Approved: January 22, 2004

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Chairman Kenny Wilk at 3:30 p.m. on January 20, 2004, in Room 526-S of the Capitol.

All members were present except:

Committee staff present: Kathie Sparks, Office of Legislative Research
Susan Kannarr, Office of Legislative Research
Renae Jefferies, Office of Revisor of Statutes
Helen Pedigo, Office of Revisor of Statutes
Fulva Seufert, Committee Secretary

Conferees appearing before the committee: Stephen R. Weatherford, President, Kansas Development Finance Authority (KDFA)
Matt Goddard, Vice President, Heartland Community Bankers Association (HCBA)

Others attending: See attached list

Chairman Wilk called the meeting to order at 3:30 p.m. and announced that William Keeton , Vice President of Research, Federal Reserve Bank, will be presenting at the Senate Commerce Committee on Wednesday, January 21, 2004, at 8:30 a.m. and in the Senate Ways and Means Committee at 11:00 a.m. Chairman Wilk strongly recommended members to attend if possible. He also announced there would be a Joint meeting of Tourism and Parks Committee in Room 241-N at 3:30 p.m., Wednesday, January 28, 2004. This will be an overview of Bureau of Traffic Engineering presented by the following KDOT personnel: David Church, Bureau Chief of Traffic Engineers; Linda Voss, State Traffic Engineer; and Robert Ott, Coordinator Management.

Chairman Wilk then asked the committee members to direct their attention to **SB 222**.

SB 222 - Authorizing the Kansas Development Finance Authority to issue mortgage revenue bonds.

The Chair said that the committee would not be working the bill today, but Kathie Sparks, Legislative Research, would be briefing members and that he had invited Steve Weatherford and Matt Goddard to each speak for about twenty minutes to refresh the committee's memories.

Chairman Wilk recognized Kathie Sparks who reviewed **SB 222**. She said that several days of hearings were held last year on **HB 2395** (House version) and **HB 2373** (amendment), so it was not necessary to have another day of hearings. Ms. Sparks spoke to all the components of **SB 222**, and after some discussion, members also got up to speed on the following bills that had hearings in 2003:

HB 2373 - Amending Kansas Development Finance Authority to allow loans directly to individuals to finance housing developments.

HB 2395 - Authorizing the Kansas Development Finance Authority to issue mortgage revenue bonds.

In 2003, the Senate Commerce Committee and the Senate of the Whole made several modifications to **SB 222**. Ms. Sparks explained all these modifications. Chairman Wilk thanked Ms. Sparks and welcomed Mr. Steve Weatherford, a proponent of **SB 222** who said he could shed some additional light on **HB 2373** and **HB 2395**. He said **HB 2373** was a bill offered by Rep. Flora to add the word moderate, and that **HB 2395** was the bill the committee held hearings on for several days last session and that all the Senate amendments were discussed in the testimony on **HB 2395.**

Mr. Weatherford addressed the following key provisions of **SB 222:**

- Bonding Authority
- Partnership with Mortgage Lenders
- Down Payment Assistance
- Rural Set Aside
- Continuous Lending
- Loan by Loan Reservation
- Current MRB Program Protected
- Earnings Reinvested in Housing (Attachment 1)

During discussion, questions concerning the average sale price and sales price restriction for first time home buyers were answered.

Chairman Wilk thanked Mr. Weatherford and welcomed Mr. Matt Goddard, Vice President, Heartland Community Bankers Association (HCBA), who said he appreciated the opportunity to review with the committee their opposition to **SB 222**. He, too, said the bill was very similar to **HB 2395** and specifically spoke to the changing times in the mortgage industry and the financing mechanisms that are currently available to the public for home buying. He stressed that financing is much different today than it was when most state bond programs were created. He also stated that the HCBA does not believe that moderate-income Kansans are being under served by mortgage lenders. He believes the KDFA would become a competitor of the private sector and would have too much power. Mr. Goddard said that "a Secretary of Commerce could decide that all bond programs should be administered through KDFA and thus, decide not to allocate any additional bond authority for local programs." This could result in a slow death for those programs which would affect local communities who could no longer create their own bond programs to address specific local needs. He summarized the provisions in the bill concerning the geographic distribution of loans and the actual need for affordable housing. In conclusion, Mr. Goddard said that **SB 222** would make KDFA one of the largest mortgage lenders in Kansas and they would be competing for customers who are already being served by private, tax paying businesses. (Attachment 2)

Chairman Wilk then opened the meeting for committee members to address questions to either Mr. Weatherford or Mr. Goddard. Mr. Weatherford was asked when the KDFA determined the need for the Kansas Housing Resource Corporation. He said it was created as a result of the Governor's reorganization order issued in the 2003 Legislature, and that the Department of Commerce Housing Division falls under all the same requirements as the Department of Commerce. In answer to another question, Mr. Weatherford explained that KDFA was fee funded and does not receive any general funds for its operation. He also said there is no statewide housing program if there is a lender in an area that has purchased a commitment. Rep. Krehbiel asked specifically about the subsection on page 7, line 20 of the bill and commented that it provided the KDFA with a huge advantage.

Chairman Wilk commented that **SB 222** is a very complex bill that the committee will eventually work, but requested that the two parties find some common ground before the committee considers this important public policy. He thanked Mr. Weatherford, Mr. Goddard, and Ms. Kathie Sparks for their informative briefings.

Representative Krehbiel made a motion to approve the minutes of the January 13, 2004 meeting, and Representative Kuether seconded. Minutes were approved. The meeting adjourned at 5:00 p.m.

HOUSE ECONOMIC DEVELOPMENT COMMITTEE
GUEST LIST
DATE: ~~Thursday~~ Tuesday, January ~~15~~ 20, 2004

NAME	REPRESENTING
Larry R. Baer	LKM
Paul Johnson	PACK
Martha Jean Smith	KMHA
ED JASKINIA	TALK
Megan Dunn	Hein Law Firm
Chuck Stones	Ks Bankers Assn
Christine Crieter	Federico Consulting
Barb Hinton	Post Audit

TESTIMONY OF KANSAS DEVELOPMENT FINANCE AUTHORITY TO THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE PRESENTED BY KDFA PRESIDENT STEPHEN R. WEATHERFORD REGARDING SENATE BILL NO. 222

JANUARY 20, 2004

KANSAS STATEWIDE HOMEOWNERSHIP PROGRAM

Federal Resources - The federal government allocates mortgage revenue bond resources to the states to provide homeownership opportunities to low and moderate-income families.

No State Tax Dollars The federal regulations permit recovery of all expenses necessary for the administration of this program. No additional burden will be placed on the state general fund.

Statewide Program Loan by loan reservations, rural set a side requirements and continuous lending features ensures that <u>ALL</u> Kansas families have access to these resources

KEY PROVISIONS OF SENATE BILL NO. 222

- **Bonding Authority -** Authorizes KDFA to issue Mortgage Revenue Bonds (MRB's) for the purpose of assisting low and moderate-income homebuyers.

- **Partnership with Mortgage Lenders** – Our Statewide Homeownership program will purchase first mortgage loans originated by hometown mortgage lenders participating in the program (No direct first mortgage lending).

- **Down Payment Assistance -** Second mortgage loans will be provided directly to homebuyers to finance down payment and closing cost assistance.

- **Rural Set Aside** – Twenty per cent (20%) of all new money bond proceeds will be reserved for ninety (90) days to purchase first mortgage loans from rural areas of the State. The ninety (90) day period provides easier access to mortgage funds for rural mortgage lenders.

- **Continuous Lending** – Established lines of credit will allow mortgage loans originated by hometown mortgage lenders to be purchased at any time during the year.

- **Loan by Loan Reservation** – Allowing mortgage lenders to reserve funds after they have taken the borrowers application will encourage more lenders to participate in the Statewide Homeownership program. The Counties MRB program requires lenders to purchase large blocks of funds exposing them to capital risk if they are unable to originate.

- **Current MRB Program Protected -** Permits the continued operation of single-family MRB programs by Sedgwick and Shawnee counties.

- **Earnings Reinvested in Housing -** Requires income received by KDFA from our Statewide Homeownership Program to be used to support affordable housing programs.

House Economic Development
1-20-2004
Attachment 1

HEARTLAND COMMUNITY BANKERS ASSOCIATION

Matthew S. Goddard, Vice President

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To: House Committee on Economic Development

From: Matt Goddard
Heartland Community Bankers Association

Date: January 20, 2004

Re: Senate Bill 222

The Heartland Community Bankers Association appreciates the opportunity to appear before the House Committee on Economic Development to review our opposition to Senate Bill 222. The bill is very similar to House Bill 2395, which this committee held hearings on last year.

The Heartland Community Bankers Association represents thrifts in Kansas, Colorado, Nebraska and Oklahoma. Our members specialize in residential mortgage lending. Kansas thrifts made more than $2.4 billion in residential mortgage loans in both 2001 and 2002. For the first nine months of 2003, Kansas savings associations made more than $2.1 billion in residential mortgage loans.

Senate Bill 222 authorizes the Kansas Development Finance Authority to issue mortgage revenue bonds for financing, acquiring and originating mortgage loans. HCBA remains concerned that this expansion of powers will put KDFA and the State of Kansas in the position of competing with taxpaying mortgage lenders, both directly and indirectly. For example, KDFA would use its ability to issue tax-free bonds to establish artificially low pricing for mortgage products that taxpaying businesses will be unable to match.

Changing Times

The mortgage industry is quite different today than it was most of the nation's other statewide mortgage revenue bond programs were created. HCBA is concerned that the public policy rationales for bond programs lack the same validity today that they did when they were first created. Then, interest rates were high, the secondary market was limited and funding for mortgage loans was hard to find. With mortgage rates still at near historical lows and a bustling secondary market providing funding, the historical arguments for bond programs lack validity in the current mortgage marketplace.

The financing mechanisms available to the public for home buying are also much different today than they were when most state bond programs were created. Commercial banks were not allowed to become members of the Federal Home Loan Bank system until 1990. As members, institutions are eligible for advances that provide an affordable source of funding for lenders to make loans. The Topeka bank currently has **billions** of dollars in outstanding advances to Kansas lenders. In addition, Freddie Mac and Fannie Mae, government-sponsored enterprises involved with the secondary mortgage market, each funded **billions** of dollars in mortgage loans to Kansas in 2002. The three

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major national banking trade groups – American Bankers Association, Independent Community Bankers Association and America's Community Bankers – all have secondary market programs that help low-volume lenders sell mortgage loans to Freddie and Fannie.

Are Moderate-Income Kansans Underserved?

HCBA does not believe that moderate-income Kansans are currently being underserved by mortgage lenders. According to 2002 data, mortgage lenders subject to the Home Mortgage Disclosure Act made over $4.4 **billion** in purchase mortgage loans to Kansans that year. Of that $4.4 billion, over $2.2 **billion**, or 50 percent, went to loan applicants making 115 percent or less of the area median income. During 2002 Kansans making 80 percent or less of the area median income, generally defined as low income, received over $1.04 billion in mortgage loans from HMDA lenders.

Competition

Although proponents of SB 222 talk of a partnership with private lenders, KDFA's "partnership" will cannibalize much of the business already done by taxpaying private businesses. This is the historical pattern in other states, including Georgia. A 1998 study of the Georgia Housing and Finance Authority, conducted by that state's Department of Audits, shows that:

> *"According to GHFA staff, GHFA is not the lender of last resort for most GHFA loan recipients since they tend to make enough money and have good enough credit to get loans from commercial lenders, although at higher interest rates."*

Regulations from the Internal Revenue Service require that the proceeds of a mortgage bond program be used on individuals or families making no more than 115 percent of the area median income and who have not owned their place of residence within the past three years. Depending on the applicant's location, for a one or two person household the maximum eligibility amount would range from $52,900 to $66,700. For a household of three or more, the maximum income limit would range from $60,835 to $76,705. In a targeted area, the maximum income limit is 140 percent of the area median income.

There is nothing in SB 222 to suggest that the KDFA program will target anyone beyond those customers already being served by the private sector. Since the mortgage revenue bonds must be repaid, homebuyers under the KDFA program have to meet underwriting standards similar to those already used by traditional mortgage lenders. This will create a preference within the program for moderate-income applicants.

KDFA will not focus on those Kansans who suffer from poor credit and are thus unable to qualify for mortgage financing through a private lender. There is a strong likelihood that if your loan application is denied now because of your credit, KDFA will also deny your loan. The website for the Missouri Housing Development Commission clearly states in its Frequently Asked Questions: "*Borrowers qualifying for loans under the MRB program will need to meet the same credit requirements as any other homebuyer... This is not a 'credit-repair' program.*" Other state finance agencies also share this warning. This furthers our concern that KDFA will compete with private lenders over consumers who don't need government assistance to qualify for a loan.

Loan Servicing

HCBA is also concerned that KDFA has indicated it will use a master-servicer to service all mortgage loans made with bond proceeds. In fact, Senate Bill 222 expressly allows KDFA to use an out-of-state mortgage servicer. Many savings and loans, as well as some commercial banks and manufactured home lenders, are still portfolio lenders. This means that when the institution makes a loan they service the loan themselves and do not sell the servicing rights on the secondary market. Even when they do sell the actual loan, like many commercial banks, they retain the servicing rights. This ensures that the mortgage is handled locally and the local lender is there to help if the borrower needs assistance. If KDFA uses a master servicer, however, Kansans may be forced to call XYZ Mortgage Company in New York or Florida to ask questions about their monthly mortgage payment.

A review of the websites of the 49 other state housing finance agencies shows that at least 15 states allow loan originators to also service the loans they originate. Some of those 15 states use a master servicer for those instances when the originator does not wish to retain the loan servicing. At least seven states use this "hybrid" approach. Of extreme concern to HCBA are the eight states where the housing authority does its own loan servicing "in-house." We would be very opposed to any attempt to prohibit private mortgage lenders from servicing the loans they originate so that a state agency could keep that business for itself.

Growing KDFA's Power

Most of the bonds issued by KDFA will be tax-exempt and therefore fall under IRS regulation. However, there is nothing in SB 222 that limits KDFA's bonding authority to only issue private activity bonds that fall under IRS jurisdiction. There would be no federal income or purchase price restrictions on money derived from taxable bonds. In some states, such as West Virginia, the housing finance agency issues taxable bonds and then uses those funds for loans and activities not approved by the IRS. That includes loans for current homeowners and the refinancing of existing loans.

Despite assurances from KDFA that the agency will not originate loans, Senate Bill 222 makes three separate references to the origination of home mortgage loans. Although KDFA has said it would only purchase loans from existing mortgage lenders, the definition of "home mortgage loan" includes a mortgage "...purchased or *originated by the authority*..." This is particularly disturbing because SB 222 gives KDFA the power not only to issue bonds for the purpose of acquiring loans, as would be expected, but it also gives KDFA the power to issue bonds for *originating* home mortgage loans. Finally, KDFA would write all of its own rules and regulations in respect to home mortgage loans. The bill authorizes KDFA to establish standards and requirements applicable to the purchase of home mortgage loans or the *origination* of home mortgage loans.

Senate Bill 222 also removes a prohibition against KDFA making construction loans directly to consumers. Current law says that except as otherwise provided in the subsection, "nothing in this act shall be construed to authorize the authority to make loans directly to individuals to finance housing developments." "Housing developments" is defined elsewhere in statute as new construction or rehabilitation of an existing house for elderly people or families of low income.

However, Senate Bill 222 gives KDFA the authority to also make loans for housing developments to *moderate income families*, not just those who are low income, and deletes the language that says "nothing in this act shall be construed to authorize the authority to make loans directly to individuals to finance housing developments." In its place, KDFA substituted language that prohibits the Authority from originating loans that are "in competition with private lending institutions." The bill offers no definition or other method of determining what is "in competition," so it is up to KDFA to determine for themselves when they are competing with taxpayers. HCBA supports an explicit prohibition on any **direct** originations by KDFA to Kansas consumers.

Local Mortgage Revenue Bonds

As originally drafted, Senate Bill 222 would have essentially gutted the Local Residential Housing Finance Law and put all mortgage revenue bond programs at the state level. This was because KDFA wanted to be the sole administrator of mortgage revenue bonds in Kansas. The Senate Commerce Committee amended the bill so that the current bond program administered by Sedgwick and Shawnee counties could continue.

Unfortunately, the Senate amendment does not guarantee the future viability of local mortgage revenue bond programs. Each year the Secretary of Commerce allocates the State's Private Activity Bond authority to various applicants. Nothing in current law requires the Secretary to allocate any bonding authority to local programs. A Secretary of Commerce could decide that all bond programs should be administered through KDFA and thus decide not to allocate any additional bond authority for local programs. Those programs would then begin to die a slow death. In the future, local communities would no longer have the ability to create their own bond programs to address specific local needs.

Geographic Distribution of Loans

Proponents of SB 222 continue to allege that the current bond program administered by Sedgwick and Shawnee counties fails to distribute loans across the state in an equitable manner. They cite a study conducted by a professor at the University of Kansas to back this contention.

What we see in Kansas, however, is not that different from experiences in other states. An urban area is much more likely to have a significantly greater number of first-time homebuyers than a rural county with a population of 10,000 people. Colorado, for example, has a similar distribution pattern to the one we see in Kansas. Referring to the 1998 audit in Georgia, approximately 79 percent of the 12,283 loans in GHFA's portfolio were in MSA counties while approximately 87 percent of the 2,759 loans closed since 1996 were in MSA counties.

The sudden existence of a statewide mortgage revenue bond program under the auspices of KDFA will not suddenly create a surging loan demand for first-time homebuyers in rural Kansas.

The Senate Commerce Committee amended SB 222 to require KDFA to reserve 20 percent of bond proceeds for areas outside a metropolitan statistical area for a period of 90 days following a bond issuance. However, there is no guarantee that 20 percent of the bond proceeds will actually be **used** in rural areas. This creates the same alleged problem that exists now with loans not being distributed equitably across the state. In addition, upwards of 40 percent of the Kansas population lives outside an MSA, so a 20 percent set-aside would not be representative of Kansas demographics.

Affordable Housing

A number of proponents spoke last year during the hearing on HB 2395 regarding the need for affordable housing. Unfortunately, a statewide mortgage revenue bond program will do little to bring down the cost of new home construction in high cost areas. The problem in parts of western Kansas is that it actually costs more to build a house than the house is actually worth. This predicament is not unique to Kansas. According to a 1998 background memorandum for an affordable housing study prepared by the North Dakota Legislative Council staff for the Commerce and Agriculture Committee:

> *The resolution states that the ability of rural communities to attract private home construction at an affordable price is hampered by the differential between the construction cost and the appraised value.*

Providing subsidized interest rates and downpayment assistance to homebuyers will do nothing to address the fundamental issue of high construction costs. Without doing something to bring those costs under control, they will continue to escalate in the future, possibly beyond the reach of first-time homebuyers.

Conclusion

If a statewide mortgage revenue bond program was a panacea for every housing ill facing our state, then Kansas would be the only state in the nation with housing problems. It is not. The experiences of other states suggest that the KDFA program contained in SB 222 will have only a minimal effect on those Kansans who are most in need of state assistance for housing. The housing problems confronting Kansas today will continue to persist even if SB 222 becomes law.

Senate Bill 222 will make KDFA one of the largest mortgage lenders in Kansas. KDFA's sister agency in Massachusetts is not alone in billing itself as the "State's Affordable Housing Bank." HCBA simply does not see the need for the State of Kansas to become an active player in our state's mortgage industry. Rather than dedicating itself to serving those Kansans who are currently unable to qualify for mortgage financing, the need to payback the mortgage revenue bonds means KDFA will compete for customers who are already being served by private, tax paying businesses.

The Heartland Community Bankers Association appreciates the opportunity to review our opposition regarding Senate Bill 222 with the House Committee on Economic Development.