Arizona Housing Commission
Task Force on Tax-Exempt Mortgage Financing
2001 Annual Report

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David W. Herlinger

Mr. Herlinger, who wrote the initial version of this report, has an extensive background in the area of public finance. He worked for the Colorado Housing and Finance Authority for almost 25 years as staff and executive director. Mr. Herlinger has served as the President of the National Council of State Housing Agencies and is presently a board member of that organization. He also currently serves as a member of the Board of the Federal Home Loan Bank of Topeka and the Board of Director of the Lowry Air Force Base Redevelopment Authority. He is a graduate of Colgate University, and has a Masters degree from the University of Colorado.

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A. Introduction

The Arizona Housing Commission Task Force on Tax-Exempt Mortgage Financing has been established to review and report on 1) the availability of financing for single family housing and 2) the role of the private activity bond allocation process in facilitating the availability of housing for low-to-moderate income families in all areas of Arizona.

Pursuant to Chapter 33, Laws of 1999, the Arizona Housing Commission Task Force is to issue an annual report of its activities, findings, and recommendations, including information reported to it by the Industrial Development Authorities (IDAs) in Arizona that issue tax-exempt mortgage revenue bonds (MRBs) or mortgage credit certificates (MCCs). They are the IDAs of Maricopa County, Pima County, City of Phoenix, and City of Tucson. These four IDAs are asked to report their use of Mortgage Revenue Bonds, Mortgage Credit Certificates, and Private Activity Bonds within their own jurisdictions and in the "rural areas" of the State. (Note that within the Tax-Exempt Mortgage Financing programs in Arizona, and therefore in this report, the term "rural" refers to anywhere outside of Maricopa and Pima Counties. Anywhere within Maricopa and Pima Counties is considered "urban.")

In this second annual report, the Arizona Housing Commission Task Force outlines its legislative mandate, reports on its activities during the second year, submits information received from the four IDAs, analyzes and compares information received from the IDAs, and makes certain findings and recommendations.

B. Legislative Mandate

Chapter 334, Laws of 1999, created the Arizona Housing Commission Task Force on Tax-Exempt Mortgage Financing to review the work of the four participating IDAs' housing programs. The legislation provides that the Arizona Housing Commission Task Force issue an annual report on or before August 31 of each year "of its activities, findings, and recommendations."

The annual reports shall include:

1. Information concerning the uses of private activity bonds issued by eligible corporations during the two preceding calendar years.
2. Information concerning the use of mortgage revenue bond proceeds or mortgage credit certificates issued during the preceding three calendar years, including:
    a. The dollar amount of mortgage revenue bonds and mortgage credit certificates issued.
    b. The location of the recipients of loans financed through mortgage revenue bonds.
    c. The location of the recipients of mortgage credit certificates.
    d. The dollar amount of loans and credit certificates processed by each mortgage lender or program administrator.

e. A summary of demographic information concerning the recipients of loans financed through mortgage revenue bonds or mortgage credit certificates, to the extent permitted by law.

f. A detailed schedule of the costs associated with the mortgage revenue bond program or the mortgage credit certificate program including issuance costs, program administration costs, program marketing costs, recipient fees and charges, and any other costs or charges.

The Arizona Housing Commission Task Force is also charged with making recommendations for any modifications of Title 35, Chapters 5 and 7, Arizona Revised Statutes. The legislation contemplates that such recommendations will be addressed in the interim report due August 31, 2002, and the final report due August 31, 2004.

C. Background: Mortgage Revenue Bonds, Mortgage Credit Certificates, and Private Activity Bonds

The IDAs issue Mortgage Revenue Bonds (MRBs), a form of Private Activity Bond (PAB), to help qualified Arizonans buy first homes or homes in designated target areas. MRB investors accept lower interest on these bonds because the interest earnings on the bonds is not included in the holder's adjusted gross income. The IDAs pass the interest savings on to qualified homebuyers through mortgages with below market interest rates and/or grants that can be applied for down payment or closing costs, significantly lowering home buying costs.

Except for homes in target areas, federal tax law limits MRB use to first-time homebuyers who earn no more than the greater of their statewide or area median income. (Families of three or more can earn up to 115 percent.) The cost of an MRB-financed home cannot exceed 90 percent of the average home price in its area. Borrower income and home purchase price limits are higher in strictly defined "target areas," which are areas of predominantly low income and/or chronically economically distressed and in need of affordable housing.

IDAs may elect to use a portion of their MRB authority to issue Mortgage Credit Certificates (MCCs), which provide a federal income tax credit for part of the mortgage interest qualified homebuyers pay. MCCs attempt to serve the same public purpose as MRBs.

In 1986, the Arizona Legislature established a private activity bonding authority under the provisions of a 1984 federal Deficit Reduction Act. The federal act designates each state allotment of tax-exempt private activity bonds based on population. Until 2000, the allocation was $50 per capita. Congress recently passed the federal Community Renewal Act that increases the allocation amount beginning in 2001. This year, the allocation amount is $62.50 per capita and will rise to $75 in 2002. Beginning in 2003 and thereafter, the amounts will be adjusted for inflation. (Projects financed with tax-exempt bonds must comply with the Internal Revenue Code and any applicable state laws.)

In Arizona, this formula gives the state approximately $321 million in volume cap for 2001, which is allocated to projects in categories:

- 35% for MRBs and MCCs,
- 20% for student loans,
- 15% for manufacturing facilities,
- 15% for all other private activity bonding authority uses, and

- 15% for allocation at the discretion of the Department of Commerce Director. Traditionally, the director's discretion category is allocated to manufacturing projects, if available.

Note that of the 35% allocated for MRBs and MCCs, approximately 78% is distributed between Maricopa and Pima Counties and the Cities of Phoenix and Tucson, based on population, and approximately 22% is allocated to a "rural" program for the remaining counties.

For 2002 and 2003, the following state volume cap allocations have been approved through changes in the legislation:

- 35% for MRBs and MCCs,
- 20% for student loans,
- 15% for manufacturing facilities,
- 10% for qualified multi-family residential rental projects,
- 10 % for all other private activity bonding authority uses, and
- 10% for allocation at the discretion of the Director of the Arizona Department of Commerce.

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These changes in the allocation of Private Activity Bonds (PAB) by component will revert to their 2001 percentages by 2004. The work of a legislative committee could result in further modifications in the PAB allocation.

Bonds issued to finance multi-family residential rental (apartment) projects are separate and distinct from MRBs and MCCs. For multi-family bonds to qualify as tax-exempt, at least (a) 40 percent of a building's apartments must be occupied by families with incomes of 60 percent of the area median income (AMI), or (b) 20 percent of a building's apartments must be occupied by families with incomes of 50 percent or less of AMI.

D. Recent Change in Tax-Exempt Mortgage Financing Allocation Process

Until legislative changes took effect in 2000, access to volume cap for MRB and MCC programs was subject to a lottery system under which one IDA was selected at random each year to administer the entire statewide program. Secondary lottery allocations were made during the year when funds were available. The legislative changes that took effect in 2000 allow each of the four major Industrial Development Authorities (Pima County, Tucson, Maricopa County, and Phoenix) to administer these programs for its own jurisdiction. In addition, the legislative changes allow the Director of the Arizona Department of Commerce to select one IDA (or joint IDA) proposal to administer MRB and/or MCC programs for the remaining areas of the state in what is referred to as the statewide rural program.

E. Report on Findings

The initial reports received from the IDAs this year were lengthy, complex, and formatted in a variety of ways, making comparative analysis difficult and cumbersome. However, the information requested by the Commission was provided. After a number of Arizona Housing Commission Task Force meetings and discussions with staff and representatives of the IDAs, it was agreed that the IDAs would resubmit the requested information in a summarized and similarly organized format. These discussions, negotiations, and subsequent communications and agreements delayed the preparation and submission of this report. It should be noted that the representatives of the IDAs have been cooperative and helpful in providing the requested and required information.

Summary charts from each IDA are attached to this report. More specific and detailed information from each IDA is being delivered with this report to the Governor, the President of the Senate and the Speaker of the House of Representatives and will be available at the offices of the Arizona Housing Commission staff.

Arizona Housing Commission Task Force members, staff, and Consultant David Herlinger, hired by the Arizona Department of Commerce, have reviewed the information in detail. The challenge of this report in its narrative form is to provide succinct, relevant and useful data to the reader that will aid in preparing and delivering the interim and final reports in August of 2002 and 2004.

A significant number of specific criteria were analyzed as this document was developed. Private Activity Bonds are the vehicle for a number of specific uses including loans for homeownership to first time buyers of modest income and for the financing of rental housing whose tenants will be of low and moderate income. This report focuses on Mortgage Revenue Bonds (MRBs) and Mortgage Credit Certificates (MCCs), which are the vehicles used to provide home loans and financial assistance to eligible homebuyers. The loans provided by MRBs are typically 30-year, fixed rate loans that are below market rate and often include some form of down payment or closing costs assistance.

1. Costs of Issuing Bonds

Mortgage Revenue Bonds (MRBs) that were issued during the reporting period were reviewed and analyzed for the cost of issuing the bonds, as well as specific criteria for homeowner eligibility and dollar volume of bonds issued including new money bonds and recycled bond proceeds.

Based on the analysis of the independent consultant, it appears that the cost of issuing the bonds was well within the range of housing bond issues around the country including state housing finance authorities and local government housing bond issuers. Costs of Issuance (COI) typically include marketing and selling the bonds, legal costs, financial advisors, printing, rating agency fees, trustee, and can include fees for administrative costs to the bond issuer, i.e. the IDAs. The fees for the bonds issued by the four Arizona IDAs during the reporting period were analyzed by the consultant and were found to be within an acceptable range (one half of one percent to one and one half percent of the bond issue) when compared with other housing bond issuers around the country. The range is explained by the variety of distinctions in the market place. When the bonds are issued and the size of the bond issue are but two factors that must be considered.

The consultant employed by the Arizona Department of Commerce surveyed twelve State Housing Finance Authorities, four Local Government Housing Bond Issuers, and three Investment Banking Firms that have not done business with any of the four Arizona IDAs. This informal survey and the consultant's first hand knowledge of the cost of issuing housing bonds indicates a range of 0.75% to 1.75% as a percentage of the bonds issued.

The ongoing financial operations of the IDAs seem extremely stable and the funds available to the individual IDAs annually is consistent with surplus revenues of other housing bond issuers around the country, as surveyed by the consultant. The IDAs are also using premium bond proceeds and aggregate bond issue surpluses for down payment assistance to the first time homebuyer beneficiaries.

2. Mortgage Loan Products

Each of the reporting IDAs provided excellent program descriptions including homeowner income eligibility criteria, maximum mortgage loan amounts, down payment assistance availability, and the pertinent information regarding mortgage companies and banks that were available to originate the loans. These loans are originated, then the loans are bundled into mortgage-backed securities, and the mortgage-backed securities are then sold to the bond trustee. The IDAs also reported the fees that each loan originator was allowed to charge the homeowner and the fees that loan servicers charged for servicing the mortgage loans. Based on the analysis of the independent consultant, all of the fees reported by IDAs are well within an acceptable and reasonable range in this market. The loan origination and servicing fees are also well within allowable fees that are related to mortgage backed bonds around the country. The loan origination fees are typically 1% paid by the homeowner, 1-2% paid by the loan servicers to the originator for a service release fee, and 3/8 of 1% charged by the loan servicer.

The use of Mortgage Credit Certificates (MCCs) is not as significant as the MRB mortgage vehicle. The MCC is a variation that can be used by all eligible issuers (IDA or the HFA) and the dollar amount available is controlled by the Federal Tax Code. The IDA issuer can elect to use MRBs or MCCs. The MCC reporting was complete and the results parallel the use of MRBs in income levels, family size and other loan and demographic information. The reported cost to the consumer (first time home buyer) is typical for other MCC issuers around the country. The fees that the lender and the issuer receive are also typical of national norms according to the consultant's survey.

3. Loan and Demographic Information

The consultant's survey also included information about income ranges, mortgage loan amounts, family sizes, new homes versus resale homes, availability of down payment assistance, "rural" versus "urban", and interest rates. This information was also available through the auspices and cooperation of the National Council of State Housing Agencies (NCSHA).

The reporting IDAs provided detailed information to the Arizona Housing Commission Task Force and staff. This information is available in detail in the attached exhibits. The pertinent information is as follows (figures are weighted):

- The average income of a typical first time homebuyer is approximately $35,000. The average income ranges from $30,216 to $40,215 depending on bond issue interest rate and is very typical. Family size is also a factor.
- The average purchase price of a home is approximately $90,000. The averages range from $71,000 to $103,551. This range is typical and is reflective of various bond issue interest rates.
- Approximately 88% of the mortgage loans are FHA insured.
- Approximately 80% of the houses purchased were detached single family.
- Approximately 85% of the houses are existing (resale) houses. This is very typical of the mortgage revenue bond programs around the country as the buyers are first time with very modest incomes and quite often cannot afford newly constructed homes.
- Approximately 97% of the buyers avail themselves of down payment assistance. Again, this is very typical as working people with modest incomes frequently have a difficult time saving substantial funds for down payments.

- Approximately 50% of the mortgage loans were made to minority households.
- In programs where both rural and urban loans were available, approximately 86% of the loans were made in "urban" areas (any location in Maricopa and Pima Counties) while approximately 78% of the allocations are designated for those areas.

The above information represents reporting from all four IDAs. These reports were remarkable in their consistency across these IDAs.

F. Observations

After a review of this information, the following observations are noted:

1. Approximately 30% of the mortgage loans during this reporting period were made to single persons. The percentage of loans made to single people (a one-person household) appears to be high. According to the consultant, other issuers around the country report percentages ranging from 15% to 22% for one-person household homeowners.

2. It appears that, in programs with both urban and rural loans available, approximately 86% of the MRB-financed loans made during this reporting period were in "urban" areas (meaning within Maricopa and Pima Counties) where about 78% of the allocation is directed according to population. "Rural" Arizona (the other counties in the State), while being allocated approximately 22% of the financing, has not used its full share of the MRB/MCC program. This disparity also exists in market rate mortgage loans. Recent data show that 92% of Arizona market rate FHA/VA mortgage loans were originated in Maricopa and Pima Counties (Mortgage Data Service FHA/VA Market Share Report by SMSA, 1997).

3. A third and substantial policy issue for the IDAs, HFA and the Arizona Housing Commission is the present statutory allocation of Private Activity Bonds across the State. The Study Committee on Industrial Development Bond Allocations was established by 2001 Arizona State Legislation, HB2390 to review the utilization of private activity bonds and make recommendations for future allocations.

Demographic Data Related to MRB and MCC
Maricopa County IDA
1998-2000

	MRB 1998-A SF	MRB 2000 – B	MRB 2000-1 SF ** (Joint…)	MRB 2000-A (Taxable)	MRB 2000-C (Taxable)	MRB 2001-A (Taxable)
Tax Exempt - New Allocation - Recycled and/or Refunded Taxable	 $32,135,000 $2,655,000 0	 0 $23,465,642 0	 $45,170,775 0 $16,995,000	 0 0 $25,000,000	 0 0 $25,000,000	 0 0 $75,000,000
Number of Loans	407	234	477	247	269	426
Loan Type: (FHA/VA) Conventional Others	 92.1% 7.9% 0%	 93.1% 1.7% 5.2%	 91% 9% 0%	 100%	 99% 1%	 98.3% 1.7%
Average Purchase Price	$86,325	$91,418*	$95,267*	94,128*	100,086*	$102,409
Average Family Income	$34,469	$35,764	$37,011	$39,604	$40,215	$39,785
Average Household Size	2	2.51	2.46	2.83	2.8	2.76
Rural Loans	13.5%	NA	NA	NA	NA	NA
Target Areas	6.6%	NA	2.73%	NA	NA	0.005%
First Time Buyers	98.8%	97.9%	96.6%	90.7%	92.9%	90.9%
Loans to Minorities	45%	44.6%	41.4%	55.8%	54.7%	55.4%
Loan to 1-Person Households	34.2%	28.6%	29.8%	19.4%	27.7%	25.1%
Existing Homes	76.2%	78%	76.9%	85%	88.1%	91.1%
# of Participating Lenders	10	10	16	11	12	12
Single Family Detached	77.2%	87.9%	84.6%	89%	93%	89.4%
Interest Rate	6.55%	93% of loans at 7.9% and 7% of loans at 6.9%	85% of loans at 7.8% and 15% of loans at 7.15%	8.62% of loans at 8.55%; 11.27% of loans at 8.65%; 14.07% of loans at 8.7%; 12.31% of loans at 8.85%; 11.72% of loans at 8.9%; 22.9% of loans at 8.95%; 12.67% of loans at 9.25%; and 6.38% of loans at 9.3%	10.47% of loans at 7.7%; 9.53% of loans at 7.8%; 14.69% of loans at 7.85%; 9.81% of loans at 7.9%; 11.62% of loans at 8.1%; 12.19% of loans at 8.25%; 22.00% of loans at 8.35%; and 9.7% of loans at 8.5%	7.28% of loans at 7.55%; 14.43% of loans at 7.6%; 3.04% of loans at 7.65%; 14.33% of loans at 7.7%; 22.84% of loans at 7.75%; 7.43% of loans at 7.80%; 6.25% of loans at 7.85%; 7.01% of loans at 7.90%; 10.59% of loans at 7.95%; and 6.80% of loans at 8.00%
30-Year Fixed Rate Mortgage (Freddie Mac Commitment)					1998 = 8.05% 1999 = 7.44% 2000 = 6.94%	

SF: Single Family Detached MRB: Mortgage Revenue Bonds MCC: Mortgage Credit Certificate
* Average Loan Size **Joint City of Phoenix IDA/ Maricopa County IDA
** 47.6 % of the loans were made in Phoenix and 52.4% in the remaining areas of Maricopa County.

Demographic Data Related to MRB and MCC
City of Phoenix IDA
1998-2000

	MCC 1998 Statewide	MRB 1998-A Statewide	MRB 1998-C Statewide	MCC 2000 Rural (1)	MCC 2000 Phoenix (1)	MRB 2000-1 Joint (2)
Tax Exempt - New Allocation - Recycled and/or Refunded Taxable	 $21,000,000 	 $30,000,000 0 0	 0 $53,995,000 0	 $18,450,035 0 0	 $9,997,067 0 0	 $14,600,000 $10,825,000 $21,500,000 $16,995,000
Number of Loans	405	375	651	13	57	476
Loan Type FHA/VA Conventional Others	 93.8% 6.2% 0%	 80% 18.4% 1.6%	 85% 12.4% 2.6%	 92.3% 7.7% 0%	 94.7% 5.3% 0%	 91.3% 4.4% 4.3%
Average Purchase Price	$86,528	$81,331	$83,475	$71,000	$87,285	$95,348
Average Family Income	$32,734	$33,073	$33,087	$34,949	$35,439	$37,011
Average Household Size	2.5	2	2	2	2.4	2.4
Rural Loans	3.6%	8.3%	8.1%	100%	N/A	N/A
Target Areas	4%	10.4%	5.4%	0%	8%	2.8%
First Time Homebuyers	98.8%	98.4%	98%	100%	94.7%	96.6%
Loans to Minorities	43.5%	42.7%	48.5%	38.46%	43.9%	41.8%
Loan to 1-Person Households	31.9%	32.3%	28.1%	30.77%	35%	29.8%
Existing Homes	73.8%	79.5%	84.2%	76.9%	98.3%	79.4%
# of Participating Lenders	35	7	10	2	7	16
SF	72.8%	76.5%	84.5%	100%	71.9%	82.4%
Interest Rate	N/A	Par – 5.95% (25.3% of loans) Assisted – 6.6% (74.7% of loans)	Par – 5.95% (20.9% of loans) Assisted – 6.6% (79.1% of loans)	N/A	N/A	Par – 7.8% (85% of loans) Assisted - 7.8% (15% of loans)
Single Head-of-Household	39.3%	36.0%	37.6%	38.5%	40.4%	42.7%
30-Year Fixed Rate Mortgage					1998 = 8.05% 1999 = 7.44% 2000 = 6.94%	

NOTES:
(1) Program still in progress - information as of 6/30/01
(2) Joint Phoenix IDA and Maricopa IDA Program. 47.6% of the loans made in Phoenix and 52.4% of the loans made in the remaining areas of Maricopa County.

MRB: Mortgage Revenue Bond
MCC: Mortgage Credit Certificate
Rural: All Counties other than Maricopa County and Pima County
Escrowed Bonds not included above: Statewide 1998B SFMRB $35,000,000; 1998D SFMRB $10,825,000; 1999 Draw Down Series SFMRB $25,000,000

Demographic Data Related to MRB and MCC
Pima County IDA
1998-2000

	MRB 1999-A Statewide	MRB 1999-B Statewide	MRB 2000-A	MRB 2000 (Joint Program) **
Tax Exempt - New Allocation - Recycled and/or Refunded Taxable	 $59,999,955 $23,500,000 $6,000,000	 $7,180,000 $48,814,812 $5,575,000	 $10,000,000 $5,725,000 $1,135,000	Pima County $ only $0 $10,000,000 $1,500,000
Number of Loans	583	565	60	209***
Loan Type FHA/VA Conventional Others	 93.6% 6.4%	 87.8% 12.2%	 95% 5%	 87.6% 7.0% 5.4%
Average Purchase Price	$86,789	$87,902	$103,551	$85,309
Average Family Income	$33,622	$34,089	$38,284	$31,527
Average Household Size	2.32	2	2.58	2.71
Rural Loans	NA	NA	0%	0%
Target Areas	7.9%	11.5%	46.7%	10.8%
First Time Buyers	NA	NA	NA	NA
Loans to Minorities	59%	55%	58.3%	53.3%
Loan to 1-Person Households	35%	43.7%	20%	
Existing Homes	100%	100%	100%	74.4%
# of Participating Lenders (Initial)	12	8	4	7
Single Family Detached	66.4%	63.7%	55%	90.4%
Interest Rate	6.53%	7.4%	6.9%	7.59%
30-Year Fixed Rate Mortgage (Freddie Mac Commitment)				1998 = 8.05% 1999 = 7.44% 2000 = 6.94%

SF: Single Family Detached
MRB: Mortgage Revenue Bonds
MCC: Mortgage Credit Certificate
**Joint City of Tucson IDA/ Pima County IDA Program
*** 96.5 % of the loans were made in Tucson and 3.5% in the remaining areas of Pima County (program still in progress).
“MRB 1999-A” and “MRB 1999-B” are closed, but “MRB 2000-A” and “MRB 2000-(joint program)” are still in progress.

Demographic Data Related to MRB and MCC
City of Tucson IDA
1998-2000

	MCC 1998	**MCC 1999**	**MRB 2000 (Joint Program) ****
Tax Exempt - New Allocation - Recycled and/or Refunded Taxable	 $6,227,019 0 0	 $3,095,046 0 0	City of Tucson $ only $10,000,000 0 $1,500,000
Number of Loans	91	32	209***
Loan Type FHA/VA Conventional Others	 74.7% 22% 3.3%	 68.7% 31.3%	 87.6% 7.0% 5.4%
Average Purchase Price	$87,403	$93,912	$85,309
Average Family Income	$30,216	$31,194	$31,527
Average Household Size	2	3	2.71
Rural Loans	2	0	NA
Target Areas	7.7%	15.6%	10.8%
First Time Buyers	91	1	206
Loans to Minorities	47.2%	50%	53.3%
Loan to 1-Person Households	40.7%	28.1%	23.67%
Existing Homes	72.5%	59%	74.4%
# of Participating Lenders	49	21	7
Single Family Detached	95.6%	100%	90.4%
Interest Rate	NA	NA	7.59%
30-Year Fixed Rate Mortgage (Freddie Mac Commitment)			1998 = 8.05% 1999 = 7.44% 2000 = 6.94%

SF: Single Family Detached
MRB: Mortgage Revenue Bonds
MCC: Mortgage Credit Certificate
**Joint City of Tucson IDA/ Pima County IDA Program
*** 96.5 % of the loans were made in Tucson and 3.5% in the remaining areas of Pima County (still in progress).