Minnesota Housing Finance Agency

March 1989

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

March 8, 1989

Members
Legislative Audit Commission

In July 1988 the Legislative Audit Commission directed the Program Evaluation Division to evaluate the Minnesota Housing Finance Agency and to determine whether its programs are adequately targeted toward low-income families. Demographic trends, rising homelessness, and an apparent lack of affordable housing led many legislators to question the state's priorities for housing assistance.

We examined MHFA's major programs designed to assist low- and moderate-income owners and renters. Overall, we found that MHFA is a very well-run agency. However, we think that changes in population trends, economic conditions, and federal policy require the agency to rethink its priorities for housing assistance. We urge MHFA to develop a long-run plan that gives more emphasis to making rental housing more affordable for low-income families.

We received the full cooperation of the Minnesota Housing Finance Agency and help from housing experts across the state.

This report was researched and written by Elliot Long (project manager) and David Rafter.

Sincerely yours,

James R. Nobles
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TABLE OF CONTENTS

LIST OF TABLES AND FIGURES

MINNESOTA HOUSING FINANCE AGENCY

Executive Summary

The Minnesota Legislature enacted the Housing Finance Agency Law of 1971 in order to help make housing affordable for low and moderate income households. To this end, the Minnesota Housing Finance Agency (MHFA) has issued about $2.3 billion in bonds backed by revenue from mortgage and home improvement loans, and received $200 million in state appropriations.

In recent years, the federal government has threatened to further restrict the use of tax-exempt revenue bonds for housing programs and has significantly cut back funds for construction of low-income housing. These changes in policy plus a shortage of affordable rental housing and an increase in homelessness have stimulated widespread interest in state housing policy and programs.

In 1988, the Legislative Audit Commission asked the Program Evaluation Division to evaluate MHFA and its programs. In this study, we focused on three broad issues:

- **Are MHFA programs appropriately targeted to populations in greatest need?**

- **Are MHFA programs administered efficiently and effectively?**

- **Have MHFA policies been responsive to significant demographic, economic, and political changes affecting the environment in which the agency operates?**

MHFA is well managed and competent.

On the whole, our assessment of MHFA is positive. The agency is well managed and competent and careful in its decisions and financial commitments. However, the environment in which MHFA operates is changing profoundly. The Legislature needs to examine whether state housing policy and MHFA's programs are appropriate given current needs and anticipated future conditions.

THE DEMOGRAPHIC CONTEXT

Housing policy for the 1990s will have to recognize important demographic and economic trends that challenge conventional beliefs about housing needs because they represent a major departure from recent experience.

The baby-boom generation (born between 1946 and 1965) has, since the 1940s, put extraordinary pressure on various societal institutions. By now, most baby boomers have purchased a house. In coming decades, this generation will be in the market for more expensive "move-up" housing and will not be a primary concern for MHFA or other providers of low cost housing.

The entrance of the smaller "baby-bust" generation into the market will mean a softening of the market for starter homes and rental units. The share of the population that is 65 and over will not change much during the 1990s but rapid growth will occur later.

These trends present an opportunity to solve some of the problems that have concerned policy makers for years. They also suggest that a reallocation of state housing efforts is in order.

The housing stock is adequate but many cannot afford decent housing.

- **The housing stock is relatively adequate going into the 1990s. A lot of new construction will not be needed.**
- **With weakening demand for starter homes and a trend toward higher vacancies in the rental market, preservation and maintenance of the existing stock will become the major challenge.**

These trends portend greater availability of both owner-occupied and rented housing and suggest that some chronic housing problems will ease. Why, then, do problems of affordability and homelessness seem to be getting worse? The short answer is that there are factors at work other than the supply of housing. One factor is the increasing inability of certain groups to afford housing even at rent levels that cover only operating costs. Another factor is the loss of affordable housing through urban renewal and deterioration. But of greater significance is the long-term decline in household size and growth in single-headed households. Single-headed households are not as economically viable as those headed by a married couple. Since growing numbers of households with children cannot afford housing, the challenge to policy makers will be to find the right mix of economic assistance and social services to meet the housing needs of this group. Emphasis on new construction which has characterized federal aid, and to some extent Minnesota housing policy, should yield to more creative use and preservation of the existing stock.

SINGLE FAMILY MORTGAGE LOAN PROGRAM

Home ownership is a basic aspiration of most American families and, for many, a source of stability and success. While home ownership has become more affordable on average during the 1980s, reversing the trend of the 1970s, younger and lower income households are not finding it as easy to afford a home as new households in previous generations.

Since 1971 MHFA has raised about $1.3 billion through bond sales for single family mortgage loans. Combined with nearly $12 million in state appropriations, these funds have financed over 23,000 mortgage loans at 1.5 to 2 percentage points below the prevailing market rate.

The availability of below-market-rate loans is made possible in large part because the federal government allows state housing agencies to issue tax-exempt bonds that carry a lower rate of interest than taxable bonds. This subsidy makes it possible for a category of potential buyers who would not qualify for a market rate loan to qualify for a lower rate loan.

To assess MHFA's performance in administering the single family mortgage loan we asked:

- **How effectively has the agency targeted loans to those unable to obtain equivalent financing, or unable to buy any home?**

- **How effectively has MHFA assembled a network of participating lenders and established a truly statewide program?**

- **How well has MHFA arranged for various financial services involved in issuing bonds, making loans, collecting installment payments, and paying bond-holders?**

MHFA has targeted mortgage loans to lower income families.

In general, we conclude that MHFA has carried out these responsibilities effectively.

- **Mortgage loans are targeted to lower income borrowers, especially when an MHFA loan is combined with additional assistance through the Homeownership Assistance Fund (HAF), which provides down payment and monthly assistance to about one quarter of MHFA assisted borrowers. To qualify for HAF assistance, borrowers must have incomes less than $23,000 in the Twin Cities area, $19,000 in outstate urban areas, and $17,000 elsehwere.**

- **MHFA has targeted its subsidized loans better than local housing finance agencies in the Twin Cities area and many other states.**

MHFA allocates loans around the state roughly in proportion to population, not in proportion to need, which MHFA estimates to be higher in the Twin Cities. This strategy ensures that available funds are not used up in high demand areas before they can be committed in other parts of the state. It also reflects the fact that alternative private financing is more readily available in the Twin Cities area. However, if this strategy leaves significant unmet needs in the metro area while fully meeting outstate needs, it may not be wise or equitable. MHFA should reassess this strategy periodically.

Analysis of the geographic distribution of loans along with a review of procedures developed to enable low-volume lenders around the state to cope with complicated paperwork requirements, supports the conclusion that: MHFA has succeeded in overcoming various obstacles to running a statewide program.

There is a significant national debate over the use of tax-exempt bonds to finance home mortgage loans. The U.S. General Accounting Office (GAO) has concluded that the federal government is not getting a good deal from programs like MHFA's Single Family Mortgage Loan Program.

- **GAO concludes that most beneficiaries of bond-assisted mortgages would have been able to obtain a conventional market-rate loan, and an additional number could have obtained an adjustable-rate loan. Also, GAO estimates that buyers get between 12 and 45 cents of benefit for every dollar of federal tax revenue that is not collected.**

As a result of skepticism among technical experts about the use of tax-exempt mortgage revenue bonds, as well as changing demographic and economic conditions that are helping to make homeownership more affordable, Congress may eliminate or further restrict the use of tax-exempt mortgage revenue bonds. As long as the federal government makes subsidized loans available, however, MHFA has no choice but to aggressively use its full authority to issue bonds, as it has done. If a state subsidy is required in the future to provide below-market-rate loans, we recommend that MHFA take a hard look at where the subsidy is coming from and the public purpose served. Our understanding of housing needs and economic and demographic trends suggests that renter programs rather than home owner programs should have a greater share of state resources in the future. If something has to give, it should be subsidies designed to assist moderate-income buyers, many of whom will be able to afford a home anyway.

In the past, Some housing analysts have justified helping home owners by proposing that benefits would trickle down to lower income households. In recent years, however, the plight of renters has worsened, while affordability has improved for owners. This experience calls the trickle-down theory into question.

Subsidized mortgages cannot be targeted with surgical precision.

MHFA and other housing finance agencies contest the findings and conclusions of the GAO study but they acknowledge that bond-assisted mortgages cannot be targeted with surgical precision. MHFA estimates that around 30 percent of loans go to borrowers who could have afforded market rate financing.

MHFA also needs to reconsider what percentage of its subsidized mortgages should be used to assist the purchase of newly constructed or existing houses. Although new construction is popular among buyers, builders, the construction trades, lenders, and their government representatives, we are drawn to the conclusion that:

- **MHFA's historic rate of new construction financing of about 35 percent is too high for the future, given projections of weaker demand for starter homes.**

MHFA eligibility requirements place a higher purchase price limit for new construction than for existing houses in recognition of the fact that construction costs are higher today than in the past. We think that this policy should be reexamined. In any case, MHFA-supported new construction should be limited to situations where it will not hasten the deterioration of suitable existing housing.

HOME IMPROVEMENT LOAN PROGRAMS

MHFA views home improvement loans as an essential part of its strategy to preserve the existing housing stock. Home improvement loans are viewed as a way to promote affordable housing more economically than through new construction of single family homes. As a result:

- **Minnesota's home improvement program is several times the size of any other state's.**

The home improvement loan program has operated since 1975. As of mid-1988, it has provided about 47,500 loans totalling about $266 million. Interest on home improvement loans ranges from 3 percent for households with (adjusted) incomes of $7,000 or less to 9 percent for households with incomes of $17,000 to $27,000 per year.

The challenge to MHFA in operating this program is to:

- design a program that can make loans available statewide to targeted households,
- raise capital mainly through bond sales to finance the loans,
- develop a product that meets a need and for which there is a demand, and
- arrange for efficient collection of installment payments and repayment of agency obligations to bond-holders.

Home improvement loans are well targeted to low and moderate income families.

In many respects MHFA's role is the same as in the Single Family Mortgage Loan Program. However, there are additional challenges to operating a successful Home Improvement Loan Program. Home improvement loans are smaller than mortgage loans, but more expensive to service. And, home improvement loans, while small, involve significant paperwork and reporting requirements by originating lenders and servicers.

We examined the results of the program since 1975 and found:

- **The financial security of the program is strong, according to bond rating agencies and financial analyses.**
- **The program has succeeded in targeting loans to low and moderate income home owners.**

Between mid-1983 and October 1988, the average household income of borrowers was $16,134. Across this time period 15 to 18 percent had incomes of $10,000 or less. Three to four percent have incomes of $5,000 or less. It is difficult to see how MHFA could restrict the program to a lower income population, given that loans need to be repaid at a fairly high rate since they are financed through bond sales.

As with the mortgage loan program, MHFA has an obligation to run a statewide program so that potential borrowers anywhere can hear about the home improvement loan program and identify a participating lender in their area.

Since availability of home improvement loan financing has exceeded demand, it has not been necessary to over-allocate funds to outstate areas in order to assure a proportionate statewide distribution. In fact:

- **We found that home improvement loans have been concentrated in outstate Minnesota. While about half the state's population is located in the Twin Cities area, only about 26 percent of the loans were made to Twin Cities area households.**

MHFA has experienced continuing problems in servicing home improvement loans.

Since there have been enough funds in each area to meet demand, and since, if anything, lenders are more accessible in the metro area, the concentration of loans outstate is due to other factors. For example, there is a greater proportion of households outstate that meet the program income limits. Also, other financing for home improvement loans tends to be unavailable in many outstate areas.

In the past, MHFA has felt that demand for home improvement loans should be higher and has worked with originating lenders to publicize the program. It also commissioned a marketing study and implemented some of its recommendations. The agency feels the program is now running well, with one important exception.

- **MHFA has experienced continuing problems with one of two servicing firms and has not been able to recruit additional servicers. At the same time, the agency has not established an in-house loan servicing capability.**

We conclude that:

- **MHFA is neither capturing the potential advantages of contracting the work out, nor the advantages of performing the work in-house.**

While the default rate on home improvement loans is well below the level that would result in a threat to the agency's financial security, MHFA needs to find a better solution to collecting the more than $100 million in home improvement loans now outstanding. Efforts to develop improved servicer capacity was not helped when a staff recommendation to suspend new referrals of loans to a poor performing servicer was over-ruled by the MHFA Board in July 1988.

- **The Board has clear authority to make this and any other administrative decision, but we believe the Board acted unwisely in over-ruling the staff recommendation.**

MHFA's staff concerns about the servicer were based on a comparison of its performance to that of the other servicing firm and to industry standards. We think the staff concerns were well founded and should have been given greater weight by the board.

REHABILITATION LOAN PROGRAM

MHFA also operates a rehabilitation loan program for very low income homeowners (those with incomes less than $7,000 per year) financed by state appropriations. About half of MHFA's current budget request is for this program. Loans are originated by local housing agencies and properties inspected by local officials before and after the improvements are made.

Rehabilitation loans carry no interest, and payment of principal is deferred and ultimately forgiven if the property is not sold within 10 years. Demand for rehabilitation loans far exceeds supply all across the state. Local housing officials feel the program serves a vital purpose. Since 1981 more than 4,800 rehabilitation loans have been made to borrowers with incomes varying between $3,785 and $4,175 over the period 1981 to 1987. Over ten percent of recipients have annual (adjusted) incomes of less than $2,000. It is hard to see how the program could be aimed at a lower income target group, given that the program is for property owners.

While rehabilitation loan borrowers have very low incomes, the properties they own have value ranging between $26,000 and $30,000 in the 1980s. Since funds are in high demand, we recommend that MHFA recapture the loan plus interest after the property receiving the loan is sold. MHFA feels that this would prevent some people from borrowing money, but since there are far more applicants than funds, this would seem not to be a problem. If the subsidy was recaptured, limited resources, in high demand everywhere, could go further to help additional people in need.

MULTI-FAMILY HOUSING DEVELOPMENT

More affordable rental housing is needed for low-income families.

Many housing analysts agree that the most pressing housing problem facing the nation is the need for affordable rental housing for low-income families. Minnesota and other states are put to a test by the termination of federal new construction subsidies which helped finance most of subsidized rental housing that MHFA has produced. It is our conclusion that:

- **MHFA's multi-family programs can not substitute for terminated federal rental subsidy programs in producing the quantity of units needed, but both the level and variety of MHFA's multi-family programs needs to be increased.**

MHFA's major activity in financing multi-family housing has been in conjunction with the federal Section 8 and Section 236 programs. These programs provide "deep subsidies" so that renters do not pay more than 30 percent of their income for housing. Using revenue bonds, MHFA financed Section 8 and Section 236 projects by offering below market interest rate mortgages.

- **Seventy-eight percent of all multi-family housing produced by MHFA has been implemented under the federal Section 8 and Section 236 programs.**

New construction subsidies were curtailed in the late 1970s, and in 1981 the federal government ceased making new commitments for Section 8 and Section 236 multi-family housing. It concluded that subsidizing rents in existing apartments rather than new construction was more cost-effective. Over the long run, in the absence of a new federal effort, subsidized units will disappear. This has not happened yet, and the extent of the problem for the near future is not clear.

Without direct federal subsidies for constucting multi-family units, MHFA has relied upon three programs. The "market rate" program which provides financing for moderate income rental units; the Apartment Renovation Mortgage Program (ARM) which provides long-term, low interest rate financing and renovation funds for low rent, existing apartment buildings; and the federal Low Income Tax Credit (LITC) program that is administered by MHFA and assists for profit developers and nonprofit sponsors in producing new low-income housing.

The ARM and LITC programs are innovative efforts on the part of MHFA to direct financial assistance to older apartment buildings where most low-income renters live and to work with nonprofit sponsors to increase the supply of low-income housing. However, these programs have not been implemented to their full capacity.

- **ARM's loan volume has been half the level desired by the agency.**
- **Only 56 percent ($5.9 million of the $10.5 million) of the low-income tax credits made available by the federal government to Minnesota for low-income rental housing were used during the first two years of the program.**

The supply of subsidized rental housing falls far short of the need.

By any measure, including MHFA's estimates, the supply of subsidized rental housing falls far short of the need. Much remains to be done to make rental housing affordable to low income households.

We analyzed the implementation of the federally assisted MHFA units (Section 8 and Section 236) and the more recent market-rate and ARM projects. We conclude that, while well managed, MHFA's multi-family development programs have not utilized the nonprofit housing sector effectively.

HOUSING FOR SPECIAL NEEDS POPULATIONS

The Legislature has given MHFA the task of improving the availability of affordable housing to groups who are not well served by the private housing market. Specific groups targeted by separate programs are the homeless, the developmentally disabled, American Indians, and the elderly. In nearly all program areas, funding levels have been small and only a small proportion of the persons in each group requiring assistance have been served by MHFA programs.

We conducted a survey of nonprofit sponsors and local housing officials. The public and private sector respondents gave high marks to the MHFA staff for their technical knowledge and their responsiveness and suggested changes in the agency's procedures. They recommended that:

- **MHFA should establish a working partnership with them in developing new low-income housing in which they would be willing to pay up to 25 percent of the development costs.**

- **MHFA should consider dropping some administrative procedures that impede nonprofit participation in special needs programs.**

We conclude that:

- **The agency lacks a plan or clear statement of goals that would set priorities among housing programs. As a result, MHFA's legislative agenda and policy initiatives have not adequately addressed the critical housing needs among these special population groups.**

MHFA needs a plan which sets priorities.

In the future, we believe the MHFA will need to be more creative and successful in providing seed money, developing capacity among nonprofit sponsors and local housing agencies, and otherwise promoting innovative efforts combining social services and housing.

CONCLUSIONS AND RECOMMENDATIONS

This study has tried to determine whether MHFA is adequately serving the needs of low and moderate income households. We have found MHFA to be a well-managed agency which receives high marks in the financial community. But we conclude that:

- **MHFA has placed too high a priority on the housing finance needs of home owners, to the neglect of low income renters.**

One reason is the fact that bond financing, the source of most of MHFA's capital, does not adequately serve the needs of low income renters. Additional vouchers that put greater purchasing power in the hands of qualifying renters are needed. While the federal government has moved in this direction and away from expensive new construction programs, need far exceeds the availability of assistance for low income housing.

But even looking at state appropriations, where the requirements of bond financing are absent, a high share of MHFA's state appropriations have gone to home ownership programs.

- **Helping low income renters and the homeless should receive a higher priority than in the past.**

It is clear that these groups need more than help with housing. Problems of the homeless, of low income families, and of the frail elderly involve some combination of income assistance, social services, job training, and other support.

The need for projects that combine housing and social services will rise.

MHFA has not worked as productively as it needs to plan for future projects that combine housing and needed social services. One predictable need is for housing with services and supervision, at relatively low cost, for the elderly who would otherwise require nursing home care. Other coordinated efforts will be necessary to respond materially to the needs of the homeless, or to help low income families use the vacant inventory of single family homes even if they cannot affort to buy. MHFA needs to improve coordination at the state level with the Department of Human Services and with local and non-profit social service agencies.

We believe that both the MHFA Board and staff can help improve the housing policy debate in Minnesota.

- **The staff should update and improve its vague, out-of-date Housing Action Plan.**

The report of the Governor's Commission on Affordable Housing (staffed by MHFA) is an important step in the right direction, but only the beginning of the educational and deliberative process that needs to be undertaken.

- **The MHFA Board should assert greater leadership in debating and deciding housing policy.**

There are functions that the MHFA staff, no matter how talented and industrious, cannot do itself and making high-level policy decisions about the basic mission of the agency is one of them.

As we discussed, nationally and in Minnesota the era of major new construction programs has ended. In coming years, MHFA should improve its working relationship with nonprofit agencies that are able to fill a niche in providing housing development and management services for groups or in areas that tend to be neglected by the private developers and management companies MHFA has traditionally favored. We recommend that:

- **MHFA should assign greater priority in the future to developing partnership arrangements with local government agencies, housing authorities, and nonprofit sponsors.**

Finally, there is one aspect of state tax policy that has an adverse effect on the situation facing low income renters. In Minnesota, the effective property tax rate on rental property is much higher than the tax rate on owner-occupied housing, both because of the homestead credit and the lower assessment rate applied to owner-occupied property. High property taxes on rental property make it difficult to provide housing for the most needy because even if there is no debt service on the property, taxes plus normal operating costs put modest apartments out of reach for many.

We believe that MHFA should take a more active role in the debate over property tax policy, where state tax policy appears to vitally affect MHFA's ability to achieve housing policy goals through its various programs.

INTRODUCTION

The 1988 Legislature directed the Office of the Legislative Auditor to carry out a study of the Minnesota Housing Finance Agency (MHFA). A study proposal consistent with legislative interest was approved by the Legislative Audit Commission.

The study that follows examines the major programs of the Minnesota Housing Finance Agency. Housing programs and policies are going through an active reexamination because of changing demographic, and economic conditions affecting housing and a change in the federal role. This report looks at how well MHFA runs its major programs and how effectively it is responding to changing conditions and needs. Although the content and emphasis of the chapters that follow varies, all consider:

- **Are MHFA's programs effectively targeted?**
- **Are MHFA's programs administered effectively and efficiently?**
- **Has MHFA achieved the social objectives of its programs while maintaining the agency's financial security?**
- **Has MHFA responded appropriately to changing conditions?**

Chapter 1 provides descriptive information on MHFA and its programs. Chapter 1 also reviews what we consider to be the key demographic and economic trends that will determine housing needs in coming years.

Chapters 2 through 5 deal in turn with MHFA's Single Family Mortgage Loan Program, Home Improvement Loan Program, Multi-Family Development Programs, and Special Needs Programs. Chapter 6 draws together general findings from these chapters and discusses our major conclusions and recommendations. A brief glossary of terms precedes Appendix A which presents the results of a survey of housing and redevelopment agencies and Appendix B presents the results of a survey of nonprofit housing sponsors. We recommend the Executive Summary, Chapter 6 and Chapter 1 in this order to readers with limited time or specialized interest in housing.

HOUSING ISSUES AND TRENDS

Chapter 1

This chapter provides an overview of housing policy issues and programs in Minnesota. After describing the significant demographic trends, the chapter reviews the major federal and state housing policies, and describes the mission and housing programs of the Minnesota Housing Finance Agency.

DEMOGRAPHIC CHANGE AND THE HOUSING MARKET

The cost, supply, and condition of housing are all being transformed by the aging of the baby-boom generation (born between 1946 and 1965) and the entrance of the smaller baby-bust generation (born after 1965). This demographically-linked housing market is expected to produce important changes, such as an increase in the demand for "move-up" homes among baby-boomers along with a decreasing demand for "starter homes" among the baby-busters. For the same reason, analysts project a decline in demand for rental housing since demand for rental units is highest among the younger households. But, because of the growth in single parent and other low-income households, competition will grow for scarce low-cost rental units. In general, older single-family homes and multi-family rental units are likely to deteriorate as market demand drops off. MHFA's housing policies and programs need to be cognizant of these changing conditions and be responsive to them.

Demand for "starter homes" and rental units will decline.

Some of the demographic characteristics of present and future households are illustrated in the accompanying tables and charts. The rapid increase in numbers of new households experienced during the 1970s will be replaced in the 1990s by a much slower rate of growth. Table 1.1 shows that the number of households grew 28.9 percent from 1970 to 1979. This corresponds to an annual rate of about 2.6 percent. Table 1.2 projects that from 1995-2000, the rate of growth in households will be 4.8 percent or less than 1 percent annually. Table 1.3 describes characteristics of Minnesota households and Figure 1.1 illustrates that the age group that will experience the largest drop in household growth between 1990 and 2000 will be the under-34-year-olds. Minnesota will experience a bigger drop in this age group than the nation.

The average size of households has been decreasing over many years as shown in Figure 1.2. Persons per household has declined from a peak of 3.8 in 1945

	Percent Change in Households	
	1970-1979	1979-1983
Total Households	28.9%	6.4%
Two or More Person Households	23.6	5.7
Married Couples	20.3	5.4
25-29 Years of Age	27.3	-27.0
30-34 Years of Age	50.1	3.0
35-44 Years of Age	13.7	12.1
45-64 Years of Age	9.9	3.5
65 Years and Over	31.8	17.0
Male-Headed Households	48.8	20.3
Female-Headed Households	46.9	1.4
One Person Households	67.7	10.5

Source: James Hughes and George Sternlieb, *The Dynamics of America's Housing* (New Brunswick, NJ: Center for Urban Policy Research, 1987), 73-75.

Table 1.1: Change in National Household Characteristics, 1970-1983

Household growth is projected to slow.

	Percent Change in Households		
	1984-1990	1990-1995	1995-2000
Total Households	9.2%	5.6%	4.8%
Age of Household Head			
Under 25 Years	-12.1%	-4.1	5.9
25-34 Years Old	6.1	-7.0	-10.1
35-44 Years Old	23.2	11.0	4.2
45-54 Years Old	13.6	23.6	18.3
55-64 Years Old	-5.0	-0.7	13.4
65 Years and Over	13.6	6.9	2.7

Source: James Hughes and George Sternlieb, *The Dynamics of America's Housing* (New Brunswick, NJ: Center for Urban Policy Research, 1987), 73-75.

Table 1.2: Projected Change in National Household Composition, 1984-2000

Renter households are much more likely than homeowners to be female-headed, single, or poor.

	Owner-Occupied		Renter-Occupied	
	Outstate Minnesota	Twin Cities	Outstate Minnesota	Twin Cities
Total Number of Households	362,200	435,300	131,600	234,500
Householder Age				
15-44 Years	40.2%	50.7%	59.0%	67.5%
45-64 Years	32.8	33.8	13.0	14.3
65+ Years	27.0	15.6	27.4	18.1
Two or More Person Household				
Married Couple	35.9%	32.4%	15.7%	14.6%
Married Couple with Children	40.1	44.0	14.4	10.6
Female-Headed Family	5.4	6.9	10.0	12.0
Male-Headed Family	1.6	2.1	1.6	2.4
Single Male	5.6	4.9	16.3	18.2
Single Female	11.8	7.4	30.0	29.1
Poverty Rate	8.1	3.2	24.8	16.0

Source: Minnesota Housing Finance Agency, *Surveying the Residential Landscape, 1986-1990* (St. Paul, 1987).

Table 1.3: Characteristics of Minnesota Households, 1980
Owners vs. Renters

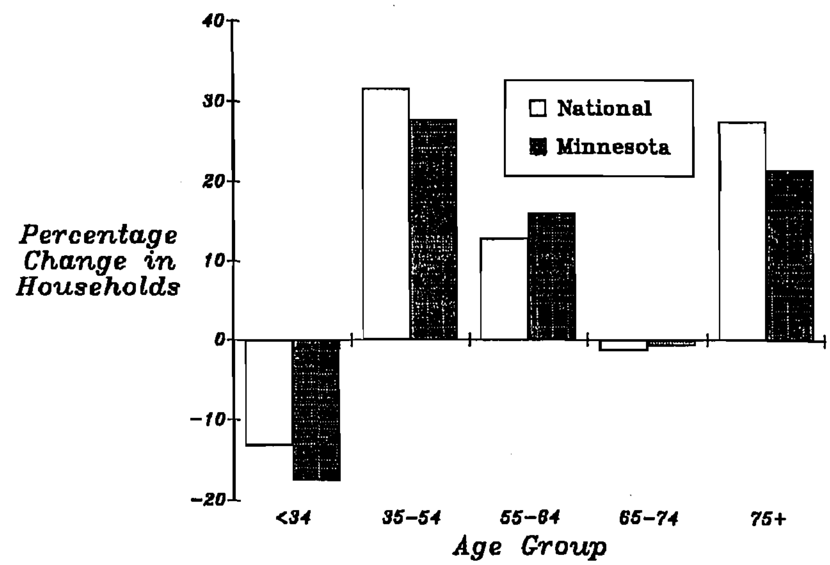

Figure 1.1: Growth in Households (by Age Group), 1990-2000
(Source: U.S. Department of Commerce, Bureau of the Census, *Series B Projections* (Washington, D.C., 1986) and Minnesota State Planning Agency, Demography Unit, *Minnesota Population Projections* (St. Paul, 1983).

Households are getting smaller.

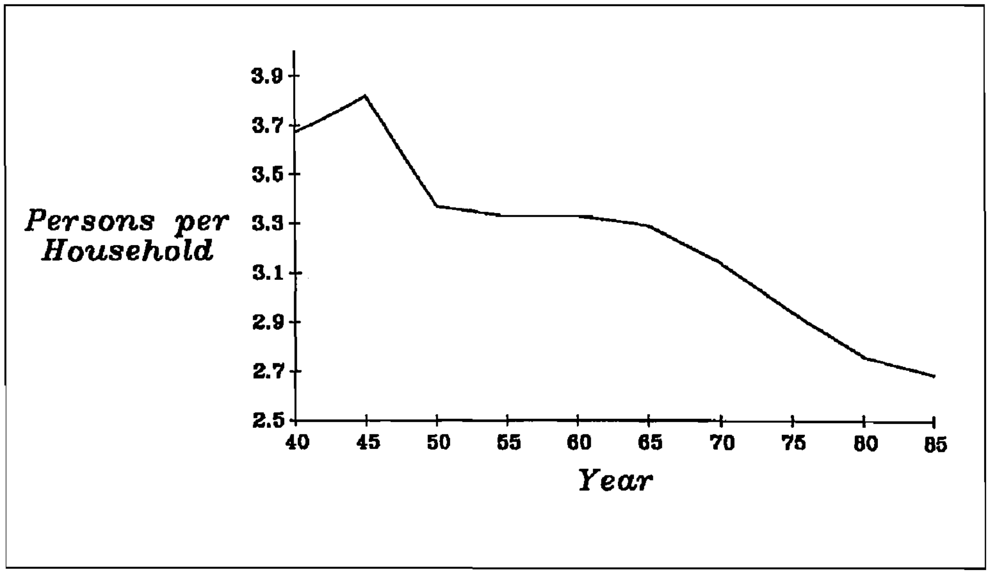

Figure 1.2: Average Household Size in Nation, 1940-1985
(Source: U.S. Bureau of the Census, *Statistical Abstract of the U.S.* (Washington, D.C., 1986).

to the current low of 2.7. As Table 1.1 shows, one person households grew 67.7 percent during the 1970s. The decline in household size has contributed to housing affordability problems. However, overcrowding, which used to be a major problem, has been significantly reduced over the years.

One of the most important demographic trends affecting housing demand is growth in non-traditional households (households not headed up by a married couple). Population experts differ on this issue as shown in Figure 1.3. George Sternlieb of Rutgers University predicts that the past decline in married couple households will level off as will the percentage of single person households. John Pitkin of Harvard and MIT disagrees and projects a continuation of the decline in percent of married couples in society and an in-

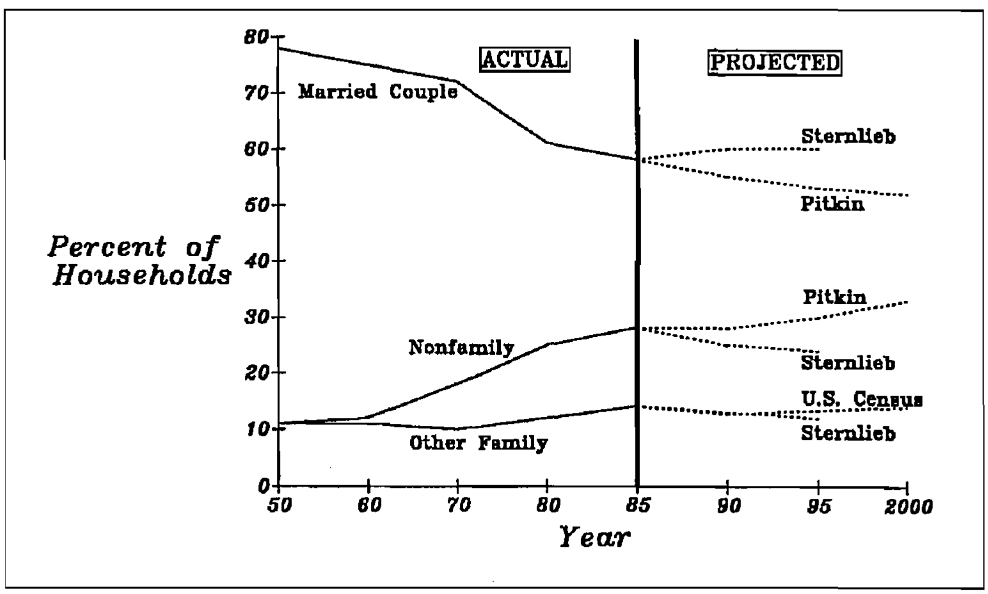

Figure 1.3: U.S. Household Composition
(Source: Metropolitan Council, *Looking Ahead at Housing* (St. Paul, 1988).

crease in the nonfamily households.
The State Demographer's projections of household types for Minnesota tend to agree with Sternlieb because they show a larger percentage change in married couples than in nonfamily households between 1990 and 2000 (see Table 1.4).

After 1990, married couple households are projected to grow faster than nonfamily households.

Household Change In Minnesota	High Estimate*	Percent Change**	Low Estimate	Percent Change**
Total Households-1985	1,634,380		1,595,760	
Total Households-1990	1,808,460	10.6%	1,730,630	8.4%
Total Households-2000	1,941,600	7.4	1,869,710	8.0
Married Couples-1985	961,910		968,050	
Married Couples-1990	1,023,250	6.4	1,035,540	6.9
Married Couples-2000	1,138,850	11.2	1,149,020	10.9
Nonfamily Households-1985	509,330		470,930	
Nonfamily Households-1990	599,230	17.6	521,990	10.8
Nonfamily Households-2000	605,180	9.9	535,260	2.5

Source: Minnesota State Planning Agency, *Minnesota Household Projections: 1985-1990* (St. Paul, 1983).

*The State Demography Unit established "high" and "low" projections based on different assumptions about household composition changes. Low scenario assumes that change will occur at 25 percent of the 1970-1980 rate of growth while the high scenario assumes change will occur at 50 percent of the 1970-1980 rate.

**1985 to 1990 and 1990 to 2000.

Table 1.4: Projected Change in Minnesota Households

Taken together, the trends just discussed imply a decrease in the upward pressure on the cost of housing of the type usually purchased by new households. Table 1.5 and Figure 1.4 confirm that in recent years homeowners' conditions have improved.

- **The rate of homeownership has remained stable between 1974 and 1987 at 64 percent in spite of the fact that millions of new households entered the housing market.**

- **The cost burden for first-time homebuyers has declined in recent years and is now at 30 percent of income.**

Due to the leveling off of housing prices and a decline in interest rates, and growth in personal income, homeowners are spending a lower percent of their income for housing. In the future, first time homebuyers should find homeownership more affordable because there will be fewer new households resulting in a decline in competition for starter homes.

On the other hand, rental housing is becoming less affordable as Figure 1.4 also shows and the financial distress among low-income renters is expected to

Low income and younger groups have experienced declines in homeownership.

Household Income (1986 dollars)	Percent of Each Income Group that are Homeowners 1974	1987
NATIONAL AVERAGE	64.7%	64.0%
Under $5,000	42.8	36.7
$5,001-10,000	48.7	45.9
$10,001-17,500	53.8	51.9
$17,501-25,000	58.7	60.0
$25,001-35,000	69.3	68.3
$35,001-50,000	78.6	79.3
$50,000+	86.2	89.1

Age of Head of Household	Percent of Each Age Group that are Homeowners 1974	1987
Under 25	22.7%	16.0%
25-34	52.0	45.0
35.44	71.7	66.8
45-64	76.4	78.2
65 and Over	69.7	75.1

Source: William Apgar and James Brown, *The State of the Nation's Housing* (Cambridge, MA: Harvard University, 1988), 7.

Table 1.5: Home Ownership in the Nation, 1974 and 1987

Housing cost burden is rising for renters but falling for first-time buyers.

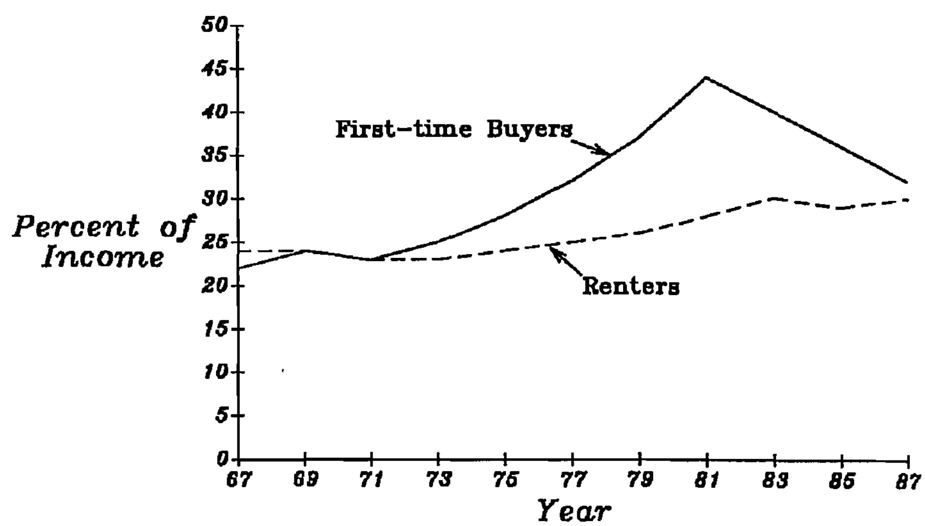

Figure 1.4: U.S. Housing Cost Burden, 1967-1987
(Source: William Apgar and James Brown, *The State of the Nation's Housing* (Cambridge, MA: Harvard University, 1988), 7; this figure presents estimates of annual cost of a representative unit as a percent of household income using 1986 constant dollars. The housing cost for first time home buyers represents total costs and the rental cost represents gross rent (includes utilities, property tax, etc.)

be the major housing problem of the 1990s. The problem in the rental market is no longer inadequate supply but rental cost in relation to income. Table 1.6 shows a growing proportion of tenants are paying above 25 percent of their income for rent. Between 1970 and 1983 the percentage of renters paying over 25 percent of their income for housing increased from 36 percent to 55 percent. Also,

Most renters now pay a large part of their income for rent.

- **Between 1970 and 1983, median rent increased at about twice the rate of median income. Renters who paid over 50 percent of their income for rent grew from 3.7 million in 1975 to 6 million in 1983.**[1]

	Percent of All Renter Households	
Rent Burden	1970	1983
Paying over 25% of income for rent	36%	55%
Paying over 35% of income for rent	23	35
Paying over 50% of income for rent	NA	22
Paying over 60% of income for rent	NA	16

Source: John Gilderbloom and Richard Appelbaum, *Rethinking Rental Housing* (Philadelphia: Temple University Press, 1988), 23.

Table 1.6: Rent Burden in Nation, 1970 and 1983

Projections of future housing market conditions indicate a further deterioration in the affordability of rental housing. As Table 1.7 shows, the National Council of State Housing Agencies has predicted that between 1983 and 2003, the surplus of 1 million low rent units will shift to a shortage of 7.8 million units.

In the past, federal and state programs assumed that a "trickle down" or filtering process would provide affordable housing for low-income households. By subsidizing homeowners in the form of tax benefits or direct subsidies (e.g. low interest mortgages), policymakers assumed that one outcome would be an upgrading of the housing conditions for all. Evidence suggests that this filtering process has slowed or stopped.

	1983	1993	2003
Households needing low rent units	11.9 million	14.3 million	17.2 million
Number of low rent units available	12.9 million	10.6 million	9.4 million
Demand/Supply Gap	+ 1.0 million	-3.7 million	-7.8 million

Source: National Council of State Housing Agencies, *Delivering the American Dream* (Washington, D.C., 1987).

Table 1.7: Demand and Supply for Low Rent Units in Nation, 1983-2003

1 The National Housing Task Force. *A Decent Place to Live* (Washington, D.C., 1988).

- **Today, a dual housing market seems to exist in which rental housing is becoming less affordable while homeownership is becoming more affordable. Improvements in the housing conditions for homeowners has not filtered down to renters.**

According to the Harvard/MIT Joint Center for Housing Studies, since 1974 the median income of renter households aged 25 to 34 fell by 18.5 percent while for homeowners, the median income of this same age group rose by 2 percent (in 1986 dollars). Figure 1.4 illustrates that the housing cost burden for renters has grown continuously during the 1980s while it has been dropping for homeowners. The supply of affordable rental housing has been further reduced by local redevelopment policies. The National Housing Task Force estimated that demolitions resulted in the loss of 4.5 million units between 1973 and 1983 and half of these units were occupied by low-income tenants.

FEDERAL AND STATE HOUSING POLICIES

Federal Housing Policies and Programs

Federal policy has shifted from new construction to subsidizing existing housing.

Federal housing policy has shifted from a period of great expansion in housing assistance and an emphasis on new construction during the 1970s to a decade of contraction and emphasis on conservation of the housing stock during the 1980s. For example, in 1970 subsidized housing constituted 29 percent of all housing starts but by 1984, only five percent of housing starts were subsidized. Around the nation, HUD provided assistance to construct only 13,109 low-income units in 1986 compared to 200,406 in 1979.[2] HUD's strategy has shifted from new construction to providing vouchers for existing housing. The end result is a significant increase in subsidized units during the 1980s at the same time HUD's budget was cut.

The major federal effort to assist low-income renters now is the Section 8 rental certificate and voucher programs which subsidized the rents of 1.9 million households in 1984 (see Table 1.8). This program pays the difference between the amount of rent a tenant can affford (30 percent of income) and the market rent of the unit.

In 1984, the federal government subsidized a total of 3.6 million households. Households receiving subsidies grew by a third from 1980 to 1988 and now total about $4.2 million, yet this number represents a small percentage of the persons in need.

- **Existing federal housing programs serve only 22 percent of all the low-income households (incomes below 50 percent of county median) who are eligible for, and in need of housing assistance (see Table 1.9).**

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2 Randy Welch, "Responding to the Housing Crisis," *State Legislatures* (Nov/Dec. 1987): 20-24.

Types of Assisted Housing	Number of Households	Federal Outlays (in billions)
Section 8	1,909,812	$6.03
Public Housing	1,313,908	2.82
Section 236	352,620	0.658
Rent Supplement	55,606	0.110
Total	3,649,946	$9.62

Source: National League of Cities, *Federal Housing Assistance: Who Gets It, Who Needs It?* (Washington, D.C., 1986), 25.

Table 1.8: Households Living in HUD-Assisted Units, 1984

About 22 percent of low-income renters receive federal assistance.

Types of Households	Percent of Group With Housing Subsidy
Below poverty level	16.0%
With incomes below 50% of county median income	21.6
With incomes below 80% of county median income	15.9

Source: National League of Cities, *Federal Housing Assistance: Who Gets It, Who Needs It?* (Washington, D.C., 1986), 25.

Table 1.9: Low-Income Households Served by Federal Housing Programs, 1985

By one standard, the largest federal housing assistance program is the $39 billion in tax deductions granted to homeowners in 1984.

There are major tax benefits for home owners.

- **As shown in Table 1.10, most housing tax expenditures are used for mortgage interest deductions which primarily benefits moderate and upper income homeowners.**

Type of Tax Expenditure	Amount (in billions) Lost to Treasurery
Homeowner Deductions	
Mortgage interest	$23.5
Property taxes	8.8
Capital gains deferral & Exclusion	6.5
Residential energy credits	0.630
Total	$39.4

Source: National League of Cities, *Federal Housing Assistance: Who Gets It, Who Needs It?* (Washington, D.C., 1986), 25.

Table 1.10: Housing Related Federal Tax Expenditures, 1984

At the same time, tax laws have been changed to the detriment of renters. The 1986 Tax Reform Act eliminated accelerated depreciation and other tax advantages enjoyed by owners of multi-family housing. The impact of these changes have been to discourage investment in rental buildings and to raise rents.

As a practical matter, federal programs and policies will need to be supplemented by state and local efforts if housing distress among the poor is to be relieved.

Federal housing policy is now being reassessed. In 1988, several major studies were conducted to evaluate present and future housing needs in the nation and to identify appropriate policy directions. One national housing analyst reached the following conclusion after a careful review of these studies:

- "Federal resources for housing will be nearly as limited in the future as they have been during the Reagan administration. Consequently, a major challenge is to leverage federal dollars with state, local, and private funds. Where supply-side (e.g. new construction) subsidies are used, they should be channeled to state, local or nonprofit agencies that can negotiate 'deals' with each other and with private developers."

- "Affordabililty is the most pressing housing problem, and it naturally impinges most heavily on the very poor. Federal housing resources should provide aid to all the poor before further subsidizing people of moderate means. Rent supplements for existing housing (e.g. housing vouchers, Section 8) are more cost-effective than supply-side subsidies in most markets, but the latter are appropriate in certain circumstances."[3]

State Housing Policies and Programs

Housing finance agencies (HFAs) have been created in 48 states, the District of Columbia, Puerto Rico and the Virgin Islands. Due to the contraction of federal activity in housing, the role of HFAs in providing affordable single family mortgage loans has grown. In 1980, the cumulative number of mortgage loans purchased by HFAs was 210,800 but by 1985, this had increased to 889,866. HFAs were also active in producing multi-family units since the number of rental units with HFA financing grew from 210,800 in 1980 to 626,515 in 1985.[4]

In addition to their traditional tasks of providing bond supported financing for single family mortgage loans and multi-family development loans, the HFAs have used state appropriations and their reserve funds for a "third generation" of innovative housing actions (see Figure 1.5).

3 Ira Lowry. Housing Policy for the 1990's, *Journal of the American Planning Association* (Winter, 1989)

4 National Council of State Housing Agencies. *Delivering the American Dream: The Challenge to State Housing Finance Agencies* (Washington, D.C., 1987).

State housing initiatives are attempting to meet low-income housing needs.

1. HOUSING TRUST FUNDS

Housing trust funds consist of dedicated revenues that are targeted to the conversion or rehabilitation of existing properties into affordable rental housing for low-income families. Examples of dedicated revenue sources include statewide surtax on deed transfers from sale of property, real estate transfer tax, etc. In 1985 and 1986, ten states developed housing trust funds with the annual proceeds varying from $2 million to $50 million.

2. STATE HOUSING PARTNERSHIP

Massachusetts has been nationally recognized for its statewide program which provides assistance to locally-based, public-private housing partnerships. The specific goals are to reclaim abandoned properties, redevelop lots in existing neighborhoods, and serve "at risk" households. The rental component of the program provides local nonprofit or limited profit corporations with 5.5 percent financing and rent subsidies (through federal or state rental assistance programs) in order to produce low-income family housing units.

3. STATE HOUSING REQUIREMENTS

The New Jersey "Fair Housing Act" attempted to meet low-income housing needs through a two-pronged approach. First, a "fair share" distribution of low and moderate income housing responsibilities was established for regions and localities in the state. Second, loans and other state aids were provided to local officials to assist them in meeting their responsibilities. A Council on Affordable Housing was created to provide guidelines for developing regional/local plans.

4. UTILIZATION OF NONPROFIT, COMMUNITY-BASED ORGANIZATIONS

There is a focus on nonprofit development in nearly all of the new state housing initiatives. Michigan State Housing Authority, for example, provides grants to nonprofit organizations to assist them in purchasing low-income housing. Massachusetts provides direct funding and support for neighborhood groups to administer housing rehabilitation programs. These efforts reflect a state policy goal of developing a new entrepreneurial capability at the local level by building a system of nonprofit housing corporations.

Source: Mary Neno, "States Respond to Changing Housing Needs," *The Journal of State Government*, 60, No. 3 (May/June 1987): 122-127.

Figure 1.5: New Initiatives of State Housing Finance Agencies

- **The new state housing initiatives have sought to balance the moderate income homeowner emphasis of previous HFA programs with a new focus on the rental housing needs of low-income families and homeless persons.**

The other interesting difference between these initiatives and earlier housing programs is that resources are being channeled through nonprofit, community-based corporations instead of through for-profit developers and financial institutions.

MINNESOTA HOUSING FINANCE AGENCY

MHFA's Powers

Minnesota was among the initial group of states to create a housing finance agency when it passed the Housing Finance Agency Law of 1971 (*Minn. Stat.* Ch. 462A). The agency has been empowered to provide loans needed for the purchase, rehabilitation, and construction of housing to serve low and moderate income persons.

The Legislature intended MHFA to serve as the state housing agency.

In addition to providing financial services, the Legislature intended MHFA to serve as the state's housing agency when it assigned it the following duties:

a) Provide rehabilitation and mortgage assistance grants to homeowners.

b) Provide loans to nonprofit sponsors, with or without interest, to aid in developing low and moderate income housing.

c) Receive federal housing assistance and distribute federal funds.

d) Encourage innovation in the development of housing through loans to nonprofit sponsors, with or without interest.

e) Provide grants to nonprofit sponsors for developing temporary housing and Single Room Occupancy housing for the homeless.

f) Acquire low and moderate income housing if needed to preserve housing assistance or interest reduction contracts.

g) Provide technical and project assistance to aid in housing planning, management, training, social services, etc.

h) To conduct research into housing conditions and needs throughout the state and make recommendations to the governor and Legislature.

i) Establish rules that insure projects are located in communities that have adopted the uniform building code and that encourage counties and cities to promote economical construction of housing for low and moderate income families.

j) Establish cooperative relationships with housing and redevelopment authorities and municipalities to develop priorities for use of agency resources.[5]

MHFA's Organization and Programs

In implementing this comprehensive mission, the agency has created 5 administrative departments. The current organization of MHFA is shown in Fig-

5 *Minn. Stat.* Chapters 462A.05 and 462A.06.

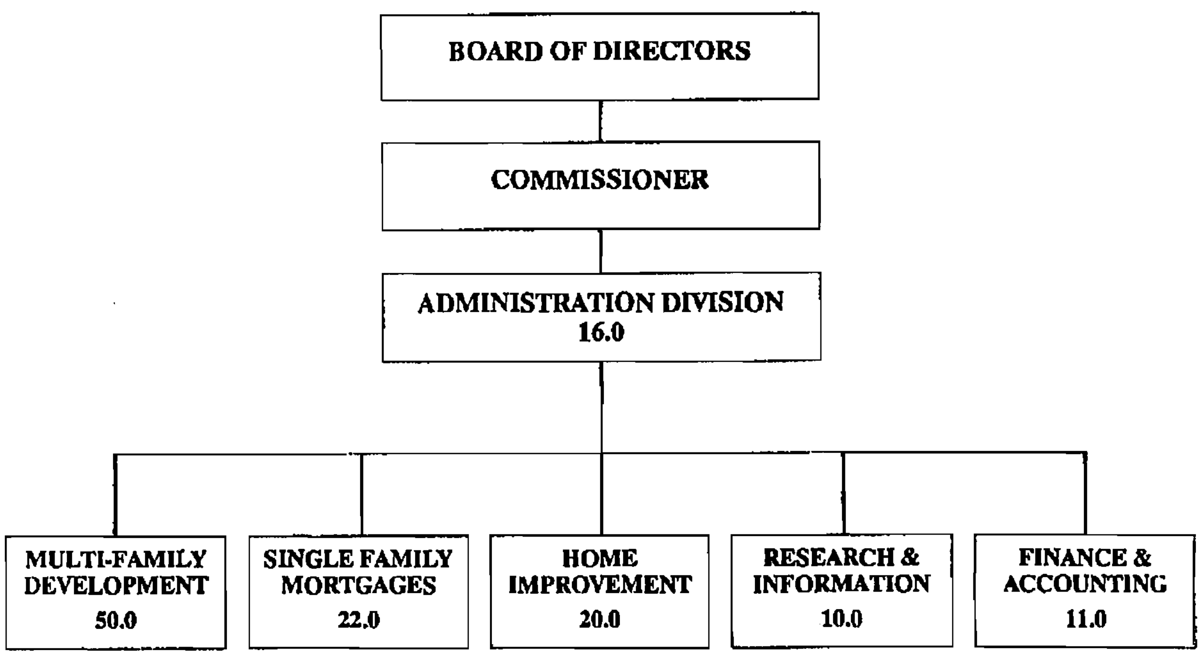
ure 1.6. The housing finance statute (*Minn. Stat.* Ch. 462A) establishes a seven member Board of Directors consisting of the Commissioner of Energy and Economic Development, the State Auditor, and five public members appointed by the Governor. The Board is the Minnesota Housing Finance Agency and management and control of the agency is vested in the Board. In practice, however, members of the Board of Directors, including the Chair, serve part-time and generally meet once per month, so their involvement in the agency is limited. The Governor also appoints the MHFA Commissioner (previously called the Executive Director). *Minn. Stat.* 462A.04, Subd. 8 says that "the agency shall be under (the) administrative control of the Executive Director . . ." As a practical matter, because the Board serves part time and due to the large professional staff, the Board's influence is limited.

MHFA has a staff complement of 129 positions.

Priorities have been established by the Board of Directors and the staff and these priorities are reflected in the staffing and expenditures of the agency. The current staff complement of MHFA is 129 total permanent positions. Figure 1.6 illustrates how these positions are distributed among the various program areas of the agency.

- **Nearly half of the staff are employed in multi-family development division. Single family mortgage and home improvement departments each employ approximately 18 percent of full-time staff.**

The remainder of agency staff are involved in research and information activities.



Total permanent positions approved, FY 1989 = 129.0.
Total number of employees, 6/30/88 = 122.0.

Figure 1.6: Minnesota Housing Finance Agency Organizational Chart and Staffing

Agency priorities are reflected in the level of funding assigned to the various programs. Table 1.11 presents a cumulative listing of appropriations and bonds sold. Between 1971 and 1988, MHFA issued about $2.3 billion of bonds and notes and received and spent $200 million in state appropriations. As Table 1.11 shows, the principal effort of the agency is to sell bonds and use the proceeds to finance mortgage loans, home improvement loans and construction of multi-family housing.

Homeowner assistance programs have dominated MHFA appropriations and bonding.

Homeowner Programs	Appropriations (in millions)	Percent of Total	Bonds Sold (in millions)	Percent of Total
Single Family Mortgages	$11.58	5.8%	$1,282.5	55.2%
Home Improvement Loans	44.78	22.4	313.7	13.5
Homeowner Assistance	17.24	8.6		
Veterans Downpayment Assistance	3.46	1.7		
Energy Loans	4.90	2.5	18.2	0.8
Emergency Energy Grants	2.00	1.0		
Accessibility Grants/Loans	3.25	1.6		
Rehabilitation Loans/Grants	72.98	36.5		
Subtotal	$160.19	80.1%	$1,614.4	69.5%
Multi-Family Programs				
Section 8	$1.80	0.9%	$593.4	25.5%
Section 236			17.9	0.8
Construction Financing			74.4	3.2
Apartment Renovation Mortgages			10.8	0.5
Energy Loan Insurance	1.50	0.8		
Apartment Grants	.50	0.2		
Subtotal	$3.80	1.9%	$696.5	30.0%
Special Needs Programs				
Group Homes for Developmentally Disabled			$ 11.8	0.5%
Temporary Housing	$ .40	0.3%		
Low-Income Persons Living Alone	.50	0.3		
Housing the Homeless	.15	0.1		
Tribal Indian Housing	27.98	14.0		
Urban Indian Housing	4.59	2.3		
Sioux Rehabilitation Grant	.25	0.1		
Chippewa Rehabilitation Grant	.15	0.1		
Elderly Homesharing	.40	0.2		
Innovative Housing	1.01	0.5		
Research Projects	.25	0.1		
Start-up Appropriations	.25	0.1		
Subtotal	$35.93	18.0%	$ 11.8	0.5%
TOTAL	$199.92	100.0%	$2,322.7	100.0%

Source: Minnesota Housing Finance Agency, *Cumulative MHFA Activity* (St. Paul, 1988).

Table 1.11: Summary of Minnesota Housing Finance Agency Housing Bonding and Appropriations, 1971-1988

In order of the magnitude of the effort, MHFA financing has been used:

- To promote the availability of home mortgage loans to first time home buyers meeting income and purchase price requirements. Since 1971, about $1.3 billion has been raised through the sale of bonds for this purpose.

- To promote construction of multi-family housing aimed at serving the needs of low and moderate income renters. Approximately $700 million has been raised through bond sales for this purpose.

- To finance home improvement loans and rehabilitation grants. Over $300 million in bonds have been sold for home improvement loans.

In addition to bond revenue, the MHFA received state funds financing a variety of programs. Appropriations totalled about $19 million in 1987. This number is down from appropriation levels of the mid and late 1970s. For example, $42 million was appropriated in 1979. Appropriations are used in most of the agency's activities and are the exclusive source of revenue for certain programs, especially those serving the most needy. However Table 1.11 reveals that when homeowner appropriations are compared with the funding for multi-family and special needs housing,

- **Eighty percent of all appropriated funds have been used to assist homeowners.**

This emphasis on homeowner assistance over the housing needs of renters or special needs populations was also reflected in the 1987-89 biennial budget approved by the Legislature (see Table 1.12). While the agency did request

Appropriated Programs	Legislative Appropriations (in millions)	MHFA Budget Request (in millions)
Homeowner Programs		
Rehabilitation Loan Program	$7.43	$7.43
Homeowners Assistance Fund	1.98	3.00
Multi-Family Development		
Bond Leveraging Fund	$4.45	$7.50
Special Needs Populations		
Indian Housing	$4.24	$2.74
Single Room Occupancy	.50	0
Temporary Housing	.15	0
Elderly Homesharing	.30	.20

Source: Minnesota Housing Finance Agency, *1987-1989 Biennial Budget* (St. Paul, 1986).

Table 1.12: Minnesota Housing Finance Agency 1987-1989 Appropriations and Biennial Budget Request

more funding for multi-family bond leveraging[6] than for any other program area, the program that ultimately received the largest appropriation was the Rehabilitation Loan Program that assists low-income homeowners.

Furthermore, the agency's request for assistance to special needs populations (e.g. Temporary Housing for the homeless, Indian housing) was generally less than the level of appropriations authorized by the Legislature.

Governor's Commission on Affordable Housing for the 1990s

Governor's Commission: "The state should first assist those who most need help and are most at risk."

In 1988, MHFA undertook a major effort to analyze the present and future housing needs in the state and to develop ideas for a housing agenda for the 1989 Legislative session. From July to December, 1988, MHFA served as staff for the Governor's Commission on Affordable Housing for the 1990s. This 24 member Commission consisted of a cross-section of representatives from the public and private, nonprofit and for-profit housing sectors.

The final report of the Commission makes several statements of principles which have important implications for MHFA's programs and policies.
In the "Introduction" section of the report, one of the Commission statements included:

- "This agenda requires the MHFA to go beyond its present role as primarily a finance agency and assume more responsibilities for technical assistance, advocacy, and capacity building with local governments, nonprofit and for profit developers, and lenders. The MHFA in cooperation with the governor and the legislature is prepared to meet this challenge and actively work with all participants in all parts of the state to implement this agenda."

In the "Basic Principles" section of the report, some of the Commission statements were:

- "State government must take a more active role in providing decent and affordable housing in cooperation with local governments, private and nonprofit developers and the entire housing production and finance system in Minnesota."

- "The state should first assist those who most need help and who are most at risk of suffering from lack of decent and affordable housing."

- Communities in all parts of Minnesota must be helped with new programs. Needs differ by area, and local communities can best determine their specific needs."

6 Bond leveraging refers to the use of state appropriations to help provide security for bond issues by contributing to a reserve fund or providing insurance against losses.

- Minnesota should establish basic housing goals and objectives and review them on a regular basis to ensure that limited resources are being directed to those households that most need help."

In the "Specific Program Principles" section of the report, some of the Commission statements were:

- "The impact of changing markets and changing demand for housing caused by the demographic changes of the 1990's must be a basic consideration in every activity in the new state effort. Adaptation, re-use, preservation, maintenance, and rehabilitation of existing housing should be a major program objective."

- "The opportunity to combine state, local, private, nonprofit, and foundation resources must be fully developed in every program or activity recommended to the legislature. "

The Governor's Commission made several good recommendations.

- Nonprofits should be supported where they can provide long-term affordability.

We think the Commission report is an important starting point for the housing policy debate that needs to take place in Minnesota.

SINGLE FAMILY MORTGAGE LOAN PROGRAM

Chapter 2

MHFA's largest program over the years has been the Single Family Mortgage Loan Program (publicly identified as the Minnesota Mortgage Program) designed to help low and moderate income buyers purchase a home. Since 1971, about $1.3 billion has been raised through the sale of bonds. In addition, about $12 million in state appropriations have been used along with bond proceeds to provide over 23,000 below-market-rate mortgage loans. This chapter describes and evaluates the Single Family Mortgage Loan Program and coordinated efforts aimed at assisting low and moderate income, first-time home buyers.

The program is targeted at buyers who would not otherwise be able to afford to buy a home. *Minn. Stat.* §462A.05, Subd. 3 says that loans are to be made only when financing is not available on equivalent terms from private lenders. Thus, the effectiveness of the mortage loan program rests on the extent to which the program serves borrowers who cannot qualify for private financing, but can predictably meet the financial obligation of a loan carrying a below-market rate of interest. We ask:

- **Are loans carefully targeted in keeping with the basic purpose of the program?**

- **Has MHFA made loans available state-wide with a minimum of red tape?**

- **Has MHFA achieved the social objectives of the program without jeopardizing its financial security?**

In addition, a key question for the future is:

- **Even if MHFA's mortage loan program is effective and efficient, is the program appropriate for the future, especially if the federal subsidy for the program is lost or restricted?**

PROGRAM DESCRIPTION AND EVALUATION PERSPECTIVE

MHFA's single family mortgage loan program is financed through the sale of tax-exempt bonds. Proceeds of bond sales are used to purchase mortgage loans from lending institutions around the state that originate the loans according to criteria and procedures set by MHFA. As monthly payments are made by borrowers, and collected by servicing agents hired by MHFA, bond holders are paid the interest and principal due them. If all goes well, the bonds and mortgage loans are ultimately all paid off.

MHFA is able to offer mortgage loans at 1.5 to 2.0 points below market interest rates.

In order for a bond-financed mortgage loan program to work, investors must have confidence that MHFA will be able to collect on the loans or cover bad loans with insurance or reserves that are adequate for this purpose. The financial community, including agencies that rate mortgage revenue bonds for Minnesota and other jurisdictions, and mortgage bankers that underwrite bond issues and assume some financial risk in the process, require that underwriting standards common to the industry be met in approving mortgage loans.

Without going into all the technical reasons and details, the significance of these standards (largely dictated by bankers, ratings agencies, and mortgage insurers) is that:

- **MHFA mortgage loans can only be made to borrowers with reasonably good financial prospects.**

Use of tax-exempt financing augmented by additional state contributions makes it possible to offer mortgage loans at an interest rate about 1.5 to 2 percentage points below the prevailing market rate.

In theory, with careful administration, this should make it possible for a category of buyers who cannot qualify for a mortgage loan, or a loan on equivalent terms, or as big a loan, to qualify for a subsidized loan. Thus, the success of the Single Family Mortgage Loan Program in achieving its basic purpose hinges on the following question:

A category of buyers can qualify for MHFA loans who would not qualify for comparable market rate financing.

- **Are MHFA loans made to buyers who could not otherwise qualify for a mortgage loan?**

This question is of interest to both the federal government and the states, since both subsidize mortgages financed through tax-exempt bonds. But the federal and state perspectives differ, since federal taxpayers in Minnesota would pay for other states' housing programs even if Minnesota did not have a mortgage loan program. Thus, it is in Minnesota's interest to participate fully in a federally subsidized mortgage loan program even if the program is inefficient. In the following sections we will review the mortgage loan program from both the state and federal perspective.

The National Perspective

The federal government provides a major subsidy to states and localities offering mortgage loans with revenue raised through the sale of bonds whose interest is exempt from federal taxes. Over $50 billion in tax exempt mortgage revenue bonds were issued nation-wide between 1982 and 1986.

Congress and the executive branch have grown increasingly skeptical of the public purpose served by mortgage loan programs run by state and local housing finance agencies. A serious effort to restrict the use of tax-exempt bonds for this purpose began in Congress in 1980. By 1988 some housing experts were predicting either the end of the program or major new restrictions. As Congress adjourned for 1988, however, authorization for tax-exempt mortgage revenue bonds was continued for another year without major new requirements. While skepticism has grown, Congressional support for this very popular program has also solidified.

An influential GAO study concludes that subsidized mortgages are inefficient and mainly help buyers who could afford to buy a home anyway.

From the perspective of the federal government two evaluation issues are critical:

- **Are buyers helped who would otherwise not be able to afford a home?**
- **Is the use of tax-exempt bonds an efficient way to deliver a subsidy to the households that are intended to benefit from the program?**

General Accounting Office Study

A March 1988 study by the General Accounting Office[1] backed up by numerous research and technical studies concludes in strong, unequivolcal terms that:

- **Most buyers assisted by tax-exempt mortgage revenue bonds could have afforded homes anyway;**
- **Under typical and best-case scenarios GAO estimates a benefit to the home buyer of between 12 and 45 cents for every dollar of federal revenue lost through issuance of tax-exempt mortgage revenue bonds.**

The GAO study bases its conclusion that most assisted buyers could afford homes without assistance on the finding that:

- **Characteristics of bond-assisted buyers and all first time buyers are similar. By some measures, bond-assisted buyers are actually better off economically than all first time buyers.**

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1 Home Ownership Mortgage Bonds are Costly and Provide Little Assistance to Those in Need, U.S. General Accounting Office, March 1988 (GAO/RCED-88-111).

Table 2.1 shows data from the GAO study[2] on income, home purchase price, and several other characteristics. The characteristics of bond-assisted buyers and all first time buyers are generally similar. Where they differ assisted buyers are not uniformly better off. For example, about 30 percent of all first time buyers have incomes less than $20,000 per year compared to 21 percent of bond-assisted buyers. Proportionately more first time buyers have higher incomes as well, 18 percent have incomes of $45,000 or more per year compared to 4 percent of bond assisted buyers. The fact that assisted buyers are concentrated in middle income groups reflects federal and state income limits on eligibility for subsidized loans. Bond-assisted buyers need to meet underwriting criteria that limit the purchase of certain properties and prevent them from borrowing if their incomes are too low. Some who cannot qualify for an MHFA loan, for example, could purchase homes on a contract for deed.

Other financing options such as VA and FHA loans also permit first time buyers to purchase a home with a lower down payment than typically required of bond-assisted buyers. Thirty-five percent of all first time buyers put less than five percent down compared to 20 percent of bond-assisted buyers.

A comparison of the age of buyers shows bond-assisted buyers to be somewhat younger than first time buyers in general. Fifty-nine percent of bond assisted buyers are under 30 years of age compared to 52 percent of all first time buyers.

Finally, mortgage revenue bonds tend to be used more often to finance new construction than other financing sources. Twenty-two percent of all first time buyers, but 39 percent of bond-assisted buyers purchase a new home. As we discussed in Chapter 1, demand for existing housing is projected to weaken, and the danger of deterioration of the housing stock to increase in the next decade. Thus, in many areas, the public purpose of financing new construction (as a housing program) is called into question.

GAO performed an analysis to determine what percentage of bond-assisted buyers could have afforded conventional financing on the same home they bought. This analysis considered household income and prevaling interest rates, and used a housing expense-to-income ratio of 28 percent in determining loan eligibility.

GAO concluded that 56 percent of assisted buyers could have afforded the same size conventional loan and an additional 12 percent could have afforded an adjustable-rate loan. An additional 11 percent could have afforded a 10 percent smaller adjustable-rate loan. The remaining 21 percent would have needed additional assistance to qualify for a loan.

- **At the very least, the GAO study calls single family mortgage loan programs such as Minnesota's into serious question.**

MHFA and other state housing finance agencies criticize the methodology and conclusions of the GAO Study. They argue that the GAO study looks at program operations before changes in participation criteria required by the 1986 Tax Reform Act (which tightened eligibility criteria) were implemented.

2 Data on bond assisted buyers was collected by GAO from 19 state and local housing agencies (not including MHFA). Data on first time buyers comes from the 1983 American Housing Survey, the major U.S. statistical source on housing.

Bond-assisted buyers resemble all first time buyers.

	Bond-Assisted Buyers*	All First-Time Buyers*
PRICE OF HOME PURCHASED (in 1986 dollars)		
$1,000 or less	0%	0%
$1,001 to $25,000	3	4
$25,001 to $50,000	31	25
$50,001 to $75,000	45	37
$75,001 to $100,000	16	20
More than $100,000	5	15
Total	100%	100%
BUYERS' INCOMES (in 1986 dollars)		
$1,000 or less	2%	1%
$1,001 to $10,000	1	9
$10,001 to $20,000	18	20
$20,001 to $30,000	46	27
$30,001 to $45,000	29	26
More than $45,000	4	18
Total	100%	100%
BUYER'S AGE		
Under 25	20%	18%
25 to 29	39	34
30 to 34	22	26
35 to 49	16	17
50 or more	3	5
Total	100%	100%
DOWN PAYMENT		
0%	10%	23%
0.1 to 4.9%	10	12
4.9 to 5.1%	32	1
5.1 to 19.9	31	40
20% or more	17	24
Total	100%	100%
NEW OR EXISTING HOME PURCHASED		
New	39%	22%
Existing	61	77
Total	100%	100%

Source: United States General Accounting Office (GAO/RCED-88-111) 84.

NOTE: Distributions are based on data on 100-160 thousand bond-assisted buyers (depending on the number of missing observations on each characteristic) and about one million first-time buyers. First-time buyers in rural areas were excluded. First-time buyers includes 6-10 percent who are bond-assisted.

*Totals may not add due to rounding.

Table 2.1: Comparison of Bond-Assisted Buyers with All First-Time Buyers

MHFA also points out that its program has been run more carefully than those in some other states and localities.

National Council Study

The National Council of State Housing Agencies (NCSHA) sponsored a recent study of Single Family Housing Bonds[3] that argues that state housing finance agencies have met and exceeded federal performance standards, and that, in general, tax-exempt mortgage revenue bonds meet an important need and serve a clear public purpose.

Among other things, this study compares bond-assisted buyers with a sample of buyers receiving conventional financing, FHA, and VA loans. The data set includes about 210,000 mortgage loans, one third of state housing finance agency activity between 1983 and 1987. Data on other buyers comes from annual surveys by the National Association of Realtors.

Table 2.2 compares bond-assisted buyers with buyers using conventional and VA financing. The number of cases of non-assisted buyers is fairly small, and excludes first time buyers using contract for deed financing, a category of buyers included in the GAO study. Contract for deed financing is now widely used by various types of buyers, but lower income buyers unable to qualify for

State housing finance agencies commissioned a study that defends the use of tax-exempt bonds to finance home mortgage loans.

	Bond-Assisted Percent	Conventional Percent	VA Percent	FHA Percent
INCOME				
Under $25,000	38%	12%	9%	15%
$25,000-29,999	22	19	24	24
$30,000-34,999	18	15	26	28
$35,000-39,999	1	14	16	15
$40,000-44,999	6	11	11	1
$45,000 or more	6	29	14	8
Number	141,814	558	245	498
AGE				
Under 25	18%	12%	7%	14%
25-29	39	46	38	51
30-34	23	27	3	22
35-39	1	9	15	1
40-44	5	4	7	3
45 and older	6	2	3	1
Number	141,814	558	245	498

Source: Wrightson (1988) 76. See text for full citation.

Table 2.2: Comparison of Bond-Assisted, Conventional, VA, and FHA First Time Buyers, 1984-1987

3 Margaret Wrightson, "Who Benefits From Single-Family Housing Bonds: History, Development, and Current Experience of State-Administered Mortgage Revenue Bond Programs." Washington, D.C. Georgetown University Graduate Program in Public Policy, April 28, 1988.

traditional loans, are disproportionately likely to use contract for deed financing.

Table 2.2 shows that bond-assisted buyers are slightly more likely to be under 25 years of age than conventional, FHA or VA financed first time buyers, but the proportion under 30 is about the same. A comparison of income shows that bond-assisted buyers are concentrated in income ranges under $35,000 compared to the other buyers shown. But there is substantial overlap between the two distributions. For example, 31 percent of conventional borrowers, 33 percent of VA, and 39 percent of FHA borrowers have incomes under $30,000 compared to 60 percent of bond-financed borrowers.

Thus, the National Council study concludes that bond-assisted buyers are concentrated at lower income levels. The study also concludes that assisted buyers purchase lower-priced homes than conventional, VA and FHA borrowers. Furthermore, the study shows that these differences have increased in recent years, apparently the result of increased efforts by the federal government and the states to target loans to lower income households.

While there is an apparent difference between the GAO study and the National Council study, many of these differences are due to the different samples of other first time buyers to which bond-assisted buyers are being compared. The National Council study uses small samples of conventional, FHA and VA borrowers. GAO uses a huge sample of borrowers from the nations best source of housing statistics. However, the data used by GAO pertain to 1983 (although income and prices are adjusted for inflation) while the National Council data came from annual surveys by the National Association of Realtors taken between 1984 and 1987.

We think the similarities between the studies are as noteworthy as the differences. Either study shows that there is substantial overlap between assisted buyers and other first time buyers. The idea that MHFA or any other housing finance agency can literally achieve the goal of providing subsidized financing only to borrowers unable to obtain equivalent financing is unachievable in a substantial number of cases. MHFA feels it does very well to target loans to households unable to obtain conventional financing, but by its own estimate, it fails about 30 percent of the time.

Cost Benefit Analysis

GAO concludes that tax-exempt bonds are an inefficient way of providing assistance to home buyers.

The calculation of the cost of tax-exempt mortgage revenue bonds to the federal government and the benefit of below market interest mortgage loans to borrowers depends on a number of factors including the spread between bond-assisted and conventional loans, the administrative cost of issuing bonds, the rate at which subsidized loans (some of which are committed to specific developers) are capitalized into the price of housing, the marginal tax rate of the home buyer, and other factors.

Using reasonable assumptions, GAO calculates the benefit to buyers per dollar of tax expenditure by the government. The best case scenario assumes no capitalization, a 14 percent conventional loan rate and a spread of 1.5 percentage points between bond-assisted and conventional financing. Even under these assumptions, benefits equal only 45 cents on the dollar. Note that computation of benefit per dollar of federal revenue lost does not depend on whether households could have qualified for financing from other sources. However, benefits include only the dollar value of the subsidy derived from tax exempt financing, not intangible benefits to households or the community derived from enabling households to buy, or buy sooner than they otherwise could.

Conclusion

The question of whether MHFA and other state HFAs are correct or if critics such as the GAO are correct about the benefits and costs of federally subsidized mortgage loans is a debate that will continue in Congress and elsewhere. Housing finance agencies in Minnesota and other states will lobby hard for a continuation of the program since it involves a large federal subsidy. The Congressional Joint Committee on Taxation estimates that the tax exemption for outstanding mortgage bonds will cost the federal government $7.8 billion for 1989-93. Other studies estimate the cost to be $150 to $200 million per one billion dollars in bonds issued. From the states' perspective, subsidies of this magnitude are worth fighting for. It is not surprising, therefore, that the states view the subsidy as an important benefit while the federal government takes a harder look at the effectiveness of the program and its affordability.

Minnesota has no choice but to actively pursue the federal subsidy provided by tax-exempt bonding authority.

It is not the purpose of this report to settle the question of whether tax-exempt mortgage revenue bonds financing single family mortgage loans should be continued by the federal government, nor to criticize MHFA and other states for their efforts in favor of continued subsidies. But since Minnesotans are also U.S. citizens, it has to be pointed out that from a national perspective, the use of tax-exempt bonds to finance home loans is regarded as a questionable program by a growing number of experts and policy makers.

The States' Perspective

From the states perspective, evaluation of MHFA's single family mortgage does not depend on whether the program makes sense from a national perspective. Rather, it depends on the following issues:

- **Has MHFA taken timely advantage of the federal subsidy, so that as many Minnesotans can benefit as possible?**
- **Has MHFA targeted home loans to buyers at the low end of the income range in which the program operates?**
- **Has MHFA targeted loans to new construction and existing houses in a way that makes sense?**
- **Has MHFA carried out these goals while maintaining the security of its mortgage backed bonds?**
- **Has MHFA administered the program competently, efficiently, and fairly?**

Subseqent sections of this chapter, in essense, provide affirmative answers to each of these questions. Minnesota's Single Family Loan Program is not perfect, but it is well managed on the whole and appropriately targeted.

PROGRAM EFFECTIVENESS

We examined the relevant history of MHFA and found:

- **MHFA has aggressively used its authority to sell bonds and offer mortgage loans.**
- **Compared to federal requirements and the practice of other states, MHFA has targeted loans to lower income buyers in a way that is consistent with the state and federal conception of the public purpose of the program.**
- **Even with aggressive efforts to target loans, a substantial share of borrowers could have bought a house anyway. It is simply not possible, as a practical matter, to avoid all overlap.**
- **Loans have been made available across the state.**
- **The security of the bonds financing the Single Family Mortgage Loan Program has been maintained.**

Program Implementation

Minnesota's program was up and running early.

MHFA was established in 1971 and the first MHFA-financed loans were issued in 1973. Between 1973 and June 1988, MHFA sold about $1.2 billion of mortgage-backed bonds and purchased 23,557 loans with a total value of $977 million.[4]

Table 2.3 presents data on the number and value of loans purchased by MHFA for Fiscal Years 1986-88 with projections through FY 1990. Table 2.3 shows that mortgage loan activity has been unusually high during FY 1988.[5]

MHFA was established prior to most state housing finance agencies and issued its first bonds relatively early. Data comparing Minnesota to other states is somewhat sketchy and incomplete, but Tables 2.4 and 2.5 compare Minnesota to other states on several general points of interest.

4 Source: MHFA 1990-91 Budget Proposal.

5 MHFA explains that activity has been high recently because of concern about future restrictions on the program.

Activity was especially high in 1988.

Fiscal Year	Number of Loans	Mortgage Loan Value (millions)	Average Loan
1986	$2,336	$111.8	$47,850
1987	1,483	69.7	47,000
1988	3,011	163.5	54,300
1989	2,181	120.0	55,000
1990	1,636	90.0	55,000
1991	1,636	90.0	55,000

Source: 1988-89 and 1990-91 Biennial Budget proposals.

Table 2.3: Single Family Mortgage Loan Program Activity, Fiscal Years 1986 to 1991

Table 2.4 presents data on a set of states selected because they are comparable to Minnesota or encompass the range of national experience. As Table 2.4 shows, Minnesota issued its first bond in 1973, several years before the other midwestern states shown. As of December 1985, Minnesota's outstanding debt was higher per capita than any state on this list except Massachusetts.[6]

Table 2.5 shows mortgage revenue bond levels by year for the same set of states. (These numbers include both mortgage loans and home improvement loans.) Minnesota issued a substantial volume of debt prior to 1980 compared to the other states shown. The right-most column on Table 2.5 shows that Minnesota financed a greater share of mortgage and home improvement loans prior to 1980 than any other state shown. While Minnesota was off and running first, other states have caught up. In recent years, and for the future, there are federal limits on each state's use of tax-exempt financing. These limits have caused states to become more like one another over time in the use of mortgage revenue bonds.

HFA	1980 Population (millions)	Size of Board	Size of Staff	Year of Enabling Legislation	First Bond Issued	Debt Ceiling 12/31/85	Debt Outstanding 12/31/85	1985 State Appropriations
MINNESOTA	4.08	7	120	1971	1973	$1,990	$1,570	$17.2
Wisconsin	4.70	11	92	1972	1979	210,000	1,253	2.5
Iowa	2.91	9	13	1975	1977	Yes	--	Yes
Oregon	2.63	Not Avail.	35	1973	1977	--	607.2	No
Colorado	2.89	9	81	1973	1974	1,800	1,182	No
Massachusetts	5.74	9	200	1968	1979	2,980	2,584	5,987
California	23.67	14	136	1975	1976	3,550	1,629	No
Michigan	9.26	7	210	1969	1977	3,000	2,081	No

Source: Council of State Housing Agencies, Production Activities of State Housing Finance Agencies 1985 and Cumulative, Washington, D.C.; CSHA, 1986.

Table 2.4: Characteristics of State Housing Finance Agencies (Dollars in Millions)

6 Minnesota's per capita indebtedness is, however, somewhat below the national average.

		1985 Cumulative-Bond Volume (millions)	Mortgage Purchase Volume (millions)		Number of Loans Financed By Type of Construction				
HFA		MRBs	Home Mortgage	Home Impr.	New	Existing	Home Impr.	Total	
MINNESOTA	Prior to 1980	577.1	--	--	5,389	6,327	31,823	43,539	(63%)
	1980-1985	484.0	372.8	137.5	2,345	3,809	18,937	24,371	(36%)
	1985	145.0	52.7	--	323	720	--	1,043	(1%)
	TOTAL	1,206.1	425.5	137.5	8,057	10,136	50,760	68,953	(100%)
Wisconsin	Prior to 1980	86.9	--	2.9	2,209	795	3,834	6,838	(24%)
	1980-1985	591.1	421.4	42.8	2,299	9,804	4,814	16,917	(60%)
	1985	209.5	178.6	8.9	627	3,206	432	4,265	(16%)
	TOTAL	887.5	600.0	54.6	5,135	13,805	9,080	28,020	(100%)
Iowa	Prior to 1980	192.6	--	--	--	--	--	4,434	(41%)
	1980-1985	238.6	134.3	--	--	--	--	3,439	(31%)
	1985	50.0	122.7	--	--	--	--	3,090	(28%)
	TOTAL	481.2	257.0	0	0	0	0	10,963	(100%)
Oregon	Prior to 1980	167.0	--	--	609	5,415	--	6,024	(61%)
	1980-1985	267.0	200.0	--	897	2,421	--	3,318	(33%)
	1985	95.0	24.7	--	80	509	--	589	(6%)
	TOTAL	529.0	224.7	0	1,586	8,345	0	9,931	(100%)
Colorado	Prior to 1980	240.0	--	--	1,910	3,022	--	4,932	(41%)
	1980-1985	362.2	239.4	--	1,721	2,748	--	4,469	(37%)
	1985	234.9	204.3	--	810	1,982	-	2,792	(23%)
	TOTAL	837.1	443.7	0	4,441	7,752	0	12,193	(100%)
Massachusetts	Prior to 1980	25.0	4.1	--	53	3,263	--	3,316	(22%)
	1980-1985	675.0	507.7	--	1,060	8,067	--	9,127	(61%)
	1985	263.0	211.4	--	510	2,015	-	2,525	(17%)
	TOTAL	963.0	723.2	0	1,623	13,345	0	14,968	(100%)
California	Prior to 1980	420.0	--	20.0	6,750	740	850	8,340	(48%)
	1980-1985	1,167.7	854.8	--	8,116	900	--	9,016	(51%)
	1985	499.3	223.2	--	161	20	--	181	(1%)
	TOTAL	2,083.0	1,078.0	20.0	15,027	1,660	850	17,537	(100%)
Michigan	Prior to 1980	240.3	104.4	12.5	9,029	250	6,483	15,762	(47%)
	1980-1985	516.1	370.9	36.0	3,100	3,948	5,839	12,886	(38%)
	1985	150.0	133.6	4.7	1,208	2,818	965	4,991	(15%)
	TOTAL	906.4	608.9	53.2	13,337	7,016	13,287	33,640	(100%)

Source: Council of State Housing Agencies, *Production Activities of State Housing Finance Agencies 1985 and Cumulative*, Washington, D.C.: CSHA, 1986.

Table 2.5: Characteristics of State Housing Finance Agency Home Ownership Programs

Targeting

The statutory purpose of subsidized loans financed by MHFA requires that loans be targeted to buyers otherwise unable to qualify for equivalent financing. Earlier in this chapter, we reviewed the findings of a GAO study (that did not include Minnesota's program) which concluded that most people helped by subsidized mortgages would have been able to arrange equivalent financing anyway.

MHFA and other states argue that they are aggressively and creatively targeting their loans. MHFA points out that it does better than most states, local HFA's in Minnesota, and better than the federal government requires.

We reviewed data on the characteristics of MHFA-assisted borrowers and talked to MHFA officials and other housing experts. Our major findings are:

- **MHFA has targeted its program to low and moderate income borrowers, while preserving the financial security of the bonds financing the loans;**

Subsidized loans cannot be targeted with surgical precision.

A bond-financed program designed to help people buy a home is a program for people who are only marginally unable to afford a home. As a practical matter, large scale, complex programs such as the MHFA's Single Family Mortgage Loan Program cannot be administered with surgical precision. There is no question that subsidized loans go to borrowers who could otherwise afford a house.

- **MHFA estimates that about 30 percent of MHFA borrowers could have obtained conventional financing.**

Additional borrowers could afford financing in the near future, if not at the same time they receive approval for an MHFA loans. Since there is a large federal subsidy provided, the inefficiency of the program is not a critical problem. If the subsidy required to provide below-market mortgages has to come from Minnesota taxpayers in the future, another hard look at targeting will have to be taken.

- **In light of MHFA's own understanding of demographic trends, the historical split between financing new construction and purchases of existing houses in Minnesota (about 35/65) is hard to justify for the future when the existing housing stock will be adequate for first time buyers in most areas, and preservation of housing will be problematic.**

In this section we will examine some relevant characteristics of MHFA mortgage loan borrowers. Then, where possible, we will compare Minnesota to other states. Table 2.6 presents descriptive data on borrowers, loans and

	Fiscal Years				
	1984	1985	1986	1987	1988
Average Borrower Income (in thousands)	$24.9	$26.6	$24.2	$22.5	$23.6
Average Mortgage (in thousands)	$47.6	$47.4	$48.4	$46.8	$54.3
Number of Loans	2,020	2,511	2,336	1,483	3,011
Percent New Construction	41.5%	41.6%	38.8%	26.0%	30.0%
Average Home Price (in thousands)	$54.0	$54.9	$53.9	$52.0	$57.7

Source: 1986-88 from 1990-91 Minnesota Housing Finance Agency Biennial Budget Proposal. 1984-85 from 1987-89 Budget Proposal.

Table 2.6: Single Family Mortgage Loan Program Descriptive Statistics on Loans, Borrowers, and Properties

properties. Table 2.6 shows that the average annual income of borrowers ranged between $23,000 and $27,000 between fiscal years 1984 and 1988.

Another data series shown in Table 2.7 shows that median incomes ranged from $17,200 in (calendar year) 1980 to $25,100 in 1988. Over the period shown 1980-88, based on 14,560 loans purchased by MHFA during this period, over half of all borrowers had incomes between $15,000 and $25,000. An additional 19 percent had incomes of $25,000 to $30,000. An additional 19 percent had incomes over $30,000. Currently, borrowers have to have an adjusted income less than $27,000.

Eligibility for an MHFA loan is limited to borrowers whose adjusted income meets the MHFA limits shown below in Figure 2.1.

Income	1980	1981	1982	1983	1984	1985	1986	1987	1988	1980-1988 Total
$5,000-9,999	1.8%	1.3%	0.9%	0.1%	0.3%	0.5%	0.4%	0.4%	0.5%	0.6%
$10,000-14,999	20.8	21.3	4.9	3.7	3.2	4.5	8.2	6.8	3.5	7.8
$15,000-19,999	62.2	64.9	17.8	17.1	13.7	18.3	25.1	23.7	13.5	26.4
$20,000-24,999	15.2	12.6	31.1	29.0	26.0	28.6	29.7	32.6	32.3	26.8
$25,000-29,999	0	0	32.4	27.8	26.9	20.2	19.2	21.6	25.9	19.3
$30,000-34,999	0	0	12.9	21.0	21.9	19.9	14.0	12.0	19.4	14.8
Over $35,000	0	0	0	1.2	8.0	8.0	3.4	2.8	5.0	4.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Median (thousands)	$17.2	$17.1	$24.2	$25.0	$23.7	$25.0	$22.7	$22.9	$25.1	$22.8
Number	682	1,825	225	813	2,596	2,888	1,393	2,624	1,514	14,560

Table 2.7: Income of Single Family Mortgage Loan Borrowers

For each Home Mortgage Loan, the Borrower's Adjusted Income cannot exceed:

If the Property to be Mortgaged is Located in:	New Construction	Existing Residence
Twin Cities Metropolitan Area	$37,500	$33,000
Olmstead, Clay and Nicollet Counties	$32,000	$26,000
Benton, Blue Earth, St. Louis, Stearns, and Sherburne Counties	$28,000	$24,000
Balance of State	$27,000	$21,000

[a]The Twin Cities Metropolitan Area"is defined as the following ten counties: Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Washingtion, and Wright.

[b]"Adjusted Income" means the gross annual projected income as of the date of application, from all sources and before taxes or withholding of all residents living in a housing unit, after deducting $1,000 for each resident of the housing unit; and in rare cases, extraordinary medical or other expenses.

Figure 2.1: Borrower Income Levels

Borrowers must be first time buyers, must be buying a home they plan to use as a principal residence year-round, and a one or two-family house. Current purchase prices are limited as follows:

The Acquisition Cost of each residence financed under the Minnesota Mortgage program may not exeed the following:

If the Property to be Mortgaged is Located in:	New Construction	Existing Residence
Twin Cities Metropolitan Area	$89,000	$79,000
Olmstead, Clay and Nicollet Counties	$72,000	$61,900
Benton, Stearns, and Sherburne Counties	$64,890	$54,000
Blue Earth County	$64,890	$52,800
Balance of State	$64,890	$47,070

Figure 2.2: Acquisition Cost Limitations

Table 2.6 shows that average home prices over the period (fiscal years) 1984-88 varied between $52,000 and $58,000. Another data series shown in Table 2.8 shows that median purchase price grew from about $44,900 in 1980 to $56,000 in 1987, then down to $54,000 in 1988. Over the 1980-88 period the median price was $52,800. Based on the data reviewed above, we concluded that:

- **MHFAs Single Family Mortgage Loan Program has successfully targeted loans to the purchase of modest homes by low to moderate income buyers.**

Purchase Price	1980	1981	1982	1983	1984	1985	1986	1987	1988	1980-1988 Total
$10,000-19,999	1.3%	2.4%	3.1%*	0.9%	0.7%	0.9%	1.3%	1.3%	0.4%	1.1%
$20,000-29,999	6.2	8.4	9.8	8.1	3.9	6.0	6.7	6.3	0.9	5.7
$30,000-39,999	20.8	20.2	19.6	12.8	10.2	13.8	15.5	8.9	13.7	13.6
$40,000-49,999	44.3	34.8	25.3	21.5	17.8	18.7	19.4	16.4	22.1	22.0
$50,000-59,999	27.4	34.1	25.8	25.0	23.5	21.0	21.9	28.2	36.1	26.6
$60,000-69,999	0	0	14.2	22.9	27.7	19.5	20.0	21.1	8.7	16.9
$70,000-79,999	0	0	2.2	8.0	13.6	14.6	10.5	12.2	13.5	10.4
$80,000-89,999	0	0	0	0.9	2.8	5.5	4.8	5.7	4.7	3.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Median	$44,900	$45,432	$46,929	$52,684	$57,441	$55,065	$53,262	$56,088	$53,601	$52,837
Number	682	1,825	225	813	2,596	2,888	1,393	2,624	1,514	14,560

*Includes one case in which the price was under $10,000.

Table 2.8: Purchase Price, Single Family Mortgage Loan Program

MHFA feels it compares favorably to other states and local Minnesota housing finance agencies in the success it has achieved in targeting its loans to lower-income households and lower-priced properties.

There is some peril in making comparisons across states because of problems in collecting and reporting comparable data, and differences in housing markets across the country. However, the National Council of State Housing Agencies study cited earlier provides data comparing states on borrower income and housing purchasing prices for bond-assisted borrowers.

Borrower income in Minnesota is higher than some comparable states, lower than others.

Table 2.9 presents data on income for each year between 1983 and 1987. Minnesota borrower incomes are lower than the average of the states shown, but not as low as some comparable states such as Michigan. For example, in 1987, the average borrower income in Minnesota (by these data) was $22,900.[7] The comparable number for Michigan is $20,461, for Pennsylvania $22,581, for South Dakota $29,541, and for Illinois $34,703. Seven states, among them Minnesota, have reduced the average borrower income over the period 1983-1987, indicating improvement in achievement of this program objective.

	1983	1984	1985	1986	1987
California	$29,300	$30,096	$31,106	$33,610	$33,990
Connecticut	N/A	26,200	26,700	26,881	31,684
Florida	N/A	19,427	23,910	23,454	28,020
Illinois	26,604	30,675	29,400	30,804	34,704
Kentucky	N/A	20,097	20,063	19,587	20,015
Maryland	25,525	25,426	25,347	24,426	23,559
Massachusetts	26,395	27,222	27,957	29,360	31,719
Michigan	21,951	20,506	20,486	21,191	20,461
MINNESOTA	**24,309**	**22,947**	**24,106**	**23,280**	**22,900**
New Jersey	N/A	35,863	31,617	32,887	31,747
New York	N/A	33,355	36,300	36,539	31,072
Oregon	21,799	22,939	23,940	23,522	23,493
Pennsylvania	22,500	21,961	22,080	22,276	22,581
South Dakota	N/A	26,113	27,740	27,986	29,541
Virginia	23,126	24,385	25,556	25,010	27,941
Wyoming	30,030	30,661	28,244	29,315	28,734
Average	$25,154	$26,117	$26,535	$26,883	$27,635

Source: Wrightson (1988), 101.

Table 2.9: Average Bond-Assisted Borrower Income, 1983-1987

Table 2.10 presents average purchase prices for the same set of states. The average price of homes purchased with MHFA financing was above the average of this set of states for the first three years shown (1983-1985) and lower in 1986 and 1987. Again, markets vary around the country but some comparable states out perform Minnesota and others do not. Michigan targets its loans to lower priced homes, but Illinois loans finance higher-priced properties in most years.

7 These numbers are close to the medians shown in Table 2.7.

	1983	1984	1985	1986	1987
California	$73,820	$76,721	$79,312	$88,275	$89,120
Connecticut	--	57,400	63,359	72,157	92,370
Florida	--	54,534	52,422	53,714	61,980
Georgia	44,723	46,445	50,357	48,026	51,839
Illinois	37,865	53,043	55,105	55,910	72,184
Kentucky	--	37,405	34,905	34,031	38,644
Maryland	53,170	48,467	50,684	48,062	50,991
Massachusetts	49,795	53,547	63,174	74,223	87,418
Michigan	41,711	39,896	37,128	40,698	36,693
MINNESOTA	**47,831**	**54,028**	**53,548**	**53,114**	**54,482**
New Jersey	31,730	62,164	60,169	62,040	67,510
New York	--	57,955	62,000	71,012	65,828
Oregon	46,431	46,664	46,000	46,475	45,000
Pennsylvania	38,500	42,183	44,555	46,563	55,364
South Dakota	--	44,242	46,310	47,734	49,701
Tennessee	35,899	38,769	41,000	41,960	41,753
Virginia	47,249	51,542	53,281	54,498	65,435
Wyoming	60,016	67,725	60,586	56,504	53,018
Average	$46,826	$51,818	$52,994	$55,278	$59,963

Source: Wrightson (1988), 102.

Table 2.10: Average Bond-Assisted Borrower Purchase Prices, 1983-1987

Closer to home, the question can be raised how MHFA compares to local housing finance agencies in the Twin Cities area who also run single family mortgage loan programs. This comparison shows:

- **MHFA income eligibility limits and purchase price limits (for the Twin Cities area) are lower than those of the four local housing finance agencies running comparable programs.**

MHFA's eligibility limits are stricter than those of Twin Cities area local housing finance agencies.

Housing finance agencies in Dakota and Washington counties and Minneapolis and St. Paul have established (adjusted) income limits of $44,770 compared to $37,500 (the Twin Cities limit) for MHFA loans.

All four local agencies establish a purchase price limit of $93,510 for existing housing and all but Dakota use a $115,200 limit for new construction.[8] MHFA's limits are $79,000 for existing housing and $89,000 for new construction. We conclude:

- **MHFA targets its loans more effectively than most states, and more effectively than local housing finance agencies in the Twin Cities area.**

8 Dakota's limit is $96,000 for new construction.

Single family loans are distributed in proportion to population rather than need or demand for loans.

Geographic Distribution

MHFA allocates mortgage funds across Minnesota according to a formula intended to reflect the regional distribution of housing needs and need for subsidized financing.

The formula includes such factors as: the rate of household formation, housing vacancies, and the number of income-eligible renter households. In the June 1988 allocation MHFA made an adjustment to the formula in order to allocate a minimum of $1.6 million to each region.

Table 2.11 shows the unadjusted regional share (determined by formula), the adjusted share, and the resulting loan account. From this it is clear which regions benefit from the minimum allocation of $1.6 million. Also presented in the column to the right of the adjusted share is the distribution of loans (by number) actually made between 1980-1988.

Region	Unadjusted Regional Share	Adjusted Regional Share	1980-88 Loan Distribution by Number	Loan Account
1	0.9%	3.5%	1.1%	$1,600,000
2	1.0	3.5	0.8	1,600,000
3	5.3	5.3	5.8	2,438,000
4	2.8	3.5	4.2	1,600,000
5	1.9	3.5	2.6	1,600,000
6E	1.6	3.5	2.9	1,600,000
6W	0.4	3.5	1.1	1,600,000
7E	1.9	3.5	1.9	1,600,000
7W	5.0	5.0	8.7	2,300,000
8	1.3	3.5	2.3	1,600,000
9	3.2	3.5	4.9	1,600,000
10	7.0	7.0	11.9	3,220,000
11	67.7	51.2	51.7	23,642,000
State Total	100.0%	100.0%	100.0%	$46,000,000

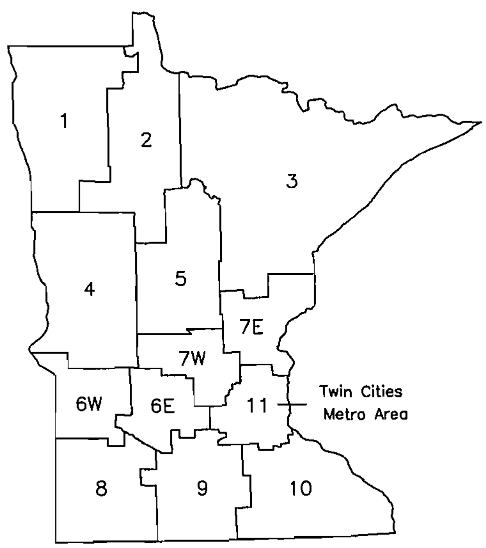

Table 2.11: Minnesota Housing Finance Agency June 1988 Allocation of Single Family Mortgage Funds

As Table 2.11 shows, the Twin Cities area, Region 11, is materially affected by the allocation procedure used. By formula, the Twin Cities should receive 67.7 percent of available funds. However, this allocation is reduced to 51.2 percent because of the $1.6 million minimum for each region. Actual experience follows the adjusted allocation closely: 51.7 percent of loans were made in the Twin Cities area during the 1980s.

When all is said and done, mortgage funds are allocated in close proportion to the fifty-fifty distribution of population and political representation between the Twin Cities and the rest of the state. While the forces that urge this distribution are strong, the concept that funds should be distributed on the basis of need got lost in the shuffle.

- **MHFA has, during the 1980s, achieved a state-wide program, although by its own measures it has failed to served the Twin Cities metro area in proportion to need and demand.**

MHFA has successfully built a statewide program.

The actual allocation of single family loans is more complex than the simplified description offered here. There are mechanisms for targeting loans within the overall regional allocation to households eligible for the Homeownership Assistance Fund (discussed later) as well as certain other households.

Based on our review of MHFA's allocation plan and process, and actual results achieved from 1980 to 1988, we conclude that MHFA has struck a reasonable balance between somewhat incompatible objectives:

- **It has successfully run a state-wide program and provided subsidized loans statewide.**

- **It has allocated resources on an assessment of need and demand, while preventing high-demand areas from using up all the available financing.**

- **It has made a special effort through a "targeted buyer commitment pool" and the Homeownership Assistance Fund to pursue additional strategies designed to achieve the public purpose of the program.**

- **In reaching these goals, it has not proportionately served high-demand areas like the Twin Cities region.**

Affordability

The use of tax-exempt bonds supplemented with state appropriations to finance mortgage loans allows mortgage loans to be made available at below market rates. This makes it theoretically possible to make loans to buyers who, by the formulas used by lending institutions, cannot qualify for equivalent loans at higher interest rates.

Table 2.12 shows a comparison of MHFA mortgage interest rates with market rates for the period 1984 to 1988. Also shown is MHFA's estimate of how much less annual household income would be required to qualify for an MHFA loan than a market rate loan. As Table 2.12 shows:

- **The spread between MHFA loans and market interest rate for comparable (long-term fixed rate) market rate loans has narrowed since 1984.**

- **The amount of income needed to qualify for a SFMLP loan is $3,600 less than a market rate loan in FY 1988, down from $6,504 in 1984.**

Because the spread between tax-exempt and taxable bond interest rates has declined, MHFA's subsidized loans have declined in value.

	Fiscal Year				
	1984	1985	1986	1987	1988
Market Interest Rate	14.37%	13.25%	10.00%	9.92%	10.75%
MHFA Rate	10.70%	9.95%	8.65%	8.40%	8.85%
Lesser Amount of Annual Income Needed to Qualify With MHFA Loan	$6,504	$5,736	$2,304	$2,448	$3,600

Source: 1987-89 and 1990-91 MHFA Biennial Budget Proposals.

Table 2.12: Minnesota Housing Finance Agency Loan/Market Rate Comparison

By itself, the spread between MHFA loans and market rate financing has limited power to make housing affordable. In recognition of this, MHFA runs a Homeowner Assistance Fund (HAF), first authorized and funded in 1977 (*Minn. Stat.* §462A.21). This program, financed through state appropriations, has provided assistance totalling $18 million in down payment and monthly payment assistance to 5,200 households or about 25 percent of MHFA-financed borrowers.

Currently, to qualify for assistance through the Homeowner Assistance Fund, incomes must be under $23,000 in the Twin Cities area, $19,000 in seven out-state counties containing or near an urban center, and $17,000 elsewhere.

Homeowner Assistance Fund (HAF) monthly assistance consists of a loan to the borrower that covers part of the installment payments due on a mortgage loan. Depending on income, assistance ranges from $20 to $100 per month for the first year of the loan. This decreases by $10 per month each year. The year after assistance reaches zero, repayment of the loan commences. The HAF loan is interest-free.

HAF down-payment assistance is 50 percent of the down-payment up to $1,500. The borrower must make a down payment of five percent of the purchase price separate from HAF assistance. As noted earlier, part of the regional allocation of mortgage loan commitment consists of a "targeted borrower commitment pool" which is reserved for borrowers eligible to receive HAF assistance.

Table 2.13 provides descriptive information on HAF loans and borrowers for the period 1980 to 1988. These figures cover a total of 3,539 loans. The following generalizations are supported by the data:

- **HAF loans are reaching their target of lower income households. Over the 1980s median household income was $17,500.**

- **The median purchase price of the homes purchased with HAF assistance between 1980 and 1987 is $46,700. This is lower than the median of all MHFA assisted buyers.**

- **During 1980-88 about half of HAF assisted buyers were single-headed households.**

- **Seventy-six percent of HAF loans assist the buyers of existing housing, 24 percent go to purchasers of new housing.**

The Home Owner Assistance Fund Program makes it possible for lower income households to buy a house.

	1980	1981	1982	1983	1984	1985	1986	1987	1980-87 Total
Median Income (thousands)	$15.8	$16.3	--	$18.6	$18.7	$19.0	$18.2	$17.7	$17.5
Median Purchase Price (thousands)	$42.6	$43.1	--	$45.7	$48.3	$47.6	$47.7	$54.4	$46.7
Median Loan Amount (thousands)	$39.6	$39.2	--	$42.0	$45.0	$43.8	$43.5	$48.0	$42.7
Percent:									
New Construction	12%	34%	--	22%	26%	19%	22%	19%	24%
Existing House	88	66	--	78	74	81	78	81	76
Percent: Single-Headed Households	47%	39%	--	48%	42%	46%	51%	61%	48%
Number of Loans	268	908	--	50	309	655	470	691	3,351

Source: Minnesota Housing Finance Agency.

Table 2.13: Characteristics of Home Owner Assistance Fund Borrowers

MHFA points to the Home Owner Assistance Fund as emblematic of the agency's committment to its goal of making home ownership reachable by the lowest income buyers that can reasonably afford a loan.

There are technical and substantive issues central to an understanding of how the program operates and its future role. According to MHFA, use of HAF is below the level it wants to achieve and further changes will need to be made. Currently, there is a problem with how the Federal Housing Administration (FHA), which insures an increasing number of home loans purchased by

MHFA, regards HAF assistance. Private mortgage insurers have been more willing than FHA to recognize HAF payments in qualifying borrowers for mortgage insurance. The substantive concern is whether HAF loans will be as secure in the future as they have been in the past. The predicted softness in the housing market suggests not. In any case, mortgage insurers are already under stress.

Another issue that pertains to HAF assistance and all subsidized loans is the question of whether households with low incomes in a given year are going to be unable to afford a home forever. If a significant state subsidy is proivded on a 30 year loan, to be paid by present and future taxpayers, the reason for the subsidy needs to endure. It is very typical for individual or family incomes to rise with increasing age and work experience. As we noted earlier, the GAO criticized subsidized mortgages because they were awarded to households that predictably would qualify for market rate financing in the fairly near future.

When the target of government action is lower income households unable to afford housing without a subsidy, an alternative use of public funds are programs designed to help renters. As we point out elsewhere, helping even very low income home buyers does not meet the needs of even needier renters. While this is inevitable in the case of bond financed programs, appropriations-financed programs such as the Home Owner Assistance Fund are not so constrained. And these still are predominately aimed at owners or those who would be owners.

Existing Versus New Construction

MHFA's programs are based on population projections that provide insight into the likely shape of future housing needs. As we discuss in Chapter 1, both nationally and in Minnesota there will be considerably fewer households aged 25-34 at the end of the 1990s than at the beginning.

The consequences for the housing market will be growing vacancy rates in the rental market and reduced demand for "starter" homes.

We conclude:

- **MHFA should emphasize the use of its Single Family Mortgage Loan Program for the purchase of existing housing rather than new construction. New construction in areas that have a surplus of existing units will tend to accelerate the deterioration of the existing stock. In the Twin Cities area this will disproportionately affect the central cities and first ring suburbs.**

The percent of new construction in MHFA-financed homes has ranged around 35 percent during the 1980s, although it has declined to 26 and 30 percent in 1987 and 1988 (see Table 2.6).

MHFA has established higher purchase price limits for new construction than for existing homes. The limit for existing homes is $79,000 in the Twin Cities; $61,900 in Olmstead, Clay and Nicollet; $54,000 in Benson, Sherburne and Stearns; $52,800 in blue Earth County; and $57,090 in the balance of the state. The levels for new construction are $10,000 to $17,800 higher (see data in Figure 2.2).

The limit for existing homes is roughly the median sale price in each area. Higher limits for new construction reflect higher construction costs today than in the past, and the fact that there is strong interest from consumers, lending institutions and builders for new construction financing.

MHFA should not subsidize new construction in areas where there is an adequate supply of sound existing housing.

Over the years, MHFA has participated in several techniques for setting aside funds for specific development projects. Both MHFA and the federal government agencies are concerned about such committments because the subsidy from tax-exempt financing can go to developers rather than consumers, by being capitalized in the price of homes. Also, when money lent for specific projects get tied up because of construction delays, the repayment of loans can be affected, adversely affecting MHFA's ability to meet its financial obligations.

MHFA's telephone reservation system instituted in 1982 more or less precluded set asides. In 1983 to 1986 set asides were administered through municipalities who applied for the allocation. For the future, MHFA would like to work in partnership with municipalities to see if new construction costs can come down to the level of existing housing.

There is no question that there is strong market demand and political support for new construction. But the following questions have to be raised:

- **Does subsidizing new construction make sense when it will put further pressure on the existing housing stock? There is a growing surplus of "starter homes" in the Twin Cities area and in most outstate regions.**

- **Does it make sense to set a higher limit for new construction, a limit that is clearly above the median house price?**

As a practical matter, setting lower limits will mean that financing of new construction will be curtailed. Buyers, builders, and lenders in many areas will be unhappy. But there is a lot of unmet demand for subsidized loans, and perhaps the public purpose will be better served if MHFA's mortgage loan program is focussed more on existing homes in the future.

Actually, as data previously reviewed showed, less new construction is now being financed than in earlier years. Table 2.6 shows that 27 percent of MHFA loans financed new construction in 1987 and 1988 compared to 37 percent in 1985 and 1986 and 46 percent in 1984. If the federal tax-exemption for mortgage revenue bonds is lost in the future, and state subsidies have to be used in the place of the existing federal subsidy, it will make sense to curtail support of new construction even further.

FINANCIAL SERVICES

This study of MHFA focuses on the policy issues and program goals of the agency, and especially on the question of whether the agency is effectively serving low and moderate income households who cannot afford housing at market prices.

By a ratio of 10 to 1 MHFA's financing for these purposes comes from issuing bonds and using the proceeds to purchase loans. The skill and efficiency with which the agency carries out these services is central to a broader assessment of its performance.

The nature of the investment banking industry coupled with regulatory controls presents a tight framework in which MHFA operates. The financial community, consisting of bond counsel, investment bankers, mortgage insurers, bond ratings organizations, auditors, and others, have clear institutionalized roles. Since a cursory review shows that MHFA meets the requirements of these organizations, we have not attempted to improve upon their judgment. We judged the potential of such an investigation to be low.

Once bonds are issued, MHFA needs to see that loans are collected so that bond holders can be paid off. The question of how well MHFA manages its loan portfolio, and monitors its ability to meet its financial obligations is of key importance. Therefore, this section will look at:

- Descriptive information on bond issues, including the security of the agency's obligations as reflected in bond ratings.

- Data on delinquency rates, loan servicing, and other factors affecting the agency's financial obligations.

- MHFA's procedures and performance in arranging for various specialized services necessary in issuing bonds and paying them off.

In general, MHFA bonds carry a favorable rating. MHFA monitors performance of its loan portfolio carefully, establishes criteria for selecting servicers and monitors their performance.

Our reviews of MHFA's recruitment and oversight of other contractors, while not a detailed study, show that MHFA is carrying out its job effectively.

Single Family Bond Issues

MHFA has financed single family mortage loans under several bond resolutions over the years. The following tables present data on the issues that were used to finance single family mortgage loans.

Table 2.14 presents data on the Single Family Mortgage Revenue Bonds issued by MHFA over the years, including the size of the issue, the Moody's and

Standard & Poor's ratings, the size of the loan account created by bond proceeds, the underwriter's discount, and the number of loans purchased through mid-1988.

Table 2.14 shows that over $1.2 billion has been raised through bond sales for home loans since 1973. Like similar types of bonds issued by housing finance agencies in other jurisdictions, MHFA securities receive high ratings from bond rating agencies. Most of the bonds that have financed mortgage loans carry an S&P rating of AA, one step below the highest possible rating. The investment community thus considers the chance of default very low on MHFA's paper. Almost all state HFA's enjoy a high rating on similar types of bonds. MHFA is also rated as a "top-tier" agency by Standard and Poor's; only four other state housing finance agencies have achieved this distinction.

Table 2.14 shows the size of the loan account financed by each issue. As footnotes to the table show, in some cases bond proceeds are used to refund previous issues rather than to finance new loans. The last two columns show the underwriter's discount, a measure of the cost of issuing the bond and the number of loans financed. There are other administrative costs not shown. For example, fees from MHFA's bond counsel totalled $249,000 for the last eight single family bond issues (1986B through 1988C). Financial analysis by MHFA's advisor cost about $40,000 for six recent single family issues.

Issue	Size of Issue	Ratings Moody's/ Standard and Poor's	True Interest Cost	Size of Loan Account	Underwriters Discount	Number of Loans (thru 6/30/88)
GNMA Mortgage-Backed Securities 1973A	$30,000,000	Aaa/AA	5.72%	$30,000,000	$554,100	1,260
Single Family Housing Bonds 1974A	53,970,000	Aaa/AAA[1]		50,021,103	[2]	1,939
Home Mortgage Bonds 1977A	80,000,000	Aa/A+	5.91	72,000,000	875,407	2,207
Home Mortgage Bonds 1982A	4,415,000[3]	Aa/A+	10.96	N/A	70,000	N/A
Residential Mortgage Bonds 1978A	200,000,000[4]	Aa/AA	5.81	131,089,106	2,730,000	3,658
Residential Mortgage Bonds 1980A	123,790,000	Aa/AA	8.10	106,060,024	2,147,756	2,508
Residential Mortgage Bonds 1983A	14,660,000[3]	Aa/AA	10.33	N/A	196,940	N/A
Residential Mortgage Bonds 1983B	45,000,000	Aa/AA	10.09	40,446,550	1,054,350	834
Residential Mortgage Bonds 1983C	51,205,000	Aa/AA	10.41	46,857,500	1,096,811	868
Residential Mortgage Bonds 1984A	99,540,000	Aa/AA	10.68	89,910,178	2,199,834	1,691
Residential Mortgage Bonds 1985AB	145,000,000	Aa/AA	9.80	137,765,190	3,235,260	2,236
Single Family Mortgage Bonds 1982A	30,000,000	A1/AA	12.58	29,630,000	733,500	626
Single Family Mortgage Bonds 1982B	41,900,000	A1/AA	11.57	40,000,000	967,890	761
Single Family Mortgage Bonds 1982C	45,000,000	A1/AA	10.86	43,722,925	1,125,000	767
Single Family Mortgage Bonds 1986A	52,500,000	A1/AA	8.24	51,421,674	749,700	1,019
Single Family Mortgage Bonds 1986B	34,730,000	A1/AA	7.33	33,840,712	579,991	673
Single Family Mortgage Bonds 1986C	22,330,000	A1/AA	7.28	21,237,969	372,911	364
Single Family Mortgage Bonds 1987A	48,725,000	A1/AA	8.26	45,786,481	595,420	888
Single Family Mortgage Bonds 1987BC	50,450,000	A1/AA	8.56	49,943,077	578,157	731
Single Family Mortgage Bonds 1987D	21,050,000	A1/AA	8.38	20,366,658	284,807	208
Single Family Mortgage Bonds 1988AB	51,900,000	A1/AA	8.14	50,061,910	576,090	12
Single Family Mortgage Bonds 1988C	49,480,000	A1/AA	8.29	48,200,438	612,562	0

Source: Minnesota Housing Finance Agency.

[1]Advance refunded issue.
[2]Not applicable. Underwriters discount reflected in coupon interest rates.
[3]Current refunding issue.
[4]Includes $51,121,305 advance refunding.

Table 2.14: Characteristics of Single Family Bond Issues

Table 2.15 presents statistics, monitored regularly by MHFA, on how effectively installment payments on single family loans are being collected. As of July 1988, a balance of nearly $718 hundred million remained to be collected. The number and amount of loans past due and the number of foreclosures are shown. MHFA aims to keep its delinquency and foreclosure rate to the same level as the mortgage banking industry as a whole in Minnesota. The industry rates are something over one percent each for 60 day delinquency and foreclosure. MHFA rates are 0.66 percent for 60-89 days, 0.32 percent for 90 days, and 1.65 percent for foreclosure. The sum of these rates in July 1988 was 2.63 percent, somewhat over the industry standard. While MHFA loans have to meet underwriting standards, they are aimed at the low end of the qualifying range. In addition, about a quarter of the loans are tied to a second mortgage provider through the Homeownership Assistance Fund.

MHFA single family mortgage bonds are financially secure.

MHFA also monitors the performance of individual servicers. In mid-1988, there were 15 firms servicing MHFA home loans with total past-due rates varying from 0.51 percent to 4.44 percent. Not all past-due rates should be identical. Portfolios of different maturities will typically show different rates. MHFA has recently taken steps to improve the performance of specific servicers or transfer loan portfolios to other companies. MHFA in mid-1988 felt that the performance of a couple of its home mortgage loan servicers could be improved.

The collectability of single family loans depends on economic conditions and other factors outside the direct control of the agency. Historic default rates have been low because of generally increasing housing prices which mean a growth in equity for most owners. The demographic and social trends reviewed in Chapter 1 suggest that the 1990's will see a less favorable market for the kinds of homes financed by MHFA.

MHFA has engaged Evenson Dodge, a financial advisor, to provide consulting services and occasional formal studies of the financial security of the financial obligations of the agency. We reviewed the Evenson Dodge 1982 study of MHFA's single family program. Their study addresses questions about the financial condition of the program over the life of the bonds including detailed consideration of cash flow, need for additional financing, use of reserves, timing and amount of surpluses and other techncial questions.

Evenson Dodge examined in detail the single family bond programs in 1982 that were thought to be the most vulnerable due to what was happening to interest rates and pre-payment of mortgages (compared to assumptions) since the bonds were issued. To make a long story short, while rising interest rates mean that prepayment fell below initial assumptions, causing a cash flow shortfall in both the home mortgage program bonds of 1977 and residential mortgage program bonds of 1978 and 1980, both programs were judged to be in excellent financial shape even under pessimistic assumptions.

Evenson Dodge provides on-going consultation to MHFA on bond sales, but no study like the 1982 studies of the mortgage loan and home improvement programs has been undertaken since, nor, according to MHFA, is one needed.

By Program	Number of Loans	Balance Outstanding	60-89 Days Number	60-89 Days Percent	90+ Days Number	90+ Days Percent	Foreclosures Number	Foreclosures Percent	Total	Prior Month	Prior Year
			Payments Past Due as a Percent of Loans Oustanding								
Home Mortgage 1977A	1,675	$45,070,411.61	19	1.13%	7	0.42%	16	0.96%	2.51%	2.20%	1.63%
Residential Mortgage 1978A	821	$ 16,945,065.70	9	1.10%	4	0.49%	13	1.58%	3.17%	2.65%	2.35%
Residential Mortgate 1978A	2,649	80,393,601.69	9	0.34	5	0.19	50	1.89	2.42	2.22	2.82
Residential Mortgage 1980A	2,054	78,187,314.77	7	0.34	12	0.58	63	3.07	3.99	3.99	4.53
Residential Mortgage 1983BC	1,374	64,497,237.90	10	0.73	8	0.58	34	2.47	3.78	3.47	2.77
Residential Mortgage 1984A	1,462	69,506,334.30	19	1.30	9	0.62	34	2.33	4.24	3.46	3.41
Residential Mortgage 1985A	2,121	100,658,503.54	9	0.42	2	0.09	30	1.41	1.93	1.74	1.61
Weighted Average	10,481	$410,188,057.90	63	0.60%	40	0.38%	224	2.14%	3.12%	2.84%	2.97%
Single Family 1982AB	555	$24,242,221.48	10	1.80%	1	0.18%	23	4.14%	6.13%	5.36%	4.57%
Single Family 1982C	555	29,907,666.75	4	0.72	1	0.18	16	2.88	3.78	3.21	2.70
Single Family 1986A	1,007	48,619,765.81	5	0.50	1	0.10	3	0.30	0.89	0.71	0.37
Single Family 1986B	672	33,569,693.34	1	0.15			2	0.30	0.45	0.45	0.00
Single Family 1986C	373	20,852,266.32	3	0.80	1	0.27	1	0.27	1.34	1.10	*
Single Family 1987A	887	45,766,507.40	6	0.68	3	0.34			1.01	0.23	*
Single Family 1987B	84	4,853,054.27	1	1.19					1.19	1.89	*
Single Family 1987C	679	38,081,262.30	2	0.29	2	0.29			0.59	0.29	*
Single Family 1987D	239	13,300,015.74									*
Single Family 1988A	64	3,345,670.74									*
Weighted Average	5,115	$262,538,124.15	32	0.63%	9	0.18%	45	0.88%	1.68%	1.34%	2.15%
TOTAL	17,271	$717,796,593.66	114	0.66%	56	0.32%	285	1.65%	2.63%	2.35%	2.69%

Source: Minnesota Housing Finance Agency.

*Unavailable.

Table 2.15: Minnesota Housing Finance Agency Homeownership Delinquency Statistics, July 31, 1988

Procedures for Recruiting and Monitoring Contractors and Consultants

Here, we briefly review MHFA's approach to recruiting the contractors and consultants it needs to use in issuing bonds, originating and paying loans, and paying off bond-holders.

We raised the following questions in connection with the single family mortgage loan program and financial services relating to it and other MHFA programs.

- **Are contractors selected in a fair and open fashion, on the basis of competence and cost?**
- **Does MHFA effectively monitor the performance of contractors?**

Briefly, here are the procedures used to recruit and monitor underwriters, CPA firms, bond counsel, trustees, servicers, and lenders.

Underwriters

MHFA currently uses three investment bankers (or underwriters). It started with two firms in the early 1970s, added two more in the mid-1970s, and dropped one because of inadequate service. MHFA expects underwriters to take a position in the agency's securities. MHFA feels it is now obtaining good service at low cost. Lacking expertise in this area, we cannot disagree. The agency has not shown political favoritism in its choice of underwriters, a problem that has appeared in other jurisdictions, according to the State Auditor who is the Finance Committee Chairman on the MHFA Board.

CPA Firms

MHFA has a policy of changing its auditor every four years, and feels it needs a large, nationally recognized firm because of the agency's need to sell bonds nationally. It recruits its auditors via a request for proposals and has in recent years used several Big-Eight firms.

Bond Counsel

MHFA uses Dorsey and Whitney and has for years, on the advice of the Attorney General's staff assigned to the agency. It pays about $30,000 per bond sale for legal services.

Trustees

Trustees take the proceeds of bond issues, disburse funds to mortgage lenders, and pay bond holders the principal and interest due. MHFA solicits bids for this service for each bond resolution. Norwest has won the bid narrowly over First Banks recently. MHFA's concern is to balance the advantage of familiarity with its concern about complacency in choosing a trustee.

Loan Originators

MHFA has established a network of lenders around the state who are qualified to originate loans that MHFA will purchase. Earlier in this chapter we reviewed data on the geographic distribution of mortgage loans, concluding that MHFA, through a network of lenders and an allocation plan, has succeeded in running a statewide program.

We reviewed the procedures manual and set of forms that lenders and applicants need to complete. The paperwork requirements are considerable; many requirements originate with the federal government, others with MHFA. MHFA is aware of the complexity of these requirements and uses a "review contractor" to approve loans originated by lenders who do not have a high volume of applications.

MHFA follows reasonable procedures in recruiting various types of contractors.

The procedural manual for the FAA Minnesota mortgage program is over an inch thick. However, it documents requirements in a clear and orderly fashion and, based on our review, this and other manuals are kept up to date.

Servicers

MHFA, with board approval, adopts policies governing servicer selection and compensation and performance. From time to time, servicer performance has been a problem. Recently, the agency brought to the board a problem with the performance of GMAC Mortgage Company in collecting single family mortgage loans. Subsequently, GMAC's performance has improved. In mid-1988, the past-due rate for National Escrow Corporation was also high and had become a source of concern. Improvements in servicing NEC's home mortgage loan portfolio were also noted. The issue of NEC's performance in collecting home *improvement* loans is discussed in the next chapter. This problem was far more serious and time consuming than the issue of mortgage loan servicing. The agency's exposure is also greater in the case of home improvement loans since there are only two home improvement loan servicers compared to 15 mortgage loan servicers.

Real Estate Agents

MHFA has recently recognized the need to formalize its policies for recruitment of real estate agents to manage the properties it ends up owning. As of July 1988, MHFA owned 89 homes with an average loan balance of $36,120. At the same time an additional 172 properties had been sold, but not all sale proceeds had been received.

At the October meeting the MHFA Board approved a new policy for the selection and evaluation of real estate agents, replacing the policy first adopted in 1980 and modified in 1985. The agency needs to use agents with expertise in marketing foreclosed properties and big enough to pay monthly maintenance expenses on MHFA's behalf. The policy is to use six agencies in the Twin Cities and two in each outstate market. The policy is not to solicit multiple bids each time an agent is needed, but to qualify a panel of firms that can be used when needed.

In summary, our review of MHFA's approach to recruitment, selection and monitoring of consultants and contractors shows the agency's procedures to be reasonable and fair. Selection of contractors is a decision that should be based on technical grounds, and business considerations relating directly to cost and performance. Expectations for contractors needs to be clearly spelled out in contracts and documents, and in policy and procedure manuals and memoranda. Our general conclusion, while not based on a detailed review of every contract or policy decision, is that the agency is performing its responsibilities effectively.

HOME IMPROVEMENT LOAN PROGRAMS

Chapter 3

This chapter discusses three home improvement loan programs: (1) the Home Improvement Loan Program, an installment loan program for low and moderate income home-owners, (2) the Home Energy Loan Program for homeowners regardless of income, and (3) the Rehabilitation Loan Program for low income owners, where loans carry no interest, the repayment of loans is deferred, and the loan is forgiven after 10 years.

This chapter addresses the question of how effectively the goals of these programs have been met in recent years, including:

- **Are the loans (other than energy loans) targeted to low and moderate income households?**

- **Are the programs administered efficiently and available to potential users across the state?**

- **Are the goals of the program still appropriate under current conditions and under reasonable assumptions for the future? What are the key policy issues?**

The three programs will be discussed separately.

THE HOME IMPROVEMENT LOAN PROGRAM

Since 1975 over 47,000 households have received subsidized loans.

The Home Improvement Loan Program has operated since 1975 and as of mid-1988 has provided assistance to about 47,500 households. Major financing is through tax-exempt bonds. Between 1975 and 1988 about $314 million in bond proceeds have been combined with $45 million in state appropriations to provide low interest loans.

Currently, annual interest rates on home improvement loans range from 3 percent for households with adjusted incomes less than $7,000,[1] to 9 percent for households with incomes of $17,001 to $27,000 per year.

1 Total income less $1,000 deduction per household member in most cases.

Thus, the Home Improvement Loan Program is designed for low to moderate income households, but the basic concept of the program means that loans can only be made to households that are likely to repay the loans and can meet reasonable underwriting standards. As in the case of the mortgage loan program, true low income households are not the target of the program.

The challenge to MHFA in operating the Home Improvement Loan Program is to design a program that can deliver loans to targeted households state-wide and raise capital to finance the loans.

The program depends on:

- Developing a product that meets a real need and for which there is a demand.
- Recruitment and maintenance of a state-wide lender network.
- Arranging for efficient servicing of the loans.
- Monitoring the use of loans to verify that program goals are being met. Chief among these are that home improvements actually take place, and that loan recipients and affected properties have the characteristics anticipated and intended by MHFA.

In order to finance home improvement and energy loans, MHFA has had to solve various issues relating to the issuance of bonds backed by revenue from home improvement loans.

In general, as subsequent sections of this chapter show, MHFA has succeeded in establishing a large home improvement loan program.

- The financial security of the program is strong, according to bond rating agencies and financial analyses carried out at MHFA's direction.
- The home improvement loan program operates state-wide.
- The program has succeeded in targeting loans to low and moderate income homeowners.
- MHFA has encountered continuing problems in loan servicing that remain to be resolved.
- Demand for loans does not outstrip the available funds. MHFA needs to decide whether it should take steps to increase program activity.
- A wide range of home improvements are permissable under the program. If changes in federal policy restrict or eliminate the federal subsidy that currently makes low interest home improvement loans possible, MHFA should reconsider whether such a wide range of improvements should be subsidized, or whether limited state funds

should be restricted to rehabilitation work that directly affects basic habitability.

Program Description and Level of Activity

Between 1975 and 1988, MHFA purchased approximately 47,500 home improvement loans totalling $266 million.[2] Table 3.1 shows that between 1981 and 1988 17,581 loans were purchased totalling $116 million. In 1985 and 1986 loan volume fell off somewhat from previous levels, causing concern at MHFA. In response, the agency sponsored a marketing study that produced a set of recommendations aimed at promoting the program some of which were implemented. MHFA is now satisified that the program is operating at an appropriate level. Table 3.1 shows that the number and value of home improvement loans have increased since 1986. While funds raised through bonds sales for home improvement loans eventually get used up, most of the time available funds have exceeded demand. (This is in sharp contrast to the availability and demand for subsidized mortgage loans, where demand far exceeds supply.)

MHFA's Home Improvement Loan Program is several times the size of any other state's.

Year	Number	Dollars
1981	1,593	$10,357,755
1982	2,765	16,758,158
1983	2,544	15,606,381
1984	2,816	20,059,436
1985	1,829	12,165,964
1986	1,636	10,725,225
1987	2,410	16,803,942
1988*	1,988	13,982,468
Total	17,581	$116,459,329

Source: Minnesota Housing Finance Agency.

*As of October 30, 1988.

Table 3.1: Home Improvement Loan Volume by Year, 1981-1988

Comparison with Other States

Minnesota's Home Improvement Loan Program is several times the size of that of Michigan, the state with the next largest program. Based on the limited available data comparing activity across states,[3] Minnesota financed over 50,760 loans (home improvement and energy). The comparable number for Michigan is 13,287. Wisconsin reported 9,080 loans through the same

2 According to MHFA's 1990-91 budget proposal. This does not include home energy or rehabilitation loans.

3 The Council of State Housing Agencies, *Production Activities of State Housing Finance Agencies 1985 and Cumulative* (Washington, D.C.) 238.

period. No other state reports more than 1,500, and 82,559 are reported for the total U.S. Even if other states have more local home improvement loan activity than Minnesota, it is clear that home improvement loans are a major priority in Minnesota. The emphasis on home improvement loans fits with MHFAs analysis of future housing needs and its conclusion that preservation of the existing stock will be a major challenge for the future.

Lender Network

MHFA has developed a network of about 320 lenders with 400 offices statewide to originate home improvement loans. Home Energy Loan Program lenders are also required to participate in the Home Improvement Program.

Some lenders only make a few loans per year. Over the years, MHFA has simplified the program, for example, by reducing the number of interest rate gradations in order to simplify the loan qualifying process. But as in the case of the mortgage loan program, the required paperwork is still considerable.

Many outstate lenders are willing to participate in the program because they do not otherwise have home improvement money to lend. Lenders even have responded to MHFA's efforts to promote cooperative advertising. As noted, there is more home improvement loan money available than is used. Arguably, more vigorous promotion of the program especially through the general media would promote use of the program. MHFA hesitates to promote the program too broadly, however, because borrowers would not know which lender to contact in their area.

MHFA arranged for a marketing study of the home improvement program when it concluded that use of the program was too low. This study made many suggestions for increasing demand for loans, relatively few of which have been adopted. However, MHFA now feels the program is running well. We think the best test of the program is not the precise level at which the program is running so much as whether loans are available state-wide, and whether they are being used by the kind of borrowers for whom they were intended, and actually used for home improvements that meet program requirements and serve a public purpose.

Targeting of Home Improvement Loans

The purpose of the Home Improvement Loan Program is to help low and moderate income homeowners make needed and desired repairs and improvements. The range of eligible improvements is broad ranging from urgently needed structural repairs to redecorating. A few kinds of projects such as entertainment or recreational facilities are excluded.

We examined the following issues:

- **What is the household income of home improvement loan recipients?**

- **What types of improvements have been financed?**
- **What is the geographic distribution of home improvement loans?**
- **What are the demographic characteristics of borrowers?**
- **At what interest rates have home improvement loans been made?**

The purpose behind these questions is to permit conclusions about whether a useful public purpose has been served by the home improvement loan program.

Because home improvement loans are financed through bond sales whose proceeds are used to purchase loans, the operational requirements of the program make it necessary that loan defaults remain at predicted levels.

In reviewing the home improvement loan program we conclude:

- **MHFA has succeeded in targeting the program in a way that serves its public purpose while preserving the program's financial solvency.**

Income

Table 3.2 presents data on borrower income for a period from 1983 to 1987. The program phases indicated in the table represent pools of money against which commitments to lenders are made, not particular bond issues.

Home improvement loans have been successfully targeted to low and moderate income home owners.

	Program Phase*					
Adjusted Income**	10	11	12	13	14	Total
$5,000 or Less	3.5%	4.1%	4.4%	3.2%	2.9%	3.6%
$5,001-10,000	15.0	15.1	17.6	18.3	14.6	15.7
$10,001-13,000	14.6	14.7	13.3	10.8	12.2	13.2
Over $13,000	66.9	66.0	64.6	67.7	70.3	67.6
Maximum Income***	$24,000	$24,000	$24,000	$27,000	$27,000	
Average Income	$15,575	$15,842	$15,561	$15,857	$17,011	$16,134
Number of Loans	1,883	3,584	1,337	1,837	3,731	12,366

*Program Phases correspond to the following dates:

10	7/83 to 12/83
11	1/84 to 6/84
12	7/85 to 5/86
13	6/86 to 5/87
14	6/87 to 10/88

**Adjustments to income are $1,000 per household resident and extraordinary medical expenses.

***Not included here is the "Local Participation" limit, currently $35,100. These loans are made available to cities for addressing local needs. Loan volume is small, presently about 1.8 percent of Phase 14 loans.

Table 3.2: Home Improvement Loan Borrower Income, 1983-1988

During phases 10 to 12 (July 1983 to May 1985) maximum adjusted income allowed for loan recipients was $24,000. This was increased to $27,000 in mid 1986. As Table 3.2 shows about 68 percent of all borrowers earned over $13,000 per year. The avarage household income of all borrowers was around $15,500 to $16,000 until phase 14 beginning in June 1987. Average income in phase 14 is $17,000, and average income over the entire period was $16,134.

A significant percentage of home improvement loan recipients have quite low incomes: Across the time periods shown 15 to 18 percent have adjusted incomes of $10,000 or less and an additional 3 to 4 percent have even lower incomes.

It is difficult to see how MHFA could restrict the program to a lower income population, given that bond-financed loans need to be repaid at a high, predictable rate.

Demographic Characteristics

It is not the purpose of the program to target loans at any particular age group. MHFA data shows that 10 to 16 percent of loans go to borrowers over 62, 20-30 percent goes to borrowers under 30. About 96 or 97 percent of loans goes to whites, 65 to 70 percent goes to households headed by a married couple, 28 to 32 percent are headed by a single person. These numbers and the more detailed data on which they are based seem roughly in line with the compostion of the population targeted by the program.

Most loans go to households living in single family houses. Over the period 1983 to 1987 this percentage has ranged between about 95 and 98 percent. Virtually all the remaining loans go to two unit housing types.

Geographic Distribution

Table 3.3 and the accompanying map show the distribution of loans across the state (strictly speaking this is a distribution of properties). It is evident from a look at Table 3.3 that a disproportionate number of home loans have been made to borrowers outside the seven county Twin Cities metropolitan area. Since there have generally been more than enough funds available to meet demand in each region, and since participating lenders are if anything more accessible in the Twin Cities metropolitan area than in outstate areas, the explanation for the concentration of loans outstate, reflects other factors. According to MHFA, lenders do not have funds to make home improvement loans in many outstate areas, thus MHFA does not face competition from private lenders that provide an alternative source of capital in the Twin Cities area. Also, the income eligibility limit of $24,000 and $27,000 during the period covered in Table 3.3 means that far more households are eligible outstate than in the Twin Cities metropolitan counties where average income is higher.

Interest Rates

As noted earlier, home improvement loan rates now vary from 3 to 9 percent depending on income. Under a separate Local Participation Loan Program in which loans are made at 9.75 percent interest, a set-aside of funds is available

Proportionately more loans go to outstate households.

Region	Home Improvement Loans 1983-1988	1980 Population Percent of Total
1	3.5%	2.4%
2	2.6	1.5
3	10.5	8.4
4	7.8	5.0
5	7.1	3.2
6E	4.6	2.6
6W	3.8	1.5
7E	3.9	2.4
7W	7.8	5.4
8	5.4	3.3
9	10.1	5.4
10	7.1	9.9
11	25.7	48.7
State Total	100.0%	100.0%*
Number	12,364	4,075,971

*Does not add due to rounding.

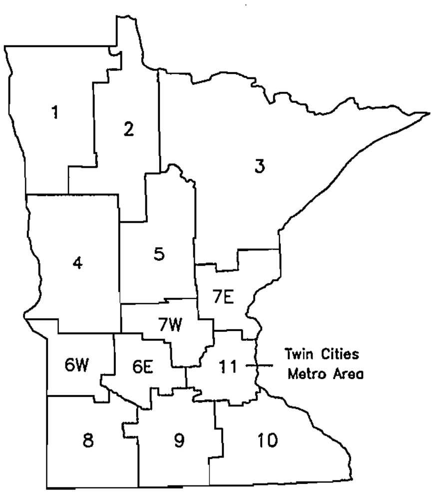

Table 3.3: Geographic Distribution of Home Improvement Loans

to meet local needs and household adjusted annual income can be as high as $35,100 under this program.

In the past, home improvement loans were made at various other interest rates. Over the last two years the program has been simplified so that loans are now made at five different rates. The interest rates that are charged at various income levels are shown below in Table 3.4 along with the percent of loans made at each rate. About half the loans are made at nine and 9.75 percent to households with incomes over $17,000. Half are made to households with incomes under $17,000.

Adjusted Income	Interest Rate	Percent of Loans 12/87 to 8/88
$7,000 or Less	3.0%	7.0%
$7,001-12,000	5.0	18.3
$12,001-17,000	7.0	24.5
$17,001-27,000	9.0	47.9
$27,001-35,100*	9.75	2.2
Number of Loans		1,442

*Local participation set-aside.

Table 3.4: Home Improvement Loan Interest Rates

About half of all borrowers have household incomes of $27,000 or less.

Types of Improvements

Table 3.5 shows what types of improvements are financed with home improvement loans for the 3,731 loans made since mid 1987. The types of improvements financed recently differs little from earlier years.

Table 3.5 shows, for example, that 11.3 percent of improvements involve structural alterations or additions, 24.9 percent are for interior finishing, 6.6 percent are for heating, cooling or ventilation improvements and 15.7 percent are for insulation. These data do not permit a close analysis of whether a useful public purpose is being served by the home improvement loan program. The purpose of the program is better served, presumably, by enhancing basic livability, less so by financing new carpeting or decorating.

Improvement Type	
Structural Additions/Alterations	11.3%
Exterior Finishing	13.4
Interior Finishing	24.9
Roofing	8.7
Plumbing-Install/Repair	10.1
Heat/Cool/Ventilation	6.6
Insulation	15.7
Miscellaneous	9.3
Total	100.0%
Number of Loans	3,731

Source: Minnesota Housing Finance Agency.

Table 3.5: Type of Improvements, June 1987 to October 1988

Verification

One obvious concern relating to the issue of whether the home improvement loan program is successful is the question of whether the loans actually are used to finance home improvements as the program assumes and requires.

MHFA contracts with a private company to inspect and report on a sample of properties that received improvements financed through the program. In 1986, 198 inspections were performed of which 20 did not have all the improvements completed that were described in loan documents. In nine cases, cost overruns prevented completion of the anticipated work. In another case, a bankrupt contractor kept the money that was paid in advance. In another case the loan was repaid. Together these represent 12 of the 20 cases. The remaining nine cases or 4.5 percent of the sample of 198 were considered to be in violation of program regulations that require loan proceeds to be used for eligible improvements. This represents 2.5 percent of the $1.2 million of loan proceeds accounted for by the properties sampled. Ultimately, all 9 cases were resolved by loan repayment or completion of the work.

It is to MHFA's credit that it has a program to follow up on home improvement loans, and the apparent rate of abuse is acceptably low. However, the follow up inspections were performed in the summer of 1986. A summary of these inspections was not available until October 1988, although the agency had a list of the problem loans. MHFA should be more interested in the outcome of the inspections it arranges and pays for.

HOME ENERGY LOAN PROGRAM

The Legislature authorized MHFA's Home Energy Loan Program in 1983. The program has been financed over the years through appropriations, bond proceeds and oil-overcharge funds.[4] The agency has not received new appropriations since 1983. Funds currently available were raised through a $5.25 million taxable bond issue combined with $575,000 of oil overcharge funds.

The purpose of the program is energy conservation, and there are no income limits defining eligibility for the loans, although loan recipients have to be creditworthy. (Energy improvements can be financed through lower-interest home improvement loans for qualifed lower-income borrowers.) Energy loans carry an interest rate of 8 7/8 percent, a limit of $5,000 per loan, and a term of up to five years. Financing is available statewide (through basically the same lender network that originates MHFA home improvement loans) except for Duluth which runs its own energy conservation program.

Table 3.6 presents statistics on the number and volume of energy loans made since 1983, the year the program began. As Table 3.6 shows, loan volume slipped during 1986 and 1987. This is due to the scarcity of funds during part of this period and also due to commitments to low activity lenders. Al-

4 From a settlement of a case brought by the state against Exxon Corporation for oil pricing violations.

Year	Number	Dollars
1983	1,292	$3,838,579
1984	3,840	12,177,734
1985	3,333	10,839,116
1986	1,159	3,678,963
1987	1,318	4,019,673
1988*	2,152	6,934,256
Total	13,094	$41,488,321

Source: Minnesota Housing Finance Agency.

*As of October 30, 1988.

Table 3.6: Home Energy Loan Volume by Year, 1981-1988

together, over the period shown, 13,094 loans totalling $41,488,321 were made.

Home energy loans are not restricted to lower income households. Their purpose is to promote energy conservation.

MHFA has administered four pools of home energy loan financing. Pools represent funds against which lender commitments can be made. Table 3.7 shows that 95 percent of borrowers since 1983 had (unadjusted) household incomes over $13,000. Average income of borrowers was $31,348 in 1983-84 and rose to $36,246 in the current phase of the program (September 1987 to the present). Overall, average income during the period was $34,313.

	Program Phase*				
Income	31	32	33	18	Total
$5,000 or Less	1.7%	1.3%	1.7%	1.3%	1.4%
$5,001-10,000	1.4	1.1	1.7	1.7	1.4
$10,001-13,000	2.9	1.9	1.7	1.6	2.0
Over $13,000	94.0	95.6	94.9	95.5	95.1
Average Income	$31,348	$34,522	$35,700	$36,246	$34,313
Number of Loans	3,147	5,371	1,242	3,356	13,114

*Phases represent pools of money against which commitments to lenders can be made. Dates corresponding to the phases are:

31	10/83 to 7/84
32	9/84 to 8/86
33	9/86 to 6/87
18	9/87 to 10/88

Table 3.7: Home Energy Loans Borrower Income, 1983-1988

Table 3.8 shows the geographic distribution of energy loans. Unlike home improvement loans in general, which are concentrated in outstate areas, energy loans are distributed across the state in very close proportion to the population. About half the loans go to households in the Twin Cities area, where about half the state's population resides. It is not necessarily easy for owners in all areas to find a lender qualified to originate home improvement or energy loans, but since 1983 over 100 loans have been made in each region.

MHFA's 1990-91 budget proposal anticipates an end to oil overcharge revenue by FY 1991 and a phase-out of the energy loan program when the oil-overcharge money is used up. Because the Energy Loan Program is not aimed at low or moderate income borrowers, the MHFA Board feels it is not a program that fits MHFA's basic organizational mission. If state appropriations have to be used in order to provide loans at below market rates, the program will lack support by the Board and staff of MHFA, unless sentiment changes.

Home energy loans are distributed across the state in close proportion to population.

Region	Home Energy Loans Percent of Total	1980 Population Percent of Total
1	2.5%	2.4%
2	1.1	1.5
3	8.2	8.4
4	3.7	5.0
5	3.0	3.2
6E	2.8	2.6
6W	1.6	1.5
7E	2.3	2.4
7W	6.0	5.4
8	3.7	3.3
9	6.0	5.4
10	9.9	9.9
11	49.3	48.7
State Total	100.0%*	100.0%*
Number	13,166	4,075,971

*Does not add due to rounding.

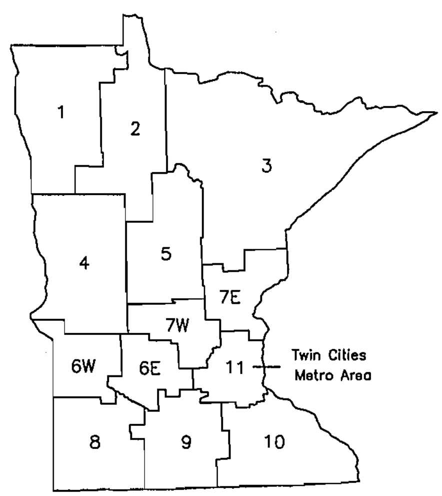

Table 3.8: Geographic Distribution of Home Energy Loans, 1983-1988

In recent years, MHFA has issued taxable rather than tax-exempt bonds to finance the program, because of the availability of oil overcharge funds. Because of new federal requirements governing the use of tax exempt bond proceeds, it will be difficult to run a loan program financed by tax exempt bonds without imposing income limits. The state Legislature and the oil overcharge case both specifically prohibit income limits from being applied.

We conclude on the basis of a review of most of MHFA's owner and renter programs that:

- **Unmet housing needs of low income households are substantial and thus state appropriations should not be used to subsidize loans to households with above average incomes.**

Energy conservation is nevertheless a worthy goal and MHFA's experience with the Energy Loan Program shows that there is steady demand for about ten million dollars of 8 7/8 percent interest loans per year. Many energy improvements, however, would undoubtedly be made by above average income households even without subsidized loans, if the energy improvements promise a positive payback.

REHABILITATION LOAN PROGRAM

Rehabilitation loans are designed to assist very low income property owners needing to make basic repairs, energy improvements, or accessibility improvements for the physically handicapped.

Applicants for rehabilitation loans may not have incomes exceeding $7,000 and assets (aside from the property to be improved) of more than $25,000. Rehabilitation loans are interest free and need not be repaid unless the borrower sells, or ceases to live in the property within ten years. The maximum loan amount is $7,500.

Zero-interest rehabilitation loans are designed to permit repairs by very low income home owners.

Rehabilitation loans are originated and administered by community action agencies, public housing authorities and other public agencies, that contract with MHFA and meet detailed procedural requirements.

Since 1981, more than 4,800 rehabilitation loans have been made. Table 3.9 shows the income of borrowers participating in the first three phases of the program. As the table shows, the average income of borrowers is very low, $3,785 to $4,175 between 1981 and 1987. Over 10 percent have annual (adjusted) incomes less than $2,000 and half or close to it have incomes less than $4,000.[5]

It is hard to see how the program could be aimed at a lower income target group, given that the program is for property owners.

MHFA collects descriptive information on borrowers, and individual properties that shows:

5 The principal adjustment to income is a $1,000 deduction per household member.

Adjusted Income**	Program Phase* 1	2	3	Total
$2,000 or Less	10.9%	12.1%	11.5%	11.6%
$2,001-3,000	15.3	17.0	9.2	14.2
$3,001-4,000	28.1	23.0	24.2	24.9
Over $4,000	45.7	48.0	55.1	49.3
Maximum Income	$6,000	$7,000	$7,000	--
Average Income	$3,785	$3,921	$4,175	$3,952
Number of Loans	1,482	1,953	1,388	4,823

*Phase 1 11/81 to 6/83
2 1/83 to 6/85
3 9/85 to 6/87

**Total annual household income less $1,000 per resident and extraordinary medical expenses.

Table 3.9: Rehabilitation Loan Borrower Income, 1981-1987

Demand for rehabilitation loans far exceeds available funds in every part of the state.

- **Most loans go for improvements to older buildings. About 42-45 percent are older than 45 years and fewer than a quarter are younger than 30 years.**

- **The average market value of properties in which borrowers live is modest ranging from $26.2 thousand to $30.4 thousand between 1981 and 1987.**

- **Loan amounts are typically for $4,000 to $7,500. Types of repairs are various but must enhance the health, safety, or energy efficiency of the property. Fifteen percent or more of recent repairs are for insulation, and interior finishing. Twelve percent are for roofing, and plumbing installation and repair. Available data on repairs does not yield much insight into whether a repair vitally affecting the liability of a unit and contributes to the preservation of the housing stock.**

Between 1981 and 1987 rehabilitation loans were made in every economic development of the state. Table 3.10 presents the distribution of the 4,823 loans made during this period across development regions. As a point of reference the population distribution across regions is presented as well. Rehabilitation loans are concentrated outside the seven county Twin Cities metro area, as this comparision clearly shows. Rehabilitation loans are more highly concentrated than population in every region except the Twin Cities. This distribution of rehabilitation loans is not necessarily unreasonable given that average incomes are higher in the Twin Cities area. In any case, fear that the rehabilitation loan funds would stick in the Twin Cities area because of more aggressive or well organized local housing agencies is not borne out. MHFA has succeeded in allocating funds to all areas with an allocation plan designed to achieve this result.

Rehabilitation loans are concentrated outstate.

Region	Rehabilitation Loans Percent of Total	Population Percent of Total
1	4.0%	2.4%
2	2.9	1.5
3	10.4	8.4
4	8.9	5.0
5	6.5	3.2
6E	4.4	2.6
6W	2.6	1.5
7E	4.1	2.4
7W	5.4	5.4
8	5.7	3.3
9	7.4	5.4
10	11.7	9.9
11	25.9	48.7
State Total	100.0%	100.0%*
Number	4,823	4,075,971

*Does not add due to rounding.

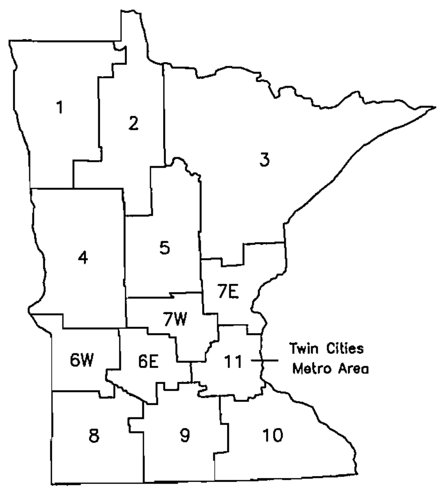

Table 3.10: Geographic Distribution of Rehabilitation Loans, 1981-1987

The rehabilitation loan program is financed by state appropriations (totalling about $7 million in 1988) and demand for loans far exceeds available money in all areas of the state. The waiting list for the program is so long that administrators do not have to publicize the program. Local agencies ought to critically examine loan applications for consistency with the program's purpose. According to MHFA, local agencies examine the properties before and after improvements are made and encourage owners to make code-related improvements. Certainly, the aggregate data reviewed in this chapter suggests that the program is targeted appropriately.

Given the severe shortage of funds for rehabilitation, several possible ways to make available resources go farther should be noted:

- **Charge a nominal rate of interest to those who can afford a small payment.**

- **Recapture loan principal or interest whenever the property is sold or transferred.**

Of these, the first has been tried. There were borrowers even at very low income levels who were required to make payments, but the 60 day past due rate on the 3 percent loans that were made in between 1981 and 1985 with appropriated money was 7.69 percent.

In general, installment loans under the rehabilitation loan program averaged $3,252. Monthly payments on a loan of this size at 3 percent is about $31.

We recommend that the state recapture its subsidy when the property is sold.

Servicing such loans is expensive and thus charging low interest to households whose income is under $7,000 holds little potential for making rehabilitation loan dollars go further. MHFA has recently proposed a 3 percent low interest loan program, however, for a higher income group, and this presumably would work better.

We recommend, however, that MHFA recapture the subsidy if provides through rehabilitation loans when the property is sold or transferred.[6] The obvious advantages are:

- **limited resources, in high demand everywhere, could go further to help people in need.**

The Rehabilitation Loan Program is considered central to MHFA's purpose. It has accounted for a large fraction of agency appropriations over the years and about half the agency's appropriations request for the coming biennium.

The agency has considered this option in the past and does not offer a compelling argument against the idea. MHFA argues that a recapture provision would dissuade some from applying for funds, but since there are more applicants than funds this would seem not to be a problem. As data presented earlier in this chapter show, the properties have significant value, and if not, no subsidy recapture would take place.

FINANCIAL SECURITY

As we discussed earlier, MHFA's effectiveness depends not only on designing and establishing a program to deliver loans to a targeted clientele, but on the competence with which the agency arranges for the financial services that are part of issuing bonds, financing loans, collecting installment payments, and paying interest and principal to bond holders. If MHFA is uanble to meet the expectations of the financial community, its ability to raise capital for its programs will be adversely affected.

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6 This is now done only when the property is sold within 10 years.

We discussed this aspect of MHFA's performance in the context of the Single Family Loan Program in Chapter 2 and have little to add here, except to briefly summarize the results of a financial analysis of the Home Improvement Loan Program, performed by Evenson Dodge, Inc. Their report of December 1983 concluded:

- **The program is financially strong, can support a default rate as high as ten percent while paying bond holders and recycling state appropriations.**

- **MHFA can safely withdraw up to one-half of one percent of the value of outstanding bonds to finance administration of the program without jeopardizing the financial security of the program.**

These findings were made in 1983 and apply to the agencies obligations at that time. Since 1983, MHFA has issued additional bonds to finance home improvement loans, and has accumulated additional data on the cost and default rate on collections. Even with the problems the agency has experienced with home improvement loan servicing (discussed in the next section) MHFA's default rate is well below levels that can be tolerated without jeopardizing payment of the agencies financial obligation.

Home improvement bonds are financially secure.

As of June 1988, 3.44 percent of home improvement loans had been submitted for an insurance claim. In mid-1988 about 1.6 percent of the total dollars outstanding were 60 or more days past due. Moody's and Standard and Poor's, bond rating organizations, rate MHFA's home improvement loan bonds favorably.

Based on these ratings and the unequivocal conclusions of the Evenson Dodge financial analysis, we conclude that MHFA has marketed bonds responsibly and met the requirements of the financial community necessary to raise capital on favorable terms.

If anything, MHFA has been criticized for excessive conservatism and concern for avoiding financial risk. If the agency is too conservative funds are reserved that could be used for expanding agency programs. If the agency is too optimistic other agency resources and other state funds may have to be used to meet MHFA's obligations.[7]

Many lending institutions in outstate areas do not have funds for home improvement loans for low and moderate income borrowers because of the uncertain risk and high expense associated with such loans. Our understanding of the housing market over the next decade suggests that equity in the types of properties financed by MHFA will grow much more slowly than it has in the recent past. This suggests that MHFA's caution is well founded. The worst thing that can happen if MHFA is too cautious is that its reserves will accumulate, to be spent in the future.

7 MHFA bonds, however, are not general obligation bonds.

HOME IMPROVEMENT LOAN SERVICING

Since 1975 MHFA has lent $305 million to borrowers in energy and home improvement loans. As of mid-1988, $107 million was approximately the balance that remained to be collected. This section asks:

- **How effectively has MHFA arranged for the collection of payments due on home improvement loans?**

In recent years, MHFA has contracted out the job of servicing home improvement loans to private firms rather than servicing them directly. In the case of home mortgage loans, as we saw in the previous chapter, this has worked well: MHFA mortgage loan servicers generally performed well, and since there are numerous firms interested in performing this job for MHFA, poor performers can be replaced by better ones.

In contrast to mortgage loan servicing, we found:

- **MHFA has had a number of problems over the years with home improvement loan servicing.**

MHFA tried servicing home improvement loans itself in the first two years of the program, but encountered problems and decided to contract with private companies. In 1982, MHFA, in a decision formally approved by the Board, decided to employ two servicing firms and divide new business equally between them. By 1983, two servicers were on board.

Compared to mortgage loans, there are few firms interested in servicing home improvement loans. There are several reasons: home improvement loans are small, there is no secondary market for the loans; lending institutions that make home improvement loans generally service their own; MHFA's portfolio, while bigger than other states, does not represent a big money-making opportunity for most banks and other agencies in the business of collecting loans. Also, MHFA reporting requirements are significant, and are often cited as the main reason potential servicers are not interested in MHFA's home improvement servicing business.

There are theoretical advantages and disadvantages to using an outside servicer versus servicing loans in-house. In-house servicing would mean that MHFA could have direct knowledge of the cost and quality of the job, and presumably could achieve any reasonable standard of performance that it set.

There are potential advantages to contracting the work out, among them:

- **MHFA can choose among competing firms on the basis of cost or quality of performance;**

- **The function of servicing loans can be carried out more efficiently by specialized firms servicing MHFA accounts along with others.**

These advantages are not realized, however, if there is a shortage of good firms willing to bid on servicing MHFA's loan portfolio, or if outside firms are unable to consistently meet MHFA's performance criteria.

After more than a decade of experience:

- **MHFA is reaping the disadvantages of not servicing loans directly, while also not capturing the advantage of contracting the work out.**

MHFA has experienced continuing problems in servicing home improvement loans.

The two servicers that MHFA has been using since 1982 resemble satellites of the agency since MHFA is the source of most of their business and it is questionable if either could survive without that business. The firms, Compu-Link Loan Service, Inc. and National Escrow Corporation are not large companies, and MHFA adopted the reasonable strategy of avoiding a "sole-source" relationship with either given the size of its loan portfolio and its financial obligations to bondholders.

Between March 1987 and July 1988 MHFA has had performance problems with both servicers and at difference points cut off new business to both. In March 1987, MHFA cut off new business to Compu-Link because of problems causing unsatisfactory performance. These problems were later resolved and a normal business relationship restored. In December 1987, MHFA cut off new business to NEC because of performance problems. According to MHFA staff, NEC's performance problems have continued.

According to MHFA, NEC's 30 days and over delinquency rates have been higher than Compu-Link every month but one since January 1988, and more than one percentage point over the industry standard five out of six months when this comparison can be made. MHFA makes a final effort to collect loans that servicers recommend for an insurance claim, and since July MHFA has successfully collected two NEC-serviced loans worth $13,270 and worked out repayment plans for three others worth $21,000.

NEC has also not provided required reports or provided them late during the period July to Novemember 1988. MHFA noted eight specific contract violations in a document dated November 17, 1988 discussed by the Board at its November meeting. There were no contract violations by Compu-Link during the same period.

In July 1988, the MHFA Board decided to award NEC 70 percent of new servicing business (measured by the fee income generated). This decision was reaffirmed in November 1988. This decision over-rode the staff's recommendation to adhere to previous Board policy establishing performance criteria and to suspend awarding new business to NEC until certain conditions were met.

The decision to reject the recommendation of staff divided the MHFA Board, and the Board from the staff. In the past, the Board has not pursued a strongly independent role. The July 1988 action was a significant departure.

There is no question that the MHFA Board has the authority to select servicers, establish performance criteria, or make any policy or operating decision for MHFA.

Loan servicing has been a running controversy at MHFA board meetings during the past year.

Nevertheless, in our opinion, based on attendance at nearly all Board meetings between July and December 1988 where this matter was discussed, the staff of MHFA has properly taken the position that servicer selection should rest on an assessment of performance in comparison with agreed upon performance criteria, as well as the contractual requirements governing the relationship between MHFA and servicers.

The Board, was persuaded by other factors including the reputation of NEC's owner George Mikan, a well-known former basketball player, and the argument that NEC was a struggling Minnesota-based business deserving of special treatment.

The staff recommendation to suspend new servicing business was based on paramount concern over performance problems (acknowledged by NEC, but described as temporary and solvable). The staff was also concerned that NEC's most recent audit did not express an unqualified opinion of NEC's net worth, and noted several questions pertaining to assets and liabilities. In our opinion, NEC's audit of October 27, 1988 conducted by Pannell, Kerr, and Forster raises questions about NEC's financial well-being and management that should be a source of concern to MHFA. The agency has a large home improvement loan portfolio to service and only one other vendor in place.

- **Thus, we think that the MHFA Board reached an imprudent decision by rejecting the staff recommendation concerning home improvement loan servicing by NEC.**

From a broader perspective, MHFA needs to further protect itself by finding additional servicers capable of servicing MHFA home improvement loans. So far, efforts by MHFA to recruit additional servicers have been unsuccessful. Since the MHFA portfolio by itself will not provide enough business, the kind of servicer MHFA would like to use will have to have other accounts. Alternatively, MHFA ought to develop an in-house servicing capacity that can function along with outside agencies or by itself.

There are disadvantages to running a loan collection operation in a government agency, oriented to achievement of social objectives. But a bigger problem will result from continued reliance on servicers whose performance is substandard.

MHFA describes loan servicing as the biggest problem now confronting the home improvement loan program. MHFA owes home improvement loan bond holders about $170 million in principal and interest. Thus, collecting home improvement loans effectively and efficiently is of more than incidental importance. But the job of a government agency is somewhat more sensitive than a private lender. Many home improvement loans are made to low-income, elderly homeowners who cannot qualify for other sources of credit. MHFA has an interest in not only whether loans are collected, but that appropriate methods are used. Thus, is is inevitable that servicing firms working for MHFA, given MHFA's organizational mission, will have to meet more stringent standards than might otherwise be imposed.

CONCLUSIONS

MHFA has succeeded in running a financially secure home improvement program several times larger than that of any other state.

MHFA has successfully targeted its installment loan program to low and moderate income borrowers. In addition, it operates a home energy loan program designed to promote energy conservation and a rehabilitation loan program with deferred repayment of principal and no interest aimed at very low income owners.

Our principal conclusions are:

- **The Home Energy Loan Program, not targeted to low or moderate income households, should not compete for scarce state appropriations needed to finance rehabilitation loans and other state programs aimed at the most needy.**

- **Demand far outstrips availability of interest-free rehabilitation loans. MHFA should establish clearer priorities for the use of such loans and recapture its subsidy when the property receiving the rehabilitation loan (really a grant) is sold. Proceeds should be recycled.**

- **MHFA has based its high priority for the home improvement program on an analysis of demographic and economic trends affecting the housing market. This analysis leads to a conclusion that preservation of the existing stock will be a preferable means of providing low cost housing in most areas than new construction. We think the agency is fundamentally correct in this assessment, but we recognize that new construction programs have a lot of support.**

- **As long as a sizable federal subsidy is available, it is less necessary to scrutinize the public purpose served by the home improvement loan program. But if state appropriations are required to provide low interest loans, a program that serves lower-middle class homeowners may not make sense. For the future, the source of the subsidy and whether it is directed to the most urgent needs, need to be more closely examined by MHFA.**

- **MHFA needs to solve the chronic problem with home improvement loan servicing either by developing an in-house capacity or identifying additional outside resources.**

MULTI-FAMILY HOUSING DEVELOPMENT

Chapter 4

MHFA has financed new construction and rehabilitation of multi-family housing since 1971. In conjunction with the federal housing subsidy programs known as Section 8 and Section 236, MHFA has financed 13,758 housing units. Also, MHFA has implemented its own "market rate" financing program and the Apartment Renovation Mortgage Program which have assisted 3,178 units and 743 units respectively. Finally, MHFA administers two federal programs: the Low Income Tax Credit program which has stimulated production of 2,591 units, and the Rental Rehabilitation Grant Program, which assisted in the rehabilitation of over 1,500 units.

Total funding for multi-family housing represents two percent of MHFA's appropriations.

While significant, this level of activity is relatively minor when viewed in the context of all MHFA housing program activity. As noted in Chapter 1, and shown in Table 1.11, MHFA multi-family housing programs account for 30 percent of all MHFA bonding and 2 percent of all agency appropriations over the years.

An important feature of the state's multi-family housing activity has been MHFA's reliance on federal subsidies (79 percent of its assisted units were produced under the Section 8 or 236 programs). In 1981, the federal government terminated Section 8 subsidies for new construction of low-income housing. In the 1990's, the contracts on these federally subsidized units will begin to expire. Therefore, this is an appropriate time in which to examine the role of MHFA in providing affordable rental housing.

In this chapter, we describe MHFA's multi-family housing programs and evaluate them by asking the following questions:

- **Has MHFA administered the programs effectively?**
- **Are MHFA programs appropriate in light of the housing needs of low and moderate income households in Minnesota?**
- **Are MHFA programs appropriate in light of the loss of federal new construction subsidies and expiration of federal mortgage contracts?**

DESCRIPTION OF MHFA MULTI-FAMILY PROGRAMS

As discussed in Chapter 1, renters are less well off economically than owners, and affordability of rental housing has been declining in recent years. Table 1.6 points out that 55 percent of renters paid over 25 percent of their income for housing and 22 percent paid over half of their income for rent. In order to help address this issue MHFA runs a variety of low-income multi-family housing programs including:

- *Construction financing and mortgage loans*: These loans use tax-exempt revenue bonds to finance developments that received federal subsidies under the Section 8 Housing Assistance Payments Program and Section 236 Rental Housing Assistance Program.

- *Market-rate mortgage loans*: These loans finance moderate income units.

- *Apartment renovation loans*: These loans provide financing for mortgages and renovation of existing apartment buildings.

- *Federal low-income tax credits*: Since 1989, the federal government provides tax credits for state and local allocation to be used in projects which construct or substantially rehabilitate low-income housing. MHFA administers this program in the state.

- *Rental Rehabilitation Grants*: Since 1984, MHFA has distributed federal rehabilitation grants to owners of apartment buildings that serve low-income renters.

Most MHFA financed multi-family housing employed federal subsidies.

Construction Financing and Mortgage Loans

Federal tax-exempt mortgage revenue bonds combined with direct federal rental subsidies have enabled MHFA to finance construction of affordable housing for low-income renters. Between 1975 and 1981, the federal Section 8 New Construction Program provided developers of low income housing with a subsidy for a specified period of time, 30 to 40 years or the life of the mortgage. The federal subsidy paid the property owner the difference between the level of rent that the tenant could afford (30 percent of monthly income) and the federally established fair market rent. MHFA used tax-exempt mortgage revenue bonds to encourage private developers to participate in Section 8 New Construction Program by supplementing the federal rental subsidy with below-market interest rate financing.

The federal Section 236 program provided developers of low-income housing with mortgages that included an interest reduction subsidy. By lowering developer's financing costs, the program aimed to lower the rents charged tenants. MHFA served as the mortgage lender for Section 236 projects and U.S. Department of Housing and Urban Development paid MHFA a subsidy that effectively reduced the mortgage interest rate down to one percent per year. Section 8-New Construction and Section 236 were ended in 1981. These programs were expensive and not responsive to conditions where new construction was not needed as much as more efficient approaches to increasing the availability of affordable housing.

Our analysis of MHFA administration of Section 8 and 236 as revealed in Figure 4.1 and Table 4.1 indicates: More than half of the units (55 percent) in the combined Section 8 and 236 programs have served elderly households and 45 percent have assisted families.

Over half of MHFA multi-family units serve the elderly.

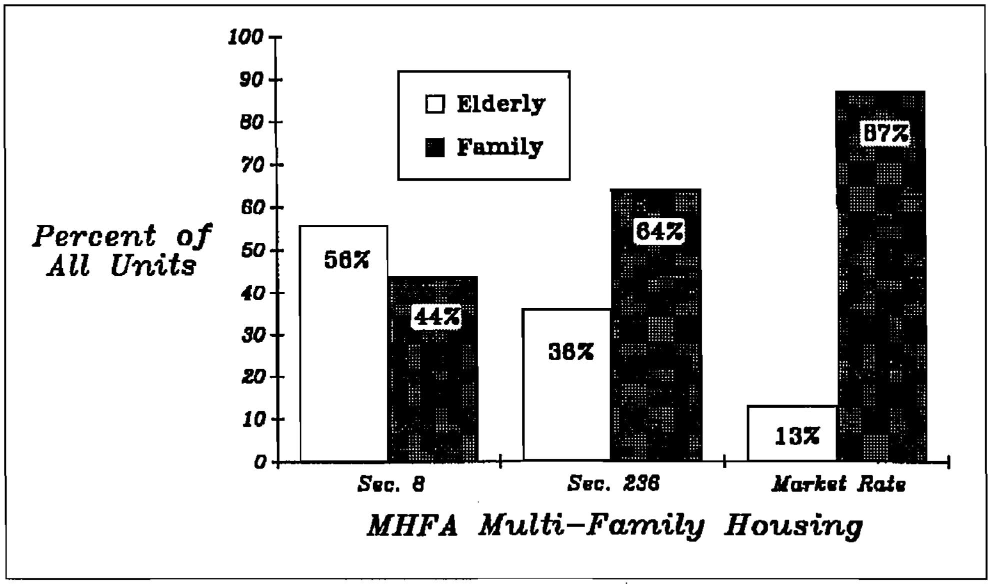

Figure 4.1: Type of Tenants in MHFA Multi-Family Developments, 1988 (Source: Minnesota Housing Finance Agency, *Multi-Family Development Activity* (St. Paul, 1988).

The dominant share of federal housing assistance has gone to housing for the elderly because of a national preference for such projects by both developers and communities. This priority of housing for the elderly exists despite the fact that the state offered developers a $5,000 grant per unit (up to $20,000 per project) as an incentive for producing three and four bedroom family units. Be this as it may, there are now vacancies in some Twin Cities area subsidized housing developments for the elderly and a critical shortage of family units. MHFA is proud of its record in producing rental housing for families in spite of tremendous obstacles. MHFA's delivery of 45 percent of all federally subsidized units for families compares favorably with the national average of only 30 percent.

In our analysis of the geographic distribution of Section 8 and 236 housing, we discovered that:

- **Section 8 and 236 projects have been distributed equally between the Twin Cities and outstate areas. Roughly half of each are located in the Twin Cities area, half outstate, in proportion to the distribution of the state population.**

Characteristic	Section 8	Percent	Section 236	Percent	Total	Percent
Elderly Units	7,320	56%	202	36%	7,522	55%
Family Units	5,871	44	365	64	6,236	45
Total	13,191	100%	567	100%	13,758	100%
Twin Cities Metro Area	6,152	47%	298	52%	6,450	47%
Outstate Minnesota	7,039	53	269	48	7,308	53
Total	13,191	100%	567	100%	13,758	100%
Bonds Sold	$612.0 million		$18.6 million		$630.6 million	
Appropriations	1.8 million				1.8 million	
Total	$613.8 million		$18.6 million		$632.4 million	

Source: Minnesota Housing Finance Agency, *Multi-Family Development Activity* (St. Paul, 1988).

Table 4.1: Minnesota Housing Finance Agency Section 8/236 Multi-Family Housing, Cumulative through 1988

MHFA has tried to develop family rental units, especially outstate.

This geographic distribution illustrated in Figure 4.2 was partially due to HUD's allocation plan which sought to place units in non-metro areas of the state where fewer subsidized housing units had been provided. The results of this geographic distribution has been that Twin Cities (Region 11) and the western portion of the state (Region 1 and 4) have been underserved (see Table 4.9).

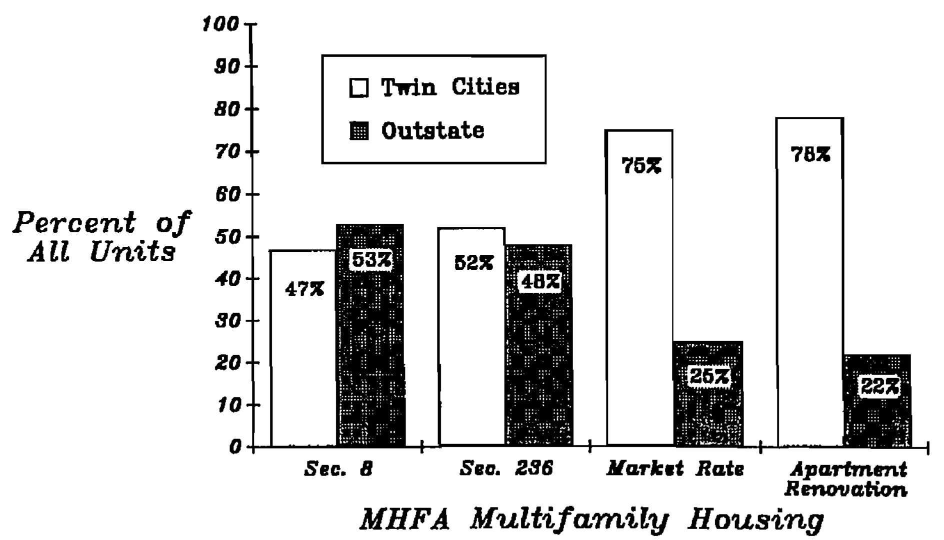

Figure 4.2: Location of MHFA Multi-Family Developments, 1988
(Source: Minnesota Housing Finance Agency, *Multi-Family Development Activity* (St. Paul, 1988).

Market Rate Multi-Family Housing Programs

Since the elimination of the federal new construction subsidy in 1981, MHFA has relied on tax exempt revenue and taxable bonds to offer below market interest rate construction and permanent financing to nonprofit and for-profit developers. This type of subsidy is considered to be a "shallow" one because MHFA is only able to pass on the reduced interest benefit that they receive from tax exempt bonds (generally 1.5 to 2 percentage points less than conventional interest rates). Therefore, this program produces units with rents that are affordable only to moderate income households.

MHFA currently operates three market rate multi-family programs:

- *The Family Graduated Payment Mortgage Program*: MHFA assists multi-family housing designed to serve families with children. The mortgages allow monthly payments to gradually increase over the first five years of the loan. MHFA uses appropriations and accumulated reserves to pay the difference between the mortgagee's gradulated rate and the fixed bond rate.

- *The Family Shallow Subsidy Rental Program*: Using the proceeds from prepaid Section 8 mortgages (which had a low interest rate) MHFA financed the development of housing to serve families with children. These units are in walk-up buildings (3 stories or less).

- *The Elderly Interest Writedown Rental Program*: MHFA finances construction of rental units for the elderly by offering 30 year fixed rate mortgages. MHFA uses its own reserve funds to provide an interest rate writedown. Twenty percent of the units developed must serve elderly persons who are low-income.

The characteristics of MHFA's market rate multi-family housing are described in Table 4.2 and show that market rate housing has provided more family units than housing for the elderly, and three units in the Twin Cities area for every one outstate.[1]

MHFA justifies the concentration of market rate housing in the Twin Cities area by reasoning that renters in the Twin Cities area can best afford the higher market rents associated with new construction.

Apartment Renovation Mortgage Program (ARM)

Most multi-family programs have assisted developers with new construction and substantial rehabilitation of rental housing. One segment of the multi-family housing market that has been neglected by these programs is existing

1 The term "family units" as it is used in Table 4.2 does not mean that the units are occupied by families, only that they were designed to serve famililies. Market rate family units are rented to anyone who wishes to occupy them while "elderly units" are designed specifically to serve elderly tenants.

Characteristic	Market Rate Number of Units	Percent
Elderly	409[a]	13%
Family	2,769	87
Total	3,178[b]	100%
Twin Cities Metro Area	2,463	75%
Outstate Minnesota	807	25
Total	3,270[b]	100%

Source: Minnesota Housing Finance Agency, *Multi-Family Development Activity* (St. Paul, 1988).

[a]Three hundred ninety three units have been completed and 16 units were under construction in December 1988.

[b]Minnesota Housing Finance Agency made commitments for 3,270 units and completed or started construction on 3,178 units.

Table 4.2: Market Rate Multi-Family Housing, Cumulative through 1988

MHFA is the nation's only housing agency to use taxable bonds to assist existing apartment buildings.

apartment buildings of five units or more. These buildings contain 74 percent of all the multi-family housing units in the state, and the owners of these buildings have faced financial problems in recent years.

To preserve the supply of affordable multi-family housing and to upgrade the quality of these units, MHFA created the Apartment Renovation Mortgage (ARM) Program in 1987. This program is unique because MHFA is the only state housing finance agency in the country to utilize the proceeds from the sale of taxable bonds combined with an agency subsidy to:

- Provide long-term, first mortgages for the purchase of rental properties,
- Refinance existing debt on properties,
- Provide financing for renovation and energy improvements.

The ARM program addresses several of the problems of existing apartments. Long-term financing, as opposed to contract-for-deed arrangements can stabilize rents for low and moderate income tenants. Refinancing of debt allows rental revenues to be set aside for management and maintenance costs. Moderate rehabilitation (average of $1,000 to $3,000 per unit) can address the problem of deferred maintenance and bring properties up to code. Furthermore, after owners receive ARM financing, they must agree to keep rents within levels affordable to moderate income households and provide monthly operational reports to MHFA.

MHFA has financed ARM mortgages with taxable revenue bonds. Such bonds do not fall under the federal restrictions but they do require higher mortgage interest payments. In order to provide interest payments to bond holders, MHFA has made ARM mortgage more affordable by using its reserves (set aside for other bond issues, but no longer needed) to subsidize the interest rate and by offering a deferred rehabilitation loan which does not need to be repaid until the property is sold.

One concern that we have with MHFA's implementation of ARM has been the fact that:

- **MHFA has not established a minimum per unit improvement cost requirement in the ARM program.**

Without needing to meet a minimum dollar amount of rehabilitation (such as $2,000 per unit) an owner could use the program solely to obtain refinancing which would not serve the intended public purpose. While the average ARM per unit rehabilitation cost is $2,388, MHFA has financed one building that made as little as $245 per unit in improvements (see Table 4.3).

Characteristic	Number of ARM Units		Percent
TYPE OF UNIT			
Efficiency	167		22%
One Bedroom	317		43
Two Bedroom	227		30
Three Bedroom	32		5
Four Bedroom	0		0
Total	743		100%
REGIONAL ALLOCATION			
Twin Cities Metro Area	577		78%
Outstate Minnesota	166		22
Total	743		100%
	High	Low	Average
MORTGAGE AMOUNTS			
Per Unit Mortgage Amounts	$24,548	$3,861	$16,624
Per Unit Rehabilitation Amounts	$7,013	$245	$2,388

NOTE: Total dollar volume of mortgages closed 1987-1988: $11,555,480

Source: Minnesota Housing Finance Agency, *Apartment Renovation Mortgage Loans*; Summary data: Closed Mortgage Loans (St. Paul, 1988).

Table 4.3: Apartment Renovation Mortgage Program, 1988

Low-Income Tax Credit Program (LITC)

The federal Tax Reform Act of 1986 created a tax credit program for developers of low-income housing. This credit allows investors in projects involving at least $2,000 per unit in new construction or substantial rehabilitation to claim a tax credit based on the number of units in the building serving low-income tenants. The program is in effect until December 31, 1989. MHFA has $15 million in credits to allocate between 1987 and 1989.

To receive the tax credits, investments must be made in a projects in which 40 percent of tenants have incomes below 60 percent of the county median and rents must remain affordable for these tenants for a period of 15 years. Ten percent of the tax credits must be set aside for nonprofit organizations. Pursuant to state law, several cities and counties receive a direct allocation of tax credits. If local governments do not use their credits by October 1st of each year, they must return them to MHFA for statewide allocation. MHFA administers the credits in areas not receiving a direct allocation. In the nation and in Minnesota, tax credit financing has not been fully utilized. Because LITC was not available until July 1987, only 20 percent of the tax credits were used in that year.

MHFA has improved its use of low-income tax credits.

Figure 4.3 illustrates that:

- **In 1987, MHFA allocated 34 percent of total tax credits available. In 1988 this increased significantly to 77 percent.**

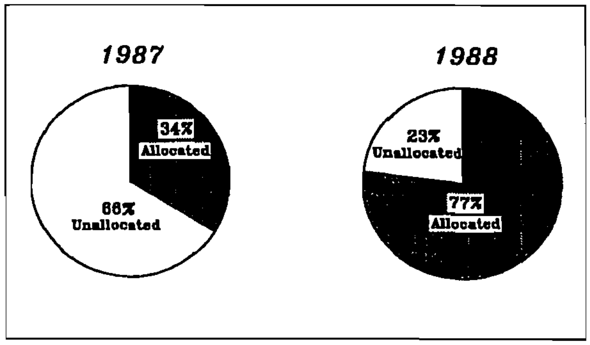

Figure 4.3: MHFA's Allocation of Low-Income Tax Credits, 1987 and 1988
(Source: MHFA, Summary of 1987 Low Income Tax Credit Program and Preliminary Data on 1988 Program (St. Paul, 1987 and 1988).

To stimulate interest in the tax credit, MHFA created the Tax Credit Mortgage Loan Program in 1988. Under this program, MHFA participates in a partnership whereby MHFA agrees to provide a first mortgage covering one-third of the project costs (either new construction of substantial rehabilitation), the city in which the project is located finances the second one-third, and tax credit syndication and other contributions represent the remaining one-third portion. Also, MHFA has made "bridge loans" which provide up-front financing for tax credit projects that is repaid by the investors as they receive their tax credits.

The characteristics of projects that have received Low-Income Tax Credits from MHFA and from cities in 1987 and 1988 are summarized in Tables 4.4 and 4.5. Two-thirds of these projects were in non-metropolitan areas of the state. New construction accounted for about half of the units.

Rental Rehabilitation Grants

The Rental Rehabilitation Program is a federally funded effort to upgrade the rental housing stock serving low-income families. The program provides entitlement grants to cities and counties in metropolitan areas and to states for administering the grant program in "small cities" outside of metropolitan areas.

Since 1984, MHFA has received $4,237,810 in rental rehabilitation grant funds from HUD. These funds have fluctuated annually based on govern-

Most low-income tax credits have been used by projects in non-metro areas.

Jurisdiction	Original Amount	Allocated	Balance	Percent Unallocated
Administered by Sub-Allocators	$2,537,473	$901,155	$1,636,318	64%
Administered by MHFA	2,179,652	857,643	1,322,009	60
Nonprofit Set-Aside	524,125	45,440	478,685	91
State Total	$5,241,250	$1,804,238	$3,437,012	66%

REGIONAL DISTRIBUTION OF MHFA ADMINISTERED TAX CREDITS

	Allocation	Percent
Within Metro Stat. Areas	10 Projects	36%
Within Non-Metro Stat. Areas	18 Projects	64
Total	28 Projects	100%

TYPE OF BUILDINGS

	Allocation	Number of Units	Percent of Units
New Construction	17	483	54%
Substantial Rehabilitation	5	179	20
Acquisition	6	232	26
Total	28	894	100%

Source: Minnesota Housing Finance Agency, *Summary of 1987 Low Income Tax Credit Program* (St. Paul, 1988).

Table 4.4: Low-Income Tax Credit Projects, 1987

ment appropriations so that in fiscal year 1984, MHFA received $778,700; in FY 1985, $696,000; in FY 1986, $328,000; in FY 1987, $901,000; and in FY 1988 it received $723,000. In addition, HUD provided Minnesota with $811,110 in bonus funds in 1985 because these funds had not been spent in other parts of the country and MHFA could demonstrate a need for the funds.

The projects that are eligible for these grants include apartment buildings that have 70 percent of their units occupied by low-income tenants and where 75 percent of the units are two bedrooms or larger. The owner must agree to pay 50 percent of the rehabilitation costs and MHFA will pay the other 50 percent up to a maximum of $6,500 for a one bedroom, $7,500 for two bedroom, and $8,500 for three bedroom units.

Twenty four cities and counties have participated in MHFA's Rental Rehabilitation Grant Program. According to MHFA, the major complaint of these cities about the program was the amount of paperwork that HUD requires and the fact that HUD did not give them an administration fee to cover their staff time until 1988.

Jurisdiction	Original Amount	Allocated	Balance	Percent Unallocated
Administered by Sub-Allocators	$2,577,614	$1,119,743	$1,457,871*	57%
Administered by MHFA	2,199,136	2,563,994	(364,858)	(17)
Nonprofit Set-Aside	530,750	402,322	128,428	24
Statewide Totals	$5,307,500	$4,086,059	$1,221,441	23%

REGIONAL DISTRIBUTION OF MHFA-ADMINISTERED TAX CREDITS

	Allocation	Percent
Within Metro Stat. Areas	15 Projects	35%
Within Non-Metro Stat. Areas	28 Projects	65
Total	43 Projects	100%

TYPE OF BUILDINGS

	Allocation	Number of Units	Percent of Units
New Construction	30	802	47%
Substantial Rehabilitation	7	485	29
Acquisition	11	410	24
Total	48**	1,697	100%

Source: Preliminary data Minnesota Housing Finance Agency (St. Paul, 1988).

*As of October 1, the sub-allocators balance is transferred to the MHFA pool.

**Five buildings received Substantial Rehabilitation and Acquisition Allocation. Number of units only counted once for multiple allocation.

Table 4.5: Low Income Tax Credit Projects, 1988

The Rental Rehabilitation Grant Program has directed funded to existing, larger units that serve low-income families. As of August 1988, 70 percent of completed rehabilitated units were two or three bedroom and 30 percent were one bedroom. The average MHFA grant was $3,000 per unit and the average size building was four to eight-units. One major benefit of this program besides the physical upgrading is that owners must provide assurances that the rents on the units after rehabilitation will remain below HUD's "fair market rents" and therefore will remain affordable to lower income families.

FINDINGS

Effectiveness of MHFA Multi-family Programs

Section 8 New Construction

One measure of the effectiveness of MHFA in administering rental housing programs is to compare MHFA's performance with the performance of other state housing finance agencies. The Council of State Housing Finance Agencies has compiled such comparative information and it is presented in Table 4.6 which shows:

- **Between 1975 and 1981, Minnesota received more Section 8 new construction units than any other state in its population class and almost twice as many as all states in its class, and three times the national average.**

			Federal Rental Program Involvement (# Units)					
State	1980 Population (in millions)	M-F Bonds (in millions)	Section 8 New Construction	Modified Rehabilitation	Certificates	Voucher	Rental Rehabilitation	Other
Minnesota	4.1	$622	13,464	--	--	--	--	2,337
Kentucky	3.7	268	12,885	497	994	33	--	--
Maryland	4.2	1,042	5,902	719	3,040	27	43	--
Tennessee	4.6	52	3,016	52	2,258	304	9	--
Washington	4.1	396	--	--	--	--	--	--
Wisconsin	4.7	422	11,818	117	--	--	113	--
Averages:								
Above States		$467	7,847	231	1,049	61	28	390
Nation's HFAs		N/A	4,270	161	772	36	37	355

Source: Council of State Housing Agencies, *Production Activities of State Housing Finance Agencies 1985 and Cumulative* (Washington, D.C., 1985).

Table 4.6: Minnesota Housing Finance Agency Multi-Family Housing Compared with Other States, Cumulative through 1985

Indicative of MHFA's active participation in Section 8, the agency floated more multi-family revenue bonds than all but one of the similar-sized states shown in Table 4.6. Also, the agency received many "bonus" Section 8 units from HUD because of its past record in producing family housing. This performance relects well on MHFA's skill in capturing the federal subsidies to provide multi-family housing.

In the other comparative categories listed in Table 4.6, however, MHFA has not been as active as the other states. In modified rehabilitation, Section 8 certificates, and rental vouchers, MHFA's activity was far below the other states with similar sized population and the national average for HFAs. MHFA officials believe that it is better policy for certificates and vouchers to be managed by local housing authorities.

Non-Profit Developers

In the past, MHFA has been reluctant to work with nonprofit organizations. The Minnesota statutes make several references to the need to assist non-profits by: a) providing them with loans for development costs of low and moderate income housing; b) providing them with loans (with or without interest) for developing innovative housing; and c) permitting them to be sponsors of temporary and single room occupancy housing (Minn. Stat. 462A.05). Non-profit officials argue that they are appropriate developers of affordable low-income rental units because they are committed to maintaining the units over the long term and can supplement housing with social services. Furthermore with the withdrawal of large federal subsidies for developing new low-income rental units, non-profit developers and local governments have become major agents for producing affordable low-income housing.

MHFA's use of nonprofit developers is below the national average.

Table 4.7 shows that only five percent of MHFA's multi-family units are owned by nonprofits.

State	Percent of Rental Properties Owned by Nonprofit Entities
Minnesota	5%
Kentucky	--
Maryland	9
Tennessee	57
Washington	1
Wisconsin	10
Average: Above 6 States	14%

Source: Council of State Housing Finance Agencies, *Production Activities of State Housing Finance Agencies 1985 and Cumulative* (Washington, D.C., 1985).

Table 4.7: Participation of Nonprofits in Minnesota Housing Finance Agency Multi-Family Housing, Cumulative through 1985

Minnesota's utilization of nonprofit organizations is below the six-state average of fourteen percent and the national average of 12.4 percent among the 30 states that reported. MHFA staff acknowledge they have a preference for working with for-profits because they view the for-profit developers as having greater expertise and are more willing to "bring cash to the table" when financing a project. Also MHFA points out that nonprofits do not exist in all parts of the state, especially outside of the metropolitan areas.

Now that the era of heavy emphasis on federal new construction subsidies is ending, use of non-profits should become a bigger part of MHFA's multi-family program. We recommend that:

- **MHFA should work to increase the involvement of the nonprofit and local government housing sectors in MHFA financed projects. Where necessary, MHFA should work to improve the development expertise and capacity of nonprofits around the state.**

MHFA has begun to solicit greater nonprofit and local government involvement through implementation of low-income tax credit and homeless programs. Also, MHFA staff involvement with the Governor's Commission on Affordable Housing for the 1990s resulted in a program to help nonprofits in developing housing. We see these actions as the beginning of a much expanded effort involving nonprofits.

Vacancy, Delinquincy and Foreclosure

MHFA has proven itself to be very effective in minimizing the level of delinquency, foreclosure, and vacancy in multi-family developments. Due to its policy of early intervention into multi-family projects that are experiencing financial problems.

MHFA has a good record in administering federally subsidized rental housing.

- **MHFA has not been forced to initiate foreclosure on any of its multi-family projects and has experienced low vacancy rates.**

When MHFA discovers problems with properties, it will refinance or change management firms in order to address the problems before foreclosure is necessary. Vacancy rates are very low for most MHFA projects: 0.8 percent for Section 8 developments, 0.6 percent for Section 236, and 6.3 percent for Market Rate units. A normal multi-family vacancy rate in the private sector is five to six percent. In the ARM program, however, the average vacancy rate is 17.2 percent. MHFA explains that this high rate is due to the fact that many units have been vacated for renovation work. Since this program is only one year old, it is still too early to judge whether there is a vacancy problem in the ARM program.

Who Has Been Served by MHFA Multi-Family Programs?

Publicly financed housing is expected to achieve social and geographic targeting goals. Social targeting refers to concentrating housing resources on lower income renters, while geographic targeting is the distribution of subsidies to those areas where housing needs are greatest concentrated.

Virtually all of Section 8 and 236 tenants are low-income because this is a requirement for receiving the subsidy (see Table 4.8). In fact, many of the ARM tenants were also found to fall below the Section 8 and 236 income limits with 69 percent below the one person and 76% below the two person income limits. Therefore, we conclude that:

- **MHFA has been successful in targeting its multi-family housing to low-income households.**

MHFA has not been as successful with age and race targeting as with income targeting. In Minnesota, 59 percent of outstate renters and 68 percent of Twin Cities renters are under 44 years old. but in Section 8 and 236 units, only 28 percent of tenants are below 34 years of age. We noted earlier that there is an overcapacity of subsidized units for the elderly in some Twin Cities communities now. We conclude that:

Section 8/236 Income Range	Percent of Tenants	ARM Income Range	Percent of Tenants
$ 0- 2,500	2.3%	$ 0- 1,999	1.4%
2,500- 4,999	15.4	2,000- 3,999	10.6
5,000- 9,999	59.4	4,000- 5,999	17.1
10,000-14,999	16.9	6,000- 7,999	13.7
15,000-19,999	4.9	8,000- 9,999	7.8
20,000-24,999	1.0	10,000-11,999	9.3
25,000-29,999	0.1	12,000-13,999	9.3
30,000-34,999	0.0	14,000-15,999	7.2
35,000 +	0.0	16,000-17,999	6.0
	100.0%	18,000-19,000	3.6
		20,000-21,999	5.6
		22,000-23,999	2.4
		24,000-25,999	1.8
		26,000-27,999	1.0
		28,000 +	3.2
			100.0%

Source: Minnesota Housing Finance Agency, *Characteristics of Tenants, Annual Income* (St. Paul, 1988); and Minnesota Housing Finance Agency, *Apartment Renovation Mortgage Program, Tenant Annual Income Summary at Loan Closing* (St. Paul, 1988).

Table 4.8: Income Characteristics of Minnesota Housing Finance Agency Multi-Family Tenants, 1988

The need for assisted rental housing far exceeds the supply.

- **MHFA multi-family housing is underserving the younger households in poverty.**

The racial composition of Section 8 and 236 housing in Minnesota is 94 percent white, four percent black, one percent Native American, and one percent Asian. This percentage distribution is approximately the same as the overall state distribution of minorities but fails to reflect their greater housing need. Minorities in Minnesota suffer a higher level of housing distress than white households because 63 percent of minorities are renters and 40 percent of minority renters pay over 30 percent of their income for housing. Therefore,

- **MHFA multi-family housing programs have underserved minority housing needs.**

Adequacy of Multi-Family Programs

In 1987, MHFA forecast the need for rental housing assistance in the state based on an analysis of household income and housing costs. If a household could not afford to purchase a home between 1986 and 1990, and would spend more than 30% of their income for rent, than it would be counted as eligible for housing assistance. In Minnesota, 113,900 renter households were identified as being eligible for housing assistance while the combined MHFA programs only served 20,270 renter households.

Furthermore, MHFA has projected the housing need by geographic region and this forecast can be compared to actual distribution of MHFA assisted units to identify those regions of the state that have been underserved (see Table 4.9). The Twin Cities (Region 11) and the western part of the state (Regions 1 and 4) emerged from this analysis as being most poorly served compared with their need. MHFA acknowledges a skewing of ARM units in favor of Minneapolis and in 1989, the agency says it will "try to increase participation both in the suburban areas and in greater Minnesota."

	Current MHFA Housing Units								1986-1990 Forecasted Need	
	Section 8/236		Market Rate		ARM		Total			
Region	Units	Percent	Units	Percent	Units	Percent	Units	Percent	Units	Percent
1	337	2.4%	8	0.2%	--	--	345	2.0%	4,404	3.5%
2	350	2.5	--	--	--	--	350	2.0	a	
3	1,731	12.6	374	11.3	--	--	2,105	11.9	10,920	12.3
4	596	4.3	36	1.1	--	--	632	3.6	5,340	4.7
5	338	2.4	16	0.5	--	--	354	2.0	2,630	2.3
6E	243	1.8	50	1.5	--	--	293	1.7	2,280	2.0
6W	201	1.5	--	--	--	--	201	1.1	4,000	3.5
7E	329	2.4	--	--	--	--	329	1.9	4,740	4.2
7W	614	4.5	123	3.7	48	8.2	785	4.4	b	
8	442	3.2	20	0.6	--	--	462	2.6	c	
9	797	5.8	30	0.9	16	2.7	843	4.8	5,200	4.6
10	1,328	9.6	150	4.5	--	--	1,478	8.4	8,980	7.9
11	6,450	47.0	2,500	75.6	523	89.1	9,473	53.7	65,740	57.7
Total	13,756	100.0%	3,307	99.9%	587	100.0%	17,650	100.0%	113,860	100.0%

Source: Minnesota Housing Finance Agency, *Multi-Family Development Activity* (St. Paul, 1988); and Minnesota Housing Finance Agency, *Surveying the Residential Landscape* (St. Paul, 1987).

[a]In calculating need, MHFA combined several regions into "areas", therefore the total forecasted need for Regions 1 and 2 is reflected in the number entered for Region 1.

[b]The total need for Regions 7E and 7W is reflected in the number entered for Region 7E.

[c]The total need for Regions 6W and 8 is reflected in the number entered for Region 6W.

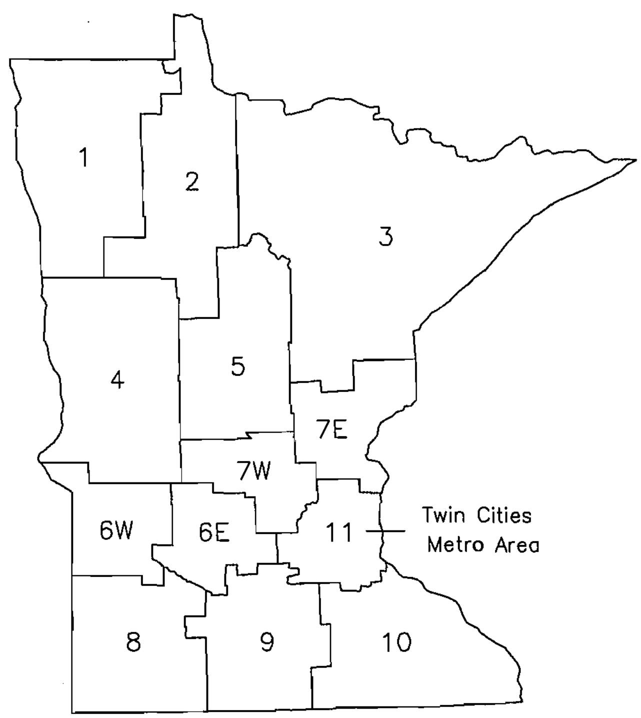

Table 4.9: Comparison of Forecasted Need with Distribution of Minnesota Housing Finance Agency Units, Cumulative through 1988

- **Overall, MHFA needs to establish plans and policies that place a higher priority on meeting the rental assistance needs of Minnesota households and that distributes units according to the varying needs around the state.**

We discuss the issue of MHFA's over-emphasis on homeowner programs in Chapter 6.

MHFA's Response to Termination of Federal Low-Income Housing Subsidies

Loss of federal subsidies places greater demands on state and local governments to develop low income rental housing.

Prior to 1981, MHFA was receiving Section 8 New Construction commitments for over 2,000 units per year. Since 1981, this infusion of federal housing funds has been cut off and MHFA has been confronted with the challenge of delivering low-income rental housing using other techniques and resources. The two strategies that MHFA adopted were the Low-Income Tax Credit and the Apartment Renovation Mortgage programs.

As described earlier, the federal government allocated $15 million in Low Income Tax Credits to Minnesota to be used in developing low-income housing between January 1987 and December 31, 1989. If these credits are not used during this time period, they will be lost.

In the 1987 calendar year, MHFA allocated 34 percent of the annual tax credits available. In 1988, 77 percent of the tax credits available for that year were used. While recognizing the complexity involved in administering the Low-Income Tax Credit, the fact remains that:

- **Only 56 percent ($5.9 million of $10.5 million) of the federal low-income tax credits available to the state during 1987 and 1988 have been used in producing low-income housing.**

The Low Income Tax Credit is now the only game in town for producing new federally subsidized units. MHFA will have to make every effort to take full advantage of the program.

There are some good examples of creative partnerships where MHFA financing was combined with low-income tax credits, foundation funds and local government monies to produce low-income housing.

- **MHFA should agressively promote and develop partnerships with local governments and the private sector in order to fully utilize the low-income tax credits and produce additional low-income housing.**

The Apartment Renovation Mortgage was created to stabilize rents in low-income apartment units and to upgrade the quality of these units. ARM's impact to date has been very limited. In an internal evaluation of ARM, MHFA concluded at the end of its first year of operation, that:

- **ARM's loan volume has been half of the desired level;**

- **The percentage of ARM loans used for renovation needs to be increased;**

- **ARM loans has been concentrated in Minneapolis and St. Paul;**

- **ARM loans have not promoted the renovation of enough 3 and 4 bedroom units.**

Based on the fact that to date the LITC and ARM programs have not been implemented at their full capacity and generally produce a small number of units, we conclude that:

- **The Low Income Tax Credit and the Apartment Renovation Mortgage programs are only beginning to achieve their full potential. Given Congressional renewal of LITC, MHFA should fully implement these programs in order to better meet the rental assistance needs of low-income Minnesota households.**

MHFA Response to Future Loss of Affordable Low-Income Units Due to Expiration of Federal Subsidy Contracts

In granting federal subsidies to developers of low-income housing, owners are restricted from converting these units to market rate housing. These restrictions are attached to a time line at the end of which all restrictions will expire. Also, owners may prepay their mortgages and thereby eliminate restrictions.

In recent years a great deal of public attention has been focused on the issue of pending expiration of federal housing subsidy contracts and the resulting impact on the availability of low-income housing. The Center for Urban and Regional Affairs at the University of Minnesota[2] has estimated that within five years, 49 percent of the state's supply of units that received mortgage assistance will be candidates for prepayment and 67 percent of the contracts for Section 8 units will reach expiration. As Table 4.10 indicates, MHFA units unlike units financed by Farmer's Home Administration (FMHA) or Department of Housing and Urban Development (HUD) are most susceptible to early prepayment because most of the units are under no prepayment restrictions. Except for requiring MHFA approval, owners of MHFA financed projects can pay off their mortgages at any time.

MHFA's position on this issue is that they oppose a "lock-in" provision (or prepayment prohibition) for mortgagees. MHFA believes that minimizing restrictions on their mortgages forces the agency to be more responsive to owners and helps in marketing MHFA mortgages to developers.

Since MHFA has taken actions to discourage prepayment we do not believe a "lock in" requirement is needed at this time. MHFA created the Redefined Equity Program (REP) and requested the Legislature for authority to intervene and protect subsidized low-income units. REP permits an apartment

2 Center for Urban and Regional Affirs, *Sooner or Later* (Minneapolis, May 1988).

	Total Units at Risk				MHFA				FmHA				HUD			
Year	Best	Percent	Worst	Percent	Best	Percent	Worst	Percent	Best	Percent	Worst	Percent	Best	Percent	Worst	Percent
1988	0	–	13,929	29.6%	0	–	13,929	96.3%	0	–	0	–	0	–	0	–
1993	0	–	22,807	48.5	0	–	13,929	96.3	0	–	5,451	47.2%	0	–	3,427	16.3%
1998	0	–	29,317	62.2	0	–	14,465	100.0%	0	–	5,451	47.2	0	–	9,401	44.8
2008	0	–	38,488	81.8	0	–	14,465	100.0%	0	–	11,553	100.0	0	–	12,470	59.4
2018	19,893	42.3%	43,286	92.0	5,394	37.3%	14,465	100.0	258	2.2	11,553	100.0	14,241	67.8%	17,268	82.0
2028	39,729	84.5	47,026	100.0	14,421	99.7	14,465	100.0	4,360	38.0	11,553	100.0	20,948	99.7	20,008	100.0

Source: Janet Larsen, *Sooner or Later: The Disappearance of Federally Subsidized Low-Income Rental Housing in Minnesota*, (Minneapolis, Center for Urban and Regional Affairs, University of Minnesota, 1988).

Table 4.10: Possible Loss of Assisted Units in Minnesota, 1988-2028

owner to recalculate equity and recognize the increasing value of their property. In effect, REP increases the profit margin the developer can earn and in return for this redefined equity, owners must agree to stay with their Section 8 contract for at least 20 years and to limit increases in rents to those needed to cover at least operating costs and to obtain a normal return on investment.

The Redefined Equity Program appears to have been successful in reducing the threat of prepayment of MHFA mortgages. Fifty of the 120 projects eligible for REP participated in the program and most of these developments were in high market demand areas such as in the suburbs where owners would have been likely to have prepaid their mortgages. Apartment owners confirmed to us that REP was an important factor in convincing the investors in the project to stay with the MHFA mortgage for the full term.

Additional authority that MHFA requested and received from the 1987 Legislature was the right to purchase and resell properties where Section 8 units were threatened with conversion to market rate. Prior to granting this power, MHFA could not own or operate housing. According to the new statute, MHFA can acquire projects and temporarily operate them if this will perserve housing that has received federal housing assistance payments. This ultimate power to purchase threatened properties has been used by MHFA in one instance to obtain an apartment building in the Twin Cities metropolitan area and then sell it to a nonprofit corporation. Thus, we conclude that:

- **MHFA has taken reasonable steps to address the problem of prepayment of mortgages on MHFA-financed multi-family housing.**

How fast owners of federally subsidized units will opt out of their government contracts is unclear, although MHFA has disagreed with alarmists on this point, because of its judgment that increasing rental vacancies will make the security of government contracts worth more than the questionable promise of greater profits in the open market place.

SUMMARY

MHFA's implementation of multi-family developments has been effective in the following areas:

- **MHFA aggressively pursued federal Section 8 and 236 housing subsidies when they were available.**

- **MHFA has developed innovative multi-family financing programs using tax exempt and taxable mortgage revenue bonds.**

- **MHFA has closely monitored the projects that it has financed and has effectively intervened to prevent delinquency and foreclosure.**

- **MHFA has targeted multi-family developments to low-income households.**

- **MHFA has devised measures that discouraged prepayment of MHFA multi-family mortgages and thereby preserved affordable rental housing in the state.**

MHFA's implementation of multi-family programs has exhibited shortcomings in the following areas:

- **MHFA needs to shift resources from homeownership programs to renter programs, considering the greater housing needs among low-income renters.**

- **While innovative, MHFA's ARM and tax credit multi-family programs are only now beginning to achieve their full potential. Combined, they have provided about half the units produced under the federal Section 8 program. These programs need to be marketed more agressively.**

- **The proportion of younger poor families and minority tenants in MHFA financed developments is too low when considered in light of the greater housing needs of these groups. MHFA should devise strategies to remedy the situation.**

- **MHFA's ARM program should require that owners who receive financing provide a minimum per unit renovation improvements.**

- **MHFA should consider participating in the Section 8 certificate and voucher programs on a project-by-project basis since these are the only direct federal low-income rental assistance programs currently available.**

- **Historically, MHFA utilization of nonprofit housing corporations has been below the national average. MHFA should expand its use of the nonprofit and local government housing sectors in developing low and moderate income multi-family housing in order to guarantee the existence of affordable units over the long-term.**

HOUSING FOR SPECIAL NEEDS POPULATIONS

Chapter 5

One reason the Legislature created the Minnesota Housing Finance Agency was to assure that "housing will be provided in sufficient quantity in the areas of need and demand."[1] Groups that have received special assistance to meet their distinct housing needs are the homeless, American Indians, elderly homeowners, and developmentally disabled persons. Since 1971, approximately $36 million in Legislative appropriations have been provided to MHFA to deliver housing for these special needs groups (see Table 1.11).

RESEARCH OBJECTIVES AND METHODS

In this chapter, we will examine each of MHFA's programs for special needs groups and analyze them by asking how well MHFA has addressed four criteria:

- ***Targeting* - To what extent has MHFA focused resources on the housing needs of each group?**
- ***Efficiency* - Has MHFA delivered the program for each group in an economical and administratively efficient manner?**
- ***Effectiveness* - Have MHFA programs met Legislative goals?**
- ***Adaptability* - Has MHFA met the changing needs and circumstances that confront special needs groups.**

The information sources used in this chapter include data and reports from MHFA, interviews with MHFA staff, housing officials and representatives of nonprofit housing organizations, and site visits to housing projects financed by MHFA. In addition, we surveyed directors of housing and redevelopment agencies (HRAs) around the state, and nonprofit sponsors of special needs housing.

The surveys provided direct input from the agencies and nonprofit organizations that are instrumental in providing housing for special needs populations because they are the administrators of these MHFA programs. The question-

1 *Minn. Stat.* §3462A.02

naire asked survey participants about their experiences in working with MHFA to implement special needs housing and their opinions about the appropriateness of MHFA housing policies.[2]

Based on this review, our conclusion is that:

- **MHFA does not view some special needs programs as a basic part of its mission. MHFA needs to develop a clearer sense of purpose in this area by establishing a housing policy plan and working more effectively with nonprofit sponsors.**

GROUP HOMES FOR THE DEVELOPMENTALLY DISABLED

MHFA's involvement in financing group homes for the developmentally disabled began in the 1970's with the movement to deinstitutionalize residents of state hospitals. In 1972, a suit was brought in federal district court against the Department of Human Services and all eight state hospitals which then served mentally retarded persons. The suit is commonly referred to as the "Welsch case" and resulted in a court decision in February 1974 which required changes in the state's treatment of the mentally retarded.

The group homes program responds to the need to deinstitutionalize mentally ill.

The outcome of this decision has been the reduction in the population of state hospitals and the fostering of community residential facilites. Between 1973 and 1980, an average of 30 new Intermediate Care Facilities-Mentally Retarded (ICF-MR) were opened each year in Minnesota. By 1985, there were 337 such facilities (45 percent were nonprofit) with a bed capacity of 5,180 persons.

Beginning in 1976, MHFA and the Department of Human Services (DHS) cooperated in a program to develop intermediate care facilities. Under the program, MHFA provided long term, low interest, mortgage loans to nonprofit sponsors for new construction or purchase and rehabilitation of residential facilities. MHFA used tax-exempt revenue bond proceeds to finance these mortgage loans. DHS allowed a portion of the operating funds that DHS commits to the sponsors to be used for payment of the MHFA mortgage. In 1983, the Legislature decided that there were enough community facilities for the mentally retarded and imposed a cap on the development of new facilities (but allowed projects already approved to be completed).

2 The survey response rate was high for HRA directors with 71 percent (100 of 140) answering the questionnaire and lower for the nonprofit sponsors where 50 percent (76 of 151) responded. The lower response rate for the nonprofit sponsors may be due to the inclusive mailing lists that were used. Some nonprofits on the lists were only marginally involved in housing, and may not have viewed the questionnaire as relevant to their activities.

Utilization of MHFA Group Home Financing

MHFA's group home financing program was in effect between 1976 and 1985. During this time it assisted 56 intermediate care facilities for the mentally retarded (ICF-MR) serving 581 residents and provided $11.8 million in mortgage financing. In other words, MHFA financed 17 percent of all ICF-MR facilities and 37 percent of the nonprofit ICF-MR facilities in operation in 1985.

MHFA explained the apparently low level of utilization of this financing program by group home facilities by noting that the agency responded to all applications submitted and that the agency only financed projects that were approved and licensed by DHS and were operated by nonprofits.

Type of Group Home Facilities Financed by MHFA

Between 1980 and 1985, most (58 percent) mentally retarded patients discharged from state hospitals were placed in moderate sized group home (7-16 residents). Nearly all (95 percent) group homes financed by MHFA were in the 7-16 bed category. The average size for all of the MHFA financed facilities was 10.4 residents. Therefore:

MHFA financed a small number of "Class B" group homes.

- **The size of group home facilities assisted by MHFA was appropriate to the need at the time.**

Intermediate care facilities for the mentally retarded are licensed as either Class A or Class B based on the type of residents they are designed to serve. Class A homes serve ambulatory and mobile persons while Class B licenses are granted to homes that serve non-ambulatory persons "not capable of self-preservation" under emergency conditions. Therefore, Class B facilities must meet more stringent fire and safety standards.

A 1986 study by the Office of the Legislative Auditor discovered that the greater need is for Class B facilities because residents now leaving state hospitals are more likely to be non-mobile.[3] In analyzing the type of licenses granted to MHFA financed group homes, we discovered that:

- **Only seven of the 56 group homes are Class B facilities.**

Thus, 88 percent of the MHFA assisted homes are not equipped to serve the mentally retarded population in greatest need of help. MHFA explains this outcome by stating that originally the principal need was for Class A facilities and most of the non-ambulatory persons were housed in regional treatment facilities.

3 Minnesota Office of the Legislative Auditor, Program Evaluation Division, *Deinstitutionalization of Mentally Retarded People* (St. Paul, 1986) 7.

Geographic Location of MHFA Financed Group Homes

Availability of group homes throughout the state is important so that residents have a choice about where they live. Table 5.1 compares the percentage distribution of MHFA financed facilities with the population distribution. Table 5.1 reveals that:

			Group Homes			
Region	Population	Percent	Number of Facilities	Percent	Number of Beds	Percent
1	97,225	3%	5	9%	50	9%
2	63,140	2	2	4	22	4
3	343,344	8	4	7	45	8
4	202,585	5	5	9	36	6
5	131,266	3	6	10	64	11
6E & 6W	168,066	4	1	2	12	2
7E & 7W	321,716	8	5	9	53	9
8	137,039	3	0	0	0	0
9	221,980	5	2	4	29	5
10	404,566	10	9	16	108	18
11	1,985,873	49	17	30	162	28
Total	4,075,971	100%	56	100%	581	100%

Source: Minnesota Housing Finance Agency, Group Homes for the Developmentally Disabled (St. Paul, 1987).

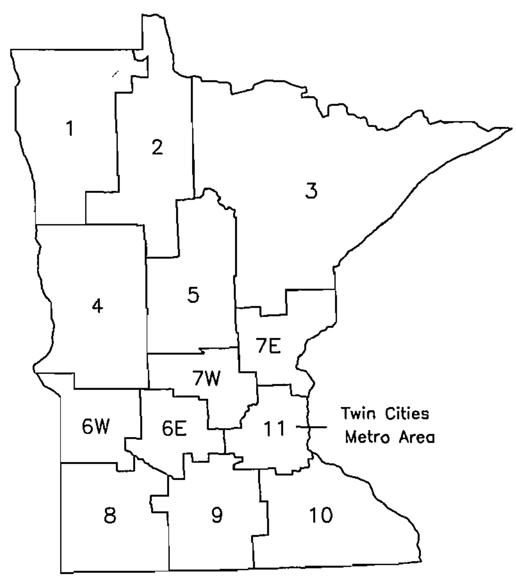

Table 5.1: Regional Distribution of Group Homes Financed by Minnesota Housing Finance Agency, 1976-1985

- **MHFA has been effective in making group home financing available to facilities throughout the state except the Twin Cities where only 28 percent of MHFA-financed beds are located.**

HOUSING THE HOMELESS PROGRAMS

In recent years, communities in Minnesota have experienced growth in the need of homeless individuals and families for emergency shelter. In its quarterly survey of homeless shelters, the Department of Jobs and Training discovered that the number of people using shelters increased from 1,165 in August, 1985 to 2,425 in August, 1987, to 2,922 by August, 1988.[4]

Homelessness is on the increase in Minnesota.

Number of MHFA Facilities for the Homeless

Responding to this problem, the Legislature created three demonstration programs that address different aspects of homelessness. Since 1984, $1,050,000 has been appropriated for the following MHFA programs:

- *Temporary Housing Program.* This program received $250,000 for the 1985-87 biennium and $150,000 for the 1987-89 biennium. This program makes grants to nonprofit sponsors to develop temporary housing for homeless persons. These facilities provide "transitional" housing since they are designed to help the homeless until they locate permanent housing.

- *Low-Income Persons Living Alone Program.* This program received $500,000 for the 1987-89 biennium to make grants to nonprofit sponsors to assist in developing permanent housing for low-income persons, including single room occupancy (SRO) housing.

- *Housing the Homeless Program.* The 1988 Legislature appropriated $150,000 for grants to nonprofit sponsors to assist in developing permanent housing for families or individuals who are homeless.

Table 5.2 presents statistics on each of the MHFA homeless programs. The Temporary Housing Program assists nonprofits in providing transitional housing and services to homeless persons. In 1985-1987, the MHFA Temporary Housing program provided an average grant of $1,984 per bed and granted 74 percent of the funds requested. This leveraging of public funds with private dollars implies that a productive partnership is possible between private and public agencies in providing temporary housing.

The purpose of the Low Income Persons Living Alone (LIPLA) Program is to provide permanent and affordable private rooms or efficiency apartments for homeless low-income persons. The costs, therefore, are much higher than

4 Minnesota Department of Jobs and Training, *Overnight Shelter Survey* (St. Paul, 1985, 1986, 1987, 1988).

Average temporary housing grant per bed is less than $2,000.

Project	Amount Requested	MHFA Grant Amount	Percent of Request Funded	Maximum Number of Persons Served/Night	Average Grant Amount Per Bed
TEMPORARY HOUSING-1985					
St. Paul	$79,000	$40,000	51%	9	$4,444
Moorhead	10,000	10,000	100	10	1,000
St. Paul CDC	25,000	25,000	100	8	3,125
Leech Lake	59,000	36,000	61	8	4,500
Mankato	75,000	50,000	67	30	1,666
Minneapolis	10,000	10,000	100	12	833
St. Paul	10,000	5,000	50	8	625
Crookston	27,164	24,000	88	22	1,090
Rochester	68,176	50,000	73	24	2,272
Average	$37,352	$27,777	74%	14	$1,984
TEMPORARY HOUSING-1987					
Crookston	$41,713	$41,200	99%	22	$1,873
St. Cloud	3,650	3,600	99	19	189
Rochester	41,041	35,100	86	22	1,595
Willmar	26,300	25,800	98	6	4,166
Mankato	11,668	6,300	54	30	210
St. Paul CDC	15,000	14,500	97	8	1,812
Minneapolis	16,585	16,000	97	16	1,000
Anoka	8,000	7,500	94	10	750
Average	$20,495	$18,750	90%	17	$1,449
LOW INCOME PERSONS LIVING ALONE					
Granite Falls	$90,000	$35,000	39%	7	$5,000
Duluth	57,000	57,000	100	20	2,850
Minneapolis	267,300	126,000	47	16	7,875
Anoka	125,000	110,000	88	10	11,000
Rochester	129,612	47,000	36	7	6,714
Duluth-Gardner	135,000	135,000	100	41	3,293
Average	$133,985	$85,000	63%	17	$5,000

Source: Minnesota Housing Finance Agency, *Temporary Housing Program, 1985 and 1987-89*, and *Low-Income Persons Living Alone* (St. Paul, 1988).

Table 5.2: Grant Per Project and Per Person in Minnesota Housing Finance Agency Homeless Programs, 1985-1988

those of the Temporary Housing Program. As Table 5.2 shows, the average grant per LIPLA project was triple the average Temporary Housing grant.

MHFA Facilities Serving the Homeless

In 1988, all MHFA-funded facilities had a maximum capacity of 349 persons per night. This capacity represents 12 percent of the the total number of persons using homeless facilities in the state on a typical night in August, 1988 according to the DJT survey.

- **MHFA has used available homeless funds to serve areas with the greatest need and to address legislative intent.**

Table 5.3 compares the location of MHFA's facilities with the location of all facilities for the homeless in the state. It shows that the majority of MHFA homeless facilities are located in outstate Minnesota while most other home-

	Percent of Persons in All Homeless Facilities May 1987	MHFA-Financed Facilities: Temporary Housing Program		Low Income Persons Living Alone and Housing the Homeless Programs	
		Number of Projects	Percent	Number of Projects	Percent
LOCATION					
Minneapolis	46.4%	2	14%	1	11%
St. Paul	23.3	2	14	1	11
7 County Metro (excluding Minneapolis & St. Paul	5.0	1	7	2	22
Outstate Minnesota	25.3	9	65	5	56
	100.0%	14	100%	9	100%
TYPE OF FACILITY					
Overnight shelter	52.4%				
Transitional Housing Program	15.3	12	86		
Battered Women's Shelter	14.3	1	7		
County Social Service Agency	6.5				
Supportive Living Residence	3.7				
Runaway/Throwaway Youth Shelter	2.1				
Detoxification Facility	1.8	1	7		
Community Action Agencies	1.7				
Minnesota Migrant Council Offices	1.7				
Permanent Housing for Homeless	0.0	—	—	9	100
	99.5%	14	100%	9	100%

Source: Minnesota State Planning Agency, *Homelessness in Minnesota* (St. Paul, 1988), and Minnesota Housing Finance Agency, *Temporary Housing Program, 1985 and 1987-89*, and *Low Income Persons Living Alone* (St. Paul, 1988).

Table 5.3: Comparison of Department of Jobs and Training Homeless Shelter Survey with Minnesota Housing Finance Agency Homeless Programs, 1985-1988

less facilities were located in the Twin Cities. MHFA contends that outstate development of homeless facilities was appropriate because these areas were most lacking in transitional housing.

Funding for Homeless Programs

Between 1985 and 1987, Temporary Housing program funding declined by 40 percent. The Temporary Housing appropriation for the 1985-1987 biennium was $250,000 while $150,000 was available for 1987-1989 period. In their 1987-1989 biennial budget request, MHFA asked for no additional funding for Temporary Housing.

Temporary housing funds have been cut.

Applications from nonprofit sponsors for Temporary Housing funding have also decreased. Fourteen applications for the 1985 funds were submitted to MHFA but only nine nonprofit sponsors applied for the 1987 appropriations.

MHFA speculates that the reasons for the decline in applications for Temporary Housing grants may have been due to a decline in interest in developing new facilities among nonprofits or it may have been due to the limited time period (6 weeks) within which sponsors had to respond to the Request For Proposal in 1987.

In its 1990-1991 Biennial Budget, MHFA requested a total $750,000 ($375,000 for each fiscal year) for all homeless programs. This figure also represents a decline from the $800,000 that was appropriated for all programs during 1987-1989.

This declining support for homeless programs contrasts sharply with the recommendations of the Governor's Commission on Affordable Housing, which called for an additional $3.6 million for housing for the homeless and mentally ill.

Administrative Procedures for Homeless Programs

The Temporary Housing Program legislation required MHFA to: a) Make grants solely to nonprofit sponsors; b) Not make grants to residential care facilities or to shelters; c) Ensure that nonprofit sponsors combine MHFA grants with other funds; and d) Require repayment of a grant if the sponsor fails to maintain the program.

In our surveys and interviews, representatives of nonprofit organizations did not consider these requirements to be a problem. However, they did criticize MHFA's requirement that all construction work be completed before funds are released. This requirement has imposed a hardship on sponsors with limited resources because it forces them to obtain expensive short term construction financing or find a contractor who will agree to defer payment until the work is completed.

- **In several instances, MHFA's procedure of not releasing grant funds prior to completion of construction has hindered efforts by non-profit agencies to develop housing for the homeless.**

Two of the sponsors approved for Temporary Housing grants in 1987 had problems initiating their projects because of this procedural obstacle. In addition, a nonprofit sponsor that received a major grant under the Low Income Persons Living Alone program complained that MHFA's refusal to release the funds until the work was completed "almost killed the project." This project involved complex negotiations with federal agencies and private foundations and the use of syndicated tax credits. One key element that had encouraged others to participate was the availability of MHFA funds. MHFA views its requirement for completion of the work as needed to ensure that state funds are spent appropriately. In the case of a Duluth project, the sponsor was working with a for-profit funding source, so state law needed to be changed to permit early release of funds. Once the law was amended, MHFA issued the grant.

On the basis of our review of MHFA's administration of the homeless programs, we conclude that:

- **MHFA has been effective in leveraging the scarce public resources with private dollars, in assisting projects outside of the Twin Cities area, and in implementing statutory requirements.**

- **While the number of homeless in the state appears to be increasing, the Legislature has reduced funding for the Temporary Housing Program. In some cases, MHFA's administrative procedures have been obstacles to nonprofit participation.**

AMERICAN INDIAN HOUSING PROGRAMS

Minnesota has been a leader among the states in providing housing for American Indians. In 1976, the Legislature created the American Indian Housing Program to be administered by tribal organizations (*Minn.Stat.* §462A.07, Subd. 13 and 14). Since 1976, $28,980,000 has been appropriated to the Tribal Indian Housing Program.

In 1978, the Minnesota Legislature created the Urban Indian Housing Program (UIHP) to provide mortgage and rehabilitation assistance to Indian households residing in metropolitan areas (*Minn.Stat.* §462A.07, Subd. 15). Between 1978 and 1988, $4,970,000 had been appropriated for UIHP. Table 5.4 presents a history of appropriations for Indian programs and Figure 5.1 highlights the statutory differences between the tribal and urban Indian housing programs.

Date	Tribal	Urban
May 1976	$5,000,000	
July 1, 1978	2,500,000	$1,500,000
July 1, 1979	3,480,000	1,500,000
July 1, 1980	2,000,000	
July 1, 1981	3,480,000	
July 1, 1983	3,000,000	
July 1, 1984	1,750,000	750,000
July 1, 1985	4,000,000	750,000
July 1, 1986*	(1,000,000)	(375,000)
July 1, 1987	3,770,000	470,000
Total	$28,980,000	$4,970,000

Source: Minnesota Housing Finance Agency, Indian Housing Program data (St. Paul, 1988).

*In 1986, there was a legislative rescission of $1 million from Tribal Housing funds and $375,000 from Urban Indian funds.

Table 5.4: History of Indian Housing Appropriations, 1976-1987

Urban Indian programs are expected to demonstrate innovative methods.

Requirement	TIHP	UIHP
Serve low and moderate income Indians	Yes	Yes
Balance funds between Indians on and off reservation	Yes	No
Programs to be administered by Indian tribes or bands	Yes	No
Serves only Indians residing in metropolitan areas	No	Yes
Demonstrate innovative methods for providing housing	No	Yes
Combine MHFA monies with other private and public funds	No	Yes
Consult with Minnesota Indian Advisory Council in implementing program	No	Yes

Source: Summary from *Minn. Stat.* 462A.07, Subd. 13 and 14.

Figure 5.1: Comparison of Statutory Requirements for Tribal Indian Housing Program and Urban Indian Housing Program

The Tribal Indian Housing Program (TIHP)

Administration of the Tribal Indian Housing Program (TIHP) has been contracted to several Indian tribes. The Minnesota Chippewa Tribe Housing Corporation administers housing for all the major Chippewa tribes in northern Minnesota except the Red Lake Band, whose programs are administered by the Red Lake Housing Finance Corporation. The Minnesota Dakota Indian Housing Authority administers housing for Sioux Indians living in central and southern Minnesota.

Types of Tribal Housing Loans

The Tribal administrators provide various types of housing loans for Indian families including:

- *Home Purchase Mortgage Loans*. State assisted mortgage loans are justified on the grounds that the unique legal status of land located in reservation areas makes it very difficult to obtain private financing.

- *Homeowner Rehabilitation Loans*. Surveys of reservation housing revealed that over half of the units needed extensive repair or total replacement. The Tribes have offered home improvement loans at three to five percent interest. Also, the Dakota Indian Housing Authority provided rehabilitation grants until 1984.

- *Rental Housing Program* - To serve Indian families who cannot afford to purchase homes, the Red Lake Housing Corporation has built 22 scattered site, single family rental units.

Geographic Allocation of Tribal Funds

Most tribal funds are allocated to the Minnesota Chippewa tribe.

The geographic distribution of Tribal funds has been based on an allocation formula developed by MHFA in cooperation with the Tribal Indian organizations. This formula assigns 62 percent of UTIP appropriations to the Minnesota Chippewa Tribe, 29 percent to the Red Lake Band and approximately nine percent to the Dakota Indian Tribe. Table 5.5 compares the allocation formula with actual distribution of funds by MHFA.

- **MHFA has followed the tribal Indian allocation formula in targeting funds to the three reservation areas.**

The Tribes can use TIHP funds for loans to Indians living on or off the reservation. However in their allocation plan, the Tribes gave priority to Indians residing on reservation lands. The Minnesota Chippewa Tribe has allocated 90 percent and the Red Lake Band has allocated 80 percent of their TIHP

Tribe	Formula Allocation	Actual Dollars Allocated	Percent	Number of Loans	Percent
Minnesota Chippewa Tribe Housing Council	62.3%	$24,803,507	62%	585	68%
Red Lake Housing Finance Council	29.2	11,625,400	29	205	24
Minnesota Dakota Indian Housing Agency	8.5	3,384,106	9	65	8
Total	100.0%	$39,813,013*	100%	855	100%

Source: Minnesota Housing Finance Agency, *1985-1987 Biennial Budget*, Tribal Housing Programs Data (St. Paul, 1988).

Table 5.5: Comparison of Tribal Indian Housing Program Allocation With Dollar Amount and Loans Made, 1976-1988

funds for loans to residents of the reservations. This policy has effected the geographic distribution of Indian housing loans. Table 5.6 confirms that:

- **The overwhelming majority of tribal Indian housing loans were made in counties where Indian reservations are located and only 13 percent of loans went to the Twin Cities where, in 1980, 49 percent of Indians lived.**

Few tribal loans assist Indians who live off reservations.

County	Number of Loans	Percent	Amount of Loans	Percent
OUTSTATE MINNESOTA				
Aitkin	1	1%	$47,250	1%
Becker	18	11	656,801	13
Beltrami	27	17	748,679	15
Carlton	14	9	414,625	8
Cass	23	14	734,819	14
Cook	6	4	205,449	4
Crow Wing	2	1	51,500	1
Hubbard	1	1	42,863	1
Itasca	3	2	116,739	2
Kanabec	1	1	41,500	1
Koochiching	1	1	41,500	1
Mahnomen	15	9	491,298	10
Mille Lacs	4	2	114,033	2
Pine	2	1	78,858	2
Polk	1	1	47,773	1
St. Louis	21	13	599,228	12
Outstate Minnesota Total	140	88%	$4,432,915	87%
TWIN CITIES METRO				
Anoka	2	1	$82,000	1
Dakota	1	1	39,425	1
Hennepin	14	7	447,789	8
Ramsey	1	1	39,425	1
Scott	1	1	37,350	1
Washington	1	1	39,400	1
Twin Cities Total	20	12%	$685,389	13%
TOTAL	160	100%	$5,118,304	100%

Source: Minnesota Housing Finance Agency, *1985-1987 Biennial Report* (St. Paul, 1985).

Table 5.6: Geographic Distribution of Indian Housing Loans, 1986-87

Who is Served by Tribal Housing Loans?

To qualify for a Tribal housing loan, an American Indian must confirm that he is at least one-quarter Indian blood and enrolled in a federally recognized Indian tribe. Income limits and sales price limits ensure that lower income families receive the loans. In Table 5.7, the characteristics of the current average MHFA Single Family Mortgage borrower are compared with the average Tribal borrower. This comparison shows that:

Borrower Characteristic	Tribal Indian Housing Program	Single Family Program
Average Income	$15,826	$23,600
Average Household Size	3.9	2.5
Average Purchase Price	$50,679	$57,700
Percent New Construction	41%	39%

Source: Minnesota Housing Finance Agency, Indian Housing Program and SFMP Data (St. Paul, 1988).

Table 5.7: Comparison of Borrowers in Tribal Housing and Minnesota Housing Finance Agency Single Family Programs, 1988

- **Tribal Indian housing programs have served Indians with significantly lower incomes and larger families than other MHFA borrowers.**

Effectiveness of the Tribal Indian Housing Program

Unlike MHFA's Single Family Mortgage Program which uses revenue bonds, the Tribal housing programs rely on appropriations for funds to initiate loans. Therefore, the Tribal loans can charge interest rates that are much lower than market rates and can serve lower income homeowners. As loans are repaid, the Tribal funds are placed in a revolving fund and used for additional housing loans. Table 5.5 identifies the total amount of loans and total number of loans made between 1976 and 1988. Table 5.8 presents financial outcome data on the three Tribal programs that demonstrates that:

Dakota Indian tribal loans had 10 percent delinquency and 16 percent foreclosure rates.

- **Tribal Indian housing programs vary widely in key financial areas indicating that some programs are more efficient than others.**

Characteristic	Minnesota Chippewa	Red Lake	Minnesota Dakota
Total Number of Loans	595	208	67
Total Dollar Amount of Loans	$17,544,224	$7,510,667	$1,908,428
Total 1988 Budget	$461,592	$257,043	$35,067
Average 1988 Administrative Cost Per Loan	$776	$1,236	$523
Delinquency Rate (60 + days)	3.4%	0	10.3%
Foreclosure Rate	1.8%	.003%	15.5%
Interest Rate Charged on Mortgage Loans	5%	4%	3.5%

Source: Minnesota Housing Finance Agency, 1988 Administrative Budget Request Submitted by Tribal Organization, Tribal Indian Housing Program Data (St. Paul, 1988).

Table 5.8: Comparison of Financial Characteristics of Three Tribal Programs, 1976-1988

The average annual administrative cost per loan serviced for Red Lake is almost double that of the other two Tribal organizations. However, MHFA explains these variations in performance by stating that Red Lake does not have the economies of scale of the Minnesota Chippewa Tribe and Red Lake administers 22 rental units which adds to their administrative expenses. The Dakota Indian Housing Authority has loan delinquency and foreclosure rates that are much greater than either Chippewa or Red Lake housing corporations. The Dakota Indian Housing Authority has experienced adminstrative problems due to constant staff turnover. The MHFA staff is working with the Dakota Indian Housing Authority staff to help them improve their procedures and efficiency.

Urban Indian Housing Program (UIHP)

The Urban Indian Housing Program (UIHP) was created to serve the housing needs of urban Indian people which were not being addressed by the Tribal Housing programs. Table 5.6 showed that only 12 percent of the Tribal housing loans were made to Indians residing in the Minneapolis-St. Paul metropolitan area. The Legislature appropriated $4.97 million to UIHP which MHFA provided to administrators in metropolitan areas to create a revolving loan fund for the construction, rehabilitation, or purchase of housing for Indian families.

Geographic Areas Served by Urban Indian Housing

MHFA, in consultation with the Minnesota Indian Affairs Council, created an allocation formula for distributing the UIHP funds to the eligible communities based on Indian population estimates. The formula assigned 53 percent of UIHP appropriations to Minneapolis, 15 percent to St. Paul, 24 percent to the Twin Cities suburbs, and 8 percent to Duluth.

Urban Indian loans have not conformed with allocation formulas.

Table 5.9 compares the allocation formula with MHFA contracts. Table 5.9 shows that the distribution of Urban Indian Housing funds and loans has not conformed with the urban allocation formula, with St. Paul projects receiving more than the formula provides and the Twin Cities suburbs receiving less. However, MHFA points out that funds were reallocated from one area to another when a city did not use all of its initial allocation.

Geographic Area	Allocation Formula	Contract Amount	Percent	Number of Loans	Percent
City of Minneapolis	53%	$3,460,993	56%	117	57.9%
City of St. Paul	15	1,450,275	23	28	13.9
Twin Cities Suburbs	24	741,750	12	21	10.4
City of Duluth	8	554,114	9	36	17.8
Total	100%	$6,207,132	100%	202	100.0%

Source: Minnesota Housing Finance Agency, Biennial Budget 1987-89, and Summary of Indian Housing Appropriations (St. Paul, 1988).

Table 5.9: Comparison of Minnesota Housing Finance Agency's Allocation of Urban Indian Housing Program Funds With Loan Activity, 1979-1988

Members of the Minnesota Chippewa Tribes Duluth Indian Housing Task Force have complained that the allocation formula for Duluth does not fairly reflect the Indian housing need in Duluth. They argue that Duluth's share is too small because it fails to recognize the increase in the number of Indians who have migrated to Duluth in recent years.

According to the 1980 census, Duluth had 664 Indian households, or 7 percent of total Indian households in the state (9,697). But if the calculation is based just on the Indian households residing in Minnesota's urbanized areas (5,036), then Duluth has 13 percent of the urban Indian households. Since the UIHP is designed to serve urban Indian households, Duluth Indians are under-represented by the allocation formula.

Administration of the Urban Indian Program

Operational problems caused MHFA to cancel urban Indian contracts in 1987.

MHFA has administered the Urban Indian Housing Program (UIHP) through six local administrators that have included city housing agencies, private non-profit agencies and Indian housing organizations. Table 5.10 presents the characteristics of these administrators.

- **Three of the six UIHP administrators have experienced serious operational problems. MHFA had to cancel their contracts and assume direct administration of the program in 1988.**

Administrator and City	Contract Years	Contract Amounts*	Number of Loans Made
Minneapolis Community Development Agency	1979-1983	$2,072,028	75
Corporation for Indian Development, Minneapolis	1985-1986	465,000	13
Project for Pride in Living, Minneapolis	1986-1988	923,965	29
Project for Pride in Living, St. Paul	1986-present	456,500	13**
St. Paul Intertribal Housing Board	1980-1984	993,775	15
Minnesota Dakota Indian Housing Authority, Twin Cities Suburbs	1983-1988	741,750	21
Minnesota Chippewa Tribe Housing Corporation, Duluth	1981-1988	554,114	36
BORROWER CHARACTERISTICS			
Average Income	$21,725		
Average Household Size	3.2		
Average Purchase Price	$52,730		
Average Age of Borrower	33.6		

Source: Minnesota Housing Finance Agency, *Summary of Indian Housing Programs* (St. Paul, 1988).

*Contract Dollar Amount includes funds for both program and administrative costs.

**Project Pride in Living continues to manage 13 rental units for Indian families in St. Paul using UIHP funds.

Table 5.10: Characteristics of Urban Indian Housing Program Administrators, 1979-1988

The three administrators who have experienced problems in implementing the Urban Indian Housing Program in accord with their MHFA contracts were the Minneapolis Community Development Agency (MCDA), the St. Paul Inter Tribal Housing Board and the Corporation for Indian Development (CID).

Minneapolis Community Development Agency (MCDA)

In 1979, MCDA contracted with MHFA to acquire, rehabilitate and sell homes to Indian families in Minneapolis. By 1984, MCDA had only produced 50 percent of the housing units specified in the contract and had incurred monetary losses estimated at $728,934. In August, 1984, MHFA filed a lawsuit against MCDA for breach of contract. An out of court settlement was reached whereby MCDA paid MHFA $364,462 for these losses.

St. Paul Inter Tribal Housing Board

A December 1984 report of the Minnesota Office of the Legislative Auditor documented misuse of Urban Indian Housing Program funds by this organization. The Board Chair was accused of filing a false application to obtain a UIHP mortgage and receiving an improper payment of $27,000 for his construction firm. In addition, irregularities were discovered in the use of public funds for non-UIHP purposes and for failure of the Board to pay sales taxes. No legal action was taken in this case because the St. Paul City Attorney and Minnesota Attorney General's Office thought it would be difficult to prove criminal intent. The contract with St. Paul Inter-Tribal Housing Board was cancelled due to noncompliance.

Corporation for Indian Development (CID)

MHFA oversight of urban Indian sponsors was weak.

In 1985, the Corporation for Indian Development (CID) received a contract from MHFA to administer the Urban Indian Housing Program in Minneapolis. In its second quarterly report in 1986, it was discovered that CID had made some questionable administrative expenditures and that MHFA funds were comingled with other CID monies in a single checking account. Because CID was not processing loans in a timely manner, it was declared to be not in compliance with its contract and the contract was cancelled. MHFA staff closed out the remaining six loans that CID was processing. MHFA estimates that less than $3,000 was lost in this contract. No legal action was taken because of the difficulty of proving that funds were misused.

MHFA's Oversight Role of Urban Indian Contracts

MHFA claims that it has learned from these negative experiences with UIHP administrators and has made the necessary program modifications. Originally, when the Urban Indian Housing Program was created, MHFA viewed its role as a "pass through" agency. Local administrators were expected to administer the program and monitor the funds. The November 1984 report of the State Auditor on the Minneapolis Community Development Agency Urban Indian Program criticized MHFA for this passive role when it stated:

> The program design was apparently not thoroughly examined by the parties, and the ultimate difficulties in implementation may stem from these design inadequacies. MHFA acted as the fund-

> ing agent but, in contracting for the program with MCDA, did not provide substantial management direction to the program, looking rather to MCDA to manage.[5]

As a result of these bad experiences involving UIHP contractors, MHFA tightened up on its reporting requirements and fund allocation procedures. MHFA claims that it was due to these more stringent financial monitoring practices that they discovered the problems with the Corporation for Indian Development before they became serious.

The "New" Urban Indian Housing Program

In 1987, MHFA decided that it could save the high administrative costs associated with the UIHP and prevent the possibility of future misuse of UIHP funds by directly administering the program. The agency obtained an administrative rule change and received approval from the Minnesota Indian Affairs Council to make this possible. In August 1988 all contracts with local UIHP administrators were terminated and the new Urban Indian Housing Program administered directly by MHFA began.

A new MHFA urban Indian program offers first time homebuyer mortgage loans.

One key feature of the new UIHP is that Indians are now offered a conventional reduced interest mortgage loan. Under the old program, some UIHP contractors had offered Equity Participation Loans that allowed Indian families to buy any home they wished as long as the price was below the maximum purchase price limits. Under the program, eligible buyers paid five percent of the purchase price as a down payment and received a zero interest rate mortgage from MHFA for half of the purchase price. This loan did not need to be repaid until the property was sold. City or foundation funds were the source of the mortgage for the remaining half of the purchase price. In some cases, down payment assistance was also provided.

Type of Loans Offered through the New Urban Indian Housing Program

The new UIHP offers Indians who are first time homebuyers and residing in metropolitan areas, a 30 year, FHA insured, six percent interest rate mortgage loan. The low six percent interest rate can be offered because MHFA has combined Urban Indian appropriations with the proceeds from an eight percent mortgage revenue bond issue. Other provisions of the loan are:

a) A down payment requirement of 3.8 percent of the purchase price.

b) Downpayment assistance up to $1,500 to families with incomes under $23,000 in the Twin Cities area and $17,000 in Duluth.

c) Local participating lenders originate the loans.

d) Income limits in the Twin Cities area of $29,000 for a new home and $20,000 for an existing home (in Duluth, $25,000 and $15,000 respectively).

5 State Auditor of Minnesota, *Minneapolis Community Development Agency-Urban Indian Housing Program* (St. Paul, November 15, 1984).

e) Purchase Price limits in the Twin Cities area of $89,000 for a new home, $79,000 for an existing home (in Duluth, $64,890 and $47,070 respectively).

MHFA has been administering this program since August 1988 and discovered that demand for the loans was greatest in the Twin Cities suburbs. Thus, it sought and obtained approval from the Minnesota Indian Advisory Council to collapse the UIHP allocation formulas (see Table 5.9) into two funds: one for the Twin Cities and one for Duluth. MHFA discovered that the down payment requirement has made these loans unaffordable to lower income Indian families. In addition, the purchase price limits are too low to acquire housing in the Twin Cities suburbs.

Service to Duluth Area by New UIHP

The Duluth Indian Housing Task Force is critical of the new urban Indian program.

While the Minnesota Chippewa Tribe approved the concept of the new UIHP, members of the Duluth Indian Housing Task Force, which advises the Minnesota Chippewa Tribe, do not approve of the new UIHP for the following reasons:

- There is no Duluth office. Since the program is administered in St. Paul, there is no local staff person to promote the program and answer questions.

- There is no local coordination. Under the old UIHP, Duluth staff were able to coordinate UIHP funds with city and other housing programs and assist Indian families with a variety of housing problems.

- The program only serves first time homebuyers. In Duluth, the major need is for rehabilitation loans which were provided under old UIHP.

- MHFA has failed to consider alternatives. The members of the Duluth Indian Housing Task Force believe the new UIHP was presented "as is" with little consultation or consideration of alternatives.

ELDERLY HOME SHARING PROGRAM

Elderly people find it difficult to remain in their homes and meet the financial costs as well as the physical maintenance demands that a home entails. Often when the elderly leave their homes, they move to retirement or nursing homes which demand greater private and public costs. One solution has been the creation of a home sharing program which matches elderly homeowners with a younger person seeking housing. The benefits of homesharing for the elderly can be additional income, companionship, and/or assistance with household maintenance.

In 1985, the Legislature appropriated funds to assist homesharing programs in the state and assigned MHFA the responsibility of allocating these funds to nonprofit sponsors. Appropriation amounts were $150,000 for the 1985-1987 biennium and $300,000 for the 1987-1989 biennium.

Geographic Areas Served by Elderly Homesharing

In 1986, 18 agencies applied for Elderly Homesharing funds and ten were approved. These 18 agencies included four from the Twin Cities area and 14 from outstate Minnesota. In 1987, 12 agencies applied for funds and six were approved. Three of the 12 were from the Twin Cities area. The geographic distribution of funds is presented in Table 5.11 and reveals that Twin Cities agencies now receive 73 percent of all Elderly Homesharing Funds.

MHFA justifies the geographic allocation shown in Table 5.11 by arguing that they funded the programs that they thought would be most effective in delivering the service.

Twin Cities agencies received 73 percent of elderly homesharing funds.

Agency	1985-87 Award	Estimated Matching Funds*	1987-89 Award	Estimated Matching Funds*
OUTSTATE MINNESOTA				
NW Minnesota HRA, Mentor	$20,000	0	0	0
Duluth HRA	20,000	0	0	0
Catholic Charities, St. Cloud	13,000	$4,000	$30,000	$5,000
Mower County Seniors	8,000	0	20,000	0
Board of Social Ministry, Mankato	9,000	20,000	20,000	15,339
Red Wing HRA	6,500	1,000	10,000	2,000
SEMCAC, Rushford	13,000	4,000	0	0
Region 6E CAA, Willmar	8,000	2,000	0	0
Subtotal	$97,500	$31,000	$80,000	$22,000
TWIN CITIES AREA				
Lutheran Social Services, Minneapolis	$38,000	$52,000	$140,000	$102,861
Washington County Human Services	15,000	6,000	80,000	12,000
Subtotal	$53,000	$58,000	$220,000	$114,861
Total	$150,000	$89,000	$300,000	$136,861

Source: Minnesota Housing Finance Agency, Homesharing Program Application Reports (St. Paul, 1986 and 1987).

*The "Estimate Matching Funds" are amounts provided by the sponsors and may not fully reflect complete match provided by the agencies in areas such as volunteer time, contributions, etc.

Table 5.11: Geographic Distribution of Elderly Homesharing Grants, 1985-1988

Who was Served by Elderly Homesharing?

Presumably those who would most benefit from a homesharing service would be single low-income homeowners, most of whom are women. In their assessment of the first round of funding, MHFA discovered that the average age of homeowners participating in the program was 71 and that most homeowners were retired, single women earning less than $15,000 per year.

Effectiveness of Elderly Homesharing

In 1987, MHFA compiled data on the performance of the 10 program administrators during the first funding cycle. The November 4, 1987 performance data revealed that of the total number of homeowners who made inquiries (965) only 15 percent (or 145) were matched. The average administrative cost per match was $1,034. This average is high compared with the six grantees who were most successful in terms of matches who had a $654 cost per match.

Based on the above data:

- **The Elderly Homesharing program matched a small number of elderly homeowners and at a high cost per match.**

We view the Elderly Homesharing Program as a pilot program. If the need is demonstrated, the program should be funded and administered at the local level. In this regard MHFA has proven to be effective in selecting nonprofit administrators and and in targeting the program to needy homeowners. The program was not very effective in achieving an efficient and economical matching service.

CONCLUSIONS

This section presents our conclusions and recommendations related to the four criteria that served to guide our analysis of special needs housing.

Targeting

Greater emphasis is needed on critical housing needs of low-income groups.

MHFA's efforts to meet the distinct needs of the special needs groups represents only a minor part of the agency's overall housing effort. Unlike MHFA implementation of single family mortgage and home improvement loans where the agency has been an active and aggressive force in providing affordable housing, in the special needs areas implementation has been passive and limited. The agency has not made strong recommendations to the Legislature in support of these programs.

- **MHFA has not viewed special needs programs as a basic part of its mission.**

MHFA should have a stronger sense of where the critical needs are concentrated and design programs in a way that will address these needs. MHFA needs to develop strategies to address the housing problems among special needs populations. Instead, MHFA has implemented each program separately without establishing short or long term goals and without making connections among them. The MHFA Action Plan makes little or no mention of special needs groups except the elderly. We recommend that:

- **MHFA should develop a comprehensive Housing Policy Plan to guide the development of housing programs and the expenditure of appropriated funds.**

The state needs a comprehensive housing plan to guide policy making.

Such a strategic plan would combine into one clear and concise document the following elements:

- **Research into the demographic characteristics of special needs populations and other groups served by the agency, and a justification for each program. For example, why have a separate program for Urban Indians?**

- **Quantitative assessment of the number and location of facilities/units currently available and the number needed to address the problem;**

- **A clear statement of goals to be achieved over a five year period; and**

- **An implementation strategy to meet those goals on both a short and long range basis.**

This plan should be updated regularly and used by MHFA as a tool for targeting and coordinating its programs. It would also be useful as a basis for developing the biennial budget and supporting the agency's funding requests to the Governor and the Legislature.

Efficiency

MHFA has established a well deserved reputation as an effective and efficient financing agency. In most of the special needs programs, we discovered that MHFA has delivered housing to very low-income groups in a manner that produces the maximum number of units for the lowest public costs.

The one major exception to this good efficiency record was the Urban Indian Housing Program. The financial problems with UIHP administrators are now being addressed by the establishment of the new state-wide, MHFA-administered UIHP. However, it is too soon to evaluate this new program.

We also questioned the efficiency of the Elderly Home Sharing program. We view Elderly Homesharing as still in a pilot stage and so,

- **MHFA should continue to work to improve the cost-effectiveness and economy of the Elderly Home Sharing program.**

Effectiveness

For many of the special needs programs, the Legislature has established goals and in general, MHFA has developed rules and procedures for most of the special needs programs that respond to the Legislative goals.

In the chapter, we have raised questions about whether MHFA's implementation of the Tribal and Urban Indian housing programs is compatible with statutory intent concerning geographic distribution.

The Minnesota Chippewa Tribe has decided that 90 percent of TIHP funds will be spent on the reservation and the Red Lake Housing Corporation has allocated 80 percent of TIHP funds for residents of the reservation. Since Minnesota statutes require that "all programs must provide for a reasonable balance in the distribution of funds... between American Indians residing on and off the reservation" (*Minn. Stat.* 462A.07, Subd. 14), we recommend that:

- **MHFA should work with the tribal housing organizations to revise their allocation formula in order that off-reservation Indians are better served by Tribal Indian housing programs.**

The new Urban Indian Housing Program was established because the private organizations formerly running the program could not do the job. We support MHFA's insistance that appropriate financial standards be adhered to in the administration of this program. Still, for the longer run:

- **MHFA should consider using local nonprofit agencies to carry out the Urban Indian Housing Program and to serve low-income American Indians.**

Adaptability--Responses to Surveys of Housing Administrators

Local housing officials are satisfied with MHFA.

In order to learn whether MHFA has been effective and responsive to changing conditions in the housing market and to the concerns of sponsors of special needs housing, we surveyed directors of housing and redevelopment agencies (HRAs) and nonprofit housing organizations. For a complete description of responses to all of the questions in the surveys, see Appendix A and B.

The Minnesota HRA Directors that we surveyed gave MHFA high marks in their overall assessment of key program areas in which they have worked with the agency (see Table 5.12). The HRAs ranked the agency highest in responding to inquiries and providing technical assistance but also thought MHFA did a good job in program creativity, consulting with them in developing housing in their area, and in tailoring housing to local needs.

- **MHFA has a good reputation among people close to housing programs and knowledgable about community housing needs.**

Analysis of the survey results also reveals the concern HRA directors had about their role in developing and implementing state housing programs.

They recommended that:

Local redevelopment agencies should have a more central role in housing policy making and program administration.

Local housing officials see housing growing in importance.

Overall Assessment of MHFA	Number of Respondents: Very Good	Good	Poor	Not Sure
Responds to inquiries	30	32	0	12
Provides technical assistance	25	32	0	17
Provides information on programs	18	39	1	15
Provides time to develop funding proposals	15	52	1	18
Creative in considering new approaches to development housing	12	40	4	19
Requires minimum paperwork	7	43	5	18
Consults with your agency before developing housing in your area	7	33	8	25
Tailors housing to local needs	4	39	5	25

Priorities Among Housing Program Areas	Number of Respondents: Very Important	Important	Not Important
Rehabilitation grants for low-income homeowners	53	17	8
Home improvement loans	46	27	4
First time homebuyer mortgages	45	25	7
Rent Subsidies for low-income families	38	31	8
Rent subsidies for low-income elderly	35	21	20
Rental rehabilitation loans	21	31	22
Transitional housing for the homeless	10	30	34
Group homes for developmentally disabled	8	36	31

Importance of Housing Issues to Local Officials	Number of Respondents: High Priority	Medium Priority	Low Priority	Not Sure
Importance of housing today	20	31	31	11
Importance of housing over the next five years	25	43	14	11

Should State Housing Policy Consist of a Partnership Where Local Public and Private Sources Contribute Up to 25 Percent of Program Costs?	Number of Respondents
Yes	35
No	9
Not sure	40

Source: Minnesota Office of the Legislative Auditor, Survey of Housing and Redevelopment Agency Directors (St. Paul, 1988).

Table 5.12: Survey Responses of HRA Directors

The responses of nonprofit sponsors to our survey is presented in Table 5.13 and reveals that they were also very satisfied with MHFA. The area where most sponsors desired change was in the agency's procedures. Forty-three percent said they would like to see changes in MHFA's procedures. Specific suggestions that they wrote in on the questionnaire included (in order of importance):

- Make income and escrow account requirements more flexible,

Local nonprofit housing sponsors support partnerships with state goverment.

Overall Assessment of MHFA	Number of Respondents: Yes	No
Has your experience working with MHFA been a positive one?	64	4
Was MHFA too conservative in the underwriting standard it used for approving loans?	16	49
Has MHFA been effective in addressing the housing needs of low and moderate income households?	54	8
Are there changes that you would like to see made in MHFA's procedures or programs?	43	23

	Number of Respondents		
Priorities Among Housing Program Areas	Very Important	Important	Not Important
Rehabilitation grant for low-income homeowners	40	21	4
Rent subsidies for low-income families	38	24	5
Rent subsidies for low-income elderly	37	21	5
Transitional housing for the homeless	32	21	9
First time homebuyer mortgages	24	30	6
Group homes for the developmentally disabled	22	27	12
Home improvement loans	20	27	15
Rental rehabilitation loans	19	33	9

Should State Housing Policy Consist of aPartnership Where Local Public and Private Sources Contribute Up to 25 Percent of Program Costs?	Number of Respondents
Yes	43
No	16
Not Sure	17

Source: Minnesota Office of the Legislative Auditor, *Survey of Nonprofit Housing Sponsors* (St. Paul, 1988).

Table 5.13: Survey Responses of Nonprofit Housing Sponsors

- Provide more funds for programs, and
- Help facilitate nonprofit involvement in housing development.

In establishing their priorities among the housing program areas, the nonprofits disagreed with current MHFA policy. They recommended that MHFA should be more responsive to the needs of low-income renters and special needs populations. Nonprofit sponsors ranked rent subsidies for low-income families and transitional housing for the homeless as more important than mortgage loans for first time home buyers or home improvement loans for homeowners.

In our interviews with nonprofit sponsors and HRA Directors, the two areas that generated the most criticism were MHFA's inflexibility in administering some of the special needs programs and the limited involvement of nonprofits in MHFA housing developments.

We believe that:

- **MHFA administative procedures should facilitate and not hinder involvement of nonprofit organizations in special needs housing.**

MHFA needs to be more supportive of the nonprofit housing sector.

Specifically, MHFA should reconsider the requirement that construction be completed before MHFA grant funds are released to nonprofits.

Several nonprofit sponsors who responded to the survey and others with whom we talked argued that MHFA could be more actively involved in assisting in the "capacity building" of nonprofit housing corporations. Such an effort would include technical assistance by MHFA staff and start-up grants to pay for initial administrative costs. They feel that MHFA needs a system of nonprofit organizations around the state because they provide a community-based, services-oriented approach to housing development which is very important in serving low-income families and persons with special needs.

In our survey, public and private housing sponsors expressed strong interest in a "partnership" approach to implementing low-income housing whereby local public and private sponsors would be actively involved in designing programs and contributing a local share to program costs.

Based on this support and the advantages of utilizing local governments and nonprofits to develop low-income housing discussed in Chapter 4, we conclude that:

- **MHFA should pursue more cooperative arrangements with local governments and private sponsors in designing, financing, and implementing low-income housing programs.**

CONCLUSIONS AND RECOMMENDATIONS

Chapter 6

In this chapter we discuss conclusions and recommendations of a general nature drawn from the study as a whole. We look at:

- managerial effectiveness,
- the MHFA Board and staff relationship,
- responsiveness to changes in the environment in which MHFA operates,
- emphasis on homeowner and renter programs,
- MHFA's relationship with human service agencies, and
- property tax policy.

MANAGERIAL EFFECTIVENESS

MHFA is well managed and competent.

MHFA is a well managed and competent organization. This is the view of people involved in housing with whom we talked in person or whose opinion we surveyed. It is also a generalization drawn from a detailed review of the Single Family Mortgage Loan Program, the Home Improvement Loan Program, the multi-family programs and the programs that serve special needs populations. It is also the conclusion we reached by observing virtually all meetings of the Governors Commission on Affordable Housing (staffed by MHFA) and MHFA Board meetings during the last half of 1988. MHFA is not perfect. Many shortcomings have been discussed in previous chapters. But our focus on the exceptions to good performance should not obscure this important general conclusion.

Some of the indicators of managerial effectiveness include:

- *Good bond ratings*. MHFA has received a "Top Tier" rating from Standard and Poor's and is regarded by them as one of the nation's best state housing finance agencies.

- *Competence of the staff.* Our surveys and interviews revealed that even MHFA's harshest critics agree that the MHFA staff is experienced and knowledgeable in the complex, technical elements of housing finance. MHFA also gets good marks for responding to inquiries and providing information.

- *Aggressive pursuit of federal housing subsidies.* The agency has taken full advantage of the federal subsidies inherent in tax-exempt revenue bonds and Section 8-New Construction subsidies.

BOARD AND STAFF RELATIONSHIP

The MHFA Board has been too passive in deliberating and deciding housing policy. In interviews with us, individual board members expressed some concern about current policy directions and acknowledged the board's inactivity in recent years.

The MHFA board needs to adopt a housing plan and open up its policy-making process.

Minnesota's housing problems are serious. The housing needs of low-income renters is a serious problem and homelessness is a great concern. Housing policy is now at a crossroads and the board ought to be more assertive in participating in the major housing policy issues that confront the state.

To assist the board, we recommend:

- **MHFA should adopt a comprehensive housing plan.**

A housing plan would identify goals in each of the agency's program areas. These goals would serve to focus the agency on critical needs and provide a criteria by which the agency's performance could be measured. The current "Housing Finance Action Plan 1984-1986" is a vague, out-of-date document of limited usefulness. As discussed at the end of Chapter 5, we also envision that such a plan would include research into demographic factors, assessment of current demand and supply of housing, and quantitative objectives for the number of units to be delivered in each of the major program areas.

- **MHFA should open up its policy-making process.**

MHFA needs to solicit broader input into its deliberations. In the past, there has not been a formal process by which cities and nonprofit housing organizations can have input into agency decision making. The newly formed Housing Trust Fund Advisory Committee (representing nonprofit organizations) is a step in this direction. In our survey, Housing and Redevelopment Agency directors expressed an interest in participating in MHFA policy making. The Board should consider forming a Local Officials Advisory Committee that would provide the board with an important perspective.

Also, MHFA served as staff to the Governor's Commission for Affordable Housing in the 1990s, which represented a broad spectrum of views towards housing policy. This commission's report was an important and overdue effort to bring the housing policy debate into greater prominance.

RESPONSIVENESS TO CHANGES IN THE HOUSING ENVIRONMENT

An important policy discussion that needs to be undertaken in the coming years is the proper role of the agency and the state in delivering housing services in light of recent changes in the demographic, economic, and political environment. Chapter 1 reviewed some of these trends: a decline in new households, a softening of the demand for rental units and "starter homes," and growth in single-parent households and low income families. In addition, the federal government has backed out of constructing new subsidized housing and has seriously considered terminating the use of tax-exempt revenue bonds for financing housing loans. An influential General Accounting Office study concluded that from the federal perspective, tax-exempt financing of mortgage loans is inefficient and a waste of money.

MHFA understands these key changes but the board has not yet decided what its response should be. Recently, the Governor's Commission on Affordable Housing, staffed by MHFA, reassessed the state's role in housing programs and developed recommendations for new housing initiatives. We believe that its report of November 1988 has important implications for state housing policy and for MHFA's traditional approach towards housing delivery. We recommend that:

- **MHFA should take the commission's recommendations as a starting point in developing a more comprehensive plan and legislative proposal.**

- **MHFA should expand its efforts in multi-family development, especially in assisting the financing needs of small scale apartment owners and nonprofit housing corporations.**

In the past MHFA has demonstrated a preference for working with large scale, for-profit housing developers. However, since 1981 most new low-income housing has been developed by nonprofits and local governments and most existing units that are affordable to the poor are in small buildings.

MHFA is right to require that developers meet stringent financial and management standards, but the Apartment Renovation Mortgage and the Low Income Tax Credit programs have demonstrated that working with small apartment owners and nonprofit organizations can produce affordable rental housing for low and moderate income households while upgrading the physical condition of the housing stock.

MHFA needs to develop partnerships.

In expanding the supply of low-income rental housing, MHFA should, like other housing finance agencies, develop closer working relationships with local governments, housing authorities, and non-profit sponsors. Such a partnership approach will require that:

- **MHFA should propose the appropriation of additional funds for seed money and capacity building to facilitate involvement of nonprofit sponsors and local governments in development of low-income rental housing.**

THE CHOICE BETWEEN HOMEOWNER AND RENTER PROGRAMS

Closely related to the points raised above is one important question posed to us by the Legislature in directing us to carry out this study: Is MHFA serving the housing needs of low and moderate income households? Our answer is that:

- **MHFA has placed a higher priority on the housing finance needs of homeowners to the relative neglect of low income renters.**

One reason for this priority has been MHFA's desire to take full advantage of the federal subsidy provided through its tax exempt bonding authority. But bond-financed programs cannot help the most needy groups. By definition, low income households cannot afford the rent that produces revenue that repays bondholders.

MHFA needs to place a higher priority on helping low income renters.

But even a high share of MHFA's state appropriations has gone to home ownership programs, and here the requirements of bond financing are absent. An argument can and has been made that by helping homeowners, renters will indirectly benefit. However, during recent years of high levels of home ownership assistance and improved housing affordability for owners, the affordability of rental housing has declined.

For these reasons, more housing assistance should be directed to renters and certain special needs populations.

Therefore, we recommend:

- **MHFA should shift its resources away from homeownership programs to programs that directly assist renters.**

- **MHFA should shift its resources to programs that serve the low income single parent families and homeless who are in greatest distress.**

- **MHFA should target its programs towards conserving the existing housing stock since in most areas this will be a cheaper strategy. In some markets, new construction will accelerate deterioration of the existing housing stock.**

- **MHFA should seek to establish long-term guarantees of rental affordablility by expanding financing programs for existing rental housing such as the Apartment Renovation Mortgage (ARM) program and assisting nonprofit developers and managers.**

We understand that MHFA is not a free agent and that decisions such as these involve internal debate within the executive branch, a budget proposal, proposed statutory changes, negotiations and compromise with the Legislature, and, throughout, concern with tight fiscal constraints.

MHFA'S RELATIONSHIP WITH HUMAN SERVICE AGENCIES

Many housing problems cannot be solved by MHFA alone. Experts estimate that a majority of the homeless have serious social or medical problems. In addition, there are individuals and families whose problem is the lack of a job or sufficient income to afford adequate housing even while there are vacant units that rent for an amount close to their operating cost.

Workable solutions to problems such as these will emerge from a joint consideration of housing policy and welfare policy. Implementation of any good ideas will involve improved coordination between MHFA and the Department of Human Services and the Department of Jobs and Training at the state level and with county government and private social service agencies at the local level. MHFA acknowledges the needs to improve its coordination with social service agencies in meeting anticipated housing needs. One example is the predictable future need for housing with services and supervision, at low cost, for the elderly who would otherwise require nursing home care.

COORDINATION OF TAX AND HOUSING POLICY

An important issue that was raised at the meetings of the Governor's Commission on Affordable Housing and in our interviews is the impact of tax policy on housing affordability. It is often observed that the federal government provides a major tax benefit to homeowners by permitting the deduction of mortgage interest and property taxes. The 1986 Tax Reform Act has reduced the appeal of investment in income producing property such as rental housing by restricting the deduction of passive losses, removing the beneficial treatment of capital gains, and restricting accelerated depreciation.

Minnesota's tax policy also favors homeowners. The state does this through a property tax policy that assesses rental property at a higher rate than owner-occupied residential property, and provides a homestead credit in addition. Renters get an income-adjusted rent credit called the property tax refund, but owners of similar income also get a similar refund. The renters' credit has been cut back in recent years and now reduces the tax burden of renters less than it used to. The result is that rental units bear a property tax that is two to three and a half times as high as owner occupied units of similar value. Statewide, the effective property tax rate (tax as a percent of value) is about 1.3 percent for non-farm homesteads and 3.8 percent for rental property. According to the Department of Revenue, about 20 percent of rent on average can be considered as covering the property tax apportioned to a rental unit. These data come from renters' credit returns, so they pertain to rental housing used by low and moderate income households.

We think that MHFA should broaden the concept of its mission to include analysis of tax policy, especially as it has implications for affordable low income rental housing. As we recommend, MHFA's primary responsibility is to address the needs of renters through its multi-family programs. But it should not ignore the effect of tax policy. Its analysis and advice in this area could be useful to state policy makers.

GLOSSARY OF HOUSING TERMS

GENERAL HOUSING ACRONYMS

HRA - **Housing and Redevelopment Agency.** Local housing agency that administers low income housing assistance programs such as public housing and the federal Section 8-Existing (certificate) program. Some HRAs also administer MHFA programs (e.g. Rehabilitation Loan Program), provide local mortgage loans, and implement redevelopment activities. HRAs can serve individual cities, counties or multi-county areas.

HUD - **U.S. Department of Housing and Urban Development.** This is the federal agency that distributes funds for housing and community development programs.

MHFA - **Minnesota Housing Finance Agency.** State agency that provides financing for first-time homebuyer mortgages, home improvements and apartment developments and administers programs for special needs populations (e.g. homeless, disabled).

FHA - **The Federal Housing Administration** (an agency in HUD). Most noted for issuance of FHA mortgage insurance for moderate income households. Since this insurance reduces risk for the lender, FHA interest rates are set lower and repayment terms cover a longer period of time than conventional uninsured mortgages.

FmHA - **Farmers Home Administration** (an agency in the U.S. Department of Agriculture). This agency originates and services loans for rural homebuyers and developers of multi-family housing. Recipients of these programs (homebuyers and renters) must meet the agency's low and moderate income guidelines.

VA - **U.S. Veterans Administration mortgage guarantee program.** The program provides a guarantee to lenders for a portion of the mortgage loan. Loan guarantees are offered to veterans and allow for no downpayment and a lower interest rate than conventional mortgages.

GENERAL HOUSING TERMS AND PROGRAMS

LOW INCOME TAX CREDIT - The 1986 Tax Reform Act created incentives for low-income housing development. For a project to be eligible, at least 20 percent of its units must be occupied by very low income households. The tax credit allows owners of projects involving at least $2,000 per unit of rehabilitation or new construction to claim a credit based on the number of units in the building serving low-income tenants. The amount of tax credits available to each state is limited by the federal government and the tax credit program is due to expire at the end of 1989.

NONPROFITS - General term used to refer to not-for-profit organizations involved in the production and management of low and moderate income housing. Nonprofits include community, neighborhood, religious, and specialized service (e.g. group homes) organizations.

SECTION 8 - A federal housing assistance program created as part of the 1974 Housing and Community Development Act. The goal of this program is to assist low-income renters (persons earning below 50 percent of the median county income) by subsidizing the difference between the tenant contribution (30 percent of their income) and the rent of the unit occupied. Section 8 has two components: the New Construction (terminated in 1981) and Existing Housing programs.

SECTION 8-EXISTING - Under this program, the eligible tenant locates a rental unit in the community and HUD pays the difference between the amount the tenant can afford (30 percent of income) and the "fair market rent." HUD establishes fair market rents based on comparable rents in the area and the unit size. The local public housing agency (HRA) certifies the tenant, inspects and approves the unit, and monitors the program.

SECTION 8-NEW CONSTRUCTION (currently inactive) - HUD contracts with nonprofit and for profit developers to produce a specific number of low-income rental units. These units receive Section 8 monthly rental subsidies for a set period of time. Due to the high cost of new construction, this program was very expensive and in 1981 it was terminated.

VOUCHERS - A rent subsidy program for low-income families similar to Section 8-Existing since it allows tenants to select a unit among existing apartments. The major difference from Section 8 is that eligible renters are given a specific monthly rent subsidy which they are free to use as they wish. They can rent a more expensive apartment and pay the difference or they can rent a unit for less than the subsidy amount and pocket the difference. Also vouchers travel with the tenant so they can move to different parts of the country and still retain their voucher. The Reagan Administration initiated this program in order to eliminate the "fair market rent" calculation, which HUD thinks is too high in some areas, in favor of a specific subsidy amount.

SECTION 236 (currently inactive) - HUD provided an interest subsidy on mortgages for projects that would serve lower income renters. HUD subsidized the interest down to one percent and provided these subsidies directly to lenders such as housing finance agencies. In some projects,Section 8 subsidies were combined with Section 236.

MHFA PROGRAM ACRONYMS

EHS - **Elderly Home Sharing.** MHFA program to match elderly homeowners who wish to rent out part of their home with another person in search of housing. Generally, the tenant receives reduced rent for agreeing to provide house maintanance services for the elderly owner. MHFA provides grants to nonprofit sponsors whoadminister the program.

EPL - **Equity Participation Loans.** Prior to 1988, some UIHP sponsors offered subsidized mortgage loans to Native Americans living in metropolitan areas that included a downpayment requirement of five percent of purchase price and a zero interest mortgage for half of the purchase price (repaid when property was sold). City mortgage programs financed the other half of the purchase price.

HIL - **Home Improvement Loan Program.** Makes loans to eligible homeowners through participating lenders at below market interest rates.

LITC - **Low Income Tax Credit.** See description above.

REP - **Redefined Equity Program.** Program to discourage owners of Section 8-New Construction developments from prepaying their mortgages and thereby releasing them from rent restrictions imposed by Section 8. Upon release, they can convert the rents of their multifamily units to the market rate. If owner agrees to stay with their Section 8 contract for the full term and to limit rent increases, MHFA will redefine their equity to recognize the increased value of the property. By obtaining redefined equity,owners are able to increase their profit margin.

SFMP - **Single Family Mortgage Program.** Makes loans at below market interest rates through participating lenders to eligible first time homebuyers.

TIHP - **Tribal Indian Housing Program.** Tribal housing agencies make low-interest mortgage loans to American Indians residing on and off reservation lands.

UIHP - **Urban Indian Housing Program.** First time homebuyer mortgage loans made by MHFA to eligible Native Americans residing in metropolitan areas of the state. Interest charged on these loans is significantly below the market rate.

SURVEY OF HOUSING AND REDEVELOPMENT AGENCY DIRECTORS, September 1988

Appendix A

1. Location of Respondents in Region of State

Number of HRAs Responding	Region	Area of State
5	1	North West
3	2	North Central
11	3	North East
12	4	West Central
9	5	Central
2	6E	Central
6	6W	West Central
4	7E	East Central
4	7W	Central
9	8	South West
10	9	South Central
9	10	South East
16	11	Twin Cities Metro
100		TOTAL

2. How would you rank the performance of MHFA in each of the following areas based on your experience working with the Agency?

Number of HRAs Responding						
Very Good	Good	Poor	Not Sure	No Response		
30	30	2	12	26	a)	Responds to inquiries.
25	30	2	17	26	b)	Provides technical assistance
20	31	7	17	25	c)	Offers informational meetings
18	36	4	15	27	d)	Provides adequate information.
15	32	2	23	28	e)	Monitors performance of housing projects on a regular basis
15	37	3	18	27	f)	Provides adequate time for you to develop proposals.
12	38	6	19	25	g)	Is creative in considering new approaches for developing housing.
7	37	11	18	27	h)	Does not demand excessive paperwork
7	27	14	25	27	i)	Consults with you prior to developing housing in your area.
4	34	10	25	27	j)	Tailors projects to local needs.

3. Did your agency participate in the Municipal Home Mortgage program in which MHFA set aside revenue bond-financed funds for local governments to use in meeting their housing needs?

Number of HRAs Responding

Yes	No	No Response
8	78	14

4. If you answered "yes" to the above question, how would you describe your experience with the Municipal Mortgage Program? (check all that apply)

Number of HRAs Responing		
6	a)	Useful in promoting homeownership.
6	b)	Useful in promoting development of affordable housing.
4	c)	Useful in targeting funds to persons who needed who needed them the most
3	d)	Useful in targeting funds to geographic areas
1	e)	Very difficult to implement.

5. How would you describe the implementation of MHFAs Single Family Mortgage Program (SFMP) and the Home Improvement Loan (HIL) program in your area? In these programs, MHFA purchases loans originated by local lenders.

Number of HRAs Responding				
Adequate	Inadequate	No response		
40	12	48	a)	Number of HIL lenders in my area
38	13	49	b)	Number of SFMP lenders in my area
37	13	50	c)	Funds available to area lenders for HIL loans have been:
28	20	52	d)	Funds available to area lenders for SFMP loans have been:

Too Conservative	Too Liberal	About Right	No Response		
12	2	33	53	e)	Underwriting standard used in approving SFMP loans in my area is
7	3	40	50	f)	Underwriting standard used in approving HIL loans in my area is

Too Low	Too High	About Right	No Response		
14	4	30	52	g)	The income limits were
14	2	31	53	h)	Loan amount/sales price limits were

6. Has your agency served as an administrator of MHFAs Rehabilitation Loan Program which provides loans to low-income homeowners?

Number of HRAs Responding

Yes	No	No Response
36	50	14

7. If you answered "yes" to the above question, how would you describe your experience with the Rehabilitation Loan program?

Number of HRAs Responding

Adequate	Inadequate		
13	23	a)	The Rehabilitation Loan funds available in my area were:

Easy to Administer	Difficult to Administer		
30	6	b)	MHFA procedures for this program were:

Responsive	Unresponsive		
33	1	c)	MHFA staff were:

Too Low	Too High	About Right		
21	0	15	d)	MHFA income limits for this program are:

8. In which of the following MHFA programs has your agency been involved? (check all that apply)

Number of HRAs Responding		
22	a)	Rental Rehabilitation Grants
16	b)	Home Energy Loans
14	c)	Multi-Family Housing Development
6	d)	Apartment Renovation Mortgages
5	e)	Low-Income Persons Living Alone
4	f)	Energy Improvement Loan Insurance
3	g)	Low Income Tax Credit
1	h)	Innovative Housing
1	i)	Indian Housing
1	j)	Elderly Homesharing
0	k)	Temporary Housing
0	l)	Group Residences for Developmentally Disabled

9. What is the nature of your agency/office? (check all that apply)

Number of HRAs Responding		
87	a)	Public Housing Agency
14	b)	Community Development Agency
7	c)	City Planning Office
3	d)	City Manager/City Administrator Office
11	e)	Other

10. What is the size of the professional staff in your agency?

Number of HRAs Responding		
8	a)	10 and over
10	b)	5 to 9
4	c)	4
9	d)	3
11	e)	2

10. What is the size of the professional staff in your agency? (continued)

49	f)	1
3	g)	0
6	h)	No Response

11. What is the nature of the service area of your agency?

Number of HRAs Responding		
64	a)	Single city
4	b)	Multi-city
19	c)	Single county
9	d)	Multi-county
4	e)	Other

12. What was the 1980 population of your service area?

Number of HRAs Responding		
5	a)	100,000 and over
4	b)	50,000 to 99,999
9	c)	25,000 to 49,999
11	d)	10,000 to 24,999
15	e)	5,000 to 9,999
11	f)	2,500 to 4,999
14	g)	under 2,500
31	h)	No response

13. What is the number of public housing units for families that your agency manages?

Number of HRAs Responding		
7	a)	100 and over
4	b)	50 to 99
7	c)	25-49
22	d)	1 to 24
4	e)	zero

14. What is the number of public housing units for elderly that your agency manages?

Number of HRAs Responding		
20	a)	100 and over
27	b)	50 to 99
18	c)	25 to 49
5	d)	1 to 24
4	e)	zero

15. What is the number of Section 8 units that your agency manages?

Number of HRAs Responding		
31	a)	100 and over
11	b)	50 to 99
0	c)	25 to 49
2	d)	1 to 24
3	e)	zero

16. What is the number of persons on your assisted housing waiting lists?

Number of HRAs Responding		
2	a)	1,000 and over
3	b)	500 to 999
5	c)	250 to 499
9	d)	100 to 249
4	e)	50 to 99
5	f)	25 to 49
25	g)	1 to 24
17	h)	zero
30	i)	No response

17. Compared to other issues, do you think local officials in your area consider affordable housing issues to be:

Number of HRAs Responding		
20	a)	a high priority
31	b)	a medium priority
31	c)	a low priority
11	d)	not sure
7		no response

18. Compared to other issues, do you think that <u>over the next five years</u>, local officials in your area will view affordable housing issues as:

Number of HRAs Responding		
25	a)	a high priority
43	b)	a medium priority
14	c)	a low priority
11	d)	not sure
7		no response

19. If priorities needed to be established among housing programs, how would you rank the following program areas in terms of the need for additional funds or units in your service area?

Number of HRAs Responding				
Very Important	Important	Not Important		
53	17	8	a)	Rehabilitation grants for low-income homeowners
46	27	4	b)	Home improvement loans
45	25	7	c)	First time homebuyer mortgage loans
38	31	8	d)	Rent subsidies for low-income families
35	21	20	e)	Rent subsidies for low-income elderly
21	31	22	f)	Rental rehabilitation grants
10	30	34	g)	Transitional housing for homeless
8	36	31	h)	Group homes for developmentally disabled

20. In other states, affordable housing policy has taken the form of a "partnership" where the state provides financial assistance for locally developed programs contingent upon the local government contributing up to 25 percent of the programs costs. Would you be supportive of such a program in Minnesota?

Number of HRAs Responding	
35	a) Yes
9	b) No
40	c) Not sure
16	No response

SURVEY OF NONPROFIT HOUSING SPONSORS, September 1988

Appendix B

1. Location of Sponsors in Regions of the State

Number of Sponsors Responding	Region	Area of the State
5	1	North West
4	2	North Central
6	3	North East
4	4	West Central
5	5	Central
2	6E	Central
2	6W	West Central
1	7E	East Central
5	7W	Central
3	8	South West
4	9	South Central
8	10	South East
27	11	Twin Cities Metro
76		TOTAL

2. In which of the following MHFA programs has your organization been involved (check all that apply)?

Number of Sponsors Responding		
26	a)	Group Homes for the Developmentally Disabled
23	b)	Rehabilitation Loan Program
9	c)	Temporary Housing Program
7	d)	Multi-Family Housing Development
7	e)	Elderly Homesharing
5	f)	Innovative Housing
5	g)	Home Energy Loans
4	h)	Low-Income Persons Living Alone
3	i)	Rental Rehabilitation Grants
2	j)	Indian Housing Program
1	k)	Energy Improvement Loan Insurance

3. Overall, was you experience working with MHFA:

Number of Sponsors Responding		
64	a)	Positive
4	b)	Negative
8		No Response

4. In your opinion, is the underwriting standard used by MHFA in approving loans:

Number of Sponsors Responding		
16	a)	Too Conservative
0	b)	Too Liberal
49	c)	About Right
11		No Response

5. In your opinion, has MHFA been an effective agency in addressing the needs of low and moderate income households in the state?

Number of Sponsors Responding		
54	a)	Yes
8	b)	No
14		No Response

6. Are there any changes that you would like to see made in either MHFAs procedures or programs?

Number of Sponsors Responding		
43	a)	Yes
23	b)	No
10		No Response

7. If you answered "yes" to the above question, explain the changes you would like to see MHFA make (write-in responses):

Number of Sponsors Responding		
9	a)	More funding is needed for MHFA programs
9	b)	Income requirements are too rigid. Lending criteria should consider farmers and business people differently in considering assets. Change income requirements to conform with federal programs.
5	c)	MHFA should be more involved in helping non-profits initiate and develop low-income housing
3	d)	MHFA should form partnerships with local non-profits and community development corporations in developing housing
3	e)	MHFA should relax escrow fund requirements because it ties up too much money
2	f)	Decrease bureaucratic obstacles (e.g. red tape)
2	g)	MHFA programs are not serving low-income persons
1	h)	MHFA programs create problems by not granting funds until work is completed
1	i)	MHFA staff will not vary rules or accept criticism

7. If you answered "yes" to the above question, explain the changes you would like to see MHFA make (write-in responses): (continued)

1	j)	MHFA should require Rehabilitation Loans to be repaid in order to serve more people
1	k)	MHFA is sitting on alot of capital that could be leveraged to produce more housing
1	l)	MHFA should solicit input for sponsors
2	m)	MHFA should provide grants to group homes

8. If priorities needed to be established among housing programs, how would you rank the following programs areas in terms of the need for additional funds or units in your service area?

Number of Sponsors Responding				
Very Important	Important	Not Important		
40	21	4	a)	Rehabilitation grants for low-income homeowners
38	24	5	b)	Rental subsidies for low-income families
37	21	5	c)	Rental subsidies for low-income elderly
32	21	9	d)	Transitional housing for homeless
24	30	6	e)	First time homebuyer mortgage loans
22	27	12	f)	Group homes for developmentally disabled
20	27	15	g)	Home improvement loans
19	33	9	h)	Rental rehabilitation grants

9. In other states, affordable housing policy has taken the form of a "partnership" where the state provides financial assistance for locally developed housing contingent upon local public agencies and private organizations contributing up to 25 percent of the program costs. Would you be supportive of such a program in Minnesota?

Number of Sponsors Responding		
43	a)	Yes
16	b)	No
17		No response

10. What is the nature of your housing organization? (check all that apply)

Number of Sponsors Responding		
42	a)	Nonprofit private housing organization
20	b)	Nonprofit group home sponsoring organization
18	c)	Community action agency
6	d)	Provides housing for the homeless
4	e)	Neighborhood organization
2	f)	Regional development agency
1	g)	Housing and redevelopment agency
1	h)	Indian housing organization

SELECTED PROGRAM EVALUATIONS

Board of Electricity, January 1980	80-01
Twin Cities Metropolitan Transit Commission, February 1980	80-02
Information Services Bureau, February 1980	80-03
Department of Economic Security, February 1980	80-04
Statewide Bicycle Registration Program, November 1980	80-05
State Arts Board: Individual Artists Grants Program, November 1980	80-06
Department of Human Rights, January 1981	81-01
Hospital Regulation, February 1981	81-02
Department of Public Welfare's Regulation of Residential Facilities for the Mentally Ill, February 1981	81-03
State Designer Selection Board, February 1981	81-04
Corporate Income Tax Processing, March 1981	81-05
Computer Support for Tax Processing, April 1981	81-06
State-sponsored Chemical Dependency Programs: Follow-up Study, April 1981	81-07
Construction Cost Overrun at the Minnesota Correctional Facility - Oak Park Heights, April 1981	81-08
Individual Income Tax Processing and Auditing, July 1981	81-09
State Office Space Management and Leasing, November 1981	81-10
Procurement Set-Asides, February 1982	82-01
State Timber Sales, February 1982	82-02
Department of Education Information System,* March 1982	82-03
State Purchasing, April 1982	82-04
Fire Safety in Residential Facilities for Disabled Persons, June 1982	82-05
State Mineral Leasing, June 1982	82-06
Direct Property Tax Relief Programs, February 1983	83-01
Post-Secondary Vocational Education at Minnesota's Area Vocational-Technical Institutes,* February 1983	83-02
Community Residential Programs for Mentally Retarded Persons,* February 1983	83-03
State Land Acquisition and Disposal, March 1983	83-04
The State Land Exchange Program, July 1983	83-05
Department of Human Rights: Follow-up Study, August 1983	83-06
Minnesota Braille and Sight-Saving School and Minnesota School for the Deaf,* January 1984	84-01
The Administration of Minnesota's Medical Assistance Program, March 1984	84-02
Special Education,* February 1984	84-03
Sheltered Employment Programs,* February 1984	84-04
State Human Service Block Grants, June 1984	84-05
Energy Assistance and Weatherization, January 1985	85-01
Highway Maintenance, January 1985	85-02
Metropolitan Council, January 1985	85-03
Economic Development, March 1985	85-04
Post Secondary Vocational Education: Follow-Up Study, March 1985	85-05
County State Aid Highway System, April 1985	85-06
Procurement Set-Asides: Follow-Up Study, April 1985	85-07

Insurance Regulation, January 1986	86-01
Tax Increment Financing, January 1986	86-02
Fish Management, February 1986	86-03
Deinstitutionalization of Mentally Ill People, February 1986	86-04
Deinstitutionalization of Mentally Retarded People, February 1986	86-05
Management of Public Employee Pension Funds, May 1986	86-06
Aid to Families with Dependent Children, January 1987	87-01
Water Quality Monitoring, February 1987	87-02
Financing County Human Services, February 1987	87-03
Employment and Training Programs, March 1987	87-04
County State Aid Highway System: Follow-Up, July 1987	87-05
Minnesota State High School League,* December 1987	87-06
Metropolitan Transit Planning, January 1988	88-01
Farm Interest Buydown Program, January 1988	88-02
Workers' Compensation, February 1988	88-03
Health Plan Regulation, February 1988	88-04
Trends in Education Expenditures,* March 1988	88-05
Remodeling of University of Minnesota President's House and Office, March 1988	88-06
University of Minnesota Physical Plant, August 1988	88-07
Medicaid: Prepayment and Postpayment Review - Follow-Up, August 1988	88-08
High School Education,* December 1988	88-09
High School Education: Report Summary, December 1988	88-10
Statewide Cost of Living Differences, January 1989	89-01
Access to Medicaid Services, February 1989	89-02
Use of Public Assistance Programs by AFDC Recipients, February 1989	89-03
Minnesota Housing Finance Agency, March 1989	89-04
Community Residences for the Mentally Ill, Forthcoming	

Evaluation reports can be obtained free of charge from the Program Evaluation Division, 122 Veterans Service Building, Saint Paul, Minnesota 55155, 612/296-4708.

*These reports are also available through the U.S. Department of Education ERIC Clearinghouse.