MaineHousing
Maine State Housing Authority

Analysis of Savings from and Benefits of Tax-Exempt Financing

Pursuant to 10 MRSA Sec. 363

March 2010

MaineHousing
Maine State Housing Authority

March 31, 2010

The Honorable Elizabeth M. Schneider, Chair
The Honorable Nancy E. Smith, Chair
Members, Joint Standing Committee on Business,
Research and Economic Development
100 State House Station
Augusta, ME 04333-0100

Subject: Analysis of Savings from and Benefits of Tax-Exempt Financing

Dear Committee Members:

Pursuant to 10 MRSA Sec. 363, please find under this cover the above referenced report along with the Independent Accountants Report on Applying Agreed Upon Procedures.

Sincerely,

Dale McCormick
Director

DM/pme
Enclosure

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MAINE STATE HOUSING AUTHORITY

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The Board of Commissioners
Maine State Housing Authority
Governor of the State of Maine
The Joint Standing Committee for Business, Research and Economic Development

We have performed the procedures in Appendix A, which were agreed to by the Maine State Housing Authority, and the Joint Standing Committee for Business, Research and Economic Development (the Committee), solely to assist you with respect to the requirements of the State of Maine 10 MRSA Sec. 363, subsection 11. The Maine State Housing Authority is responsible for the preparation of the "Benefit of 2009 Single Family Issues" (Schedule 1). This engagement to apply agreed-upon procedures was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed and our findings are summarized in Appendix A.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on Schedule 1. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of Maine State Housing Authority, the Governor of the State of Maine and the Committee and is not intended to be and should not be used by anyone other than these specified parties.

Baker Newman & Noyes
Limited Liability Company

Portland, Maine
March 23, 2010

APPENDIX A

INDEPENDENT ACCOUNTANTS' PROCEDURES PURSUANT TO 10 MRSA SEC. 363

We obtained the "Benefit of 2009 Single Family Issues" Schedule ("Schedule 1") prepared by the Maine State Housing Authority (MaineHousing) which lists the tax-exempt bonds issued in 2009 and performed the following:

1. We agreed the Lendable Proceeds for the Single Family bond issues which were 2009 Series A, 2009 Series B, 2009 Series C and 2009 Series D/E to the estimated uses of funds schedule contained in the Official Statement for the corresponding bonds.

2. We compared the average mortgage rate of the lendable Single Family proceeds produced in 2009 by MaineHousing, of 5.35% for Series A, Series B and Series C, and 5.40% for Series D/E to MaineHousing records. The 5.35% for Series A, Series B and Series C agreed to MaineHousing's records being rounded up to the next highest .05%. The Series D/E agreed to the estimated average mortgage rate per the related Official Statement.

3. We agreed the statement that applications referenced in the fourth paragraph on page 5 were less than $3 million to a report prepared by MaineHousing.

4. We agreed the average rate of 5.35% – 5.40% referenced in the "Gift of Green" paragraph on page 5 to the average mortgage rate by bond series in the table at the top of page 5.

5. We agreed the statement that applications referenced in the "Gift of Green" paragraph on page 5 were approximately $140 million to a report prepared by MaineHousing.

ANALYSIS OF SAVINGS FROM AND BENEFITS OF TAX-EXEMPT FINANCING

In 2009, the Maine State Housing Authority (MaineHousing) issued tax exempt bonds in the aggregate principal amount of $147,680,000. The proceeds of the issues were used to fund required debt service reserves, pay the cost of issuance, pay the underwriters fees, and to make or purchase new mortgage loans. The issues, which were all for single-family mortgages, generated $137 million of lendable proceeds for MaineHousing's programs.

In 2009, MaineHousing purchased $129 million in mortgage loans; substantially all of which qualified for tax-exempt financing. About $37 million of the bond proceeds used in these purchases were generated in bond sales from prior years or surplus monies. At year-end $45 million of lendable proceeds remained from 2009 bond sales.

BOND ISSUANCE AND BOND CAP USAGE

In 2009, MaineHousing issued $147,680,000 of tax exempt bonds but only expended $101,677,227 in Private Activity Bond cap. That means that over $46 million of MaineHousing's issues in 2009 did not require an allocation of bond cap. The three mechanisms used by MaineHousing to issue private activity bonds without utilizing bond cap are explained below:

1. **<u>Refunding:</u>** When the proceeds of a tax-exempt bond sale are used to redeem the outstanding bonds of a prior issue, private purpose bond cap is not required. MaineHousing did not sell any bond refunding issues in 2009.
2. **<u>501(c)(3) Multifamily Bonds:</u>** Bonds sold to fund a qualified low-income project, which is owned by a 501(c)(3) entity, do not require private activity bond cap. MaineHousing did not sell any 501(c)(3) bonds in 2009.
3. **<u>Replacement Refundings:</u>** The tax code allows that if, within 90 days of the issuance of new bonds, bonds of similar tax status are retired, that the new bonds in an amount equal to the redeemed bonds may be deemed to be replacing the prior bonds and do not require a bond cap allocation. By using $46 million of mortgage prepayments or surplus earnings to redeem prior, higher rate bonds, MaineHousing was, in effect, able to recycle bond cap allocation from prior years into tax-exempt program money in 2009.

MULTIFAMILY BOND AND THE LOW INCOME HOUSING TAX CREDIT (LIHTC)

Multifamily bonds issued from an allocation of the private activity bond cap produce an additional allocation of the LIHTC equal to 10 years of an annual tax credit equal to 4% of the cost of the low income units in a project. This tax credit is then sold to investors to produce equity capital for the project, thereby reducing the amount of debt required.

Example: A 20-unit project is being built for low-income tenants. The cost is $50,000 / unit or $1,000,000. The project, if financed with private activity bonds, would be eligible for $40,000 of annual tax credits for 10 years or a total of $400,000. Investors are currently paying approximately 95 cents on the dollar, which in this example would generate $380,000 of equity for the project. The required financing would be thereby reduced from $1 million to $620,000. If the interest rate on the $620,000 mortgage is 6.5%, the rate on a $1 million mortgage would have to be under 3% to produce the same payment. The LIHTC, therefore, supplements the impact of the lower rate by replacing debt with equity.

INCOME TARGETING: SINGLE FAMILY

The single-family program is restricted to first time homebuyers who are Maine residents buying a principal residence. The income of the borrowers may not exceed 115% of the area median and the purchase price of the residence may not exceed 110% of the area median. In 2009, the average loan size was about $125,000. The average family income was $45,000.

INCOME TARGETING: MULTIFAMILY

In multifamily projects financed with the proceeds of tax-exempt bonds, the benefits of the tax-exempt mortgage rates are passed along to tenants in the form of below market rents. The tax code requires either 20% of the units must be affordable for families at 50% of the area median income or 40% of the units for families at 60% of the area median income. The computation assumes that 30% of gross monthly income is available for rent.

In almost every program, MaineHousing requires even greater affordability than the tax code.

In multifamily projects the benefits of tax exempt financing should be measured by the rent differential between market rents and rents in the low-income units.

2009 Mortgage Purchase Program (MPP) Bond Issues - Sources and Uses of Funds

Type of Issue	2009A Single Family	2009B Single Family	2009C Single Family	2009D/E Single Family	TOTAL MPP BOND ISSUES
SOURCES:					
Principal of Bonds	25,000,000	30,000,000	22,680,000	70,000,000	147,680,000
MaineHousing Contribution	–	–	–	729,490	729,490
Original Issue Premium	–	–	42,226	–	42,226
TOTAL SOURCES	**25,000,000**	**30,000,000**	**22,722,226**	**70,729,490**	**148,451,716**
USES:					
Purchase of Non-Mortgage Investments	–	–	–	–	–
Purchase of Mortgages	23,115,000	27,059,000	20,600,000	66,000,000	136,774,000
Refunding of Prior Bonds	–	–	–	–	–
Premium of Prior Bonds	–	–	–	–	–
Debt Service Reserve	1,500,000	2,500,000	1,760,000	4,000,000	9,760,000
Cost of Issuance	175,000	175,000	149,000	380,000	879,000
Underwriters Fee/Discount	210,000	266,000	213,226	349,490	1,038,716
TOTAL USES	**25,000,000**	**30,000,000**	**22,722,226**	**70,729,490**	**148,451,716**
BOND CAP USED	**6,955,000**	**30,000,000**	**22,722,227**	**42,000,000**	**101,677,227**

Note: 2009C has a $1 difference due to rounding on the premium

I. BOND CAP AVAILABLE IN 2009

Carryforward from prior years	369,712,740
HERA Carryforward from 2008	96,550,479
Initial Allocation in 2009	50,000,000
Re-allocation during 2009	223,270,000
Total Available	739,533,219

BOND CAP USED IN 2009	101,677,227
CARRYFORWARD TO 2010	637,855,992

SCHEDULE 1

BENEFIT OF 2009 SINGLE FAMILY ISSUES

Issue	Lendable Proceeds	Average Mortgage Rate
2009 Series A	$23,115,000	5.35%
2009 Series B	$27,059,000	5.35%
2009 Series C	$20,600,000	5.35%
2009 Series D/E	$66,000,000	5.40%

The weighted average rate of the lendable single family proceeds produced in 2009 by MaineHousing as shown above is 5.35% - 5.40%. MaineHousing's mortgages were substantially all level payment, 30 year term mortgages. We estimate that closing cost grants made in connection with the mortgages funded with the proceeds of the 2009 bonds will average about 3% of the mortgage amount. The Gift of Green closing cost program is described below. Assuming average prepayment experience, the grants lower the effective rate to the borrower by about 50 basis points, to the 4.85% to 4.90% range.

A good proxy for market rates is the Fannie Mae 60 day Commitment Rate plus a servicing fee, which is included in the mortgage rate and averages 25 basis points. In 2009, the average of this market indicator, taken in each of the 52 weeks, was about 5.00% - 5.05%.

In prior years the benefit of MaineHousing's tax exempt bond funded first time homebuyer program has been achieved by comparing the average 30 year mortgage rate produced by MaineHousing's bond sales to the average rate during the year of Fannie Mae 60 Day Commitment Rate. The disruption and turbulence in both the tax exempt and taxable mortgage markets in 2009 were so massive that a simple comparison of these averages would be misleading.

In the last quarter of 2008 there was a dramatic flight to U.S. Treasury securities. The tax exempt market, especially the institutional buyers for longer housing maturities, was non-existent. In the first 5 months of 2009 MaineHousing's offered rate ranged between 5.55% and 6.35%. During this period the Fannie Mae 60 Day commitment rate averaged well below 5.00% but credit standards were so extreme that many potential buyers found credit unavailable. Applications for MaineHousing's mortgage product during the first 5 months of 2009 were less than $3 million. The real estate market was very sluggish.

Gift of Green

The $8,000 federal tax credit for first time homebuyers was announced in the spring of 2009. MaineHousing decided to leverage the federal credit by offering a program, which opened on June 15, 2009, whereby the MaineHousing mortgage product would be accompanied by a cash grant, equal to 4% of the mortgage, up to $5,000. In November 2009 the grant was reduced to $2,500. In addition, each MaineHousing First Time Homebuyer would get a $500 coupon which could be used for an energy audit of their new home. The note rate for this program ranged between 4.95% and 5.50% during 2009 with an estimated average rate of 5.35% - 5.40%. Over 1,100 applications were received during this period for approximately $140 million. Until December 2009, market rates were generally over 5.00% but access remained problematic for many potential homebuyers. The application activity for the Gift of Green program was the best in recent memory for the MaineHousing single family program.

Funding the Gift of Green Program

When the Gift of Green program was launched the worst case funding scenario was that the bond market couldn't provide funds and that the program would end when the $80 million of available liquid funds had been applied for. The Maine retail bond market however, which focuses on shorter maturities, had returned by the summer of 2009.

2009 Series A, 2009 Series B and 2009 Series C were issued between July and October of 2009. These issues all were concentrated on Maine retail. The longest maturity in these issues was 2029. In a normal environment, approximately 50% of the maturities would have been beyond the 2029 date. The institutions which normally purchase the longer maturities had not returned to the market during this period.

Funding a 30 year mortgage program with structures of such short duration was not a sustainable practice.

The GSE Program for State HFA's

Late in 2009, Fannie Mae and Freddie Mac (collectively, the "GSE's"), functioning as agents of the U.S. Treasury, launched a bond purchase program for State housing finance agencies ("HFA's") whereby the GSE would purchase up to 60% of a bond issue at an indexed rate through the end of 2010. MaineHousing was awarded $145 million of capacity in the single family GSE program at a bond rate of 3.96%. 2009 Series E for $42 million, which represents 60% of the combined 2009 Series D/E bond issue of $70 million, was the first rollout of the GSE program. MaineHousing expects to rollout the remaining $103 million of 30 year bonds in 2010 as 60% components of up to 3 bond issues.

Summary of 2009 Benefits

MaineHousing was able to offer the Gift of Green program due to the underlying strength and credit rating (Aa1/AA+) of its tax exempt Mortgage Purchase Program Bond Resolution. Unlike past years where the benefit of the tax exempt funded program was mainly the lower rate, in 2009 the benefit came from the up to $5,000 grant which could be used to pay closing costs. We feel that this helped many Maine families benefit from the $8,000 federal tax credit and by doing this, helped to revive and sustain the real estate market in Maine.