MaineHousing
Maine State Housing Authority

Analysis of Savings from and Benefits of Tax-Exempt Financing

Pursuant to 10 MRSA Sec. 363

March 2012

MAINE STATE HOUSING AUTHORITY

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INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED UPON PROCEDURES

The Board of Commissioners
Maine State Housing Authority
Governor of the State of Maine
The Joint Standing Committee on Labor, Commerce, 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 on Labor, Commerce, 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 2011 Single Family Issues" (Schedule 1) and the "Benefit of 2011 Multi-Family Issues" (Schedule 2). 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 or Schedule 2. 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 13, 2012

INDEPENDENT ACCOUNTANTS' PROCEDURES PURSUANT TO 10 MRSA SEC. 363

We obtained the "Benefit of 2011 Single Family Issues" Schedule (Schedule 1) and the "Benefit of 2011 Multi-Family Issues" Schedule (Schedule 2), prepared by the Maine State Housing Authority (MaineHousing) which lists the tax-exempt bonds issued in 2011 and performed the following:

1. We agreed the Lendable Proceeds for the Single Family bond issues in Schedule 1, which were 2011 Series A/2009 F-3 and 2011 Series D/2009 F-4, to the estimated uses of funds schedule contained in the Official Statement for the corresponding bonds.

2. We agreed the Lendable Proceeds for the Multi-Family bond issues in Schedule 2, which were 2011 Series B, C, and E, to the estimated uses of funds schedule contained in the Official Statement for the corresponding bonds.

3. We agreed the average mortgage rate of the lendable Single Family proceeds produced in 2011 by MaineHousing of 4.60% to the estimated average mortgage rate in the related Official Statement.

4. We agreed the average Fannie Mae 60 day commitment rate, shown on page 6, of 4.80%, rounded to the nearest 0.05%, for the first half of 2011, to the average of the Fannie Mae 60 Day Forward Commitment Rate obtained from Bloomberg Data for 2011, as provided by MaineHousing, plus 25 basis points for servicing.

ANALYSIS OF SAVINGS FROM AND BENEFITS OF TAX-EXEMPT FINANCING

In 2011, the Maine State Housing Authority (MaineHousing) issued or converted tax exempt private activity bonds in the aggregate principal amount of $155,895,000 in its Mortgage Purchase Program (MPP) Bond Resolution. The proceeds of the issues were used to fund required debt service reserves, pay the cost of issuance, pay the underwriters fees, refund outstanding bonds, and to make or purchase new single family and multi-family mortgage loans. The issues generated $98 million of lendable proceeds for MaineHousing's programs.

In 2011, MaineHousing purchased $116 million in mortgage loans; substantially all of which qualified for tax-exempt financing. About $45 million of the bond proceeds used in these purchases were generated in bond sales from prior years or surplus monies. At year-end $27 million of lendable proceeds remained from 2011 bond sales.

BOND ISSUANCE AND BOND CAP USAGE

In 2011, MaineHousing issued or converted $155,895,000 of tax exempt housing bonds but only expended $104,000,000 in Private Activity Bond cap. That means that approximately $52 million of MaineHousing's issues in 2011 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. **Refunding:** 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 sold $50,600,000 of bond refundings in 2011.
2. **501(c)(3) Multifamily Bonds:** 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 2011.
3. **Replacement Refundings:** The tax code allows that if, within 90 days 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. MaineHousing did not sell any replacement refunding bonds in 2011.

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 $100,000 / unit or $2,000,000. The project, if financed with private activity bonds, would be eligible for $80,000 of annual tax credits for 10 years or a total of $800,000. Investors are currently paying approximately 80 cents on the dollar, which in this example would generate $640,000 of equity for the project. The required financing would be thereby reduced from $2 million to $1,360,000. If the interest rate on the $1,360,000 mortgage is 6.5%, the rate on a $2 million mortgage would have to be 3.125% to produce the same monthly payments. 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 2011, the average loan size was about $122,000. The average family income was $50,000.

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 or rewards even greater affordability than the tax code.

In multifamily projects the benefits of tax exempt financing should be measured by the rent differential, in units of similar quality and desirability, between market rents and rents in the low-income units in the same locale. In addition, it is important to ascertain the benefits of the economic activity generated by the construction or rehabilitation of the units.

2011 Mortgage Purchase Program (MPP) Bond Issues - Sources and Uses of Funds

Type of Issue	2011A/2009F-3 Single Family	2011B Multi-Family	2011C Multi-Family	2011D/2009F-4 Single Family	2011E Multi-Family	**TOTAL MPP BOND ISSUES**
<u>SOURCES:</u>						
Principal of Bonds	40,000,000	29,325,000	33,320,000	40,000,000	13,250,000	155,895,000
MaineHousing Contribution	-	436,175	413,083	-	-	849,258
TOTAL SOURCES	**40,000,000**	**29,761,175**	**33,733,083**	**40,000,000**	**13,250,000**	156,744,258
<u>USES:</u>						
Purchase of Mortgages	37,400,093	4,750,000	6,000,000	37,282,577	12,100,000	97,532,670
Refunding of Prior Bonds	-	24,575,000	27,320,000	-	-	51,895,000
Debt Service Reserve	2,300,000	-	-	2,400,000	890,000	5,590,000
Cost of Issuance	150,000	190,000	150,000	150,000	148,212	788,212
Underwriters Fee/Discount	149,907	246,175	263,083	167,423	111,788	938,376
TOTAL SOURCES	**40,000,000**	**29,761,175**	**33,733,083**	**40,000,000**	**13,250,000**	156,744,258
BOND CAP USED	**40,000,000**	**4,750,000**	**6,000,000**	**40,000,000**	**13,250,000**	**104,000,000**

I. BOND CAP AVAILABLE IN 2011

Carryforward from prior years	$ 725,755,000
Initial Allocation in 2011	40,000,000
Re-allocation during 2011	207,820,000
Total Available	$ 973,575,000
BOND CAP USED IN 2011	$ 104,000,000
BOND CAP EXPIRING ON 12/31/11	$ 118,710,000
CARRYFORWARD TO 2012	$ 750,865,000

SCHEDULE 1

BENEFIT OF 2011 SINGLE FAMILY ISSUES

Issue	Lendable Proceeds	Average Mortgage Rate
2011 Series A/2009F-3	$37,400,093	4.60%
2011 Series D/2009F-4	$37,282,577	4.60%

The weighted average rate of the lendable single family proceeds produced in 2011 by MaineHousing as shown above was 4.60%. 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 2011 bonds will average about 2% 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 35 basis points, to approximately 4.25%.

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 2011, the average of this market indicator, taken on each business day, was about 4.40%. This 4.40% average market rate was a function of a steady downward trend during the year. Average market rates dropped from an average of about 4.90% in the 1st quarter to about 3.90% in the 4th quarter. By the end of the year, market rates were under the MaineHousing rate and demand for the tax-exempt product dropped off significantly.

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 loans purchased in 2011 were almost exclusively from the $2,500 program.

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's would purchase up to 60% of a bond issue at a rate indexed to the 10 year U. S. Treasury bond through the end of 2011. MaineHousing was awarded $145 million of capacity in the single family GSE program. Three bond issues used this GSE program to fund MaineHousing's single family program in 2009 and 2010. In the middle of 2010 the GSE's announced that the program would be extended through 2011. MaineHousing had $46 million of the original $145 million allocation to use for 2011 programs. During 2011, as part of the GSE program, $24,000,000 of the GSE escrow bonds were converted to tax-exempt bonds at a rate of 3.70% in connection with the issuance of $16,000,000 of the 2011 Series A Bonds. Later in the year, the remaining

$22,000,000 of GSE escrow bonds were converted to a tax-exempt rate of 2.47% in connection with the issuance of $18,000,000 of the 2011 Series D Bonds.

Summary of 2011 Benefits

The MaineHousing single family program, featuring the Gift of Green down payment assistance, provided a significant benefit to Maine homebuyers, especially in the first half of 2011. The actual average rate of the MaineHousing program was about 4.60%. This was about 20 basis points below the average market rate of about 4.80% in the first half of 2011 using the Fannie Mae 60 day Commitment Rate plus 25 basis points as a proxy. On the average $118,000 mortgage the 20 basis points saved our borrowers about $20 per month or $240 per year. The more significant benefit came from the Gift of Green grant which averaged about 2% of the mortgage amount or $2,500 per MaineHousing borrower.

The benefit was largely the result of the subsidy provided by the GSE program which provided below market interest rates on MaineHousing bonds. Since MaineHousing has no more authority under the GSE program, continued market normalization will be required to provide a similar subsidy with unassisted bond issues.

SCHEDULE 2

BENEFIT OF 2011 MULTI-FAMILY ISSUES

Issue	Lendable Proceeds
2011 Series B	$4,750,000
2011 Series C	$6,000,000
2011 Series E	$12,100,000

MaineHousing issued the 3 bond issues in 2011 to refund a total of $51,895,000 in prior bonds and to construct and rehabilitate 254 units in nine projects with the $22,850,000 of lendable proceeds. The major benefit of MaineHousing's tax-exempt bond funded loan program is not in the interest rate but in the loan terms and in the equity that is generated by the tax credit, which is available when tax-exempt financing is used.

Many of the 30 year loans financed with the tax-exempt proceeds have interest only payments for the first 15 years or, in some cases, for the entire 30 year life of the loan. A 6% interest only loan has substantially the same monthly payment as a 4.375% 30 year amortizing loan. Our ability to extend the duration of the loan has the same impact on the cash flow of the project as a 1.625% lower interest rate on a 30 year level payment loan.

Probably the biggest benefit of the tax-exempt program comes from the 4% LIHTC, which is available with the financing. The nine projects expected to be financed with the proceeds of 2011 multi-family bond issues are expected to generate over $13 million in equity from the sale of the tax credit. By replacing debt, this equity lowers the debt service of the projects and subsidizes the below market rents required by the tax code.