audit's findings, please contact Ms. Lash at the Division's offices.

Attachment 2
4/8/92
Sen. Eco. Dev.

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EXAMINING MORTGAGE ASSISTANCE PROGRAMS AT THE DEPARTMENT OF COMMERCE

Summary of Legislative Post Audit's Findings

Could the mortgage revenue bond program be effectively administered by the State, rather than by bond underwriters? The State could effectively administer the mortgage revenue bond program. In all other states, the program is administered either by a state housing finance authority or by a state agency. In most cases, however, these state programs still contract with bond underwriters, bond counsel, and sometimes loan servicing companies to carry out certain aspects of the program.

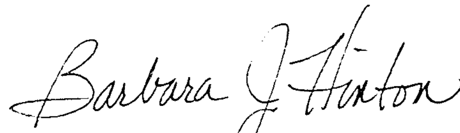
A primary reason for considering State administration of the program is the potential for greater Statewide distribution of available bond moneys. In addition, fees homebuyers pay for participating in the program may be reduced, program information would be more readily available, and oversight may be increased.

Would it be more beneficial to homebuyers if the mortgage credit certificate program were operated by the State, rather than by a bond underwriter? It would be more beneficial to homebuyers if the mortgage credit certificate program were operated by the State. Most states we contacted operated the program with in-house staff, and charged homebuyers far lower fees than are charged in Kansas.

As with the mortgage revenue bond program, State operation of the mortgage credit certificate program also could help ensure that certificates are available Statewide, fees are reduced, program information is readily available, and oversight is increased.

During the audit, we encountered difficulty with underwriters or localities who were slow in providing basic information, or who refused to provide identifiable information that would allow us to independently verify data they provided on program participants. With greater State involvement in the administration and operation of the programs, these problems would not arise, and policymakers would have ready access to verifiable information about the programs.

This audit includes recommendations for improving homebuyer access to the programs, reducing fees and increasing oversight through greater State involvement with the programs. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.



Barbara J. Hinton
Legislative Post Auditor

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EXAMINING MORTGAGE ASSISTANCE PROGRAMS AT THE DEPARTMENT OF COMMERCE

Questions have been raised about the Department of Commerce's role in the mortgage credit certificate program and its allocation of mortgage revenue bonds. Both programs are designed to assist low- and moderate-income, first-time homebuyers in obtaining affordable housing.

Many issues concerning the bond allocation process were covered in the March 1991 performance audit, Reviewing the Department of Commerce's 1991 Bond Allocations. Of specific concern in this audit is whether the mortgage credit certificate and revenue bond programs could be operated effectively by the State rather than by bond underwriters. Other areas of concern include whether the programs are available to homebuyers Statewide, and whether local units of government are benefiting financially by serving as bond issuers.

Based on these concerns, the Legislative Post Audit Committee directed this office to answer the following questions:

1. **Could the mortgage revenue bond program be effectively administered by the State, rather than by bond underwriters?**

2. **To what extent are local units of government charging families to participate in the mortgage revenue bond program?**

3. **Would it be more beneficial to homebuyers if the mortgage credit certificate program were operated by the State, rather than by a bond underwriter?**

For reporting purposes, all audit work related to the mortgage revenue bond program was treated under question one.

To answer these questions, we reviewed federal statutes and regulations regarding the programs, and interviewed officials from the Department of Commerce, bond underwriters and bond counsel, officials of localities issuing mortgage revenue bonds, and the author of a recent report concerning the Kansas mortgage credit certificate program. We also contacted officials in other states to learn how their programs were operated and staffed, and to identify the level of fees charged. We obtained data on location, income, home purchase price, and loan amounts for homebuyers participating in the programs in order to assess geographic distribution of participants, and to determine who the program is benefiting.

In general, we concluded that both programs could be effectively operated by the State, and that participants in the mortgage credit certificate program could be charged significantly lower fees if the State operated that program. It seems likely

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that fees for the mortgage revenue bond program also could be reduced. Mortgage assistance moneys are not well distributed Statewide under either program; in fact, the mortgage revenue bond program essentially is unavailable to homebuyers in western and extreme northern Kansas. We found no evidence that local units of government were charging homebuyers a fee to participate in the mortgage revenue bond program; however, many localities have benefited from restructuring or refunding old mortgage revenue bond issues.

Finally, we encountered difficulty throughout this audit with underwriters or localities who were slow in providing basic information we needed for this audit, or who refused to provide identifiable information that would allow us to independently verify data they provided on program participants. These and other findings are discussed more fully in the report.

Could the Mortgage Revenue Bond Program Be Effectively Administered By the State, Rather than by Bond Underwriters?

The State could effectively administer the mortgage revenue bond program. In all other states, the program is administered either by a state housing finance authority or by a state agency. In most cases, however, these state programs still contract with bond underwriters, bond counsel, and sometimes loan servicing companies to carry out certain aspects of the program.

A primary reason for considering State administration of the mortgage revenue bond program is the potential for greater Statewide distribution of available bond moneys. In addition, fees homebuyers pay for participating in the program may be reduced, program information would be more readily available, and oversight may be increased. These and other findings are discussed further following an overview of the program.

Overview of the Mortgage Revenue Bond Program

Federal law allows state and local governmental units to issue tax-exempt bonds to provide mortgages at below-market interest rates. Lower interest rates result in a lower monthly mortgage payment for homebuyers who qualify for the program.

In the early years of the program, state and local governments could issue virtually unlimited amounts of mortgage revenue bonds, with the proceeds benefiting any first-time homebuyers. In 1980, Congress limited the volume of these types of bonds a state could issue, and also placed an upper limit on the purchase price of homes that could be financed under the program.

Additional restrictions and limits have been added over the years. Currently, states are allowed to issue a limited amount of what are called private activity bonds. These are tax-exempt bonds issued for a private purpose, and they include such things as mortgage revenue bonds, industrial revenue bonds, and student loans. For example, the private activity bond cap for Kansas is $150 million in new bonds annually, and for the last several years, $100 million of that amount has been reserved for mortgage revenue bonds.

Since the program's inception, federal regulations regarding who can qualify for home loans funded by tax-exempt mortgage revenue bonds, and the types of homes that can be purchased, have been tightened considerably. They now include the following:

Criteria related to homebuyers:

- program participants must be first-time homebuyers, or must not have owned their principal residence during the previous three years (although five percent of the bond proceeds can be used for homebuyers who do not meet this criteria)

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- the homebuyer's income cannot exceed 115 percent of the median family income for the area, or 140 percent in a target area—an area with deteriorated housing stock and a high level of economic need
- the homebuyer may have to repay some of the tax benefit received if the home is sold within the first 10 years of ownership

Criteria related to the home:
- the purchase price of the home cannot exceed 90 percent of the average area purchase price, or 110 percent in a target area
- the home must be a single-family residence, and must be the principal residence of the homebuyer
- the home must be within the jurisdiction of the issuing governmental unit
- the home must be financed with a new mortgage

Appendix A shows actual income and purchase-price limits for Kansas localities based on these federal requirements.

Homebuyers generally hear about the program from their real estate agents, who may direct them to a specific lender, or who may provide a list of all lenders in the area who participate in the program. Only lenders who have federal approval to issue Federal Housing Authority (FHA) loans can participate in the program. The primary benefit to lenders comes from the profit they make on standard origination fees and increased volume of mortgages

Once a homebuyer has selected a home, he or she goes to a participating lender and completes an application for an FHA or VA loan. Completing the loan application and providing three years' worth of income tax returns constitutes the homebuyer's application for the program. If the homebuyer meets program criteria and FHA financing guidelines, and the lending institution has not exhausted its allocation of bond money, the homebuyer will receive a low-interest home loan financed by mortgage revenue bond proceeds.

The mortgage revenue bond program must be reauthorized by Congress each year. Concerns about the cost of the program have led Congress to provide only a six-month extension for the program, guaranteeing its viability until June, 1992.

In Kansas, Mortgage Revenue Bonds Are Issued By Localities

The Kansas Department of Commerce decides how much of the private activity bond money the State receives each year will go toward mortgage revenue bonds. The Department also has a bond advisory committee, which is made up of members of the State's financial community, including bond underwriters representing the localities that historically issue mortgage revenue bonds. This advisory committee recommends the amount of the available mortgage revenue bonds each locality should be allowed to issue. The Department makes the final determination. It has no further involvement with the program. (In our earlier audit, Reviewing the Department of Commerce's 1991 Bond Allocations, we were critical of the Department's al-

location process because it appeared to exclude localities that might be interested in participating.)

In recent years, six localities have paired-up to offer three mortgage revenue bond programs in Kansas. These six localities issue mortgage revenue bonds as follows:

- Kansas City and Leavenworth County jointly issue bonds to make loans available in Wyandotte and and Leavenworth Counties
- Olathe and Labette County jointly issue bonds to make loans available in southeastern and eastern Kansas
- Shawnee and Sedgwick Counties jointly issue bonds to make loans available in central and western Kansas

As noted earlier, a home being purchased with mortgage revenue bond proceeds must be within the jurisdiction of the issuing governmental unit. Because these six cities and counties issue the bonds in Kansas, other Kansas localities that want to participate in the program must enter into interlocal agreements with them to meet this federal jurisdiction criterion.

Once these localities are authorized to issue mortgage revenue bonds, they work with bond underwriters who determine the interest rate for the bonds and the rate to be charged to homebuyers, analyze revenues and expenditures to ensure the offering is financially viable, and determine the fees homebuyers will pay to cover bond-issuance costs.

Generally, localities work with underwriters on an on-going basis. They do not take competitive bids for underwriting services, and although they may review proposals submitted by other firms, they generally remain with the underwriter who represented them on the Department of Commerce's advisory committee, and who secured their allocation.

The process for issuing mortgage revenue bonds involves a number of individuals and institutions, including bond underwriters, counsel, and trustees; loan servicers, and lenders. The roles of the various people involved in the process are shown in the flowchart on the following page.

In All Other States Except Arizona, Mortgage Revenue Bonds Are Issued by a State Housing Finance Authority

Arizona issues housing bonds through its Department of Commerce. In the other 48 states, the state housing finance authority issues the bonds. In some states, a large metropolitan area also may have its own housing finance authority, which can issue mortgage revenue bonds within its jurisdiction.

Within Kansas, the Kansas Development Finance Authority can issue bonds for projects authorized by a political subdivision of the State. But in the area of hous-

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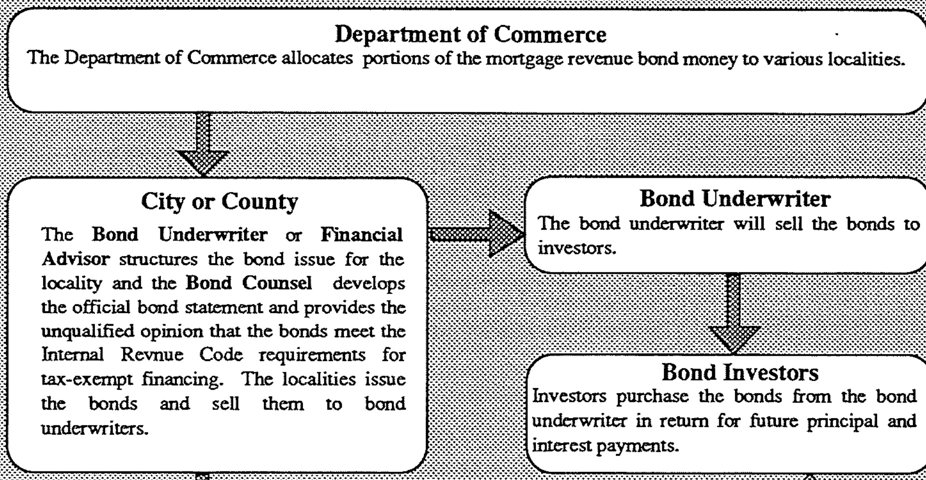
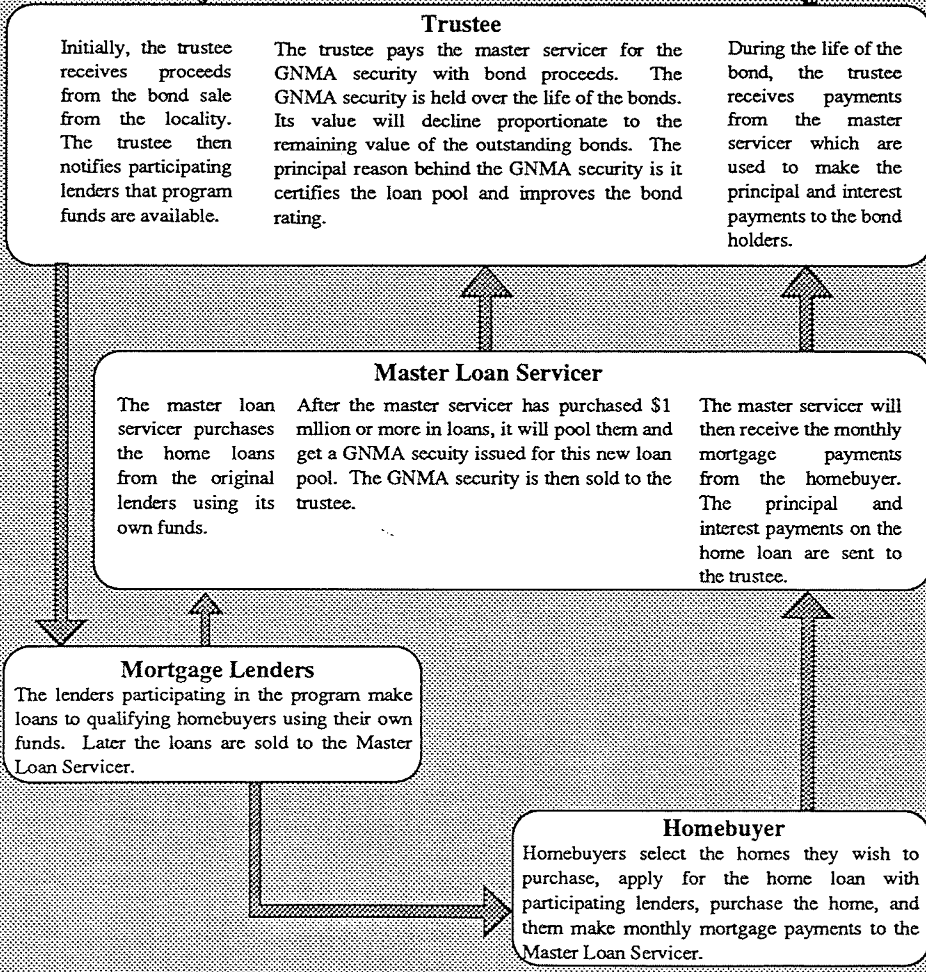
The Mortgage Revenue Bond Process

Financing The Program



Operating The Program



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ing, current State law limits the Finance Authority to issuing bonds for low-income families or the elderly. Most people who presently use the mortgage revenue bond program would be classified as having moderate income.

We contacted housing finance authority officials from eight states to determine more specifically how their mortgage revenue bond programs were operated.

The states we talked with all administered their mortgage revenue bond programs in-house, but contracted out most of the activities involved with issuing bonds. These states operated their mortgage revenue bond programs in a variety of ways. In general, a state agency, development finance authority, or the governor was responsible for determining how much of the states' private activity bond moneys would be allocated to the housing finance authorities for mortgage revenue bonds. The finance authorities then issued bonds, the proceeds of which were used to make low-interest loans available statewide.

The accompanying table shows staffing and loan activities for the housing finance authorities in the states we contacted.

Staffing and Loan Activity for Mortgage Revenue Bond Programs in 1990

State	Number of State Staff	Number of Loans	Amount of Loans Issued
Colorado	13 (a)	1,804	$ 96,694,400
Indiana	14	2,136	103,672,896
Iowa	3 (b)	1,309	55,015,961
Kansas	—	2,468	124,241,801
Maine	9 (a)	1,195	72,814,935
Missouri	9	1,880	88,352,480
Nebraska	3-4	3,018	137,017,200
Oklahoma	6	6,501	253,896,555
Wisconsin	30 (a)	6,938	317,073,538

(a) Includes everyone in the single family home ownership areas of the housing finance authorities (i.e. the number of staff shown work on more than just mortgage revenue bonds).
(b) Number of staff shown work on mortgage revenue bond and mortgage credit certificate programs.

As the table shows, the number and amount of loans these states issued varied, as did the number of in-house staff administering the program. Part of the staffing variation occurred because some states were unable to separate out staff who worked just with the mortgage revenue bond program. In addition, the number of staff involved was affected by how much work was done in-house, and how much work was left up to lenders or contracted out.

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For example, in Nebraska, officials allocate bond proceeds to lenders, work with master loan servicers, answer questions from lenders and the general public, and spot-check loans for compliance with program requirements. In Wisconsin, officials not only carry out the functions described above, but also are responsible for the final approval of all loan applications and for servicing nearly 20 percent of the loans made under the program.

All the states contract with private bond underwriters and bond counsel and use existing mortgage lenders to originate the loans. Officials indicated it was necessary to use outside firms to gain the required levels of expertise and reputation to obtain attractive ratings for their bonds.

The Primary Reasons for Considering State Administration Of the Mortgage Revenue Bond Program in Kansas Include the Potential for Greater Statewide Distribution of Bond Proceeds, Lower Fees for Homebuyers, and Better Oversight

Part of our review in this area was limited because we did not receive some basic information we requested about one of the mortgage revenue programs being operated in Kansas. When we compared the information we did receive for various aspects of Kansas' mortgage revenue bond program with other states' programs, we identified a number of potential advantages to administering the program at the State level relating to distribution, fees, program objectives, and oversight. Although other states and Kansas issuers also have used the program to generate excess revenues in the past, changes in federal law have severely diminished this option. These and other findings are discussed in the sections that follow.

We ran into difficulties trying to obtain and verify information about the distribution of mortgage revenue bond loans in Kansas. Legislative concerns have been expressed that residents in some parts of the State—particularly western Kansas—are not able to obtain low-interest loans funded by mortgage revenue bonds. The Department of Commerce does not have any information on the distribution of loans made under the program, so we attempted to obtain data from the individual bond underwriters for the State's three programs. We asked for information showing the county of residence for the homebuyer, purchase price of the home, homebuyer income, and loan amount. We also asked for the names and addresses of homebuyers and lenders to independently verify a sample of the data with the lender that originated the loan.

Two underwriters readily provided the information we requested, and we were able to use it to determine where these loans have been issued, and to independently verify the accuracy of that information. For mortgage revenue bonds issued by Kansas City and Leavenworth County, however, the underwriter indicated it needed to obtain permission from the issuers to release the information. Leavenworth County agreed to release the data. Kansas City agreed to provide only the non-identifiable information we had requested, not the names of individual homebuyers or lenders. (Even the non-identifiable was not received for more than six weeks after the City agreed to provide it.) The City raised questions about the potential confidentiality of

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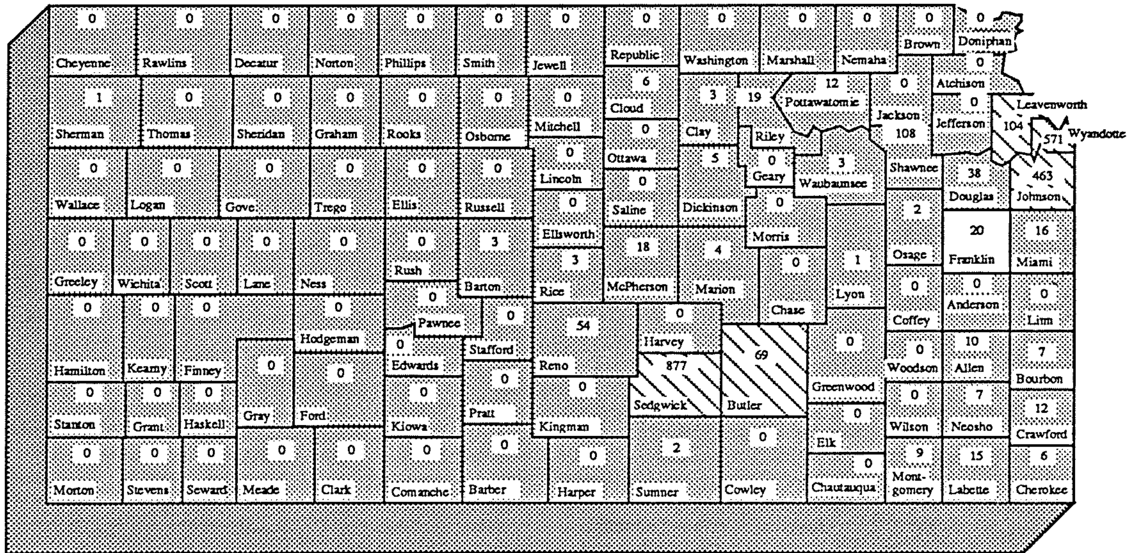
the identifiable data, and about this office's access to confidential information. We are pursuing this issue with the Attorney General's Office.

Currently, loans funded with mortgage revenue bond proceeds are not being distributed across the State. The accompanying map shows the number of homeowners in each county who received a loan through the mortgage revenue bond programs. As noted earlier, Olathe and Labette County jointly issue mortgage revenue bonds to make loans available in southeastern and eastern Kansas, and Shawnee and Sedgwick Counties jointly issue mortgage revenue bonds to make loans available in central and western Kansas. Kansas City and Leavenworth County issue bonds only for loans in their own counties.

Because loans may be made only to households that fall within certain income limits and meet other program guidelines, we compared the number of loans in each county to the number of loans that might be awarded based on the number of households in each county with incomes that fit within program guidelines. This comparison was meant only as a general indication of how the loans were distributed relative to the number of households that might have been eligible to receive them.

Distribution of Mortgage Revenue Bond Loans Based on Number of Households Meeting the Income Guidelines



County received fewer mortgage revenue bond loans than the number of households with income that fit within program guidelines would suggest.

County received more mortgage revenue bond loans than the number of households with income that fit within program guidelines would suggest.

County received about the number of mortgage revenue bond loans that the number of households with income that fit within program guidelines would suggest.

As the map shows, virtually no loans were made in western and northernmost Kansas, and most of the loans were made in the issuers' home counties. In fact, the

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counties of the six issuers received nearly 87 percent of the 2,468 loans, but have only 43 percent of the households Statewide which meet program income guidelines.

To help get an indication of why no loans were made under the mortgage revenue bond program in large areas of the State, we contacted six of the 12 FHA-approved lenders in western Kansas. The responses we got were mixed. Three lenders said they were unaware, or only vaguely aware, of the program. The three other lenders said they were aware of the program, but two said their own rates were competitive with the bond-financed loans. The other lender said it had participated in the past, but thought it was currently excluded from the pool of eligible participants.

If Kansas issued and promoted a Statewide mortgage revenue bond program rather than having several localities perform these functions, loans under the program may be more available to eligible homebuyers across the State. A Statewide program also would allow the State issuer to set targets or limits for particular areas of the State, if such action were desirable.

Fees for homebuyers are higher in Kansas than in the other states we surveyed. Unlike many types of bonds where the proceeds are used to pay bond-issuance costs, the costs of issuing mortgage revenue bonds are paid for with fees charged to participating homebuyers or, in some cases, home sellers. Bond-issuance costs may include the cost of bond counsel, underwriter, and trustee services, as well as bond rating fees, printing costs, freight, and the like. The largest single expense is for bond underwriters.

The following table shows the amount of fees charged in Kansas and the other states we contacted, as well as the bond-issuance costs reported to us by those states, where available. (Although we attempted to ensure that states reported comparable issuance costs, we did not attempt to verify the information we received.)

Fees for Selected Mortgage Revenue Bond Programs in 1990

State	Fees Charged to Homebuyers	Bond Issuance Costs/$1000
Colorado	3%	$15.00 (approx.)
Indiana	3.375%	12.60 (avg.)
Iowa	3% (a)	(d)
Kansas	4-4.5% (b)	19.50 (approx.)
Maine	3%	6.90
Missouri	3%	17.50 (avg.)
Nebraska	3.25%	13.85 (avg.)
Oklahoma	3%	na
Wisconsin	0-2% (c)	na

(a) Fees vary with each issue. The amount shown was charged in a September 1991 bond issue. Iowa did not have a mortgage revenue bond issue in 1990.
(b) Fees varied for the different programs that were operated in Kansas in 1990.
(c) Fees are charged on a sliding scale, with low income families charged nothing and moderate income families charged up to two percent.
(d) Iowa did not have a mortgage revenue bond issue in 1990.

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As the table shows, the fees charged in most of the states we contacted were about three percent. In Kansas, those fees were 4-4.5 percent for the 1990 bond issues. The table also shows that Kansas had the highest reported bond-issuance costs for mortgage revenue bonds issued in 1990.

One possible reason why other states' fees and bond-issuance costs may be lower is that those states administer their own programs, so profits are not built into their administrative costs. In addition, Kansas' bond-issuance costs may be high because those bonds are not competitively bid.

We found that three states with relatively high bond-issuance costs—Colorado, Kansas, and Nebraska—had long-standing relationships with particular underwriting firms that they used on an on-going basis. Officials in Missouri and Indiana indicated they selected underwriters based on a review of proposals solicited from many different firms. Bond issuance costs were lowest in Maine, which selects bond underwriters on a competitive-bid basis.

Given that all the other states we contacted administered their mortgage revenue bond programs in-house, had lower bond-issuance costs, and charged lower fees, it seems likely that a State-administered program in Kansas could be operated with lower fees as well.

In a related area, legislative concerns were expressed that the local units of government in Kansas that issue mortgage revenue bonds might be charging homebuyers a separate fee to participate in the program. We reviewed the budgets of the six localities that issue mortgage revenue bonds, but found nothing we could identify as fees from homebuyers in the program. Officials of the local units and their bond counsel also reported that the localities did not receive a fee from homebuyers.

State issuance of mortgage revenue bonds in Kansas would allow the State to set targets or limits that are more restrictive than federal requirements, as some other states have done. The federal maximum income levels for Kansas localities range from $34,000 to $56,280 depending on family size and the part of Kansas the homebuyer lives in. Maximum home purchase prices can range from $53,370 to $134,310, depending on whether the home is existing or new, and where it is located.

The six Kansas localities that currently issue mortgage revenue bonds have not acted to establish limits on the program beyond those set by the federal government. As shown in the accompanying table, the program continues to be targeted towards both low-income families and moderate-income families.

As the table shows, the vast majority of homebuyers in these programs had incomes in the $20,000-$40,000 range. About 14 percent of the homebuyers had incomes of less than $20,000, and 10 percent had incomes of more than $40,000. Regarding purchase price, more than 60 percent of the homes purchased were in the

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$30,000-$59,000 range, 10 percent were purchased for less than $30,000, and 28 percent were purchased for more than $60,000.

Distribution of Mortgage Revenue Bond Loans By Income and Purchase Price in Kansas During 1990

Income Level	Number of Mortgage Revenue Bond Loans: Non-Target Area	Target Area(a)	Both Areas' % of Total
$0 - 9,999	1	0	less than 1 %
$10,000 - 19,999	307	22	13
$20,000 - 29,999	926	39	39
$30,000 - 39,999	899	21	37
$40,000 - 49,999	226	6	9
$50,000 - 59,999	20	1	less than 1
Total	2,379	89	100 %

Average income: $29,554

Purchase Price	Number of Mortgage Revenue Bond Loans: Non-Target Area	Target Area(a	Both Areas' % of Total
$0 - 9,999	0	0	0 %
$10,000 - 19,999	33	2	1
$20,000 - 29,999	193	20	9
$30,000 - 39,999	431	25	19
$40,000 - 49,999	531	22	22
$50,000 - 59,999	513	8	21
$60,000 - 69,999	433	6	18
$70,000 - 79,999	137	4	6
More than $80,000	108	2	4
Total	2,379	89	100 %

Average purchase price: $50,642

(a) Information on target area loans was not available for the Kansas City/Leavenworth County program.

Four of the eight states we contacted had established stricter limits than those set by the federal government. Officials in two states reported that they had established lower income restrictions than allowed by federal law. Officials in two other states said they changed the restrictions from bond issue to bond issue, depending on the circumstances. For example, they might have a program with a very low interest rate and target it to low-income families by setting exceptionally low income limits.

If the State administered the mortgage revenue bond program and issued those bonds, it would be able to adjust federal eligibility requirements to target the program to particular groups of people, if it chose to do so.

Currently, the State does not have uniform summary program data for policy, management, and oversight purposes. The mortgage revenue bond program in Kansas is really three programs, which are under the control of six localities. Data from the programs are not routinely or uniformly provided to the Department of Commerce, nor is there any Statewide summary of program activity. In other words, Statewide no one knows such basic information as how many loans have been made, where those loans have been made, borrowers' income levels, or home purchase prices. Our experience suggests that this information is not readily available to anyone. Further, because bond underwriters indicated they were unable to break out their costs for administering the programs and issuing the bonds, program cost data are not available, as well.

Under a State-administered program, State policymakers in the legislative and executive branch should have this type of information available to them on a regular basis. Such information could be used to help set State housing policies, target or limit particular geographic areas or program participants, if desirable, and show how effectively the program was meeting its objectives.

In addition, a State-administered program could have procedures for routine monitoring of the program. Although not required by federal law, some form of oversight is necessary to ensure the program is functioning in the manner intended, serving the populations it is designed to serve, and not being abused or misused.

Although other states, and possibly Kansas issuers, have used the program to generate excess revenues in the past, changes in federal law have severely diminished this option. Many of the housing finance agencies we contacted in other states were in operation before 1980. Before 1980, it is our understanding that federal law did not restrict the spread between interest rates paid to bondholders and interest rates charged to homebuyers. Thus, if a bond's interest rate was 8 percent and the mortgage rate charged to homebuyers was 12 percent, the issuers could generate revenues at a rate of 4 percent of the bond money.

In 1980, the federal Mortgage Subsidy Tax Act limited the spread between the mortgage interest rate and the bond interest rate to one percent (1 and 1/8 percent after 1981). This change significantly reduced the income-generating potential of mortgage revenue bond programs. One official we spoke with in another state said that any housing finance agency beginning operation now—after the changes in federal law—would be a break-even proposition, at best.

In Kansas, cities or counties that issued mortgage revenue bonds in 1980 or earlier may have earned additional revenues from the program in this manner as well, but that information would not be readily available.

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Another way states may have freed up or generated additional moneys to subsidize other housing programs in recent years was to refinance or restructure their bonds. These processes work as follows:

- Restructuring. Bonds that were issued from 1979 to 1981 were required to have large reserve funds to help ensure that bondholders would be paid in the event homebuyers defaulted on their loans. Federal changes in the mid-1980s substantially lowered reserve requirements. Many issuers took advantage of this change by drawing out excess funds from the reserve account, and supplementing the reserve with an insurance policy.

- Refunding. When interest rates drop markedly, it may be to an issuer's advantage to reissue the bonds. In some instances, refunding a bond issue may allow the issuer to make a gain on the transaction.

Information about specific programs and "excess" moneys spent on them was not readily available from other states. The table below shows the amount of moneys the six current issuers in Kansas have realized by restructuring and refunding bonds. In addition, we were told that several other counties that issued mortgage revenue bonds in the past also have received funds from restructuring or refunding those issues. Those counties and the net proceeds they received are listed in Appendix B.

Restructuring and Refunding Activities
Of Current Issuers of Mortgage Revenue Bonds in Kansas

Current Issuer	Type of Transaction	Year of Transaction	Net Proceeds
Kansas City	Restructure	1987	$ 2,928,017
Labette County	Restructure	1986	848,542
Sedgwick County	Restructure	1986	2,363,794
Shawnee County	Restructure	1987	2,778,622
Sedgwick County	Refunding	1989	563,217
	Total restructured or refunded:		$ 9,482,192

Local officials told us that most of these funds were placed in the city's or counties' general funds to be used for a variety of public purposes; only $3.1 million was reportedly used for housing. However, Kansas City, which claimed nearly $2 million of the $3.1 million housing-related expenses, had not provided documentation of its expenditures by the time this audit was released. Officials we spoke with in other states said that any "excess" revenues they generated, or proceeds they realized early, remained within the agencies to be used for housing-related programs. Such revenues were not used to fund other aspects of state government.

Bond counsel and underwriters for the Kansas mortgage revenue bond programs told us that they advised cities and counties that the funds generated by restructuring bonds that were issued before the federal Mortgage Subsidy Tax Act of 1980 took effect could be used for any lawful public purpose. In reviewing applicable sec-

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tions of the act, we could not tell whether this was allowable. We attempted to verify this assertion with the Internal Revenue Service, but officials there told us they would have to research the issue to determine if these were allowable uses of the money.

It Appears the State Could Effectively Administer the Mortgage Assistance Program, But If It Does It Should Consider Contracting Out Many of the Activities

A State-administered program could be housed within either the Department of Commerce or the Kansas Development Finance Authority. Staff at the Finance Authority have extensive experience issuing bonds for many types of State projects, and probably would be best prepared to assume the responsibility.

In either case, State law would have to be changed. For the Department of Commerce to administer the program, extensive changes would be necessary, because the Department does not have the authority to issue bonds. For the Finance Authority to administer the program, the definition of housing developments found in K.S.A. 74-8902(l), "dwelling accommodations for elderly persons and families of low income in need of housing," would need to be expanded to include persons of moderate income. If the Finance Authority administered the program, officials would need to coordinate with the Department of Commerce to ensure that program requirements were consistent with State housing policy.

As noted earlier, officials in other states indicated they contracted with outside bond counsel and underwriters because the reputation of these professionals can influence the rating awarded to the bonds. A 1989 U.S. General Accounting Office briefing report, Tax-Exempt Bond Issuance Costs, appeared to support this position. It said, in part:

> it may cost more to have in-house staff do bond issuance work than to have outside specialists do the same job. Interest costs may also increase if more work is done in-house. For example, investors value an independent assessment of the legal form of the bond issue. Increased use of in-house legal staff rather than outside bond counsel could lead to increased interest costs as buyers may perceive the bonds as a riskier investment.

If the State administered the mortgage revenue bond program, and contracted for such services as bond counsel, bond underwriting, bond trustee, loan origination and servicing, we estimate an in-house staff of four could administer the program, at a cost of about $219,000 in the first year. After the first year start-up costs, we estimated that annual costs would be about $190,000. Fees charged to homebuyers could be set at a level to make the program self-supporting.

We based our estimates on information provided by other states and from interviews with officials with the Finance Authority. Our costs include staff compensation, office equipment, supplies, travel, and office space. Our estimates are on the high side, because in-house staff may need to make significant efforts to promote the program and improve Statewide distribution. This would require extensive travel and communication expenses, at least initially.

Would It Be More Beneficial to Homebuyers If The Mortgage Credit Certificate Program Were Operated By The State, Rather Than By A Bond Underwriter?

Our findings for the mortgage credit certificate program were very similar to our findings for the mortgage revenue bond program. We concluded that it would be more beneficial to homebuyers if the mortgage credit certificate program were operated by the State. Most states we contacted operated the program with in-house staff, and charged homebuyers far lower fees than are charged in Kansas. A State-operated program also could help ensure that certificates are available Statewide. In addition, control and monitoring of the program could be significantly improved. These and other findings are discussed following an overview of the program.

Overview of the Mortgage Credit Certificate Program

The mortgage credit certificate program was authorized by Congress in the 1984 Tax Reform Act as a new means of providing assistance to low- and moderate-income homebuyers.

Under the program, qualified homebuyers receive a credit against their annual federal income tax liability. Unlike the mortgage revenue bond program, this program does not directly provide lower mortgage interest rates or lower monthly payments. Instead, homebuyers receive the once-a-year benefit of a tax credit. However, homebuyers can elect to decrease the amount of federal tax withheld from their paychecks, based on the tax credit they will receive, which would increase the funds available to them to make mortgage payments.

The amount of the tax credit is based on a percentage of the mortgage interest paid during the tax year, but it cannot exceed $2,000, nor can it exceed the total federal tax liability after all other tax credits and deductions are taken into account. Program participants are eligible for the tax credit each year they continue to live in the home and pay interest on the original mortgage.

Federal regulations regarding who can qualify for the program are essentially the same as for the mortgage revenue bond program. A few additional restrictions apply only to the mortgage credit certificate program, as follows:

- all participants must be first-time homebuyers, or must not have owned their principal residence during the previous three years (except in target areas—areas with deteriorated housing stock and a high level of economic need)
- the home cannot be financed with qualified veteran's bond moneys or mortgage revenue bond moneys
- the program cannot be limited to specific lenders
- interest on the mortgage cannot be paid to a person related to the homebuyer
- if the home is sold or the homebuyer quits living in the home, the certificate must be revoked

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Appendix A shows the actual income and purchase price limits for Kansas localities based on the federal requirements. These limits are the same for both mortgage assistance programs.

To issue mortgage credit certificates, a governmental unit must trade its mortgage revenue bond authority for the authority to issue mortgage credit certificates. The trade is made at a rate of $4 in mortgage revenue bond authority for $1 in mortgage credit certificate authority. The box below shows how this trade and the credit rate chosen by the issuer affect the program.

The Tax Credit Rate's Effect on the Homebuyer's Tax Liability and Mortgage Volume

The example below demonstrates how the credit rate chosen by the issuer affects the tax credit that can be claimed by the homebuyer and the volume of mortgages that can benefit from the program. The credit rate, which by law can range from 10 percent to 50 percent, is the percentage of the homebuyer's mortgage interest, up to a maximum of $2,000, which can be claimed as a tax credit.

The Tax Benefit for the Homebuyer

Under this program, homebuyers will receive a credit against their annual federal income tax liability each year they continue to reside in their home and pay interest on the original mortgage. The amount of the tax credit is based on a percentage of the mortgage interest paid during the tax year, but cannot exceed $2,000.

In this example, we assume the homebuyer paid $5,000 in mortgage interest during the tax year. Depending on the credit rate chosen by the issuer, the homebuyer may claim a credit ranging from as little as $500 to the maximum allowable of $2,000.

At this credit rate...	the homebuyer would receive this amount of credit against his taxes...
10%	$ 500
20%	1,000
25%	1,250
30%	1,500
40%	2,000
50%	2,000 (a)

(a) The program limits the annual tax benefit to a maximum of $2,000.

Volume of Mortgages that Can Benefit From the Program

To issue mortgage credit certificates, a governmental unit must trade its mortgage revenue bond authority for authority to issue mortgage credit certificates. The trade is made at a rate of $4 in mortgage bond authority for $1 in mortgage credit certificate authority.

In this example, we assume the issuing governmental unit elects to trade $20 million in mortgage bond authority for mortgage credit certificates. According to the conversion formula, this would equal $5 million in mortgage credit certificate authority. Depending on the credit rate chosen by the issuer, certificates could be issued for as little as $10 million in mortgages, or as much as $50 million.

At this credit rate...	the program could issue certificates for this amount of mortgages...
10%	$50.0 million
20%	25.0 million
25%	20.0 million
30%	16.7 million
40%	12.5 million
50%	10.0 million

Thus, if the issuer selects a lower credit rate, the program can benefit more people, but the tax credit each homebuyer receives is smaller and few, if any, of the homebuyers would reach the $2,000 cap. If the issuer selects a higher credit rate, the program will benefit fewer people, but each homebuyer would receive a bigger tax credit. Selecting the higher credit rate also will cause a greater number of the homebuyers to hit the $2,000 cap on their annual tax credit.

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In Kansas, Mortgage Credit Certificates Are Issued by Geary and Riley Counties, But the Program Is Administered By a Private Investment Banking Firm

Since 1987, the Department of Commerce also has authorized Geary and Riley Counties to issue mortgage revenue bonds. However, these two counties have elected to convert that authority to issue mortgage credit certificates. Rather than developing and administering a mortgage credit certificate program themselves, the counties have contracted with a private investment banking firm, George K. Baum and Company, to carry out all program activities. In return, the private firm receives all fees collected through the program. The chart on the facing page shows how the program operates in Kansas.

Staff at George K. Baum and Company are responsible for promoting the program, as well as for administrative functions such as filing federal reports, maintaining a database on program participants, and operating a toll-free telephone number to answer questions about the program. The company contracts with two banks to serve as regional administrators for the program. Homebuyers submit their applications for the program to the banks, which are responsible for reviewing all elements of the application and accompanying material, contacting applicants to get additional information or secure missing information, determining whether the applicant meets all program criteria, and awarding certificates.

Lenders have a very limited role. They can inform homebuyers of the availability of the program and supply them with applications, but this function is often performed by the realtor. Lenders also may help the homebuyer complete an application for the program, but they are not required to do so. The lender is required to submit one form, which indicates that the lender is not related to the borrower and did not charge the homebuyer any additional fees for the loan.

Many States Operate Their Mortgage Credit Certificate Programs With In-House Staff

During this audit we contacted 12 states to determine if they currently operate, or have ever operated, a mortgage credit certificate program. The states we contacted include the four surrounding states and Alabama, Indiana, Iowa, Maine, Ohio, Oregon, Washington, and Wisconsin. Of the 12 states, six currently operate a program, four never have offered a program, and two have discontinued the program.

Of the six states that currently have a mortgage credit certificate program, five operate the program with in-house staff. Oklahoma contracts with a private company, and we were unable to obtain much information regarding that program. For the other states, the table below highlights some of the data from our interviews and shows comparable information for the Kansas program.

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The Mortgage Credit Certificate Process

Authorizing The Program

Department of Commerce

The Department of Commerce allocates portions of the mortgage revenue bond money to various localities.

City or County

The locality elects to exchange its mortgage revenue bond authority for authority to issue mortgage credit certificates. The locality then must administer the program or appoint a private entity to administer the program on its behalf. In Kansas, George K. Baum and Company, an investment banking firm, has been selected as program administrator.

Operating The Program

Program Administrator

Initially, George K. Baum and Company notifies lenders, realtors, and other interested parties that program funds are available.

George K. Baum and Company selected two banks to serve as its regional administrators, and the banks are responsible for all aspects of processing applications.

George K. Baum and Company completes various federal reporting requirements based on information supplied by its regional administrators.

Regional Administrator

The two banks review all program applications and supporting information to determine whether the homebuyers are eligible for the program. If a homebuyer is eligible for the program, the bank sends the homebuyer an approval letter. If not eligible, the homebuyer will receive a letter explaining why.

The bank reviews the final application affidavits and, if all is in order, issues the mortgage credit certificate to the homebuyer. Quarterly, the bank provides information to the program administrator to satisfy federal reporting requirements

Homebuyer

Homebuyers select the homes they wish to purchase; apply for home loans; complete the program applications; forward the application and copies of three years' income tax returns; and provide additional information to the regional administrator.

If the application is approved, the homebuyer closes on the home loan, provides affidavits from the seller and lender, and sends all information and the two percent fee to the regional administrator

The homebuyer claims the tax credit, up to $2,000 each year he or she continues to live in the home and pay interest on the mortgage.

Lenders/Realtors

Lenders and realtors tell potential homebuyers that the tax credit program is available.

Mortgage Lenders

The lenders make loans to qualifying homebuyers using their own funds and collect the monthly mortgage payment.

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Mortgage Credit Certificate Activity
For a Sample of Other States in 1990

State	No. of Certificates Issued	Sum of Mortgages	Average Loan Amount	Credit Rate	FTE Staff
In-House Operation					
Alabama	488	$29,519,322	$ 60,490	20%	1
Colorado	540	30,289,034	56,091	20%	5 (a)
Indiana	526	33,257,346	63,227	25%	7-9 (a)
Iowa	1,558	65,767,743	42,213	25%	1
Oregon	1,604	47,643,455	29,703	20%	1
Private Contractor Operation					
Kansas	722	36,788,131	50,953	25%	4-7

(a)All staff also assist with the mortgage revenue bond program. Officials could not estimate the full-time-equivalent staff associated with the mortgage credit certificate program alone.

As the table shows, Iowa and Oregon issued the largest number of certificates in 1990 for the greatest amount of mortgages. The average loan amount handled under the program ranged from about $30,000 in Oregon to slightly more than $63,000 in Indiana.

We found that the program was not always well-liked among the other states. Two states no longer operate it. Officials in Ohio indicated the program was stopped because it was difficult to administer and monitor. Washington opted to allocate all its bond authority to mortgage revenue bonds after the state's private activity bond allocation was lowered. Officials in several other states indicated they have never attempted to offer the program because they thought it would be cumbersome to administer and monitor, or was less effective at serving low- and moderate-income families than mortgage revenue bonds.

The Primary Reasons For State Operation Of the Mortgage Credit Certificate Program Include the Potential for Greater Statewide Distribution of Certificates, Lower Fees for Homebuyers, and Better Oversight

When we compared the information we had concerning various aspects of the mortgage credit certificate program in Kansas with other states' programs, we identified a number of potential advantages to State operation of the program relating to distribution, fees, program objectives, and oversight. Some of our findings in these areas are based on data we were unable to verify because of difficulty getting certain information from the program administrator.

We were unable to verify data on program participants because George K. Baum and Company delayed providing us with complete information. As with the mortgage revenue bond program, we were not able to obtain all the data we

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needed for this program. George K. Baum and Company provided us with non-identifiable information on 1990 program participants, but initially refused to provide identifying information about homebuyers' names and lenders which would allow us to verify the accuracy of the data.

Although the firm subsequently agreed to provide names and addresses for a sample of homebuyers and lenders, we did not receive this information until December 5th, which was too late for us verify the data used to develop the map on the following page, and the tables on page 24.

Although the program is available Statewide, most mortgage credit certificates are awarded in the metropolitan areas of the State. In 1990, 722 certificates were awarded to homebuyers in Kansas, predominantly in the eastern and central portions of the State. Because certificates are awarded only to households that fall within certain income limits and meet other program guidelines, we compared the number of certificates awarded in each county to the number of certificates that might be awarded based on the number of households in each county with incomes that fit within program guidelines. This comparison was meant only as a general indication of how the certificates were distributed relative to the number of households that might have been eligible to use them.

The location of the certificates that were awarded and the results of our comparison are depicted in the map on the following page.

As the map shows, the majority of the mortgage credit certificates were issued to homebuyers in Sedgwick, Shawnee, and Johnson Counties. These three counties got nearly 68 percent of the certificates issued in 1990, but accounted for less than 33 percent of the households meeting the income guidelines across the State.

Although few certificates were issued in western Kansas counties, those counties received approximately the same number of certificates as suggested by our comparison. Counties that may be underserved were generally in southeast and southcentral Kansas.

It is impossible to know exactly how many households in a county are potential users of the program because, in addition to meeting income limits, the households must be in the market to buy a new home and must be first-time homebuyers or must not have owned a home within the past three years. The number of households that could potentially use the program is also affected by the economic health and level of real estate activity in the area.

If the State operated the mortgage credit certificate program in-house, it could take actions to encourage wider distribution of certificates across the State. A Statewide program also would allow the State to set targets or limits for particular areas, if such actions were desirable.

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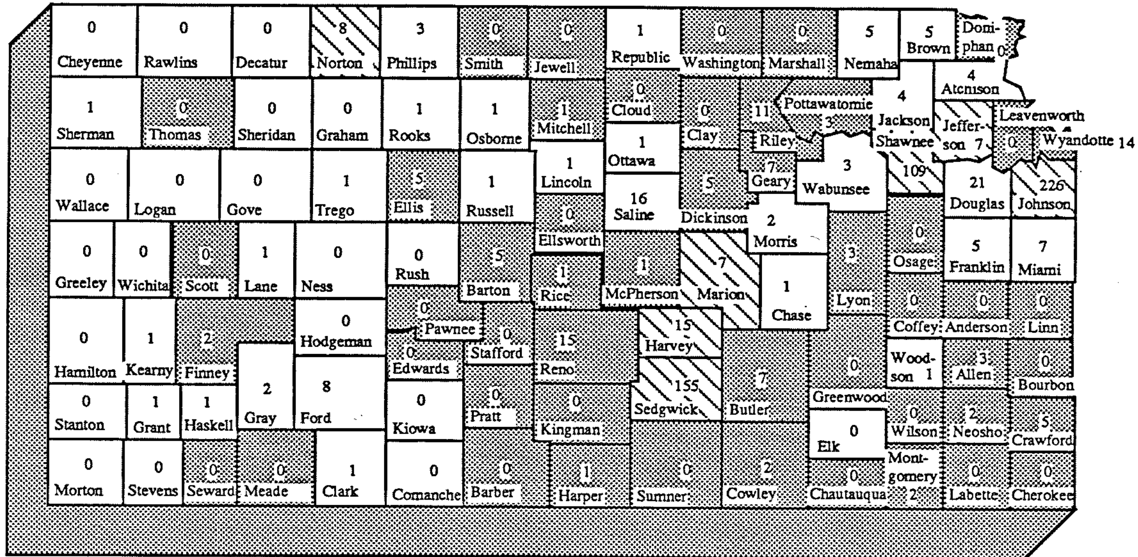
Distribution of Mortgage Credit Certificates Based on Number of Households Meeting the Income Guidelines



County received fewer mortgage credit certificates than the number of households with income that fit within program guidelines would suggest.

County received more mortgage credit certificates than the number of households with income that fit within program guidelines would support.

County received about the number of mortgage credit certificates that the number of households with income that fit within program guidelines would suggest.

Fees for homebuyers participating in the program are notably higher than in other states. Federal regulations allow fees that "are reasonably necessary to cover any administrative costs incurred by the issuer or its agent in issuing mortgage credit certificates." As the table on page 23 shows for the five states we contacted that operate the program in-house, homebuyers' fees ranged from $50 to $325. All the states indicated their program was self-supporting.

By comparison, the program fee in Kansas is two percent of the loan amount, or $400, whichever is greater. With an average loan amount of $50,000, the average fee is about $1,000 per homebuyer. In 1990, when 722 certificates were issued covering total loans of $36,788,131, George K. Baum and Company would have received a minimum of $735,000 in fees. Company officials indicated they were unable to provide us figures showing the actual cost of operating the program.

Borrower Fees for the Mortgage Credit Certificate Program In Kansas and a Sample of Other States, 1990

State	Borrower Fees
Alabama	$ 300
Colorado	325
Indiana	275
Iowa	200
Oregon	50
Kansas	**$1,020** (a)

(a) Based on the 1990 average loan amount of $51,000

Information from other states suggests the State could operate the program for far less than the current administrator receives, largely because the State would not expect to make a profit on the program. Rather, it could charge fees that would allow the program to be self-supporting, and pass the cost-savings on to the homebuyer.

Operating the program in-house would allow the State to set targets or limits that are more restrictive than federal requirements. Questions have been raised about who is benefiting from the program. Federal statutes set upper limits on the income of homebuyers who can participate in the program, and on the cost of the home that can be purchased, but allow issuers to impose more stringent limits to ensure that only those individuals who otherwise could not purchase a residence will benefit from the credit.

As with the mortgage revenue bond program, maximum homebuyer income in Kansas ranges from $34,000 to $56,280, depending on family size and where the home is located. Maximum home purchase price ranges from $53,370 to $134,310, depending on whether the home is new or existing and where it is located. As noted on page 24, we were unable to independently verify the data on which these tables are based.

As the table shows, most of the homebuyers who received certificates in 1990 had income in the $20,000 to $40,000 range (85 percent) and purchased homes in the $30,000 to $70,000 range (80 percent). At the two extremes, 51 homes (seven percent) had a purchase price of less than $30,000, and 90 homes (12 percent) had a purchase price exceeding $70,000.

Some Homebuyers Appear to be Financing Program Fees

Legislative questions were raised about whether homebuyers could finance program fees along with the home mortgage, rather than paying the fees out-of-pocket. Officials with George K. Baum and Company told us that if the appraised value of the home was higher than the purchase price, banks generally would finance the fees.

Comparing the loan amount to the purchase price for all homebuyers in the program in 1990, we found that 425 of the 722 homebuyers (59 percent) received a loan equal to, or more than, the price of the home they purchased. The average loan was $2,700 more than the average purchase price. This suggests that many homebuyers have been able to finance such things as program fees, repairs, or the like.

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Distribution of Mortgage Credit Certificates Awarded by Income and Purchase Price in Kansas During 1990

Income Level	No. of Mortgage Credit Certificates Issued: Non-Target Area	Target Area	Both Areas' % of Total
$0 - 9,999	2	0	less than 1 %
$10,000 - 19,999	58	2	8
$20,000 - 29,999	295	9	42
$30,000 - 39,999	304	5	43
$40,000 - 49,999	42	2	6
$50,000 - 59,999	0	3	less than 1
Total	701	21	100 %

Average income: $29,615

Purchase Price	No. of Mortgage Credit Certificates Issued: Non-Target Area	Target Area	Both Areas' % of Total
$0 - 9,999	1	0	less than 1 %
$10,000 - 19,999	13	0	2
$20,000 - 29,999	35	2	5
$30,000 - 39,999	109	2	15
$40,000 - 49,999	139	6	20
$50,000 - 59,999	158	3	22
$60,000 - 69,999	160	4	23
$70,000 - 79,999	35	1	5
More than $80,000	51	3	7
Total	701	21	100 %

Average purchase price: $53,609

If the mortgage credit certificate program were operated by the State, adjustments could be made to the income and purchase price limits, if desired, to target the program to particular groups of people. Other types of adjustments could be made as well. For example, one county requested George K. Baum and Company to limit the program to the purchase of existing housing within the county. Such adjustments could be made to reflect Statewide housing priorities as well.

Monitoring and oversight of the program are limited. Federal regulations do not set out specific monitoring requirements for this program. Neither the Department of Commerce nor Geary and Riley Counties monitor the activities of George K. Baum and Company as program administrator. The Counties, and sometimes the Department, receive summary reports from the firm showing such things as the number of homebuyers participating, the cities and counties where certificates have been awarded, and income and purchase price distribution of homebuyers, but they have not attempted to verify the information, nor have they taken any actions to ensure that the program is operating properly.

If the State operated the program, it could set up procedures for routine monitoring of the program. Although it is not required by the federal government, some

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form of oversight would be necessary to ensure the program is functioning in the manner intended, serving the populations it was designed to serve, and not being abused or misused.

In addition, a State-operated program should systematically maintain basic program data that would allow for greater oversight by the legislative and executive branches of government. This data could be used to help set State housing policies, target or limit particular geographic areas or program participants, if desirable, and show how effectively the program was meeting its objectives.

Kansas Could Operate the Mortgage Credit Certificate Program With a Limited Number of Staff

A recent report by a University of Kansas professor entitled Mortgage Credit Certificates as an Aid to Affordable Housing suggested that the mortgage credit certificate program in Kansas could be run by less than one full-time person. Officials at George K. Baum and Company reported that the equivalent of 1-2 people from that office work with the program full-time. In addition, they stated that each of the two banks appointed as regional administrators has one person assigned to the program full-time, with other staff assisting if there is a large volume of applications.

Based on our interviews with other states, the University professor, and officials of George K. Baum and Company, we concluded that the State could effectively administer the mortgage credit certificate program. To keep staffing levels down, the program could be structured as it is in other states, where lenders are responsible for collecting and submitting all application materials to the program administrator, and for following up with questions about the application. Lenders receive compensation out of homebuyer fees for these efforts. In Kansas, lenders currently have a much more limited role.

With this assumption, we estimated that an in-house staff of three full-time equivalent staff could operate the mortgage credit certificate program at a cost of about $201,800 in the first year of the program. After the first year start-up costs, we estimated that the program could be operated with two full-time-equivalent staff, and that annual costs would drop to about $147,200. Fees charged to homebuyers could be set at a level to make the program self-supporting.

Our estimated costs include salaries and benefits, office equipment, supplies, travel, and office space. As we did with the mortgage revenue bond program, we estimated costs on the high side for this program because in-house staff may need to make significant efforts to promote the program, work with lenders regarding their new role, and improve Statewide distribution. These tasks could require extensive travel and communication expenses, at least initially.

We were unable to compare our estimates to the current cost of operating the program. Officials of George K. Baum and Company declined to provide information specifying their cost of operating the program.

Conclusion

The State as a whole does not appear to be well-served by the current structure of the mortgage revenue bond and mortgage credit certificate programs. Homebuyers in only a few counties receive most of the loans and certificates issued under the programs. For both programs, homebuyers pay higher fees than in other states. Because many other states administer their mortgage revenue bond and morgage credit certificate programs in-house, there is no reason to think that Kansas could not effectively administer these programs as well. If the programs were administered by the State, they could be used to improve the availability of affordable housing in certain areas of the State, potentially at less cost to homebuyers. For these reasons, it appears that State administration of the mortgage assistance programs should be considered.

Recommendations

1. To improve homebuyer access to mortgage revenue bond loans and mortgage credit certificates, reduce homebuyer fees, and provide increased accountability over the program, the Legislature should consider directing one or more State entities to take over administration or operation of the programs.

2. In its deliberations, the Legislature should consider whether the programs should be located in the Department of Commerce, the Kansas Development Finance Authority, or some other entity. The Finance Authority seems best suited to administer the mortgage revenue bond program at this time, because of its experience with issuing bonds. However, it would need to consult with housing officials at the Department of Commerce to ensure that the program reflected State housing policy. Cost savings might occur by having both the mortgage revenue bond program and the mortgage credit certificate program housed within the same agency. That way, promotion of the programs and coordination with lenders could be accomplished at the same time for both programs.

3. If the Legislature decides to have one or more State agencies administer or operate the mortgage assistance programs, it should require the appropriate officials to submit plans to the Legislature showing how the programs would function, including staffing, fees needed to be self-supporting, ideas for improving Statewide distribution of benefits, targeting the program to particular groups of homebuyers, and adequate program monitoring.

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APPENDIX A

Federal Income and Purchase Price Guidelines for the 1990 Kansas Mortgage Revenue Bond and Mortgage Credit Certificate Programs

	Maximum Income Number of People in the Household		Maximum Purchase Price	
	1 or 2	3 or More	Existing Home	New Home
General State Limits	$ 34,000	$ 39,100	$ 53,370	$ 59,040
Areas with higher limits:				
Junction City	34,000	39,100	53,370	59,040
Junction City Target Area	40,800	47,600	65,230	72,160
Kansas City Metro Area (includes all homes located in Wyandotte, Johnson, Leavenworth and Miami Counties)	38,800	44,620	69,750	98,640
Kansas City Target Area	46,560	54,320	85,250	120,560
Lawrence Metro Area (includes all homes located in Douglas County)	34,300	39,445	71,280	59,040
Lawrence Target Area	41,160	48,020	87,120	72,160
Wichita Metro Area (includes all homes located in Sedgwick, Butler and Harvey Counties)	40,200	46,230	74,430	109,890
Wichita Target Area	48,240	56,280	90,970	134,310
Lyon County	35,400	40,710	53,370	59,040
Seward County	34,100	39,215	53,370	59,040
Topeka Metro Area (includes all homes located in Shawnee County)	37,300	42,895	59,310	89,730

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APPENDIX B

Other Kansas Counties That Have Restructured Or Refunded Mortgage Revenue Bonds

In addition to current issuers of mortgage revenue bonds, the counties listed below also have restructured or refunded mortgage revenue bonds. This list was obtained from the underwriter who carried out these activities for the counties, and may not cover all previous Kansas issuers. Because of time constraints, we did not contact the counties listed below to determine whether any of the proceeds were used for housing-related programs.

Issuer	Type of Transaction	Year of Transaction	Net Proceeds
Cowley County	Refunding	1989	$ 566,231
Johnson County	Residual Bond	1987	3,951,044
Reno County	Residual Bond	1987	545,245
	Refunding	1991	463,174
Riley/Geary Counties	Restructure	1986	714,616
Saline County	Restructure	1986	417,666
	Refunding	1991	286,148

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APPENDIX C

Agency Responses

On December 2, 1991, we provided copies of the draft audit report to the Department of Commerce and the Kansas Development Finance Authority. Their responses are included as this Appendix.

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KANSAS

DEPARTMENT OF COMMERCE

Joan Finney
Governor

Laura E. Nicholl
Secretary

December 9, 1991

Ms. Barbara Hinton
Legislative Post Auditor
Legislative Division of Post Audit
1200 Merchants Bank Tower
8th & Jackson
Topeka KS 66612-2212

RE: Mortgage Assistance Programs Audit Report

Dear Ms. Hinton:

We generally agree with the findings of the Post Audit regarding the present administration of mortgage revenue bond and mortgage credit certificate programs. Following are our comments concerning the various issues identified in the report.

ISSUE 1: A State Administered Mortgage Revenue Bond and Mortgage Credit Certificate Program

It is a fact that all of the other 49 states issue mortgage revenue bonds at the state level. That is just one reason why the Governor has proposed that the Kansas Development Finance Authority be given statutory authority to do likewise. The Department of Commerce would have no objection to KDFA's issuance of such bonds as long as its role remains purely financial and that the role of setting housing policy, such as structuring the program and targeting certain income groups, home price limits, or areas of the state, remains vested in the Department of Commerce. We concur with the conclusion of the Post Audit that if the programs were administered by the State, the availability of the programs could be improved statewide and, in addition, centralized reporting of mortgage data would allow us to more accurately assess the housing needs of the state and properly monitor the programs. For example, data could be collected statewide on participant income, household size, home prices, etc. However, it must be noted that if the State does administer the mortgage bond program, it will still be necessary to contract with bond underwriters in order to properly design and market the bonds. Insofar as the MCC program is concerned, it could be administered with relative ease. We likewise concur with the staffing estimates for the programs administered at the state level.

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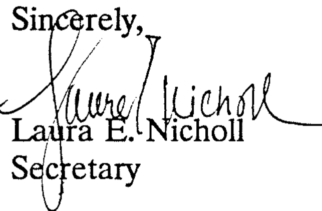
ISSUE 2: Costs Associated with the Programs.

There is no question that "economies of scale" could be realized by the state administering mortgage revenue bond and mortgage credit certificate programs at the state level. One program run by the State, rather than several run by localities, would require less staff time and unnecessary duplication would be eliminated. The table on page 10 of the Post Audit is very compelling in regard to MRB's. It shows an average of about 1% lower costs in the other states surveyed. In addition, the comparison on page 23 on MCC's tells a similar story. It is our opinion that if the state administered either or both programs, costs could be reduced to the homebuyer and more realistic fees could accrue to the State to administer the program and to leverage federal funding for other housing programs which require state matching funds.

Thank you for collecting the information in the Audit and allowing us to respond.

Sincerely,



Laura E. Nicholl
Secretary

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DEC 9 1991

KANSAS

KANSAS DEVELOPMENT FINANCE AUTHORITY

Joan Finney
Governor

Terence J. Scanlon
President

December 10, 1991

Ms. Barbara Hinton
Legislative Post Auditor
Legislative Division of Post Audit
1200 Merchants Bank Tower
8th and Jackson
Topeka, Kansas 66612-2212

RE: Mortgage Assistance Programs Audit Report

Dear Ms. Hinton:

We have received the Mortgage Assistance Program Audit report and generally agree with the conclusions and recommendations. We also complement the thoroughness of the research.

The Kansas Development Finance Authority is a financial service unit established to assist state agencies, local governments when needed and requested, multifamily low-income housing and certain economic growth progress such as the Beginning Farmer assistance in acquiring their first land and equipment, with long term financing.

KDFA has concentrated its efforts in facilitating these programs access to capital at the most reasonable rates and in accordance with sound fiscal management of debt.

KDFA is not involved in any programs where we offer services directly to the public or other clients. Our role is one of finance only and we are not geared to conduct policy formulation and carrying out of state programs. For this reason, if authorized to do so for housing, KDFA would restrict its role to facilitating the Housing office with access to capital.

KDFA is geared and backgrounded in the roles it would play in issuing Mortgage Revenue Bonds and conduct the Mortgage Credit Certificates financial structures. We also agree that from our research with other states, that these programs can be carried out within the costs estimated in the report.

The costs associated with the MRB and MCC would be covered by the cost of issuing the bonds and certificates so the program would be self supported and require no State General Fund appropriations.

BOARD OF DIRECTORS
LAURA E. NICHOLL, CHAIRPERSON; H. EDWARD FLENTJE, CHRISTOPHER McKENZIE, DENNIS McKINNEY, HARRY WIGNER, DIRECTORS
400 SW 8TH STREET, SUITE 100 / TOPEKA, KANSAS 66603 / (913) 296-6747 FAX (913) 296-6810

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Conclusion:

While there are many reason we could support the findings of the post audit report from a sound public policy point of view, our comments here are restricted to being able to respond to the bonding and issuing of certificates only.

If the state adopts this central management of MRB's and MCC's, KDFA can respond in a timely and professional manner.

Very truly yours,

Terence J. Scanlon
President

TJS:dc

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PERFORMANCE AUDIT REPORT

REVIEWING THE DEPARTMENT OF COMMERCE'S 1991 BOND ALLOCATIONS

OBTAINING AUDIT INFORMATION

This audit was conducted by Jim Davis, Auditor, of the Division's staff. If you need any additional information about the audit's findings, please contact Mr. Davis at the Division's offices.

Attachment 3
4/8/92
Sen. Ec. Dev.

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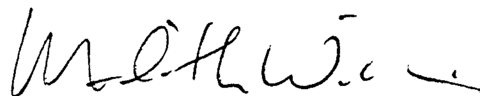
REVIEWING THE DEPARTMENT OF COMMERCE'S 1991 BOND ALLOCATIONS

Summary of Legislative Post Audit's Findings

Does the Department of Commerce have an adequate process for authorizing localities to issue tax-exempt bonds? The Department's process for authorizing localities to issue tax-exempt bonds is not adequate. The Department has some informal policies, procedures, and criteria for processing and evaluating applications, but they are not written and do not cover all aspects of the allocation process. The Department has no formal policies and procedures for notifying potential applicants, and the steps taken have been insufficient. As a result, all those who wanted to participate in the program may not have had the opportunity to do so. Department officials said they followed consistent practices and criteria in the allocation process. But, because the Department's procedures and criteria were not in writing and the actions taken were not sufficiently documented, we were not able to confirm this in many respects.

Was the Department of Commerce's 1991 bond allocation process carried out in accordance with applicable laws, regulations, policies, procedures, and standard practices? In general, the Department's process for allocating bonds in 1991 appeared to comply with applicable laws, but the timing of the allocations for mortgage revenue bonds for 1991 was very different from the timing of allocations made in the two previous years. In 1991, the entire amount earmarked by the Department for allocation to mortgage revenue bonds had been approved by January 10. By contrast, in 1989 and 1990, mortgage revenue bond allocations were not made before May of either year. The former Secretary of Commerce said the mortgage revenue bond allocation was made in early 1991 because applicants had indicated they would need their allocations early that year. Department records did not include documentation for allocation decisions. However it appeared that decisions regarding which applicants would receive mortgage revenue bond allocations, and in what amounts, were effectively delegated to the bond underwriter members of a Department advisory committee.

The report makes recommendations to the Department regarding its bond allocation process. We would be happy to discuss the recommendations or any other items in the report with any legislative committees, individuals legislators, or other State officials.



Meredith Williams
Legislative Post Auditor

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REVIEWING THE DEPARTMENT OF COMMERCE'S 1991 BOND ALLOCATIONS

Each year, the Department of Commerce gives localities the authority to issue up to $150 million in tax-exempt bonds under the 1988 Private Activity Bond Allocation Act (K.S.A. 74-5058 *et seq.*). Localities may apply to the Department at any time during the year to issue these bonds, which are for such projects as new or expanding businesses and mortgage revenue bonds. According to Department records, $150 million has been allocated each year since 1988. Through February 28, 1991, about $130 million had been allocated.

Concerns have been expressed about the Department's approval to issue tax-exempt bonds for 1991. These concerns focus on the timing of the allocations for mortgage revenue bonds and on the issue of due process. More than three-fourths of the amount allocated through February 28, 1991—$100 million of $130 million—was for mortgage revenue bonds that were authorized on or before January 10, 1991. The 1991 allocation contrasts sharply with the Department's past practice of authorizing relatively small amounts before March of each year, and making no mortgage revenue bond allocations before March.

The Governor has requested an audit of the Department of Commerce's 1991 bond allocation process to determine whether that process was carried out in accordance with relevant federal or State laws and Department policies and procedures. To address these concerns, the Legislative Post Audit Committee directed the Legislative Division of Post Audit to conduct a performance audit answering two questions:

1. **Does the Department of Commerce have an adequate process for authorizing localities to issue tax-exempt bonds?**

2. **Was the Department of Commerce's 1991 bond allocation process carried out in accordance with applicable laws, regulations, policies, procedures, and standard practices?**

To answer these questions we reviewed federal and State laws and interviewed current and former officials of the Department of Commerce, as well as others in the State's financial industry. We also reviewed and analyzed Department records for bond allocations made in the past three years. In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

In general, we found that the Department's process for authorizing localities to issue tax-exempt bonds is not adequate. The Department has some informal policies, procedures, and criteria for processing and evaluating applications for the authority to issue such bonds, but they are not written and do not cover all aspects of the allocation process. We also found that the Department's process for allocating bonds in

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1991 appeared to comply with applicable laws, but that the timing of the allocations for mortgage revenue bond authority for 1991 was very different from the timing of allocations made in the previous two years. Also, certain aspects of the allocation process were not adequately documented. These and other findings are discussed in more detail following a background section that describes the private activity bond allocation program.

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An Overview of the
Private Activity Bond Allocation Program

The private activity bond allocation program is a federal initiative, the details of which are outlined in the Internal Revenue Code. The program allows states to grant authority to their governmental units to issue tax-exempt bonds. The program has been in existence for a number of years; beginning in 1988, the dollar amount of bond issuing authority that a state may grant annually became the greater of $50 multiplied by the state's population, or $150 million. Given Kansas' population, $150 million is the greater amount and, therefore, is the maximum amount that may be issued in the State. The authority for this program in Kansas rests with the Department of Commerce.

Federal law defines the different types of private activity bonds and the requirements for each of them to qualify as tax exempt. Seven different types of private activity bonds are defined in federal law, but only three types have been used in Kansas in recent years. These three types are:

Qualified Mortgage Bonds. These include mortgage revenue bonds, mortgage credit certificates, and qualified veterans' mortgage bonds.

Qualified Small Issue Bonds. These are industrial revenue bonds that can be used for a wide variety of facilities, but not for such things as golf courses, massage parlors, and racetracks.

Exempt Facility Bonds. The types of projects that may be provided with these bonds include airports, mass commuting facilities, sewage and solid waste disposal facilities, and qualified residential rental projects.

The following table shows the amounts issued in Kansas since 1988 for each of these types of bonds.

Private Activity Bond Allocations in Kansas: Calendar Years 1988-1991(a)

Type of Bond	1988	1989	1990	1991
Exempt Facility	$ 2,050,000	$ 7,800,000	$ 23,100,000	$ 12,850,000
Mortgage Revenue	109,889,000	106,181,360	99,999,271	100,000,000
Small Issue	37,661,000	35,993,640	25,893,643	17,200,000
Total	**$149,600,000**	**$149,975,000**	**$148,992,914**	**$130,050,000**

(a) Figures shown for 1988-1990 are amounts actually issued. Figures shown for 1991 are amounts the Department authorized to be issued, through February 28, 1991.

For each of the years shown, the amounts allocated for mortgage revenue bonds have been more than twice the amount allocated for all other bonds combined.

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In addition, exempt facility bond issues have increased and small issue bond issues have decreased somewhat for the period.

State statutes place certain restrictions on the Department of Commerce for granting governmental units the authority to issue these bonds. Governmental units must apply to the Department in writing to request an allocation. In addition, the Department must do the following:

- approve applications for allocations for small issue bonds of $5 million or less on the basis of the order in which they are received

- notify applicants in writing within five days of the date their applications are received of the status of their applications

- reserve a portion of the total amount that can be allocated in a year until October 15 (that date was June 1 for 1990), so that it will be available for allocation to small issue bonds and two other rarely issued types of bonds

Within the statutory restrictions, the Department may approve all, part, or none of the amounts requested. It may also put applications on hold pending receipt of additional information, or pending a review of the effect approval would have on the total amount allocated for the year.

When the Department approves an application, the locality has 60 days to issue the bonds, and the Department may grant an extension for an additional 30 days. If the bonds are not issued within that time limit, the authority expires and the allocation reverts back to the Department. Localities also may voluntarily surrender their approved allocations back to the Department, in whole or in part, if the project falls through or is undertaken on a smaller scale than anticipated. If a locality is unable to issue its bonds before the end of the calendar year, it may apply to the Department for authorization to carry the unissued amount forward into the next year. (Exempt facility and small issue bonds are not eligible to be carried forward.)

In the years we reviewed, applications for private activity bond authority were made by local governmental units and by the Kansas Development Finance Authority. Most often, applications were made by local units. Therefore, for purposes of this report, applicants will be referred to generally as "localities." Finally, although applications are submitted under localities' names, local officials often leave the transactions to the bond underwriters and bond counsel who are involved in the issuance of the bonds themselves.

Does the Department of Commerce Have An Adequate Process For Authorizing Localities To Issue Tax-Exempt Bonds?

The Department's process for authorizing localities to issue tax-exempt bonds is not adequate. The Department has some informal policies, procedures, and criteria for processing and evaluating applications, but they are not written and do not cover all aspects of the allocation process. The Department has no formal policies and procedures for notifying potential applicants, and the steps taken have been insufficient. As a result, all those who wanted to participate in the program may not have had the opportunity to do so. Department officials said they followed consistent practices and criteria in the allocation process. But, because the Department's procedures and criteria were not in writing and the actions taken were not sufficiently documented, we were not able to confirm this in many respects.

The Department's Process for Authorizing Localities To Issue Tax-Exempt Bonds Is Inadequate In Several Areas

For that process to be adequate, the Department should have policies and procedures that address applicable legal or regulatory requirements and good management practices. Because the Department has wide discretion over the amounts allocated to different localities under this program, good management practices would suggest that the process include the following:

- solicitation of applications for the program from all interested parties
- evaluation of applications on a consistent basis, using defined criteria
- establishment of formal policies and procedures and documentation of the process followed, including the bases for decisions

The Department does not have written policies, procedures, or criteria for its allocation process. Therefore, we interviewed current and former Department officials to learn what the Department's practices have been in processing and evaluating applications since 1988.

The officials we spoke with said that, in the absence of written policies and procedures, they relied on statutory mandates for direction. State law requires that small issue bond applications be processed in chronological order, and officials said they extended this practice to applications for all types of bonds. In addition, officials said that applications were considered in light of the statutory requirement that a portion of the State's total annual amount available for allocation be reserved until October 15 (June 1 in 1990), so that it would be available for small issue bonds. Finally, officials said they notified applicants within five business days concerning decisions on their applications.

The current and former Department officials we spoke with also stated that all applications were evaluated using the same basic criteria. These stated criteria in-

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cluded consideration of the population that would be served, the amount of unused allocation at the time the application was received, internal Department assessments of the proposals, and, in regard to applications for mortgage revenue bonds, consideration of prior-year allocations (in other words, an attempt was made to balance localities' allocations from year-to-year).

In addition, the former Department Secretary appointed an advisory committee to consult with concerning the bond allocation program and other Department programs. Its membership included venture capitalists, bond counsel, bond underwriters, officials of the Small Business Administration, commercial bankers, and others in the State's financial community.

The advisory committee was formed in 1988 after the Department made a controversial allocation of mortgage revenue bond authority in late 1987. In December of that year, the Department had about $200 million in unallocated bond authority (before 1988, the maximum a state could allocate in bond authority was much higher than in later years). Riley and Geary Counties applied for and received the entire $200 million allocation for their joint mortgage credit certificate program.

Because of the controversy this allocation generated within the State's financial community, the Secretary of Commerce in 1988 decided that the members of that community—bond underwriters and bond counsel—who put similar bond issues together in various parts of the State should be consulted regarding their needs for bond money before future years' allocations were made. The bond underwriters and bond counsel who were invited to be on the advisory committee were the ones who worked with the localities that historically issued mortgage revenue bonds in the State. In practice, bond underwriters generally set up such programs and market them to governmental issuers, and local officials are not involved in the details of issuing the bonds.

Officials indicated that meetings of the advisory committee also served as the Department's means of notifying interested parties about the bond allocation program. In addition, the former Department Secretary said he relied on the committee for recommendations concerning the allocation of authority to issue mortgage revenue bonds.

If followed, the Department's stated practices would appear to address applicable legal requirements, but they do not adequately address good management practices in this area. The things that led us to this conclusion are as follows:

Insufficient notice. Department officials indicated that members of the advisory committee are informed of the bond allocation program. However, other potential applicants who are not members of that committee are excluded from the process, and would not receive any notice.

No written criteria for evaluating applications and making awards. These criteria could include such things as who is eligible to apply, the documentation

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required to support an application, and the factors to be considered in approving applications. Without well-defined, stated criteria, applicants do not know the basis to be used for evaluating their applications in advance. Also, there is a lack of assurance that applications will be evaluated and approved on a consistent basis. This latter point would appear to be especially true in regard to mortgage revenue bonds, where the allocation apparently is influenced by the recommendations of selected members of the State's financial community.

No written policies and procedures for processing applications. Beyond the relevant Kansas statutes, the Department has no formal description of the process it follows for allocating the authority to issue bonds. In addition, it has no regular means for documenting decisions made in approving or denying requests for allocations. For example, Department officials were able to provide little formal documentation of advisory committee recommendations. They could provide copies of minutes for only one meeting of the advisory committee, but other Department records indicated that at least three meetings had been held.

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Was the Department of Commerce's 1991 Bond Allocation Process Carried Out In Accordance With Applicable Laws, Regulations, Policies, Procedures, and Standard Practices?

In general, the Department's process for allocating bonds in 1991 appeared to comply with applicable laws, but the timing of the allocations for mortgage revenue bonds for 1991 was very different from the timing of allocations made in the two previous years. In addition, certain aspects of the process were not adequately documented.

The Bond Allocation Process for 1991 Appeared to Comply With Applicable Laws, But the Timing Differed Considerably From the Two Previous Years

The 1991 mortgage revenue bond allocation process represented a break from the pattern previously established by the Department. In 1989 and 1990, the Department received most mortgage revenue bond applications in March. Those applications were put on hold until May in both years, and then the allocations were made. The detail of the mortgage revenue bond allocations for both years is shown in the following table.

Mortgage Revenue Bond Allocations: Calendar Years 1989 and 1990

Applicant	Bond Program Underwriter	Amount Requested	Amount Approved	Date Requested	Date Approved or Denied
Riley/Geary Counties	George K. Baum	$ 50,000,000	$ 10,590,680	1/18/89	12/28/89
Sedgwick County	Ranson/Kirchner Moore	50,000,000	21,250,000	3/24/89	5/10/89
Labette County	Stern Brothers	25,000,000	21,250,000	3/28/89	5/10/89
City of Olathe	Stern Brothers	25,000,000	21,250,000	3/28/89	5/10/89
Shawnee County	Ranson/Kirchner Moore	25,000,000	21,250,000	3/30/89	5/10/89
Sedgwick County	Ranson/Kirchner Moore	35,000,000	0	6/16/89	12/28/89
Leavenworth County	B.C. Christopher	20,000,000	0	8/3/89	12/29/89
Sedgwick County	Ranson/Kirchner Moore	25,000,000	10,590,680	12/21/89	12/28/89
City of Olathe	Stern Brothers	10,000,000	0	12/28/89	12/28/89
Labette County	Stern Brothers	10,000,000	0	12/28/89	12/28/89
1989 Total		$275,000,000	$106,181,360		
City of Kansas City	B.C. Christopher	30,000,000	0	1/24/90	1/24/90
Leavenworth County	B.C. Christopher	30,000,000	0	1/24/90	1/24/90
Shawnee County	Ranson/Kirchner Moore	20,000,000	20,000,000	3/1/90	5/2/90
Sedgwick County	Ranson/Kirchner Moore	20,000,000	20,000,000	3/2/90	5/2/90
Geary County	George K. Baum	20,000,000	16,500,000	3/26/90	5/2/90
Riley County	George K. Baum	20,000,000	16,500,000	3/26/90	5/2/90
Labette County	Stern Brothers	25,000,000	13,500,000	3/27/90	5/2/90
City of Olathe	Stern Brothers	25,000,000	13,500,000	3/27/90	5/2/90
1990 Total		$190,000,000	$100,000,000		

As the table shows, by May of each year, 80-100 percent of the total mortgage revenue bonds approved had been allocated. Most applications were approved for less then the amount requested.

In 1991, the applications were received and approved much earlier than in the two previous years. The detail of mortgage revenue bond allocations for 1991 is shown in the following table.

Mortgage Revenue Bond Allocations: Calendar Year 1991

Applicant	Bond Program Underwriter	Amount Requested	Amount Approved	Date Requested	Date Approved
Sedgwick County	Ranson/Kirchner Moore	$25,000,000	$12,500,000	1/9/91	1/10/91
Shawnee County	Ranson/Kirchner Moore	25,000,000	12,500,000	1/10/91	1/10/91
City of Kansas City(a)	B.C. Christopher	40,000,000	40,000,000	1/10/91	1/10/91
City of Olathe	Stern Brothers	25,000,000	7,500,000	1/10/91	1/10/91
Labette County	Stern Brothers	25,000,000	7,500,000	1/10/91	1/10/91
Geary County	George K. Baum	25,000,000	10,000,000	1/10/91	1/10/91
Riley County	George K. Baum	25,000,000	10,000,000	1/10/91	1/10/91
1991 Total		$190,000,000	$100,000,000		

(a) Documentation in the Kansas City application file indicates that this request was made in conjunction with Leavenworth County.

As the 1991 table shows, mortgage revenue bond applications were submitted to the Department in January—most of them on the 10th—and were processed and approved almost immediately. Appendix A presents a full listing of all the bond applications received, approved, and issued by the Department in 1989 through 1991.

The former Secretary of Commerce said the mortgage revenue bond allocation was made in early 1991 because applicants had indicated they would need their allocations early that year. We asked current and former Department officials why the applications were submitted so early in 1991 compared with earlier years. The former Secretary said that, in December 1990, an official with Ranson and Company (a member of the Department's advisory committee) contacted him to ask if there was any unused allocation remaining for 1990. When informed there was none, the individual indicated his firm's mortgage revenue bond program might need an allocation in early 1991. He was told an early allocation of 1991 authority was a possibility, but the Secretary would not make any allocation without input from others on the advisory committee. The individual agreed to contact the other committee members involved with mortgage revenue bond programs to reach a consensus as to the amount of mortgage revenue bond authority each would need in 1991.

The individual contacted the Secretary on January 8, indicating the bond underwriters and bond counsel on the committee had reached an agreement about their respective needs for mortgage revenue bond programs for 1991. By January 10, all their applications had been submitted to the Department. In all but one instance, the amounts requested were greater than the amounts the underwriters had agreed

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they actually needed. That one instance involved a $40 million request for the Kansas City/Leavenworth program. Documentation from the files indicated that the bond underwriter said he would forego the requests for $30 million each for Kansas City and Leavenworth in 1990 with the understanding he would receive $40 million at a later time—possibly in 1991.

According to the former Secretary, because all relevant committee members had been consulted and had submitted applications for the localities they worked with, he approved them all for the amounts members had said they actually needed. This approval included the promised $40 million for the Kansas City/Leavenworth program.

The $100 million in allocations approved by the former Secretary on January 10 represented the entire amount of the State's total allocation earmarked for mortgage revenue bonds for 1991. That figure was about the same amount as had been allocated for mortgage revenue bonds in the past, and left $50 million to be allocated to exempt facility bonds and small issue bonds.

The current Secretary of Commerce has asked those who received allocations to delay issuing the bonds until the matter was reviewed by Legislative Post Audit. In addition, the current Secretary has not approved any additional allocations for mortgage revenue bonds, but has approved $14.8 million of authority for exempt facility bonds and small issue bonds.

Department Records Did Not Include Any Documentation for Its Allocation Decisions

As noted earlier, the Department has no written criteria for evaluating private activity bond applications. In our review of Department records of allocations made since 1989, we found nothing to document the basis used for evaluating applications, deciding which ones to approve, and determining how much to award. Only the Department's final decisions were recorded.

In all three years reviewed, it did appear from the application files that applications generally were considered in the order in which they were received and, at least for mortgage revenue bonds, that consideration was given to how much an applicant had received in prior years. But for these and the other evaluation criteria Department officials had said they used—such as the population to be served, the amount of unused allocation at the time the application was received, and internal Department assessments of the propos-

The Department Did Not Keep Required Amounts Reserved Until Late In the Year

State law requires the Department to reserve a portion of the total amount that can be allocated in a year until October 15 (June 1 for 1990), so that it will be available for small issue bonds and two other rarely issued types of bonds. In none of the years we reviewed, did the Department reserve the amounts as required. However, in 1989 and 1990—the only complete years we reviewed—enough of the approved allocations expired or were surrendered that the Department had sufficient amounts to accommodate requests for the specified types of bonds.

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als—Department officials were unable to provide any documentation that the criteria had been considered.

Department records also do not include the dates that notifications were sent to applicants concerning the status of their applications. Therefore, we were unable to determine whether the Department provided written notification within five days, as required by State law. The date that application decisions were made is recorded, but the date that notification was sent to the applicant is not.

In the case of mortgage revenue bonds, it appeared that the former Secretary effectively delegated to selected members of his advisory committee the decisions concerning which applicants would receive allocations, and in what amounts. The former president of the Kansas Development Finance Authority, who also was a member of the Secretary's advisory committee, indicated that the decision on how to divide the amount earmarked for mortgage revenue bonds was left to the bond underwriters on the committee. He said they would decide among themselves the amounts that would go to the mortgage revenue bond programs their firms were associated with. Their agreement was subsequently approved by the Secretary. This practice seemed to be the same one followed for the 1991 mortgage revenue bond allocations.

Conclusion

Each year, the Department of Commerce has a limited amount of tax-exempt bond authority to allocate to localities within the State; since 1988, the amount has been $150 million. Each year, the Department receives requests for more bond authority than it can approve. Because the Department is responsible for allocating the authority to issue tax-exempt bonds among the localities that apply, its allocation process should conform to the requirements of law and to good management practices. Although the Department's actions have complied with applicable laws, during the past three years it has not had a formal process for making bond allocations, and it did not maintain documentation to show that applications were evaluated and approved on a consistent basis.

In addition, the mortgage revenue bond allocations appear to have been handled in a way that would have excluded localities that might have been interested in participating. Although the Secretary's intentions in establishing an advisory committee appeared to have merit, allowing the bond underwriter members of that committee to decide among themselves who would receive mortgage revenue bond allocations, and in what amounts, gives at least the appearance of a conflict of interest. Establishing a more formal way of operating the program, carrying it out in the most open setting possible, and documenting the way it is carried out, are all steps the Department should take to help minimize such problems.

Recommendation

1. To ensure that it has an adequate process for authorizing localities to issue tax-exempt bonds, and that it is accountable for the way that process is carried out, the Department of Commerce should do the following:

a. Provide general notice about the program and about the deadlines for making applications to all potential applicants.

b. Develop standard criteria for evaluating applications and authorizing localities to issue tax-exempt bonds. These criteria could include such things as who is eligible to apply, the documentation required to support an application, and the priority factors to be considered in approving applications. The criteria that will be used should be communicated to all those who apply under the program.

c. Develop formal policies and procedures for processing applications. At a minimum, these policies and procedures should fully describe how the Department will carry out the allocation process, and should specify the types of records that will be maintained to document the Department's actions and decisions related to this program.

2. If the Department plans to use an advisory committee to help evaluate applications under the private activity bond allocation program, the membership on that committee should include locally elected officials.

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Appendix A

Private Activity Bond Allocations:
Calendar Years 1989-1991

The tables on the following pages show all of the applications submitted to the Department of Commerce for private activity bond allocations for the years 1989 through 1991 (figures include applications submitted through February 28, 1991). The tables include the names of the project or beneficiary of the bonds, the governmental issuer who made the application, the bond type, the amount of the application, the date the Department received the application, the amount of bond authority approved, the date the Department made the approval (or denial) of authority, the date the bonds were issued, any amounts that expired or were surrendered by the issuer, and the net amount of the bond issue.

The types of private activity bonds that may be issued are:

1) exempt facility bonds
2) qualified mortgage bonds
3) qualified small issue bonds
4) qualified redevelopment bonds (none were issued 1989-1991)
5) tax reform act transition rule bonds (none were issued 1989-1991)
6) private activity portion of government use bonds
7) qualified student loan bonds (none were issued 1989-1991)

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Private Activity Bond Allocations:
Calendar Year 1989

Project/ Beneficiary	Applicant/ Issuer	Bond Type	Amount of Application	Date Dept. Received Application	Amount Approved	Date Approved/ Denied	Date Issued	Amount Surrendered Or Expired	Net Amount Issued
Mortgage Credit Cert. Program	Riley & Geary Counties	2	$50,000,000	1/18/89	$10,590,680	12/28/89	5/16/90	$0	$10,590,680
Saunders Mfr. Co., Inc.	City of Atchison	6	300,000	1/20/89	300,000	1/24/89		300,000	0
Figge Properties, Inc.	City of Elwood	3	1,500,000	1/25/89	1,500,000	1/26/89	2/15/89	15,000	1,485,000
Shasta Beverages-Mid Amer. Corp.	City of Lenexa	1	2,400,000	1/26/89	2,400,000	1/27/89	3/1/89	0	2,400,000
Central Plastics, Inc.	City of McPherson	3	750,000	1/31/89	750,000	2/2/89	6/14/89	0	750,000
Extrusions, Inc.	City of Fort Scott	3	1,000,000	3/16/89	1,000,000	3/17/89	4/4/89	0	1,000,000
IFR Systems, Inc.	City of Goddard	3	3,500,000	3/17/89	3,500,000	3/21/89	5/25/89	0	3,500,000
Mortgage Revenue Bond Program	County of Sedgwick	2	50,000,000	3/24/89	21,250,000	5/10/89	7/18/89	0	21,250,000
Mortgage Revenue Bond Program	County of Labette	2	25,000,000	3/28/89	21,250,000	5/10/89	6/8/89	0	21,250,000
Mortgage Revenue Bond Program	City of Olathe	2	25,000,000	3/28/89	21,250,000	5/10/89	6/8/89	0	21,250,000
Mortgage Revenue Bond Program	County of Shawnee	2	25,000,000	3/30/89	21,250,000	5/10/89	7/18/89	0	21,250,000
Diversified Health Companies	County of Coffey	3	5,000,000	4/5/89	5,000,000	4/6/89	6/28/89	0	5,000,000
Pitt Plastics, Inc.	City of Pittsburg	3	1,750,000	4/13/89	1,750,000	4/17/89		1,750,000	0
DINA Manufacturing	City of Oswego	3	275,000	5/4/89	275,000	5/5/89	8/17/89	0	275,000
Lawrence Paper Co.	City of Perry	3	1,200,000	5/12/89	1,200,000	5/16/89	7/13/89	0	1,200,000
Superior Industries Int., Inc.	City of Pittsburg	3	2,248,640	5/15/89	2,248,640	5/16/89	6/19/89	0	2,248,640
RAM Company	City of Lawrence	3	2,500,000	5/16/89	2,500,000	5/17/89	8/15/89	0	2,500,000
Mac Equipment, Inc.	City of Sabetha	3	1,050,000	5/16/89	1,050,000	5/18/89	6/21/89	0	1,050,000
Morrison Marketing, Inc.	City of Anthony	3	700,000	5/22/89	700,000	5/22/89		700,000	0
KOPCO, Inc.	City of Caney	3	1,400,000	5/24/89	1,400,000	5/30/89	8/30/89	140,000	1,260,000
Mobile Traveler, Inc.	City of Junction City	3	200,000	6/14/89	200,000	6/16/89	8/16/89	0	200,000
Mortgage Revenue Bond Program	County of Sedgwick	2	35,000,000	6/16/89	0	12/28/89		0	0
Systech Environmental Corp.	City of Fredonia	1	8,000,000	6/20/89	8,000,000	6/26/89	8/17/89	2,600,000	5,400,000
Ward/Kraft, Inc.	City of Fort Scott	3	1,500,000	7/3/89	1,500,000	7/5/89	7/25/89	0	1,500,000
Laich Industries, Inc.	City of Ottawa	3	1,500,000	7/7/89	1,500,000	7/10/89	9/28/89	0	1,500,000
American Metal Products, Inc.	County of Coffey	3	1,500,000	7/12/89	1,500,000	7/18/89	8/17/89	0	1,500,000
Mega Manufacturing, Inc.	City of Hutchinson	3	1,250,000	7/14/89	1,250,000	7/18/89	7/31/89	0	1,250,000
Shield Industries, Inc.	City of South Hutchinson	3	250,000	7/14/89	250,000	7/18/89	7/31/89	0	250,000
Apico Corp.	City of Girard	3	900,000	7/24/89	900,000	7/24/89		900,000	0
Morrison Marketing, Inc.	City of Anthony	3	850,000	7/27/89	850,000	7/28/89	9/22/89	0	850,000
Mortgage Revenue Bond Program	County of Leavenworth	2	20,000,000	8/3/89	0	12/29/89		0	0
Collins Industries, Inc.	City of Newton	3	1,250,000	8/3/89	1,250,000	8/4/89	10/18/89	0	1,250,000
Osborne Industries, Inc.	City of Osborne	3	1,750,000	8/21/89	1,750,000	8/23/89	11/20/89	0	1,750,000
Pac-Serve Investment Co., Inc.	City of Gardner	3	3,500,000	9/12/89	3,500,000	9/14/89		3,500,000	0
Independent Salt Co.	County of Ellsworth	3	2,600,000	9/19/89	2,600,000	9/22/89	11/10/89	400,000	2,200,000
Culligan Water Conditioning	City of Olathe	3	1,600,000	9/21/89	1,600,000	9/22/89	11/22/89	0	1,600,000
Mid West Ind. & Dev., Ltd.	City of McPherson	3	1,000,000	9/26/89	1,000,000	9/29/89		1,000,000	0
Composite Ind. Dev. Bond Program	Kansas Dev. Finance Authority	3	12,400,772	9/26/89	12,400,772	10/17/89		12,400,772	0
American Maplan Corp.	City of McPherson	3	500,000	10/5/89	500,000	10/19/89		500,000	0
La Siesta Foods, Inc.	City of Topeka	3	2,500,000	10/5/89	2,500,000	10/19/89		2,500,000	0
SOR, Inc.	City of Lenexa	3	5,000,000	10/9/89	5,000,000	11/30/89(a)		5,000,000	0
Femco, Inc.	City of McPherson	3	400,000	10/18/89	650,000	11/30/89		650,000	0

(continued on the next page)

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Private Activity Bond Allocations:
Calendar Year 1989 (continued)

Project/ Beneficiary	Applicant/ Issuer	Bond Type	Amount of Application	Date Dept. Received Application	Amount Approved	Date Approved/ Denied	Date Issued	Amount Surrendered Or Expired	Net Amount Issued
Future Foam, Inc.	City of Newton	3	550,000	10/23/89	550,000	11/30/89	12/28/89	25,000	525,000
Tru-Circle Corp.	City of Wichita	3	1,350,000	11/2/89	1,350,000	11/30/89	12/21/89	0	1,350,000
Vornado Air Circulation Systems	City of Wichita	3	1,000,000	11/2/89	1,000,000	11/30/89		1,000,000	0
Penn Plastics, Inc.	City of Lawrence	3	6,000,000	11/8/89	0	11/8/89(b)		0	0
Strongheart Products, Inc.	City of Pittsburg	3	5,250,000	11/16/89	5,250,000	11/30/89		5,250,000	0
Parker/Marshall Group	City of Chanute	3	950,000	11/21/89	950,000	12/12/89		950,000	0
Mortgage Revenue Bond Program	County of Sedgwick	2	25,000,000	12/21/89	10,590,680	12/28/89	6/21/90	0	10,590,680
Mortgage Revenue Bond Program	City of Olathe	2	10,000,000	12/28/89	0	12/28/89		0	0
Mortgage Revenue Bond Program	County of Labette	2	10,000,000	12/28/89	0	12/28/89		0	0
1989 Totals			$364,124,412		$189,555,772			$39,580,772	$149,975,000

(a) $2,780,588 was approved 10/19/89 and an additional $2,219,412 was approved 11/30/89.
(b) Application withdrawn.

Private Activity Bond Allocations: Calendar Year 1990

Project/ Beneficiary	Applicant/ Issuer	Bond Type	Amount of Application	Date Dept. Received Application	Amount Approved	Date Approved/ Denied	Date Issued	Amount Surrendered Or Expired	Net Amount Issued	Not Yet Issued
Femco, Inc.	City of McPherson	3	$650,000	1/2/90	$650,000	1/4/90		$650,000	$0	$0
American Maplan Corp.	City of McPherson	3	500,000	1/2/90	500,000	1/4/90		500,000	0	0
Penn Plastics, Inc.	City of Lawrence	3	6,000,000	1/5/90	6,000,000	1/8/90		6,000,000	0	0
SOR, Inc.	City of Lenexa	3	5,000,000	1/9/90	5,000,000	1/11/90	4/10/90	350,000	4,650,000	0
Mortgage Revenue Bond Program	City of Kansas City	2	30,000,000	1/24/90	0	1/24/90(a)		0	0	0
Mortgage Revenue Bond Program	County of Leavenworth	2	30,000,000	1/24/90	0	1/24/90(a)		0	0	0
American Maplan Corp.	City of McPherson	3	575,000	1/30/90	575,000	2/1/90	2/22/90	40,000	535,000	0
Strongheart Products, Inc.	City of Pittsburg	3	5,250,000	2/12/90	5,250,000	2/14/90		5,250,000	0	0
Kinedyne Corp.	City of Lawrence	3	2,000,000	2/20/90	2,000,000	2/22/90	3/22/90	150,000	1,850,000	0
Mortgage Revenue Bond Program	County of Shawnee	2	20,000,000	3/1/90	20,000,000	5/2/90	6/21/90	729	19,999,271	0
Mortgage Revenue Bond Program	County of Sedgwick	2	20,000,000	3/2/90	20,000,000	5/2/90	6/21/90	0	20,000,000	0
M-C Industries, Inc.	Kansas Dev. Finance Authority	3	600,000	3/6/90	600,000	3/8/90	5/9/90	0	600,000	0
Kansas Color Corp.	Salina Airport Authority	3	1,050,000	3/22/90	1,050,000	3/26/90	7/31/90	0	1,050,000	0
Soo Plastics, Inc.	Salina Airport Authority	3	850,000	3/22/90	850,000	3/26/90	7/31/90	0	850,000	0
La Siesta Foods, Inc.	City of Topeka	3	2,000,000	3/23/90	2,000,000	3/26/90	4/19/90	0	2,000,000	0
Mortgage Credit Cert. Program	County of Geary	2	20,000,000	3/26/90	16,500,000	5/2/90	5/16/90	0	16,500,000	0
Mortgage Credit Cert. Program	County of Riley	2	20,000,000	3/26/90	16,500,000	5/2/90	5/16/90	0	16,500,000	0
Mortgage Revenue Bond Program	County of Labette	2	25,000,000	3/27/90	13,500,000	5/2/90	9/6/90	0	13,500,000	0
Mortgage Revenue Bond Program	City of Olathe	2	25,000,000	3/27/90	13,500,000	5/2/90	9/6/90	0	13,500,000	0
Strongheart Products, Inc.	City of Frontenac	3	5,000,000	4/12/90	5,000,000	4/13/90		5,000,000	0	0
Lindarsu, Inc.	City of Kansas City	1	2,150,000	4/30/90	2,150,000	5/2/90	7/26/90	0	2,150,000	0
Rockview Dev. Corp.	City of Mission	1	11,500,000	5/4/90	11,500,000	5/10/90	5/30/90	400,000	11,100,000	0
Pineview Estates, Inc.	City of Andover	1	8,000,000	5/7/90	8,000,000	6/7/90	9/6/90	0	8,000,000	0
Associated Company, Inc.	City of Wichita	3	4,000,000	5/23/90	4,000,000	5/24/90	8/15/90	1,000,000	3,000,000	0
Beginning Farmer Program	Kansas Dev. Finance Authority	3	2,500,000	6/11/90	2,500,000	6/14/90	9/28/90	629,300	1,870,700	0
Vornado Air Care Systems	City of Andover	3	1,000,000	6/14/90	1,000,000	6/21/90	8/23/90	0	1,000,000	0
Mainline Printing, Inc.	City of Topeka	3	1,500,000	6/28/90	1,500,000	7/2/90	9/28/90	0	1,500,000	0
Superb Meats of Kansas	City of Clay Center	3	1,000,000	7/5/90	1,000,000	7/6/90		1,000,000	0	0
Tri-State Realty Inv.	Kansas Dev. Finance Authority	1	4,000,000	7/6/90	0	12/31/90		0	0	0
Mid-Continent Dev.	Kansas Dev. Finance Authority	1	3,907,086	7/6/90	3,864,172	10/24/90		1,007,086	0	2,857,086
Mid-Continent Dev.	Kansas Dev. Finance Authority	1	4,700,000	7/6/90	0	12/31/90		0	0	0
Mid-Continent Dev.	Kansas Dev. Finance Authority	1	2,400,000	7/6/90	0	12/31/90		0	0	0
Aqua Farms of America	County of Sherman	3	800,000	7/6/90	800,000	7/9/90		800,000	0	0
Coons Manufacturing, Inc.	City of Oswego	3	400,000	7/10/90	400,000	7/11/90	9/29/90	0	400,000	0
National Tank Company	City of Hutchinson	3	1,015,000	7/17/90	1,015,000	7/18/90	9/25/90	0	1,015,000	0
Beginning Farmer Program	Kansas Dev. Finance Authority	3	500,000	7/18/90	500,000	7/23/90	9/28/90	0	500,000	0
Acra-Plant, Inc.	City of Garden City/KDFA	3	2,226,000	7/19/90	2,226,000	7/23/90	9/26/90	1,000	2,225,000	0
Beginning Farmer Program	Kansas Dev. Finance Authority	3	500,000	7/24/90	500,000	7/25/90	9/28/90	0	500,000	0
Graphic Technology, Inc.	County of Johnson	3	2,000,000	7/26/90	2,000,000	8/6/90	9/28/90	0	2,000,000	0
Beginning Farmer Program	Kansas Dev. Finance Authority	3	1,000,000	8/1/90	774,729	8/8/90	9/28/90	426,786	347,943	0
Plastic Enterprises, Inc.	City of Olathe	3	4,000,000	8/8/90	0	8/9/90(b)		0	0	0
Barkman Honey Co., Inc.	City of Hillsboro	3	250,000	8/13/90	0	8/13/90(b)		0	0	0
Balfour House of Kansas, Inc.	City of Lawrence	3	600,000	8/15/90	0	8/15/90(b)		0	0	0
1990 Totals			$279,423,086		$173,204,901			$23,204,901	$147,142,914	$2,857,086

(a) Application withdrawn with the understanding that a later allocation would be granted for $40 million (combined for both applicants).
(b) Application withdrawn.

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Private Activity Bond Allocations: Calendar Year 1991 (Through February 28, 1991)

Project/ Beneficiary	Applicant/ Issuer	Bond Type	Amount of Application	Date Dept. Received Application	Amount Approved	Date Approved/ Denied	Date Issued	Net Amount Issued	Amount Not Yet Issued
Kasa Ind. Controls	City of Salina	3	$400,000	1/4/91	$400,000	1/7/91		$0	$400,000
Tri-State Realty Inv.	Kansas Dev. Finance Authority	1	4,000,000	1/7/91	4,000,000	1/10/91		0	4,000,000
Tri-State Realty Inv.	Kansas Dev. Finance Authority	1	2,350,000	1/7/91	2,350,000	1/10/91		0	2,350,000
Beginning Farmer Program	Kansas Dev. Finance Authority	3	15,000,000	1/7/91	5,000,000	1/10/91		0	5,000,000
Mortgage Revenue Bond Program	County of Sedgwick	2	25,000,000	1/9/91	12,500,000	1/10/91		0	12,500,000
Heatron, Inc.	City of Leavenworth	3	1,500,000	1/9/91	1,500,000	1/10/91		0	1,500,000
Aqua Farms Int., Inc.	County of Sherman	1	1,000,000	1/10/91	1,000,000	1/10/91		0	1,000,000
Mortgage Revenue Bond Program	City of Kansas City	2	40,000,000	1/10/91	40,000,000	1/10/91		0	40,000,000
Mortgage Revenue Bond Program	City of Olathe	2	25,000,000	1/10/91	7,500,000	1/10/91		0	7,500,000
Mortgage Revenue Bond Program	County of Labette	2	25,000,000	1/10/91	7,500,000	1/10/91		0	7,500,000
Mortgage Credit Cert. Program	County of Geary	2	25,000,000	1/10/91	10,000,000	1/10/91	2/11/91	10,000,000	0
Mortgage Credit Cert. Program	County of Riley	2	25,000,000	1/10/91	10,000,000	1/10/91	2/11/91	10,000,000	0
Mortgage Revenue Bond Program	County of Shawnee	2	25,000,000	1/10/91	12,500,000	1/10/91		0	12,500,000
Aqua Farms Int., Inc.	County of Sherman	3	1,000,000	1/10/91	1,000,000	1/10/91		0	1,000,000
Galt Plastics	City of Lawrence	3	8,000,000	1/18/91	4,500,000	1/28/91		0	4,500,000
Lincoln Meadows, Inc.	City of Wichita	1	5,500,000	2/5/91	5,500,000	2/15/91		0	5,500,000
Reser's Fine Foods, Inc.	City of Topeka	3	4,800,000	2/11/91	4,800,000	2/18/91		0	4,800,000
Wesparke Village	City of Topeka	1	5,000,000	2/27/91	--	(a)		0	--
1991 Totals			$238,550,000		$130,050,000			$20,000,000	$110,050,000

(a) No action had been taken on this application at the time of this audit.

4/8/92
3-20

MAR 26 1991

KANSAS

DEPARTMENT OF COMMERCE

Joan Finney
Governor

Laura Nicholl
Secretary

REVIEWING THE DEPARTMENT OF COMMERCE'S
1991 BOND ALLOCATION

Department of Commerce overall response

The Department of Commerce has the responsibility for administering the allocation of $150 million in tax-exempt bonds under the 1988 Private Activity Bond Allocation Act. Localities apply to the Department throughout the year to receive an allocation to be able to issue tax-exempt bonds and support either economic development projects or housing programs. This year more than three-fourths of the total amount was authorized on or before January 10, 1991, with $100,000,000 allocated for mortgage revenue bonds, sharply in contrast to the timing of allocations made in previous years.

In light of this unusual activity, the Secretary requested an audit to determine both if the Department has an adequate process in place for making these allocations and if the 1991 process to date had been carried out in accordance with applicable laws, regulations and procedures.

The Department is pleased with the findings of the Post Audit report. The Department agrees that the timing of the allocation, while within the letter of the law, was not appropriate and that the previous procedures were not adequate to serve the public purpose intended under the program, nor representative of good management procedures.

It is the intention of the Department that the availability of allocations be open to all eligible parties and that the overriding public purpose be served in use of this scarce resource. The Department has already initiated procedures to improve the overall allocation process and will proceed to implement the recommendations of the report as follows:

* Publish notice in the Kansas Register of the Department's intent to accept applications,
* review allocation procedures, policies, and criteria used in other states,
* develop standard criteria that include who is eligible to apply, the documentation required to support an application, and priority factors,
* develop more formal, documented policies and procedures for processing applications, and
* establish an advisory committee that includes locally elected officials as well as appropriate representatives from financial institutions to make certain the public purpose is best served.

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APPENDIX B

Agency Response

On March 21, 1991, we provided a copy of the draft audit report to the Department of Commerce. Its response is included in this Appendix.

4/8/92
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KANSAS NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS

Testimony
Before the Senate Economic Development Committee
On HB 2918
By Noelle St.Clair
For Kansas NAHRO

April 8, 1992

Senator Kerr, and members of the committee; I am Noelle St.Clair the Legislative Co chair for the Kansas Chapter of Housing and Redevelopment Officials (NAHRO) . I appreciate the opportunity to speak in support of HB 2918. This bill is an important tool that will empower the state to effectively respond to it's citizens ever changing housing needs.

Kansas NAHRO members work in Housing Authorities and Community Development Agencies in 105 counties of this state and see first hand what kind of housing needs their communities have. NAHRO members know in order for Kansas to have effective housing programs and policy we cannot leave out anything that would give the state the ability to creatively package the finances needed to carry out our objectives.

As noted in the Legislative Post Audit, Kansas would benefit if the State Finance Authority were given the authority to issue bonds for housing development . Kansas NAHRO also sees the importance of securing a new commitment of resources that will encourage economic development and the formation of partnerships. This bill will not only give us a new resource of funding but will allow our state to use those funds as a leverage to attract other dollars.

Armed with new federal funds, creative credit enhancements and technical assistance Kansas can implement creative finance products that will create affordable housing, new jobs and business expansion.

Attachment 4
4/8/92
Sen. Eco. Dev.

H 2918

KANSAS DEPARTMENT OF COMMERCE
OFFICE OF HOUSING

DENNIS SHOCKLEY, CHIEF OF HOUSING DEVELOPMENT & POLICY
TESTIMONY BEFORE THE SENATE ECONOMIC DEVELOPMENT COMMITTEE

APRIL 8, 1992
ON
HOUSE BILL 2918

The Kansas Department of Commerce appears today in support of HB 2918, which would give the Kansas Development Finance Authority the ability to issue single-family mortgage revenue bonds (MRBs).

The state of Kansas is the <u>only</u> state of the 50 that does not issue these bonds at the state level. Forty-eight states issue MRBs through a state housing finance agency, and Arizona through its Department of Commerce.

The current system of allocating this bonding authority is thoroughly outlined in two Legislative Post Audit reports of March and December, 1991. The reports conclude that the state: is not well-served by the current structure of having this bonding authority passed through to local units of government; that homebuyers in only a few counties receive most of the loans or certificates, and that homebuyers pay higher fees than in other states.

Since KDFA already has the statutory authority to issue low-income and multi-family housing bonds, it is the logical state agency to issue MRBs.

In addition, if the state issued MRBs, program fees to homebuyers and/or bond proceeds that might accrue to the issuer could be earmarked for the state Housing Trust Fund and used to leverage other federal housing monies. For example, the new federal HOME program, which means $6.5 million to the state of Kansas, requires matching funds the second and subsequent years at a rate of 25% to 50%.

In closing, I would just like to encourage members of the Committee to read two aforementioned Post Audit reports, which makes an excellent case as to why Kansas should join the other 49 states in issuing MRBs in a manner which will allow us to look at the interests of the whole state as we proceed to aid, especially, first-time homebuyers in achieving their piece of the American Dream of homeownership.

Attachment 5
4/8/92
Sen. Eco. Dev.

Kansas-Nebraska League of Savings Institutions

Jeffrey D. Sonnich, Vice-President

Suite 512
700 Kansas Avenue
Topeka, Kansas 66603
(913) 232-8215

April 8, 1992

TO: SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

FROM: JEFFREY SONNICH

RE: H.B. 2918 - MORTGAGE REVENUE BONDS; K.D.F.A AUTHORITY

Mr.Chairman. Members of the Committee. The Kansas-Nebraska League of Savings appreciates the opportunity to appear before the Committee on Economic Development in support of H.B. 2918.

Probably the best sources of information available to the Committee regarding the mortgage revenue bond program in Kansas is found in the December 1991 Performance Audit Report. The Report points out that the six issuing counties received 87% of the 2,468 loans issued. Virtually no loans were made in western and northwestern Kansas. The report also indicates that the state could reduce the overall costs of bond issuance by issuing the bonds at the state level. In the interest of time I will not attempt to go through the entire audit report, but rather try to provide the committee with some additional information regarding the bond program in Nebraska.

Since our organization's expansion into Nebraska in 1989 we have had the opportunity to experience first hand a state-run mortgage revenue bond program. In Nebraska the bulk of the mortgage revenue bonds issued goes to finance single family homes although authority is

Attachment 6
4/8/92
Sen. Eco. Dev.

Kansas-Nebraska League of Savings Institutions

also given to finance student loans and industrial loans. The Governor initially makes the determination of the percentage make-up of the bond issuance. The Nebraska Investment Finance Authority (NIFA) then contacts lenders throughout the state to determine the dollar volume of the issuance. The lenders respond to NIFA by estimating the dollar volume they think their local market can handle. Once all of the information is compiled, NIFA issues the bonds and eventually makes a three-tier distribution of the money to the lenders. To receive the funds the lender must put up a 1.75% commitment fee which they recapture at origination. All loans are securitized into Ginnie Mae securities and sent to the Trustee to hold. All of the servicing of the loans is done by a master servicer, who has acquired that right through a bidding process. NIFA monitors the distribution of the funds via loans throughout the state. If they determine that a lender is not originating enough loans in specific area they may require the lender to shift the money to a branch office in another part of the state where the loan demand is higher. NIFA may also require the lender to sell it's allotment to another lender who may have a higher loan demand. As you can see the mortgage bond program is very much market driven. The money flows to the areas of the state that have the demand. According to NIFA officials the bulk of the money ultimately flows to the large metropolitan areas simply because that's where the loan demand is. They feel that the method of distribution insures that all areas of the state have an opportunity to receive funds.

Kansas-Nebraska League of Savings Institutions

I would also like to share with the committee some of the fixed costs associated with issuing mortgage revenue bonds. The purpose is to give you some comparative information so that the question of cost savings can be fairly analyzed. The last MRB issue, according to NIFA, was for $110 million. The majority of which were for single family homes. The fixed costs were:

Bond Counsel	$124,253.00
Accountant Verification	$ 22,844.00
Printing	$ 10,332.50
Rating agencies:	
S&P	$ 33,000.00
Moodys	$ 29,000.00
Trustee acceptance	$ 11,180.46
Bond Underwriter fee which is a variable cost	$1,305,638.00

Although these figures give you some idea of the dollars that are involved with issuing the bonds they don't compare the costs of a small issuance versus a large issuance. To demonstrate the possible saving we have included a breakdown of fixed cost from the late 1983 NIFA bond issue and the early 1984 bond issue.

	1983 58.4 million issue	1984 $188 million issue
Bond Counsel	$ 79,958.00	$127,928.00
Accountants	$ 6,000.00	$ 12,000.00
Printing	$ 48,188.70	$ 58,933.24
Rating service:		
S&Ps	$ 10,000.00	$ 15,000.00
Moodys	$ 11,000.00	$ 20,000.00
Trustee acceptance	$ 11,403.00	$ 16,660.00
Total fixed	$166,550.00	$250,251.00
Cost per thousand	$2.87	$1.33

Difference of $1.58 per thousand

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Kansas-Nebraska League of Savings Institutions

Add in underwriter's fee	$1,251,216.00	$3,848,360.00
Total fixed/var costs	$1,430,278.00	$4,098,881.00
Cost per thousand	$24.66	$21.80

Difference of $2.86 per thousand

As you can see there may be some cost savings by issuing mortgage revenue bonds at the state level. While this simple illustration does not categorize every cost associated with the bond issuance, it does include the main cost items. The cost differences could conceivably be three times as high as those shown above since Kansas has three issuances per year.

In closing we would add that these cost savings could be passed on to the consumer in terms of lower rates and fees. These extra costs are now being paid by the homeowners who participate in the mortgage bond program. And if the distribution of the funds was set up similar to Nebraska, the mortgage revenue bond money would be available to a greater number of Kansans.

Jeff Sonnich
Vice President

4/8/92
6-4

STATE OF KANSAS

OFFICE OF THE GOVERNOR

JOAN FINNEY, *Governor*
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Testimony Before the Senate Economic Development Committee
on House Bill 2918
by Gary Reser, Governor's Legislative Liaison

April 8, 1992

Senator Kerr, Senator Moran, members of the Committee, thank you for the opportunity to appear on behalf of Governor Joan Finney to ask for your approval of HB 2918, authorizing the Kansas Development Finance Authority to issue single-family mortgage revenue bonds. Kansas is the only state that does not issue these bonds through a state agency.

If KDFA had the issuing authority, mortgage revenue bonds could be issued through one statewide single-family program, allowing for simplicity in program design, reduction in program fees, and better statewide distribution of home loans.

The Governor made this proposal last November as part of her initiative in the area of housing. It is her hope that if KDFA is given this authority, any bond proceeds or incidental program fees that might accrue to the state could be used to leverage federal dollars for other housing programs.

KDFA has successfully issued multi-family housing bonds and should have no problem taking on this new responsibility.

I respectfully urge you to act affirmatively on HB 2918 and recommend its passage to the full Senate.

Thank you again for the chance to be here today.

Attachment 7
4/8/92
Sen. Eco. Dev.

STATE OF KANSAS

THOMAS A. BISHOP
"TOM"
REPRESENTATIVE, 91ST DISTRICT
SEDGWICK COUNTY
1500 W. 32ND N.
WICHITA, KANSAS 67204

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
MEMBER: ECONOMIC DEVELOPMENT
ELECTIONS
PUBLIC HEALTH AND WELFARE
ADVISORY COUNCIL ON AGING

To: Senator Dave Kerr
Members of the Senate Economic Development Committee

From: Rep. Tom Bishop

Re: Testimony regarding Executive Reorganization Order #23

Date: April 8, 1992

Senator Kerr, members of the committee, I am pleased to be here this morning to support HB2918 as a most important measure for the Kansas homebuyer.

HB 2918 enables KDFA to coordinate the issuance of mortgage revenue bonds for the state of Kansas.

Why is this measure needed? As outlined in the Legislative Post Audit...

1. Kansas costs are higher than any other state to access these mortgage programs. These excessive fees only increase the profits of the bond houses and local units of government.

2. Present program does not serve all residence of the state. Procedures and costs limit geographic distribution.

3. Kansas is the ONLY state in the nation without statewide coordination and a mechanism for serving as issuer.

4. Kansas in 1991 had the lowest percentage of first time homebuyers in the nation. Our economy was preforming better that the nation, on average. Interest rates were down to the lowest point in a decade. Excessive fees built into the present mortgage assistance programs prevent many first time buyers from entering the market.

5. Consolidation of issues and the fees charged for these issues will result in reduced costs for home buyers.

HB 2918 does not prevent an urban county from continuing to offer their own issue. It fact, many states continue to have statewide and coordinated issues.

I urge the committee to give it's full support to HB 2918.

Attachment 8
4/8/92
Sen. Eco Dev.

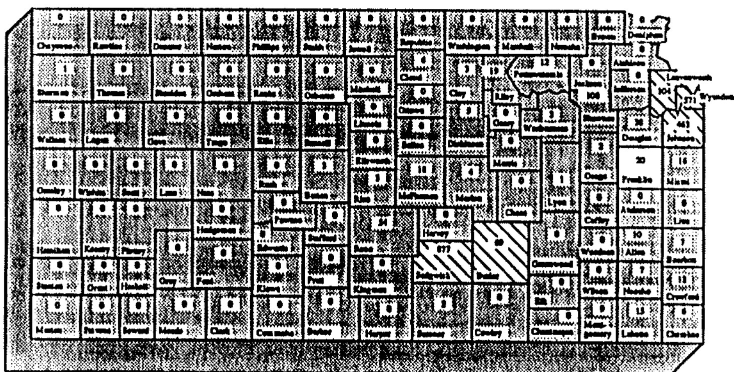
Tom Bishop RE: HB 2918

the identifiable data, and about this office's access to confidential information. We are pursuing this issue with the Attorney General's Office.

Currently, loans funded with mortgage revenue bond proceeds are not being distributed across the State. The accompanying map shows the number of homeowners in each county who received a loan through the mortgage revenue bond programs. As noted earlier, Olathe and Labette County jointly issue mortgage revenue bonds to make loans available in southeastern and eastern Kansas, and Shawnee and Sedgwick Counties jointly issue mortgage revenue bonds to make loans available in central and western Kansas. Kansas City and Leavenworth County issue bonds only for loans in their own counties.

Because loans may be made only to households that fall within certain income limits and meet other program guidelines, we compared the number of loans in each county to the number of loans that might be awarded based on the number of households in each county with incomes that fit within program guidelines. This comparison was meant only as a general indication of how the loans were distributed relative to the number of households that might have been eligible to receive them.

Distribution of Mortgage Revenue Bond Loans Based on Number of Households Meeting the Income Guidelines



☐ County received fewer mortgage revenue bond loans than the number of households with income that fit within program guidelines would suggest.

▧ County received more mortgage revenue bond loans than the number of households with income that fit within program guidelines would suggest.

☐ County received about the number of mortgage revenue bond loans that the number of households with income that fit within program guidelines would suggest.

As the map shows, virtually no loans were made in western and northernmost Kansas, and most of the loans were made in the issuers' home counties. In fact, the

counties of the six issuers received nearly 87 percent of the 2,468 loans, but have only 43 percent of the households Statewide which meet program income guidelines.

To help get an indication of why no loans were made under the mortgage revenue bond program in large areas of the State, we contacted six of the 12 FHA-approved lenders in western Kansas. The responses we got were mixed. Three lenders said they were unaware, or only vaguely aware, of the program. The three other lenders said they were aware of the program, but two said their own rates were competitive with the bond-financed loans. The other lender said it had participated in the past, but thought it was currently excluded from the pool of eligible participants.

If Kansas issued and promoted a Statewide mortgage revenue bond program rather than having several localities perform these functions, loans under the program may be more available to eligible homebuyers across the State. A Statewide program also would allow the State issuer to set targets or limits for particular areas of the State, if such action were desirable.

Fees for homebuyers are higher in Kansas than in the other states we surveyed. Unlike many types of bonds where the proceeds are used to pay bond-issuance costs, the costs of issuing mortgage revenue bonds are paid for with fees charged to participating homebuyers or, in some cases, home sellers. Bond-issuance costs may include the cost of bond counsel, underwriter, and trustee services, as well as bond rating fees, printing costs, freight, and the like. The largest single expense is for bond underwriters.

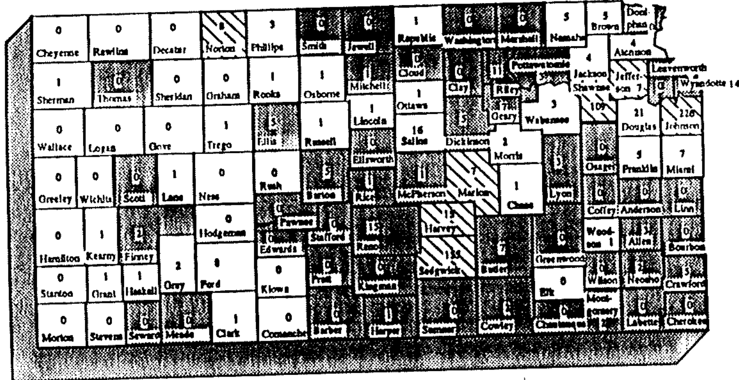
The following table shows the amount of fees charged in Kansas and the other states we contacted, as well as the bond-issuance costs reported to us by those states, where available. (Although we attempted to ensure that states reported comparable issuance costs, we did not attempt to verify the information we received.)

Fees for Selected Mortgage Revenue Bond Programs in 1990

State	Fees Charged to Homebuyers	Bond Issuance Costs/$1000
Colorado	3%	$15.00 (approx.)
Indiana	3.375%	12.60 (avg.)
Iowa	3% (a)	(d)
Kansas	4-4.5% (b)	19.50 (approx.)
Maine	3%	6.90
Missouri	3%	17.50 (avg.)
Nebraska	3.25%	13.85 (avg.)
Oklahoma	3%	na
Wisconsin	0-2% (c)	na

(a) Fees vary with each issue. The amount shown was charged in a September 1991 bond issue. Iowa did not have a mortgage revenue bond issue in 1990.
(b) Fees varied for the different programs that were operated in Kansas in 1990.
(c) Fees are charged on a sliding scale, with low income families charged nothing and moderate income families charged up to two percent.
(d) Iowa did not have a mortgage revenue bond issue in 1990.

Distribution of Mortgage Credit Certificates Based on Number of Households Meeting the Income Guidelines



- ☐ County received fewer mortgage credit certificates than the number of households with income that fit within program guidelines would suggest.
- ☒ County received more mortgage credit certificates than the number of households with income that fit within program guidelines would support.
- ☐ County received about the number of mortgage credit certificates that the number of households with income that fit within program guidelines would suggest.

Fees for homebuyers participating in the program are notably higher than in other states. Federal regulations allow fees that "are reasonably necessary to cover any administrative costs incurred by the issuer or its agent in issuing mortgage credit certificates." As the table on page 23 shows for the five states we contacted that operate the program in-house, homebuyers' fees ranged from $50 to $325. All the states indicated their program was self-supporting.

By comparison, the program fee in Kansas is two percent of the loan amount, or $400, whichever is greater. With an average loan amount of $50,000, the average fee is about $1,000 per homebuyer. In 1990, when 722 certificates were issued covering total loans of $36,788,131, George K. Baum and Company would have received a minimum of $735,000 in fees. Company officials indicated they were unable to provide us figures showing the actual cost of operating the program.

Borrower Fees for the Mortgage Credit Certificate Program in Kansas and a Sample of Other States, 1990

State	Borrower Fees
Alabama	$ 300
Colorado	325
Indiana	275
Iowa	200
Oregon	50
Kansas	**$1,020** (a)

(a) Based on the 1990 average loan amount of $51,000

Information from other states suggests the State could operate the program for far less than the current administrator receives, largely because the State would not expect to make a profit on the program. Rather, it could charge fees that would allow the program to be self-supporting, and pass the cost-savings on to the homebuyer.

Operating the program in-house would allow the State to set targets or limits that are more restrictive than federal requirements. Questions have been raised about who is benefiting from the program. Federal statutes set upper limits on the income of homebuyers who can participate in the program, and on the cost of the home that can be purchased, but allow issuers to impose more stringent limits to ensure that only those individuals who otherwise could not purchase a residence will benefit from the credit.

As with the mortgage revenue bond program, maximum homebuyer income in Kansas ranges from $34,000 to $56,280, depending on family size and where the home is located. Maximum home purchase price ranges from $53,370 to $134,310, depending on whether the home is new or existing and where it is located. As noted on page 24, we were unable to independently verify the data on which these tables are based.

As the table shows, most of the homebuyers who received certificates in 1990 had income in the $20,000 to $40,000 range (85 percent) and purchased homes in the $30,000 to $70,000 range (80 percent). At the two extremes, 51 homes (seven percent) had a purchase price of less than $30,000, and 90 homes (12 percent) had a purchase price exceeding $70,000.

> **Some Homebuyers Appear to be Financing Program Fees**
>
> Legislative questions were raised about whether homebuyers could finance program fees along with the home mortgage, rather than paying the fees out-of-pocket. Officials with George K. Baum and Company told us that if the appraised value of the home was higher than the purchase price, banks generally would finance the fees.
>
> Comparing the loan amount to the purchase price for all homebuyers in the program in 1990, we found that 425 of the 722 homebuyers (59 percent) received a loan equal to, or more than, the price of the home they purchased. The average loan was $2,700 more than the average purchase price. This suggests that many homebuyers have been able to finance such things as program fees, repairs, or the like.

State HFA	Total Loans in 1990	Total MRB Issuance	Average Borrower Income	Average Purchase Price
Alabama HFA	3,048	200,000,000	29,153	57,739
Alaska HFC	1,498	529,603,544	35,696	64,731
Arizona DoC	1,500	89,100,000	25,890	59,649
Arkansas DFA	2,500	75,000,000	24,250	43,500
California HFA	5,480	528,690,026	32,210	88,089
Colorado HFA	1,804	84,865,000	28,700	53,600
Connecticut HFA	2,399	270,550,000	40,067	113,899
D.C. HFA	528	165,000,000	31,176	86,607
Delaware SHA	997	134,314,018	29,694	74,280
Florida HFA	1,078	230,220,000	27,161	59,943
Georgia RFA	2,233	120,638,702	26,638	56,843
Hawaii HFDC	401	50,000,000	32,431	98,891
[illegible]HA	3,778	346,708,732	23,123	47,013
[illegible] HDA	3,521	61,139,169	32,333	68,332
[illegible]na HFA	2,136	313,000,000	29,189	50,101
Iowa FA	1,309	0	27,881	42,307
Kansas DoC	**	**	**	**
Kentucky HC	2,239	145,450,000	21,716	41,615
Lousiana HFA	1,888	96,000,000	25,411	48,196
Maine SHA	1,195	210,000,000	26,975	61,024
Maryland CDA	4,428	155,061,471	25,659	60,089
Massachusetts HFA	1,574	160,000,000	32,072	93,000
Michigan SHDA	4,186	169,500,000	25,540	43,374
Minnesota HFA	2,079	109,465,000	24,505	56,204
Mississippi HC	1,112	126,808,911	25,690	51,312
Missouri HDC	1,880	135,000,000	26,903	47,198
Montana BoH	1,176	75,000,000	25,650	48,000
Nebraska IFA	3,018	260,000,000	28,220	46,188
Nevada HD	1,231	131,785,000	29,208	77,340
New Hampshire HFA	1,429	51,000,000	37,595	98,998
New Jersey H&MFA	2,749	315,075,422	36,000	88,400
New Mexico MFA	793	37,333,333	25,697	55,267
New York HDC	***	18,215,000	***	***
New York SMA (SONYMA)	6,154	204,000,000	34,775	79,548
North Carolina HFA	2,133	124,200,000	25,546	56,115
North Dakota HFA	1,018	150,000,000	26,962	45,996
Ohio HFA	13,033	513,519,493	28,098	53,947
Oklahoma HFA	6,501	66,885,000	26,519	40,500
Oregon HA	672	46,589,850	23,480	48,139
Pennsylvania HFA	5,435	364,335,000	27,089	57,684
Rhode Island H&MFC	2,016	195,760,000	31,708	103,434
South Carolina SHA	1,798	95,640,000	25,984	57,101
South Dakota HDA	1,861	0	26,985	46,436
Tennessee HDA	4,701	226,975,000	21,770	43,583
Texas HA	2,319	140,045,000	28,722	45,998
Utah HFA	2,532	148,215,000	29,440	56,983
Vermont HFA	998	110,000,000	27,900	71,800
Virginia HDA	4,084	312,654,823	27,724	65,932
Washington SHFC	1,527	125,206,485	29,085	58,910
West Virginia HDF	1,084	50,000,000	28,340	50,170
Wisconsin HEDA	6,938	229,430,000	29,698	53,373
Wyoming CDA	1,538	87,800,000	29,346	49,506
GRAND TOTAL	**131,529**	**8,585,778,979**	**28,568**	**59,705**

*Local issuance nationally is estimated at approximately 50% of the state issuance volume.
** MRBs in Kansas are issued at the local level. Production information was not available to NCSHA.
***The New York HDC issued MRBs to support the underlying mortgage for cooperative housing units to be completed in 1991-92.

SOURCE: NCSHA

MRBs have broad and deep support in Congress.

- The effort to make the Mortgage Revenue Bond (MRB) program permanent is well underway in the new Congress. Eighty-eight Senators, including 15-members of the 20-member Finance Committee, have cosponsored MRB legislation, S. 167, introduced by Senators Riegle (D-MI) and Chafee (R-RI) on January 14. The House bill, H.R. 1067, introduced by Representative Kennelly (D-CT), has 348 cosponsors, including 25 members of the 36-member Ways and Means Committee.
- An overwhelming majority, 457 of the 535 Members, cosponsored legislation in the last Congress to extend the MRB program, including more than a majority of both the Finance and Ways and Means Committees.
- Despite this broad and deep support, Congress has chosen for budget accounting reasons to reconsider the MRB program every year for the past three years. The MRB program is currently scheduled to expire on December 31, 1991 unless Congress extends it.

MRBs are the only federal home mortgage assistance program.

- The MRB program is the **only** federal program available to reduce home mortgage costs for first-time homebuyers whose incomes would otherwise be inadequate to purchase a home.
- MRBs issued by State Housing Finance Agencies (HFAs) have helped more than 1.3 million lower income households to become homeowners - with over 131,000 households assisted in 1990 alone. Local housing finance agencies have assisted an additional 474,000 households.

MRBs enable lower income households to become homeowners.

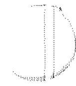
- Purchase price and income limits direct MRB benefits to lower income households. By statute, HFAs may only offer MRB-assisted loans to one or two person households which earn 100 percent or less of area median income. Larger households may qualify for an MRB loan with incomes up to 115 percent of area median. MRB home purchase prices are limited to 90 percent of average area purchase price.
- In practice, many HFAs target households whose incomes fall at 80 percent or less of area median income. According to preliminary 1990 data compiled by the National Council of State Housing Agencies (NCSHA), the average income of an MRB borrower was $28,424 in 1990, compared with $44,500 for the average conventional first-time homebuyer, $53,000 for all conventional homebuyers, and $35,700 for the median U.S. household. The average purchase price of an MRB-assisted home was $59,569, compared with a conventional first-time average price of $111,100.
- Because buyers of tax-exempt bonds are paid a lower rate of return on their investment than if the bonds were taxable, the HFA issuing the bonds can lend the proceeds to homebuyers at interest rates as much as 2.5 percent below conventional rates, resulting in savings of as much as $100 per month on a typical MRB mortgage. That savings equals nearly 20 percent of a monthly payment.

MRBs aid in the economic recovery of distressed housing markets.

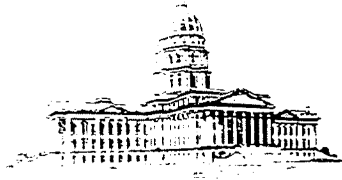
- The MRB program provides financing to the lower income first-time buyers of foreclosed homes owned by the Federal Housing Administration (FHA), Veterans Administration (VA), Farmers Home Administration (FmHA), and Resolution Trust Corporation (RTC). More than $185 million in MRB funds have been reserved for RTC home sales. In 1990, more than 60 percent of all lower-priced RTC home sales were financed by MRB loans.

MRBs cost the federal government little.

- Congress has imposed a stringent overall cap on the volume of bonds like MRBs that has the effect of limiting total bond volume to no more than its level prior to 1986.
- The Joint Committee on Taxation (JCT) estimates that extending the MRB program permanently would cost only $770 million over a five-year period, 3.7 percent of the total five-year cost of permanently continuing the 12 popular tax programs known as "the expiring tax provisions" that Congress has reauthorized each year.



STATE OF KANSAS



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HOUSE OF
REPRESENTATIVES

THOMAS A. BISHOP
"TOM"
REPRESENTATIVE, 91ST DISTRICT
SEDGWICK COUNTY
1500 W. 32ND N
WICHITA, KANSAS 67204

COMMITTEE ASSIGNMENTS
MEMBER: ECONOMIC DEVELOPMENT
ELECTIONS
PUBLIC HEALTH AND WELFARE
ADVISORY COUNCIL ON AGING

Real Estate

First-time buyers — Here's a distressing surprise.

Kansas had the lowest percentage of first-time home buyers (as a percentage of all home buyers) last year of any other state, according to a nationwide survey of home sales by Century 21 Real Estate.

The study showed that the state's percentage of first-time buyers in 1991 declined by 5.6 percent, compared with 1990.

Of the homes purchased last year in Kansas, first-time buyers bought 37.2 percent of them. That was down from 42.8 percent in 1990 and 43.7 percent in 1989.

While the percentage of Kansas' first-time buyers declined, the percentage of first-time buyers nationally grew to 40.8 percent. That compared with 38.4 percent in 1990 and 38 percent in 1989.

What's distressing about the report is that lower mortgage interest rates last year should have made homes more affordable to many more first-time buyers. In fact, by the end of the year, the long-term, fixed rate had plunged to 8.23 percent, the lowest level in 18 years.

The results of the Century 21 study are in line with what Wichita brokers and agents have been saying: The majority of buyers last year were move-up buyers. And apartment managers buttressed that observation, saying they lost some renters via the home-buying route but not that many.

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LAW OFFICES
LATHROP & NORQUIST
1050/40 CORPORATE WOODS
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OVERLAND PARK, KANSAS 66210-2007
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RECEI
FEB 14 1992

February 13, 1992

Senator Paul "Bud" Burke, Jr.
Vice President
Ranson Capital Corporation
9400 Mission Road, Suite 203
Shawnee Mission, KS 66206

Mr. David C. Owen
Stephens, Inc.
11011 King Street, Suite 260
Overland Park, KS 66210

Dear Senator Burke and Mr. Owen:

At Senator Burke's request, Harry Wigner and I agreed to meet for breakfast on February 3, 1992 with Senator Burke to discuss matters relating to KDFA. I was pleased to have the opportunity to meet both of you to discuss KDFA matters.

As we discussed on February 3, 1992, it is my personal belief that the KDFA Board should be open-minded about entertaining "proprietary proposals" from investment banking firms on a case by case basis. However, the overriding presumption with which the Board must proceed in its affairs is that competitive bidding is the rule, from which exceptions can be made only in justifiable situations. Obviously, until the full Board can evaluate ideas that investment banking firms believe are proprietary, it is impossible to predict whether the Board will determine that such a justifiable situation exists. Thus, I can make no commitment as to whether ideas will be deemed "proprietary" until I, and the other Board members and the staff, have had the opportunity to review proposals claiming such proprietary rights. I do believe, however, that with the limited staff and resources available to KDFA at this time, we should encourage private investment banking firms to come up with innovative ideas to assist KDFA in serving its role as mandated by the Legislature.

I was interested in your comments that there seems to be general sentiment in the Legislature to restrict or eliminate the activities of KDFA because it has, as you said, "gone far beyond the bounds of what the Legislature intended." It seems to me from

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Sen. Eco. Dev.

the enabling legislation that the Legislature intended KDFA to have broad authority in order to best serve the State.

It seems illogical to me that the Economic Development Committees of both houses of the Legislature would believe restricting the activities of KDFA would have a positive economic benefit on the State. To the contrary, I believe the role KDFA plays, and can hopefully play in the future, in allowing various entities within the State to access capital markets in an economical manner greatly enhances, rather than hinders, economic development and fiscal responsibility within the State. Reduced fees earned by investment banking companies and bond lawyers because of the involvement of KDFA in various transactions has a minimal effect on the overall economic climate in the State.

Thank you for understanding my insistence on purchasing my own breakfast. With the current focus on public officials, I believe the avoidance of any appearance of impropriety is essential to maintain the integrity of the process.

Once again, I appreciate your thoughts and would welcome the opportunity to discuss these matters with you again in the future. Should you want to present your ideas to the KDFA Board, please contact Chairperson Laura Nicholl to request that you be placed on the agenda for the March meeting.

Sincerely yours,

Curtis A. Krizek

CAK:kl

cc: Secretary Laura Nicholl, Chairperson
Secretary Jim Cobler, Acting President
KDFA Board Members
Governor Joan Finney

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THE UNIVERSITY OF KANSAS

Graduate Program in Urban Planning

RECEIV...
MAR 18 1991

Allen Bell, President
Kansas Development Finance Authority
400 Southwest 8th Street, Suite 100
Topeka, Kansas 66603-3957

March 15, 1990

Dear Mr. Bell,

Enclosed is a copy of the report describing my research on the Mortgage Credit Certificate (MCC) program as it was operated in Kansas during 1989. I am sending this to you as I know that your agency may soon be administering housing finance programs in Kansas, and I think that the information in paper may be of service to you in that effort.

This research investigated the relative costs of the program to various levels of government. In addition, it examined the relative benefits of the program to participating households compared to the mortgage revenue bond (MRB) program alternative.

In summary, the report finds:

1. The MCC program saves the federal government money. With the Kansas program, the federal government will save about $350 per household per year.

2. Both the MCC and the MRB programs are effectively costless to state and local government.

3. The MCC program is not as beneficial to the participating household as the MRB program because:

   a. The MCC program does not reduce the monthly loan payments as is the case with the MRB program.

   b. The subsidy from the MCC program is usually realized through an income tax refund at the end of the calendar year which forces the participating household to pay market rate loan payments during the early months of ownership without any program assistance.

   c. The MCC program, as practiced in Kansas, charges a 2 percent fee to participating households. This places an additional burden upon low and moderate income households who are attempting to save enough money to purchase their first home.

4. The program appears to be relatively easy to administer and eliminates the need for the large array of regulatory and managerial staff required to run an MRB program.

Attachment 10

SCHOOL OF ARCHITECTURE AND URBAN DESIGN · 317 MARVIN HALL, LAWRENCE, KANSAS 66045-2250 · TEL. 913-864-4184 · FAX: 913-864-5393

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Sen. Eco. Dev.

This research suggests that the State of Kansas should carefully review any plans to continue with the MCC alternative assuming that the U.S. Congress continues to authorize the use of MRB's and MCC's. Specifically, the State of Kansas may want to consider:

1. Administering the program internally and absorbing the cost of administration.

   The charging of fees places a heavy burden upon those households least able to pay any additional costs. During 1989, each of the 1,114 MCC recipients was assessed a 2 percent fee which averaged about $1,000 per household. The program administrator received over $1,100,000 to process the forms on these 1,114 households. This appears to be payment that is out of proportion to the amount of effort required to operate the program.

   The State could administer the program with only limited staff time, probably less than one full-time person. This staff time would impose a relatively small cost upon the State. If the state absorbed this cost, the households participating in the program could more easily enter into home ownership for the first time as they would have significantly lower closing costs.

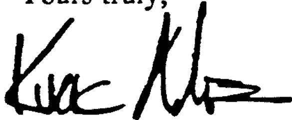
2. Closely monitoring the terms of the loans offered to MCC program participants and comparing them to the loans terms offered to MRB program participants.

   The MRB program has the benefit of lowering the monthly payments of the participating households. Further benefits are found in the ability of MRB sponsors to make loans with low origination fees and high loan-to-value ratios. MCC program participants must accept market rates on loans. To fully compare the relative benefits of the MRB and the MCC programs, the state needs to obtain full data on these loan terms.

   The administrator of the MCC program has not made this information available nor does the State require that the private sector program administrator file reports describing this information. The State should arrange for periodic reporting by the program administrator whether the program is operated in-house or through a private firm. This reporting should cover loan terms, purchase price, and household income level. Only in this way will the State of Kansas be able to fully evaluate the relative value of the MCC and the MRB programs.

I hope that this research will be of some assistance to you. I will be happy to discuss it with you or any other members of the staff. If you have any questions or need any additional information, please feel free to contact me. Thank you again for your assistance in this research effort.

Yours truly,



Kirk McClure
Assistant Professor

MORTGAGE CREDIT CERTIFICATES
AS AN AID TO AFFORDABLE HOUSING

Kirk McClure
Assistant Professor
Graduate Program in Urban Planning
University of Kansas

This research was supported by
The General Research Fund of
The University of Kansas

March, 1991

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MORTGAGE CREDIT CERTIFICATES
AS AN AID TO AFFORDABLE HOUSING

Abstract

The Mortgage Credit Certificate (MCC) program has been used as a means to provide assistance to low and moderate income households in their efforts to purchase their first home. This program was designed to be an alternative to the frequently used mortgage revenue bond (MRB) program. Examination of recent use of MCC's finds that the program is administratively easier to operate than the MRB program and is less costly to the federal government. However, it provides few advantages to the needy home buyer. The MCC program does not reduce the household's monthly loan payments; rather, it grants a rebate through reduced taxes usually at the end of the year. Further, if the program sponsor charges the full fees that are permitted, then the MCC program can actually make housing affordability more difficult to attain, rendering the program of little value except to those households who could already afford to purchase a home without assistance.

INTRODUCTION

The federal government has a long history of intervention in housing markets to assist needy households in purchasing a home. Among the most popular forms of government assistance is the use of Mortgage Revenue Bonds (MRB's). MRB's make use of tax exempt bonds to lower interest rates on home loans for eligible buyers. A recent alternative to MRB's is the use of Mortgage Credit Certificates (MCC's). MCC's lower the eligible buyer's federal income tax liability by some proportion of the amount of interest that the buyer pays on a home purchase loan.

MRB's have been used a great deal in the past. They proved to be extremely popular with local governments during the 1970's and 1980's, because the program is essentially "free." For a period of time, the federal government did not limit the issuance of tax exempt bonds for these purposes, and the local government did not have to contribute anything more than limited staff time to participate in the program. After 1980, the federal government imposed limits on both the dollar volume of such bond issues and upon the income of buyers who could participate. Despite these constraints, the program continued to be popular given the lack of costs to local sponsors.

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The federal government sought an alternative to the MRB and believed it found one in the MCC. At hearings held by the Senate Finance Committee to review the MCC as a replacement for the MRB, Senator Dole stated that MRB's are "akin to the once popular medical practice of bloodletting." The costs to the treasury "have simply been excessive." As a consequence, the Senator favored the use of MCC's stating that, "For every dollar exchanged (MRB's for MCC's) substantial revenues will be saved." Dole opposed retention of the MRB program in any form and favored replacing it entirely with the MCC alternative [U.S. Senate Committee on Finance, 1983].

This paper examines the MCC approach to resolving housing affordability problems using evidence from Kansas, Senator Dole's home state and a state that has used both the MCC and the MRB programs in its efforts to help needy home buyers. The issue being addressed is whether or not the design of the MCC program makes it a preferred alternative to the MRB program.

THEORY OF PROGRAM DESIGN

Whenever government intervenes in the operation of private sector markets, it seeks to do so with a minimum of efficiency loss in the marketplace and at the least cost to the government. However, the government constructs elaborate mechanisms to assist potential homeowners in purchasing a home. Rather than offer direct assistance, the federal government: provides insurance on home purchase loans; provides insurance on deposits held by firms making these loans; maintains secondary markets for these loans to ensure an adequate supply of credit to home buyers; regulates the terms of the loans; and grants generous tax benefits to home owners lowering the after tax cost of buying a home.

Where these efforts fail to bring down the barriers to home ownership, the federal government has taken additional steps to become a form of low-cost lender for borrowers in need of further financial assistance through the use of MRB's.

The MRB program is simple in concept but becomes complex in its execution. The program uses federal tax exemption to lower the cost of borrowing money to purchase a home. This concept is

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implemented through a state or local government issuing bonds, the interest on which is exempt from federal income taxes. All proceeds from the sale of the bonds, net any costs of issuance and any funds held back for reserves against loss, must be loaned to eligible borrowers for the purchase of a home. Given the tax exempt status of the bonds, the interest rates paid on the bonds are below the interest rates on taxable bonds. These lower interest rates are passed through to the borrower, permitting the end loans to be made at rates that are below those offered with conventional, unsubsidized financing. As a result, a borrower's monthly payments of principal and interest are lower than what they would be with conventional financing. This reduces the burden of housing costs on the borrower's income. It may help the household to purchase more housing than would otherwise be the case. Finally, it may help the household in surmounting the price barrier that prevents it from moving out of rental tenure and into home ownership.

Congress has now placed tight controls upon the ability of state and local governments to issue this type of bond. Initially, the federal government placed a ceiling upon the total dollar amount of the bonds issued and placed limitations upon the maximum price for a home purchased through the MRB program. These limits have been revised periodically in the past. Currently, the purchase price limit is 90 percent of the average area purchase price. This may go up to 110 percent if the home is located within a "target area." A target area is defined as a census tract or tracts where at least 70 percent of the families have income that is less than or equal to 80 percent of the state median or is an area of chronic distress as determined by the poor condition of the housing stock and the lack of available mortgage credit. A minimum of 20 percent of the MRB funds must be made available for use in a target area for a period of one year after the issuance of the bonds. After this time the funds are available for use anywhere within the jurisdiction.

With the Tax Reform Act of 1986, Congress added limitations on the income of the households participating in the program. Again the limitations reflect averages for the area in which the program is implemented. A household participating in the program must have an income of no more than 115

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percent of the median income in the area. The income limit is 140 percent if the home is purchased in a target area.

The program is also intended primarily for first-time home buyers. A borrower must not have owned a home during the preceding three years and must occupy the purchased home as its principal residence. Homes purchased for recreational or business purposes are not eligible. The three-year prior ownership rule may be waived if the house is located within a target area. Beginning in 1991, a home buyer will be subject to a recapture provision if the home is sold prior to ten years after the subsidized purchase. This recapture can be as much as 6.25 percent of the loan amount but is scaled back depending upon the length of residency, income level of the household and reason for the sale.

To implement this program a complex array of administrators must be organized. The MRB approach calls upon the bond issuers to take on many of the roles normally performed by conventional lenders. The issuer must prepare the bond issue itself; it must arrange for dispersal of the bond proceeds through loan originators (usually selected lending institutions); it must provide for management of any reserve funds held back from the bond proceeds; and it must arrange for pass through of loan payments to the bond holders. This necessitates a large and costly administrative mechanism [U.S. G.A.O, 1983; U.S. G.A.O., 1988].

In an effort to find a better form of subsidy mechanism, the federal government created the Mortgage Credit Certificate program as part of the Deficit Reduction Act of 1984. The MCC program permits states to trade in some or all of their authority to issue qualified mortgage bonds in exchange for authority to award MCC's to needy households. States may trade in their MRB authority for MCC's on a four-to-one ratio. That is, for every four dollars of MRB authority that the state agrees not to issue, the state may issue one dollar of MCC's.[1] Even fewer MCC's are permitted in some states to prevent excessive market penetration. Where the volume of the MCC's would become too great a proportion of

[1] The ratio was five-to-one MRB dollars for MCC dollars prior to 1987. It was lowered to four-to-one with the Tax Reform Act of 1986.

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total mortgage activity, the total MCC's that may be granted by a state is lower. This provision responds to a problem noticed first with the MRB program. It was discovered that home prices tend to increase if the infusion of funds from a public sector program constitutes too large a share of the total volume of market activity [Clauretie, 1986]. By placing a low ceiling on the maximum share of the home sales market that can benefit from the MCC program, it is hoped that the problem of program induced price increases can be avoided.

These MCC's can be used by the home buyer to reduce their federal income taxes. The credits can be claimed against the MCC holder's federal income tax liability during any year in which the MCC holder lives in the home purchased for coverage. In the event that the credit amount exceeds the MCC holder's tax liability, the MCC holder may carry the unused credit forward for up to three years.

The credit amount is the product of the interest paid on the home purchase loan and the "credit rate," which may not be more than 50 percent nor less than 10 percent, but the total credit amount claimed in any one year cannot exceed $2,000. Any interest deduction claimed by the home buyer, if the taxpayer itemizes deductions, is reduced by the amount of the credit claimed.

The MCC program was created to serve the same population as the MRB program but at a lower cost to the federal government. Thus, the same income, purchase price, recapture and three-year prior ownership rules apply. However, states may be more restrictive in order to better target the MCC's to needy populations. As with the MRB program, participants buying a home in a target area need not meet the first-time buyer, three-year requirement. The MCC is not transferrable except within very tight restrictions and may be revoked if the participant moves out of the house.

While the federal government has created the program and funds it through the process of not collecting income taxes from the holders, it does not administer the program itself nor does it provide funds for the program's administration. In order to minimize the possible costs to the local sponsor from participation in the MCC program, the federal regulations permit the sponsors to assess a fee against the MCC holders. The MCC recipient may be required to pay a fee of up to 2 percent of the mortgage loan

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amount to the program sponsor in order to cover the costs of administration.

The MCC program was designed to be a replacement for the MRB program. As such, the loan must not be from the proceeds of a MRB issue, although the proceeds from a taxable bond issue may be used. The loan may not be from a related individual. The MCC program may be combined with other subsidy programs as long as the loan funds do not come from a pool of funds raised through the sale of tax exempt securities.

Generally, MCC's are not to be reserved for use with individual developments. Such reservations are permitted within the program, however, as long as a plan is submitted to the federal government which demonstrates that the prices of the homes sold are not higher than would be the case in the absence of the MCC program. This requirement addresses a problem identified with the MRB program. It was discovered that when developers were able to arrange for a set-aside of MRB funds for a specific development, the price of the units in the development rose such that the seller captured some of the benefits of the below market interest rates intended for the buyer [Durning and Quigley, 1985; Benjamin and Sirmans, 1987; McClure, 1989].

Similarly, the MCC's may not be restricted to any set of lenders thus eliminating the reservation process used in the MRB program. This process permits lenders to pay a commitment fee to the MRB program sponsor in exchange for which the sponsor reserves some portion of the MRB funds for the exclusive use by the lender. Borrowers eligible for MRB program benefits must arrange to borrow from a lender having a set-aside of MRB funds. By contrast, a participant in the MCC program may borrow from any lender.

The borrower must apply for the MCC and be approved for participation in the program prior to closing the loan. As such, the program is intended only for new mortgages; it cannot be used for loans already closed or for assumed mortgages.

The MCC is valid for each year the eligible household occupies the home. The household must submit form 8396 with their federal income tax return in order to claim the credit. The lender also has

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a reporting requirement through which they certify the amount of the loan taken out by the borrower for the purchase of the home.

A LOOK AT THE KANSAS MCC PROGRAM

The Kansas MCC program was jointly sponsored by Geary and Riley counties, two essentially rural counties located in central Kansas. Sponsorship was local, but the program was administered for the benefit of all eligible households statewide. As is often the case with MRB programs, the sponsorship of the program is something of a formality with the actual administration of the program being performed by a private underwriting firm.[2]

This was the only MCC program active in the state during 1989. The program was advertised broadly through brochures designed for prospective MCC recipients and instructional meetings designed to inform lenders and brokers of how the program works. The program offered credits equal to 50 percent of the interest paid by eligible borrowers up to the maximum permissible amount of $2,000 per household per year. Kansas chose not to vary the credit rate but chose instead to give the maximum allowable credit to each program participant independent of the household's income or the home's purchase price. The program administrator charged a 2 percent fee payable at the closing of the loan.

The federally imposed price limitations did not prove to be a burden given the relatively stable housing market that exists in Kansas. Generally, the homes purchased for participation in the program had to be priced at or below $70,000 if newly constructed and below $52,000 if they were existing homes. The urban areas had higher limits. In Kansas City, for example, the limits were $99,000 for newly constructed homes and $71,000 for existing homes. The income limits also did not hinder the program's implementation. They were $36,000 in general and about $41,000 in the Kansas City area.

Within these limits, the MCC program assisted 1,114 households as they purchased a home.

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[2] The Kansas MCC program was administered by George K. Baum and Company, a Kansas City, Missouri based underwriting firm.

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Table 1 profiles the MCC's awarded by income of the buyer and by the purchase price of the home.

The federal government counts the aggregate volume of MCC's in terms of the borrowers' debt and credit rates they receive. This volume is the product of the credit rate times the buyer's mortgage loan amount summed over all MCC's issued. Using this measure, the program awarded just under $28 million in MCC's during 1989. Given the exchange rate of four-to-one, the state of Kansas had to forego about $112 million in MRB authority in order to issue the MCC's.

Table 1.: Mortgage Credit Certificates Awarded by Income and Purchase Price in Kansas during 1989

Annual Gross Income	Non-Target Area	Target Area	Total
$ 0 - 9,999	1	0	1
$ 10,000 - 19,999	99	4	103
$ 20,000 - 29,999	399	11	410
$ 30,000 - 39,999	484	21	505
$ 40,000 - 49,999	83	11	94
$ 50,000 +	0	1	1
	1,066	48	1,114
Purchase Price			
$ 0- 19,999	16	2	18
$ 20,000 - 39,999	229	14	243
$ 40,000 - 59,999	473	20	493
$ 60,000 - 79,999	273	7	280
$ 80,000 +	75	5	80
	1,066	48	1,114

The aggregate MCC volume does not accurately indicate the value of the subsidy awarded to the program participants, as it does not reflect the actual interest payments made by the various recipients, nor does it recognize the $2,000 per household annual ceiling on the MCC's. A typical loan among the

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program participants was about $50,000 as the modal category of program participants by home purchase price was $40,000 to $60,000. Thus, the typical borrower agrees to make principal and interest payments of about $460 per month causing the borrower to pay over $5,000 in interest each year during the early years of the loan. These interest payments are eligible for application of the credit rate of 50 percent which would generate credits in excess of the $2,000 per year limit. As a result, the typical participant in the program will claim the maximum allowable $2,000 per year in credits. However, some participants will claim less as their annual interest payments are less than $4,000. About one-fourth of the participants purchased homes at prices under $40,000 indicating a debt amount of less than $40,000. At current market lending rates, any loan of less than $40,000 would have annual interest payments of $4,000 or less. Thus, about one-fourth of the MCC holders will claim credits of less than $2,000 per year. Taken over all program participants, the program during 1989 has 1,114 households who will receive tax credits averaging just under $2,000 per year amounting to about $2,200,000 in housing subsidy per year.

EVALUATION OF THE KANSAS MCC PROGRAM

The MCC program, as implemented in Kansas during 1989, provides an opportunity to make several observations concerning the design and effectiveness of the MCC approach to resolving housing affordability problems. Specifically, the MCC program can be compared to the MRB program in terms of costs, in terms of ease of administration, and in terms of acceptability to both lenders and borrowers.

Comparing MCC and MRB Costs and Subsidy Amounts

The federal government appears to be saving some money on the Kansas MCC program which would be typical of other states. Kansas had to forego about $112 million dollars of MRB's during 1989 to issue the MCC's. The annual interest that would have been paid on these MRB's had they been issued

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would be about $9.3 million. Table 2 outlines these items. As all of this interest would have been exempt from federal income taxes, the government would have foregone about $2.6 million in taxes assuming that the average investor is in the 28 percent tax bracket. Given that the MCC program forgives about $2.2 million in income taxes each year, there is a net "gain" of about $400,000 per year. This gain is actually a reduction in the amount of taxes not collected, but it does represent a savings over the MRB approach.

The MCC program does not seem to be serving as many households as would have been the case if MRB's had been issued, and this appears to be related to the credit rate used by the state. The credit rate can be set anywhere from 10 percent to 50 percent. Kansas chose to set all of the MCC's at the maximum permissible 50 percent level. Table 3 illustrates the problem. With the 50 percent credit rate, the $28 million of MCC volume could serve only about 1,100 households. Assuming the same average debt per household as was experienced with the MCC program, an MRB program could have served about 2,200 households using the foregone MRB bond authority. Had the state lowered the credit rate from 50 percent to 40 percent, it would not have affected most of the program participants as, even at this lower rate, they still would would have been able to claim only the maximum permissible $2,000 in credits each year. However, with the lower credit rate, the available credit volume could have been dispersed over about 1,400 households. This gain of 300 households could have been achieved by a simple administrative decision to grant lower credit amounts to households who could not make use of the full credit rate anyway. The state could also have lowered the credit rate in order to expand the number of households served. If the credit rate had been lowered to 25 percent (equal to the MRB:MCC exchange rate), the number of households served with the MCC program would have reached parity with the number of households that could have been served with the MRB approach. However, by lowering the credit rate past the 40 percent level, the amount of subsidy per household realized through the MCC program is reduced.

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Table 2. Estimation of Savings to the Federal Government

Number of MCC's issued:	1,114
Credit Rate:	50.00%
Aggregate Indebtedness:	
Nontarget areas:	53,538,754
Target Areas:	2,268,451
TOTAL:	55,807,205
Average Debt per Recipient:	50,096
Aggregate Amount of MCC's:	27,903,602
(Aggregate debt * credit rate)	
Estimation of Savings to Federal Government:	
Exchange rate MCC's for MRB's:	25.00%
MRB's Foregone:	111,614,410
Annual interest that would be paid in first year if MRB's had been issued for a fifteen year term at an 8.5 % interest:	9,340,000
Federal taxes foregone on above interest if average investor is in 28% tax rate:	2,615,000
Federal taxes foregone on 1989 Kansas MCC's if typical participant uses the maximum credit available: (1,114 participants * $2,000 credits per year)	2,228,000
Federal savings:	387,000

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The reduction in the subsidy per household with the lower credit rate is not necessarily prohibitive. A typical MRB program participant receives subsidy through the reduction in the monthly payments on the loan. This reduction amounts to about $1,100 per year. If the credit rate in the MCC program is lowered to 20 percent, then the average subsidy per household is lowered to about $1,100 per year or an amount equal to the subsidy that would have been received with the MRB program. There appears to be no easy way to balance the desire to provide as much subsidy as possible to a household versus the desire to serve as many households as possible. One result is clear however, the decision to grant 50 percent credit rates to all households needlessly reduced the number of households that could have been served by the program.

Table 3. Comparison of the Number of Households Served

Number of MCC's issued: 1,114
MRB's foregone / Avg. Debt.:2,228

Credit Rate:	Number of MCC's:	Credit per Household:
10.00%	5,570	550
20.00%	2,785	1,100
25.00%	2,228	1,375
30.00%	1,857	1,650
40.00%	1,392	2,000
50.00%	1,114	2,000

Typical savings in annual principal and interest payments with MRB financing, assuming 11% APR market rate and 8.5% APR tax exempt rate, both on 30 year terms:

Annual P&I payments market rate:	5,725
Annual P&I payments tax exempt rate:	4,622
Annual Savings to household:	1,103

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Administration of the MCC Program

The MCC program proved to be relatively easy to administer given the simplicity of the program's design, especially in comparison to the complexity of the MRB program. With the MCC program, there is no need to raise the funds for the end loans to the borrowers as is true with the MRB program. As a result, the MCC program does not require the presence of underwriters or the preparation of a bond offering statement. There is no need for bond brokers nor for any of the accounting mechanisms necessary to transfer the payments from the borrowers to the bond holders. With the MRB approach, there are usually reserve fund requirements that must be met and bond insurance coverage that must be obtained. The MCC approach does not require that administrators manage such funds or monitor the flows of funds to bond holders so as to determine the need to make any draw downs from the reserve funds. Neither does the MCC approach necessitate any negotiations with insurance carriers.

Given the absence of this administrative overhead, the MCC program is relatively easy to run. The only remaining administrative tasks require an apparatus: to solicit applications from prospective home buyers; to review the applications for conformance with the program's requirements; to award the available MCC's to the eligible households; and to provide some ongoing reporting of the program's progress to the federal government. This is not a complex process, and with the Kansas program, it proved to require only a limited amount of staff time and effort.

A further comparison concerning program administration concerns the ability of administrators to run the program within the income and price constraints imposed by the federal government. The program administrators found that they had no difficulty in implementing the program within these income and price limitations. There is certainly no reason why they should have; the limitations have not hindered the MRB program. In fact, from an administrative viewpoint, the administration of these limitations may be easier with the Kansas MCC program given the existence of a single administrative agent operating throughout the state. With the MRB program, it is typical that many local governments within a state will want to implement their own version of the MRB program making it necessary to train

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multiple sets of administrators on how to meet the income and price restrictions. The MCC program can be decentralized within a state such that local sponsors could act as independent administrators, but Kansas did not chose to follow this path. Given the administrative simplicity of the program, there seems to be little argument for such decentralized management; statewide administration is the preferred alternative.

Lender Opposition

While the MCC program may have been easy to administer, it had considerable difficulties getting started. The program confronted opposition on the part of mortgage lenders. In some cases, the resistance was only token opposition to any new form of government intervention into the housing market; in others, the lenders felt that the MCC program represented a threat to their prior investment in the MRB program.

With the MRB program, lenders pay a commitment fee to the MRB sponsor in return for an allocation of the funds raised through the sale of the MRB's. Once the block of MRB funds are received, the lender clears the borrower's credit, closes the loan and receives payments. This system provides the means through which lenders are able to enlarge their pool of borrowers and, as a consequence, the fees they receive from servicing loans. The key advantage of this system to the lenders is that they do not have to raise the funds themselves, increasing their reserve requirements and making further demands upon their marketing efforts. Rather, the public sector raises the funds, and the lender makes the loans from these funds.

The MCC program does not permit a set-aside of credits to be used by a single lender. With few exceptions, the credits must be allocated by the program sponsor on a first-come, first-served basis. Thus, the loans must be conventional loans meeting all normal underwriting requirements. Any gain to the lender is little more than the marginal increase in business brought about by the presence of the MCC program.

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However, to some lenders, the presence of the MCC program may represent a loss of business. The experience in Kansas suggests that the lenders who participate in the MRB program tend to be the larger firms and tend to be located in the larger urban areas of the state.[3] In contrast, MCC's tend to be attractive throughout the state, in rural as well as urban areas. As a result, the MCC's can enter into housing markets that MRB's do not reach. While the state may view this as a positive attribute of the MCC program, the larger, urban lenders who have invested the time, effort and fees necessary to participate in the MRB program see such dispersal as a reduction of the pool of available borrowers with which they can do business. In effect, the net increase in total mortgage business statewide may come at the expense of these larger lenders.

In addition, the MCC program pays no fees to lenders. Rather, it requires some reporting on the part of the lender making a loan to a MCC holder, while it provides no compensation to the lender for this administrative requirement. With the MRB program, the lender confronts significant administrative problems requiring a commitment of staff and other resources. In exchange, the lender is able to gain servicing fees from loans made from non-bank sources. The MCC program provides none of these benefits, contributing to the lender opposition to the program.

On the positive side, however, at least one case was found where a lender was able to use the MCC program to resolve a problem. MCC's were used as the means to help sell homes possessed by the lender due to loans in default. In a rural, western Kansas town with a depressed real estate market, a lender held 14 homes as mortgagee-in-possession and faced some difficulties in selling the homes given the soft market. When the lender learned of the MCC program, it quickly moved to find a set of eligible buyers and informed them of their eligibility for the program. As such, the lender was able to sell these homes in a fairly short period of time. The program requirements were met which mandated that the price paid for these homes could not be any higher than the price expected in a private, unsubsidized sale.

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[3] Interview with Roger Edgar, chief administrator of the Kansas MCC program with George K. Baum and Company.

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But the MCC program provided the means for the lender to facilitate the quick sale of units that might otherwise have stayed in their portfolio of losses for some time.[4]

Borrower Acceptance

It is in the area of borrower acceptance that the MCC program seems to find its greatest problems. For the program to be of real value in helping a household purchase a home, the lender must be willing to recognize the value of the credit as an enhancement to income. The credit reduces the household's tax burden and, therefore, it has more money available to pay the carrying costs of the home. If the lender fails to recognize the MCC as a gain in income, the underwriting standards would be the same with or without the MCC. Without an adjustment of the lender's underwriting standards, the borrower would have to be able to afford the home without the MCC. This means that the program tends to exclude those households who cannot afford a house without the subsidy, or forces the participating households to purchase lesser priced homes.

The design of the MCC program forces a borrower to pay conventional monthly payments on their mortgage loans. The benefits of the MCC program are only realized through the borrower's income tax returns. If a borrower can arrange to have smaller amounts withheld from its paychecks to reflect the value of the MCC's, then the benefits of the MCC's can be enjoyed monthly. However, if the borrower is unable to make such an arrangement, then the borrower will only see the value of participation in the MCC program at the end of the tax year.

It can be argued that this is a problem only for the first year during which a household participates in the MCC program. Assuming no reduction in the household's income tax withholding, the household must make full, market rate payments on the home loan during the first year but will receive an income tax refund at the end of the year. This income tax refund can be saved and used to pay part of each monthly loan payment during the second year. This system can continue for as long as

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[4] Ibid.

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the household participates in the MCC program. In this convoluted manner, the MCC program can be viewed as offering the same subsidies to the program participants as the MRB program alternative except for the first year. The difference is that the MRB program lowers the actual monthly payment while the MCC program lowers the payment though a rebate after the fact.

Housing affordability problems stem not only from an inability of a household to afford the monthly payments but from an inability of a household to amass the savings necessary to meet equity and closing cost requirements. Often, needy households are making monthly rental payments that are comparable to the monthly carrying costs of buying a home; they simply cannot save enough money to make the down payment. As a result, the biggest barrier to affordability is the down payment [Apgar, DiPasquale, McArdle and Olson, 1989, p. 1]. It is in this area that the MCC program is inferior to its alternative, the MRB program.

The MCC program as practiced in Kansas imposes a 2 percent fee payable at closing adding a significant cost to the borrower. On a typical $50,000 home this means $1,000 that the prospective program participant must raise in addition to the other equity, loan origination and insurance costs payable at closing. The proponents of the MCC program argue that the fee is less than the typical credit amount received by the program participant at the end of the first year.[5] But this provides little comfort to the borrowers, as they must have the funds prior to closing, and it is very unlikely that a lender would loan against the ultimate reduction of income taxes advancing the needed funds to a buyer.

As such, the MCC program further exacerbates the housing affordability problems of low or moderate income households by not only failing to lower the before tax monthly payments but by increasing the amount of money that must be saved before the home can be purchased. The MRB program, by comparison, can actually improve both aspects of this problem. It has a clear advantage in that it lowers the monthly payments, but it can also lower the closing costs to the borrower. Typically,

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[5] This argument is made in a promotional brochure prepared and circulated by the MCC program administrator.

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some fees are charged with MRB programs, but rarely do they require that all fees be paid at closing. An MRB sponsor can structure the program to permit high loan-to-value ratios and to finance any fees over time rather than requiring them up front.

CONCLUSION AND POLICY IMPLICATIONS

If the goal of the MCC program is to make home ownership affordable to households who are not otherwise able to purchase a home, then the MCC approach is poorly designed. Borrowers are unable to lower monthly payments, at least in the first year, and they may confront additional closing costs making even greater demands upon the savings of these low and moderate income households. Assuming that lenders will demonstrate an understandable reluctance to recognize MCC's as an increase in income, the only borrowers who are able to leverage a loan are those households who would qualify for the loan in the absence of the MCC program, making it unnecessary in terms of bringing the borrower into home ownership.

If the goal of the MCC program is to lower the burden of housing costs upon the income of needy households, the MCC program works, but in a manner that is poorly suited to what is needed. The MCC eligible household, like any first-time home buyer, faces the greatest budget strain during the first year of ownership. It is during the first year that the ratio of home payments to income will be highest. After the first year, the household's income should increase while the house payments will be adjusted only for escrow payments; the principle and interest payments will stay the same reducing the pressure on the family budget. However, it is during this first year that the MCC program provides no assistance. The typical participating householder receives no assistance until after filing their income tax return and will often have no savings to fall back upon as they have used all of their savings to meet the closing costs when buying the home.

This examination of the MCC program suggests that states think long and hard before foregoing their ability to issue MRB's in order to utilize the MCC program. At the very minimum, the experience

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suggests that the MCC program has the advantage of being administratively easy to implement, especially if administered at the state level rather than being decentralized to the local level. It also suggests that states should consider bearing the costs of MCC program administration rather than passing the costs along to the program participants. It is apparent that the staff time and effort to run the program is minimal and could easily be absorbed by a state agency already geared up to administer housing programs. Compared to the federal contribution through foregone taxes, the costs of administering the program is very small. Absorbing these administrative costs would eliminate one form of hardship that the MCC program places upon the program participants. Finally, the experience with the MCC program suggests that the program administrators should promote to the program in such a way that it encourages lenders to offer the best possible terms to the borrowers. As the program participants will confront difficulties in meeting the closing costs, the program administrators should call for financing closing costs wherever possible. To induce lenders toward this end, the program may want to give preferential treatment to loans offered with no points and only minimal origination fees.

The mortgage credit certificate program does provide an option for states to consider when they survey the range of available housing affordability programs. The program is attractive to the federal government as it saves some money. It is even more attractive to state and local governments given its administrative simplicity and low costs. These attributes should not cause states to unnecessarily adopt the program without first adopting administrative procedures designed to provide the maximum amount of assistance possible to the needy households that the program is intended to serve.

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Submitted to the Senate Committee on Economic Development
April 8, 1992

Christopher Imming, Community Investment Officer
Federal Home Loan Bank of Topeka

The purpose of this testimony is to provide information to the committee about the Federal Home Loan Bank of Topeka's affordable housing efforts and its involvement with two of the state housing finance programs involved in mortgage revenue bond financing within its district. As you know from previous testimony submitted to this committee earlier in this session, the Federal Home Loan Bank of Topeka administers two housing programs targeted specifically for low- and moderate income residents of its district, which includes Kansas, Colorado, Nebraska and Oklahoma. These programs are offered through approximately 150 member financial institutions located in those states. In addition to funding low-income housing efforts in the district, the Bank also provides a wide range of credit products and correspondent banking services to assist lenders with their housing finance needs.

The Community Investment Program (CIP) which makes low-cost funds available to members involved in financing housing projects targeted to households with incomes at or below 115 percent of area median income has resulted in a total of $225 million in CIP loans to assist in financing more than 6,000 housing units for low- and moderate-income households.

The CIP has enabled members to provide financing through the Nebraska Mortgage Revenue Bond Program at lower than market rates to first-time home buyers in all parts of the State of Nebraska. A portion of these loans ($18 million) were provided at an even lower rate (6 percent) than normal bond program rates (7.5-8.5 percent) to lower income first-time home buyers over the past two years. The state wide availability of the mortgage revenue bond program in Nebraska has enabled first time homebuyers in all areas of the state to benefit from bond financing programs.

The second program administered by the Bank is the Affordable Housing Program (AHP), which provides below market-rate loans and direct subsidies for low-income housing projects. In the first two years of the program, the Bank has provided $8.8 million in subsidy funds to 47 projects in its four-state district. The 47 projects involve 3,068 housing units with a total development cost of approximately $56 million. Eight of those projects, utilizing approximately $1.7 million in approved AHP subsidy, have been approved in Kansas. None of the Kansas projects have involved

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mortgage revenue bond financing.

Many of the approved projects involve various federal, state and local housing programs, including mortgage revenue bonds, as components of the financing package necessary to make them feasible for low-income housing.

Within this district the Colorado Housing and Finance Authority (CHFA) has been very active in its support and promotion of affordable housing programs in the state, including its use of mortgage revenue bond financing.

For example, CHFA has initiated and developed several low-income multi-family rental projects. The agency has undertaken the acquisition and rehabilitation of several hundred units of existing housing previously owned by the Resolution Trust Corporation. Upon completion the agency has transferred the ownership and management of these projects to local non-profit housing groups. Financing for these projects also involved significant levels of permanent, long-term, lower cost loans from CHFA to the local housing groups.

Another example of CHFA's involvement in facilitating and financing affordable housing is located in a more rural community. CHFA has coordinated a project to construct a new apartment project in a smaller community located near a newly constructed prison. The agency will construct the project on a turn key basis for the local housing authority. Kansas communities affected by the construction of similar facilities could benefit from the type of initiative provided in Colorado by CHFA, a statewide housing finance resource which is accessible to all communities.

The availability of the statewide financing resource available from CHFA and NIFA is only one part of the reason that those resources have been effective in promoting affordable housing. In addition to the authorization of the financing tools necessary to promote affordable housing, these agencies must have the commitment of state government and the persons appointed to direct such programs. The success of the statewide financing effort in Colorado is attributable not only to the resources they have available but just as importantly, to the professional, committed and experienced people that staff and administer these programs.

THE UNIVERSITY OF KANSAS

Graduate Program in Urban Planning

April 7, 1992

TO: Committee on Economic Development of the Kansas Senate

FROM: Kirk McClure

RE: **H.B. 2918, Mortgage Revenue Bond Authority for K.D.F.A.**

Administration of affordable housing programs is most efficient when administered by a state agency because:

> **Public agencies avoid the excessive fees charged by private operators,**
>
> **Public agencies serve the entire eligible population while private operators serve the least needy,**
>
> **Public agencies facilitate efficient allocation of resources among programs.**

Thank you for the opportunity to offer testimony in support of H.B. 2918, a much needed piece of legislation to assist the housing needs of Kansas families confronting great difficulties in their efforts to find affordable housing.

At issue with this legislation is selection of the best mechanism for the administration of mortgage revenue bond (MRB) programs and other related programs such as mortgage credit certificate (MCC) programs. The state of Kansas has avoided the creation of a state housing finance agency or an independent department of housing to administer these programs. Rather, the state has relied upon administration by private underwriters working under the sponsorship of various city and county governments linked through inter-local agreements.

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Monitoring Program Operation: Private Operators Serve the Least Needy

The administration of any public sector program requires that a variety of decisions to be made concerning the program's eligibility requirements and the amounts of subsidy to be granted to each participant. Administration by a variety of private and public entities has led to less than the best program implementation. Private administrators will often seek out the least needy among eligible households. They have often established program subsidy levels so as to allocate the available subsidy to fewest number of households possible, minimizing their work but reaching out to far fewer needy Kansas families than would otherwise have been the case.

State administration assures that the program guidelines will be devised so as to make the program as effective as possible. State administrators are much more likely to strive for better geographic distribution of the program benefits and better matching of subsidy levels to the needs of eligible households. State administration also provides for greater scrutiny of administrative procedures, permitting constant revision and improvement where deficiencies are found.

Allocating Resources: Public Operation Allows for Efficient Allocation

Market conditions change with time altering the desirable mix of programs and the terms under which these programs are offered. Centralized state administration of these programs will facilitate greater responsiveness to the needs of low and moderate income families. For example, when the spread narrows between the market rate for conventional mortgage loans and the end rate charged to households using MRB funds, MRB's may not be an effective subsidy mechanism. Such a condition makes the MCC alternative preferable. When the spread is ample, MRB's may be preferred. However, depending upon lender acceptance, the MRB program can be designed to reach specific types of need. MRB allocations can favor those lenders that are granting high loan-to-value ratios so as to assist the most needy.

This type of quick response to changing economic circumstances and detailed response to particular needs can only be accomplished through centralized, state administration.

I would like to briefly summarize the findings of research performed by myself an others addressing the administration of housing programs. This research leads to the conclusion that administration of these programs at the state level, by a state agency will result in the greatest program effectiveness.

This research examines how well MRB and MCC programs have served the intended population as well as a long list of other related issues. Others have addressed the dollar savings in the costs of issuing bonds at the state level versus at the local level. As such, I will summarize just a few other issue areas that are important to this bill. These include: assessing fees, monitoring program operation, and allocating resources between programs.

Assessing Fees: Private Operators Charge Excessive Fees

We have learned in Kansas that administrators are tempted to assess the highest fees permitted when implementing these programs. This is especially true with private firms employed to run these programs under the sponsorship of local governments. Recently, private underwriters administering the Kansas MCC program charged low and moderate income first-time home buyers a fee equal to 2 percent of their home loan amount in order to participate in MCC program. This averaged over $1,000 per household, an amount far in excess of the actual costs of administering the program and an amount that placed an additional burden upon first-time home buyers. North Carolina runs a virtually identical program at the state level, charges only $125 per household, and finds this amount sufficient to cover the costs of program operation.

Charging fees to low and moderate income households is to be avoided whenever possible. Where program costs cannot be absorbed by the state, fees charged to cover costs should be kept as low as possible minimizing the hardship that they place upon the families these programs are designed to assist. State administration permits greater scrutiny of the fee structure and ultimately greater fairness.

CITY OF KANSAS CITY, KANSAS

Finance Director's Office
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April 8, 1992

The Honorable Dave Kerr
Members of the Senate Economic Development Committee
Capitol Building, Room 123-S
Topeka, KS 66612

HOUSE BILL 2918

Senator Kerr and Members of the Senate Economic Development Committee,

I am appearing today in opposition to House Bill 2918 as this bill will restrict the ability of local units of government to issue Single Family Mortgage Revenue Bonds and it will be costly to the state financially, as well as to homeowners needing the lowest mortgage rates possible. We feel that it is critical that local units of government are able issue low interest financing to homeowners and be able to manage the uses of funds for their residents. The Mortgage Revenue Bonds which have been issued by our city as well as other local entities have been successful in funding housing programs across the state. These programs have stimulated housing activity and provided a means of financing for families who could not of otherwise been able to afford homes. My point being that the Mortgage Revenue Bond system we now have is working, thus, "if the patient is not ill why treat him."

Proponents of this measure claim it will be less expensive to fund a Mortgage Revenue Bond program at the state level than it is locally. This assertion is based on the experience that states which started programs years ago are now successfully being funded at the state level, however we must realize that early Mortgage Revenue Bond programs utilized surplus funds to help offset their start-up cost, a fund which can no longer be utilized. To compare these states to Kansas is not practical and we must face the fact that starting a new state bureaucracy under the guidelines of today's Mortgage Revenue Bond programs will cost the state money. Thus, new state bureaucracy should not be created absent demonstration of need, and in this instance no need has been demonstrated.

I urge you to critically review this bill with the knowledge that the system it will change is now working and meeting the needs of Kansans.

Respectfully Submitted,

Nancy L. Zielke

Nancy L. Zielke,
Director of Finance/Budget Director
City of Kansas City, Kansas

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PROPOSAL FOR REVISION

Of The

KANSAS BASIC ENTERPRISE PROGRAM

By

The Institute for Economic Development
Pittsburg State University

The Huck Boyd National Institute for Rural Development recently completed a study entitled "Rural Kansas: An Agenda For The Future". The study determined that the State of Kansas should strengthen the ability of rural communities to support those who want to live and/or work in a rural area. To accomplish this, certain key issues would need to be addressed, one of which is the need for available capital. Of particular importance is business financing for micro-businesses which are the backbone of rural Kansas communities. Most of these small operations are not eligible for state or federal financing, do not meet the criteria of local economic loan programs, and are too risky for conventional lenders.

The Problem

Most revolving loan funds are not available to the retail and service sectors. A job creation requirement is usually imposed which precludes most businesses except manufacturing. The same issue applies to most state and federal programs. Conventional lenders are not as concerned with job creation and would like to finance these micro-businesses. However, a conservative banking climate established by state and federal regulators has tightened credit standards. Thus, many bankers do not feel comfortable making a small business loan without a guarantee from the U.S. Small Business Administration.

This poses a problem for most small business owners. The SBA has established very strict debt-to-equity requirements. Brochures distributed by the SBA clearly state that equity after the loan must be one-third to one-half of total assets. Unfortunately, many small business owners do not have equity of that magnitude. This can eliminate many good business proposals as the following example illustrates:

> A business person wants to establish a new service and retail company. The business plan is complete, the management team has years of experience in all critical areas, the product and/or service has a good market, and the pro formas, although conservative, render a healthy profit margin and cash flow. The local lending institution has performed a credit check and, after a careful analysis of the business plan, has approved the loan application contingent upon an SBA loan guarantee.
>
> The total project cost is $100,000. The business person has $10,000 to invest. The seller of certain equipment has

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taken a second mortgage for $5,000 and placed it on standby, and relatives of the business owner have also loaned $5,000 on standby. A standby loan, as defined by the SBA, is a note that pays interest only for an indefinite period of time. There is no principal reduction and the lender cannot demand repayment. The loan remains on standby until either the SBA loan is paid in full or the SBA allows the standby agreement to be rescinded. As long as the loan is on standby, the SBA views it as equity. This is because the standby has many of the characteristics of preferred stock. Yet it is important to note there is no ownership involvement.

By placing those loans on standby, the equity according to SBA guidelines is $20,000. Unfortunately, the business would normally need at least $30,000 of equity in a $100,000 project to qualify for an SBA loan. This business, one which might have been very successful, will never open due to the partial lack of equity.

This scenario is frequently repeated throughout Kansas, not only in rural areas but also in cities. There is a great need for small equity injections in micro-businesses in order to leverage larger amounts of federal loan dollars. This would primarily benefit service, retail and small manufacturing concerns that do not normally qualify for venture capital funds.

Venture capital is usually directed to high-technology firms with tremendous growth potential. Additionally, venture capitalists prefer equity injections of at least $250,000 - $300,000. This is not the type of financing that most small businesses require. Usually, micro-businesses only lack small amounts of gap equity ranging from several thousand dollars to less than $50,000.

The State of Kansas has a seed capital program, but the use of monies from that program has been restricted to business plans, prototype development, and marketing studies. These businesses have developed beyond that stage. What is needed is equity financing.

There are numerous local economic development organizations throughout the state with available funds. However, those loans must normally be repaid on an amortized basis, be tied to job creation, and collateralized with fixed assets. Boards governing those agencies are in a stewardship position and cannot place those funds at risk.

The Proposal

The following proposal would address this problem. The Kansas Basic Enterprise Program (KBEP), already authorized by the Kansas legislature, would be capitalized with a minimum $1.0 million dollar appropriation from the state lottery (EDIF) fund. With the benefit of a few changes, the program could be implemented by the Kansas Development Finance Authority (KDFA). The funds

would serve as quasi-equity and leverage at least $4.6 million, and most likely $6 - $7 million, of additional financing. The program would be available throughout the state and, although directed to rural areas, could benefit small urban enterprises.

The primary amendments to the existing statute would include:

1) Broadening the definition of basic enterprise to include the service and retail sectors. Possibly the name could be changed to the Kansas Business Enterprise Program.

2) Utilizing the fund, in conjunction with other governmental loan guarantee programs, to guarantee standby loans as defined by the SBA.

3) Limiting the percentage of a financing package that can be guaranteed by KBEP funds to no more than eighteen percent (18%) of the total. Presently, it is conceivable that ninety percent (90%) of a financing package can be guaranteed with KBEP funds. This severely limits the amount of additional financing that can be leveraged from private sources.

The revised KBEP would be utilized in the following manner. A loan application approved by a lending institution could be submitted to the SBA with a KDFA financing provision. If the application met all the SBA's loan approval standards with the exception of required equity, then KDFA could use KBEP funds to guarantee a separate loan made to the small business. As the loan would be guaranteed, it could be placed on standby and thus serve as equity for the SBA. The standby loan could be made by either the lending institution or a local economic development group.

Bank officials have indicated that non-amortized debt without a demand feature would be allowed by regulators if it was substantially guaranteed by state funds. Similarly, local revolving loan funds guaranteed by the KBEP program would not be at risk and would not place the board's stewardship in jeopardy.

The KBEP funds would remain under the control of a state agency. The funds would continue to earn interest as they normally would. They would simply be pledged as collateral.

The guarantees would be systematically released so the KBEP funds could support other loans. Thus, a state-wide revolving loan fund would be established. To accomplish this, each firm participating in the program would agree to escrow two percent (2%) of net sales on a quarterly basis. The escrow account, in the firm's name, would be pledged as collateral for the standby note. As the escrow account builds, a similar amount of the KBEP guarantee would be released. As an alternative, the KBEP guarantee could be released in one thousand dollar ($1,000) increments.

With the unencumbered funds, the Kansas Development Finance Authority would be able to repeat the process and provide additional equity financing for other small businesses.

The escrowed funds (held in the name of the business) would not be an expense, so the escrow would not affect the company's income statement. The escrow of cash would only serve to strengthen the balance sheet. The standby note, with no principal reduction, would not be affected by the escrow. Hence, there would be no violation of SBA policy. The company would only be encumbering money. However, the SBA would probably stipulate in its loan authorization that no funds could be escrowed during any time the company is behind on its SBA loan payment.

Neither the State of Kansas nor the Kansas Development Finance Authority would have any legal involvement or ownership in the companies. The state would merely be providing a financing vehicle for small business.

KDFA would not have to make the credit decision or administer the loan. That would be handled by the local lending institution and the SBA. Neither would KDFA have to liquidate the firm if the company failed. That would also be handled by the SBA and the local lending institution. The state's only involvement would be the pledging of collateral. However, it should be clearly stated that the Kansas EDIF funds allocated to this project would be AT RISK.

Certain rules would apply to the loan participation program as follows:

1) The KBEP funds would be utilized in conjunction with SBA loan programs on a first come, first served basis.

2) The owner(s) must contribute a minimum of ten percent (10%) of the total project as equity. No more than twenty percent (20%) of the total project can be financed through a standby note.

3) The percentage of KBEP guarantee placed on the standby loan should not exceed the percentage of SBA guarantee. If an SBA 504 loan is utilized, in which there is no SBA guarantee, the KBEP percentage should not exceed 85%.

4) No more than ninety percent (90%) of the standby note can be guaranteed with KBEP funds. This would limit KBEP involvement in the total project to no more than eighteen percent (18%). The maximum KBEP participation would be fifty thousand dollars ($50,000) and the minimum would be one thousand dollars ($1,000).

5) KBEP funds would not be allowed for loan authorizations issued by SBA Preferred Lenders, urban banks able to make credit decisions and loan guarantees in-house. Only loans authorized by the SBA District offices in Kansas City and Wichita would be eligible. Thus, SBA Preferred Lenders would not be able to participate in the KBEP unless the loans were forwarded to the respective district office for approval.

6) Certified Development Companies (CDCs), non-profit financing organizations certified by the SBA and funded by the state, would either package or review each loan application prior to its submission to the SBA. This would allow the CDC to ascertain that no other financing source is available and the KBEP request is for the minimum required amount.

7) Other governmental loan guarantee programs, such as the Farmers Home Administration's Business & Industry loan, could be utilized in lieu of the SBA if all the guidelines were met. This would pertain particularly to credit analysis and approval, loan servicing, liquidation, and the use of standby loans.

8) The standby loans issued by the local lending institutions or economic development groups would need to clearly state the terms and conditions of the note. The stated interest rate, either fixed or variable, should not exceed the New York Prime rate plus two percent (2%). This slight reduction in interest would clearly benefit the company during its start-up or expansion.

9) Interest earned on KBEP funds would be used to recapitalize the fund.

10) An initial loan collateralization fee of five percent (5%) would be assessed on the amount of KBEP funds pledged by KDFA. Additionally, an annual fee of two percent (2%) would be charged on KBEP funds still pledged at the end of each year, based on the year's ending balance. There would be a minimum loan collateralization fee of two hundred dollars ($200) and a minimum annual fee of fifty dollars ($50). The fees would be a modest amount for the business owner to pay in return for KDFA providing necessary equity financing. This is especially true when one considers the rates of return being requested by venture capital firms.

The loan collateralization fees would be used to recapitalize the fund and/or provide administrative support for the program. The Kansas Development Finance Authority would administer this program. The KDFA has been successfully administering the Kansas Beginning Farmers Program, where it works with a sizeable network of rural lenders in all areas of the state. It is suggested that similar prodedures be adopted for this program.

In the prior example of the small business lacking equity funds, the program could be utilized as follows:

Source of equity:		
Owner equity injection	$ 10,000	(10% of total project)
Seller/relative standby	10,000	
Bank standby	10,000	(Guaranteed with $9,000 of KBEP funds)
Total equity:	$ 30,000	
SBA loan:	$ 70,000	(90% guarantee)
TOTAL PROJECT COST:	$100,000	

KBEP funds, representing 9% of the total project, would leverage a $91,000 private investment. The business would have to pay an initial $450 loan collateralization fee and up to $180 per year thereafter.

Conclusion

The loan participation program outlined above is an innovative financing plan which has not been implemented anywhere else in the United States. The program, if enacted, would be the first state loan program for small business. All other programs in the state are conduits using federal money, which increasingly has become more restrictive and less available. Through this program, Kansas would move to the foreground of small business economic development. One of Kansas' economic goals is to enhance the business environment in rural areas, and a program which augments the start-up or expansion of micro-businesses will help accomplish that goal.

Financial capital has been identified by Kansas, Inc. and the Institute for Public Policy and Business Research at the University of Kansas as one of the seven foundations of economic development. As such, the state has asked for strategies to target assistance to entrepreneurs and micro-businesses, and to develop and/or encourage use of loan guarantee programs through the state and agencies such as the Small Business Administration. The proposed capitalization and revision of the Kansas Basic Enterprise Program will meet that challenge and address those needs.

According to the recent study completed by the Huck Boyd Institute, more than 95 percent of all respondents of the Kansas Rural Issues Poll strongly support economic development in general. More than 87 percent support the use of local funds for economic development. Thus, it could be concluded that legislation appropriating funds to the Kansas Basic Enterprise Program would be met with acceptance by Kansans throughout the state.

Note: The $1.0 million appropriation should be confined solely to Item B, Page 6 which pertains to the above outlined loan participation program.

KANSAS

KANSAS DEVELOPMENT FINANCE AUTHORITY

Joan Finney
Governor

Wm. F. Caton
President

MEMORANDUM

DATE: April 8, 1992

TO: Senate Economic Development Committee

FROM: Marty Bloomquist, Program Manager
Kansas Development Finance Authority

SUBJECT: Testimony on House Bill 3163 - Concerning the Kansas Development Finance Authority - Establishing a Standby Loan Participation Program for Kansas Businesses

This bill amends the "powers" section of KDFA's enabling legislation. Language has been added that expand's the authority's current ability under the Kansas Basic Enterprises Loan Program (KBEP) to include a standby loan participation program for Kansas Retail and Service businesses to be used with direct loan or loan guarantee programs be they private (ie. conventional bank loans), federal (ie. SBA) or state. The total amount of one or more standby guarantees for any project would not exceed $50,000.

This loan program would make up the difference between the borrower's equity, which has to be at least 10% of the project, and the amount of the project that the lender will loan with or without a guarantee. This type of program is often called "GAP" financing.

The Certified Development Companies (CDC's) brought this concept to KDFA, the Kansas Banker's Association, Kansas Inc. and the Department of Commerce for discussion last summer. Throughout the past few months, many of the aforementioned parties have assisted the CDC's in further development of the idea. This idea was developed as a result of the increasingly restrictive equity requirements on SBA direct loans and loan guarantees. The CDC'c around the state work with businesses and lenders to package loan and loan guarantee programs, including SBA loans and loan guarantees.

Attachment 15
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Sen. Eco. Dev.

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It is anticipated that KDFA would administer this program using a "letter of credit" (LOC) approach. It is envisioned that money would not leave the standby loan fund, but instead an LOC would be placed with the lender. All credit analysis would be handled between the CDC and the lender. KDFA would have an application that would have certifications by the lender, borrower, and perhaps the CDC. The purpose of the KDFA application would be assurance that the conditions of the statute and other conditions of the authority would be met. KDFA would execute a standby loan agreement with the borrower. The borrower would contribute money to a fund set up with the lender until there was a sufficient amount to release the LOC. The LOC would not be drawn from the fund unless there was a default by the borrower and all other remedies of default had been exercised.

This bill would expand KDFA's current authority in the area of business finance. KDFA already has a statewide loan program network of over 60 rural lenders as part of its Beginning Farmer Loan Program that is allowed by the Federal Tax Codes. Attached is a map showing the locations around the state where KDFA has worked with lenders to close Beginning Farmer Loans.

KDFA would need to charge a modest application fee and some sort of small administrative fee to the borrower for the use of the letter of credit. Like it's other programs and projects, KDFA has been able to hold costs down on its projects and programs by competitively selecting all finance professionals involved.

MB:bhs

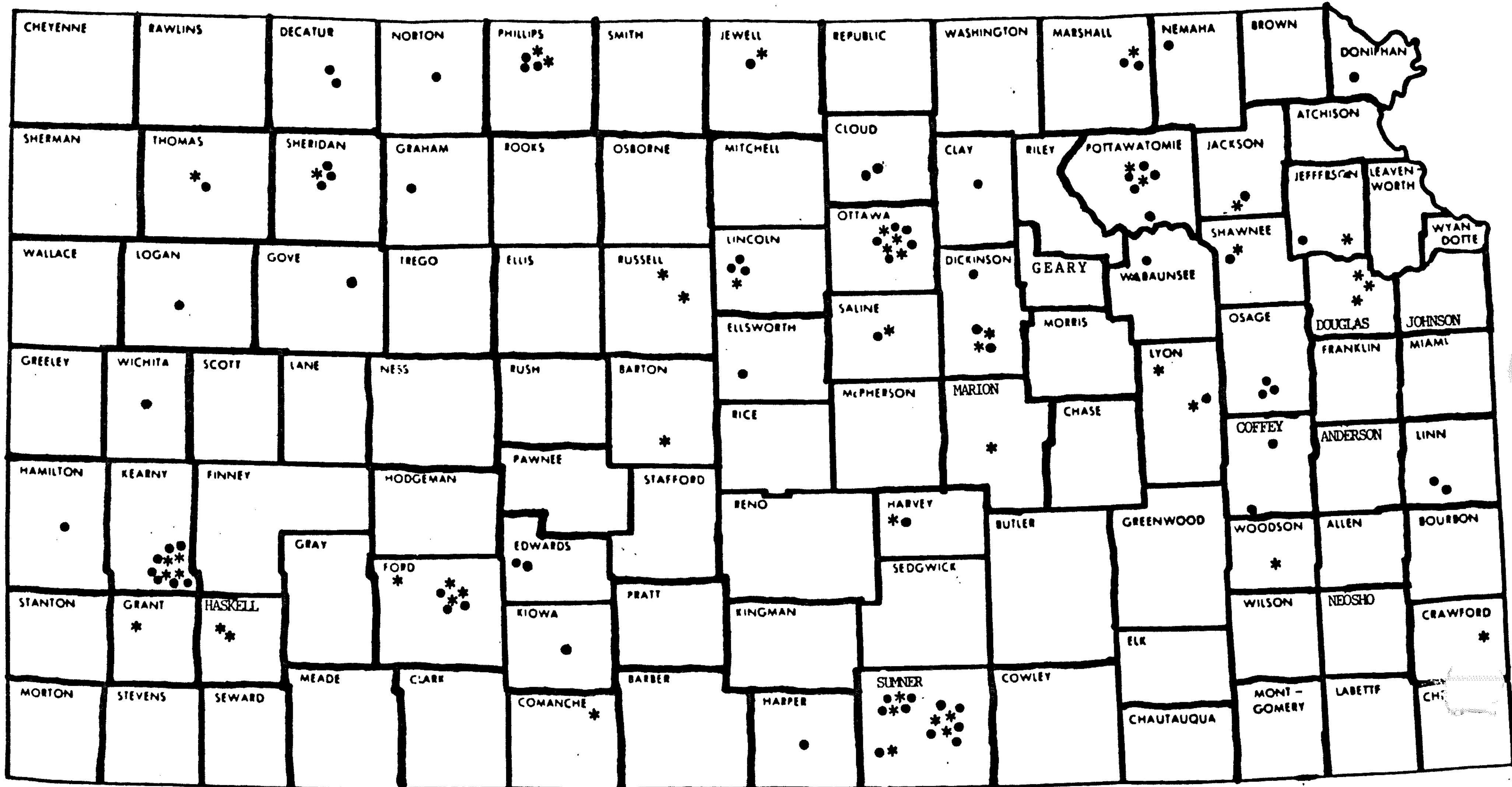
Attachment

cc: Wm. F. Caton
Acting President, KDFA

KANSAS DEVELOPMENT FINANCE AUTHORITY

BEGINNING FARMER LOAN PROGRAM

Location of Participants – Loans Closed June 1990 through December 1991



* Loans Closed June 1990 through December 1990

● Loans Closed January 1991 through December 1991

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