REPORT OF THE
JOINT LEGISLATIVE
AUDIT AND REVIEW COMMISSION ON

The Virginia Housing Development Authority

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

Senate Document No. 6

COMMONWEALTH OF VIRGINIA
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PREFACE

Senate Joint Resolution 7 of the 1984 Session of the General Assembly dirested the Joint Legislative Audit and Review Commission (JLARC) to evaluate the programs, operations, and management of the Virginia Housing Development Authority (VHDA). Our review of VHDA included assessments of single-family and multi-family programs designed to provide affordable housing for low- and moderate-income Virginians. In addition, we reviewed the financing of programs, and the management of the agency.

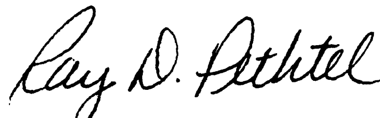
In general, we found that VHDA is well managed, and is regarded by municipal bond experts as one of the financially strongest state housing finance agencies in the nation. VHDA programs have provided quality housing to more than 64,000 families.

In the future, VHDA will need to do more to serve low-income clients. Recent cuts in federal housing subsidy programs have shifted the primary responsibility for low-income housing to the states. We found, however, that VHDA's current conventional rental program is not designed to serve significant numbers of low-income families. In addition, we found that one fourth of the mortgage loans made by VHDA went to applicants with sufficient income to qualify for loans in the conventional market. VHDA could do more to make home ownership affordable to low- and moderate-income Virginians by restricting the loans to those unable to qualify for conventional financing.

The mandate for our review of VHDA also directed us to assess the appropriateness of the moral obligation pledge on the authority's bonds. VHDA's strong financial position now makes it possible to issue single-family bonds without that pledge. The authority has chosen to issue recent bonds without the pledge, and the General Assembly may wish to restrict its use permanently. However, it may be necessary to retain the pledge on multi-family bonds.

In the course of our review, we also found that VHDA now has one of the largest general fund balances of any housing finance agency in the country. Though a large portion of the fund balances are unallocated, and could be used for additional housing programs, VHDA has no plans to use the funds. Given the continued need for low cost housing in Virginia, and the cuts in federal assistance, we believe VHDA should reconsider its decision not to use such funds for housing programs.

On behalf of the Commission staff, I wish to acknowledge the cooperation and assistance provided by the staff of VHDA in the preparation of this report.



Ray D. Pethtel
Director

October 30, 1985

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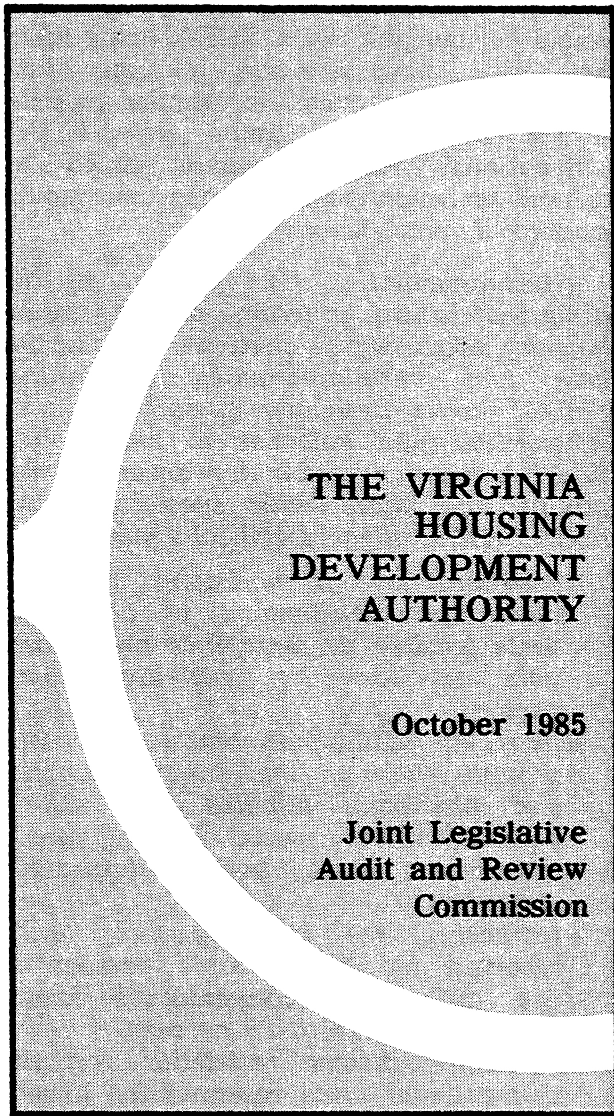


The Virginia Housing Development Authority (VHDA) was established in 1972 as a political subdivision of the State to assist low- and moderate-income families in obtaining affordable, safe, and sanitary housing not available from private sources. As of December 31, 1984, over 32,000 families have received loans to purchase single-family dwellings. In addition, VHDA has financed 32,334 rental units in 211 developments located across the State. The authority is the eighth largest financial institution in Virginia in terms of assets.

The types of individuals and families served by VHDA programs vary according to eligibility requirements, the amount of financial assistance provided, and the general conditions of the housing market. VHDA's enabling statutes do not specifically define "low" and "moderate" income. In some programs, VHDA is required to use federal income definitions, while in others it has established its own eligibility requirements.

The financing for VHDA programs comes principally from the sale of revenue bonds. Because the bonds are exempt from federal and State taxes, VHDA loans carry interest rates below private market financing. Although no State-appropriated funds are involved, most VHDA bonds issued through 1981 carried the "moral obligation" backing of the Commonwealth, and over half of the outstanding bonds carry such obligation. Since 1981, however, less than 15 percent of VHDA's bonds have been issued with the moral obligation backing.

A JLARC REPORT SUMMARY

Concerns about the housing needs of low- and moderate-income families, the effectiveness of mortgage revenue bonds as a viable financing method, and the State's moral obligation to back VHDA's $1.2 billion bond indebtedness led the 1984 General Assembly to direct JLARC to evaluate the programs, operations, and management of VHDA. Specific points of interest mentioned in Senate Joint Resolution 7 are:

- the activities of VHDA supported by mortgage revenue bonds,
- the extent to which the programs have benefited persons of low and moderate income,
- VHDA's definition of low and moderate income,
- the operations, management, and administration of VHDA, and
- other matters deemed appropriate by the JLARC staff.

In general, JLARC found that VHDA is regarded by municipal bond experts as one of the financially strongest housing finance agencies in the country. Greater efforts are needed, however, to better target the authority's housing programs to serve low- and moderate-income persons whose needs are not

met in the private market. Such efforts are particularly important given the funding and program changes at the federal level and the continued need for affordable housing opportunities in the State. JLARC found that although VHDA's programs will not be able to entirely fill the void, the authority's strong financial position could enable it to fund additional programs and modify existing programs to reduce the impact of federal housing cuts.

Multi-Family Development and Monitoring (pp. 11 - 34)

VHDA has provided loans for the construction and rehabilitation of nearly 200 subsidized and non-subsidized rental projects and administers federal rent subsidies. The authority sets eligibility guidelines for its rental programs and selects projects to finance. VHDA also has continued oversight responsibilities for the financial and physical condition of its projects.

Need for Low- and Moderate-Income Rental Housing. Although about 80 percent of the rental units financed to date have housed low- and very-low income persons, VHDA's current multi-family program is focused on financing non-subsidized rental projects for moderate-income households. Households having gross annual incomes as high as $49,500 can live in some of the authority's non-subsidized apartments. This change in emphasis has coincided with the dramatic reduction in federal housing programs, and leaves the State without a program to add significantly to the number of rental units affordable to most lower-income households. Furthermore, the Governor's Commission on Virginia's Future reported in 1984 that "some recent shifts in the rental market . . . are making it harder for [low- and moderate-income citizens] to find suitable housing at affordable prices."

JLARC's review found that VHDA's "seven-times test" for its conventional rental projects enables some high-income households to occupy these units. VHDA's eligibility limits for most projects are above area median incomes and the authority's income limits for its homeownership program. As a result, some households which are eligible to occupy a VHDA conventional apartment would be ineligible for a VHDA home mortgage loan. These indicators, and the limits imposed by other states for similar projects, suggest that income limits for VHDA's conventional rental program could be reduced to better target lower income groups in need of rental housing.

Recommendation (1). In light of the decline of federal programs and the rental housing needs which continue to exist for low- and very-low-income Virginians, VHDA should designate a portion of its substantial fund-balances to make additional housing available for lower income groups and those with special housing needs. VHDA might specifically consider:

- *providing low- or no-interest loans to make the development of additional units feasible at rents that are affordable to low- or very-low-income persons;*
- *financing additional rental units for groups, such as the State's mentally and physically disabled and elderly persons, whose special housing needs may not have been adequately addressed;*
- *increasing the percentage of units reserved for lower-income persons in the authority's conventional rental projects from 20 to 25 percent;*
- *tightening income restrictions on the conventional units reserved for lower-income groups by establishing different standards based on tenant household size; and*
- *providing direct rental subsidies for lower-income tenants.*

Recommendation (2). VHDA should replace the current seven-times test for determining eligibility for its conventional rental units with a standard that more closely approximates the authority's single-family loan limits and better targets the households which VHDA was mandated to serve. The authority could set its standard at 120 percent of the area median income for future conventional project tenants. This standard would lower income eligibility and would not be tied to a given unit's rent.

Multi-Family Development Selection. VHDA appears to have made sound financial decisions in its selection of multi-family developments. However, improvements in the processes used to select projects and developers are needed.

Although broad regulatory guidelines and *Code* provisions help guide the authority's multi-family financing decisions, VHDA has not developed specific selection criteria. The absence of written selection criteria has contributed to VHDA financing some projects which have extraordinary development costs and rents. Such projects might experience marketing difficulties in the future. The use of written criteria would help VHDA staff to determine if an application satisfies the intent of statutory and regulatory guidelines.

Although VHDA has made loans to about 70 private developers, 35 percent of all projects financed as of November 1984 were sponsored by six developers. The number of loans awarded to three developers account for 28 percent of the total selections and 21 percent of the total dollar amounts awarded. Only four projects were totally or partially sponsored by minority developers. While not all experienced developers are interested in becoming involved with government-financed projects, these figures and the responses to a JLARC telephone survey of 20 developers raise questions about the openness of VHDA's loan award process. Limitations on the amount of loan dollars awarded to any one borrower, such as those imposed on private lenders by State and federal laws, would serve as an additional financial safeguard for the authority in the event a developer defaulted, and would encourage a competitive process. In addition, the authority needs to take steps to increase the level of minority participation in its multi-family development program.

Recommendation (3). In light of its public responsibility to serve low- and moderate-income Virginians, VHDA should participate in projects with rents affordable to those income groups. VHDA should develop and use written criteria to review and select proposals under its Conventional Loan Program. Written selection criteria – developed before proposals are accepted for review – should ensure that uniform consideration is given to each proposal, and should serve as a guide to prospective applicants. The authority may wish to reconsider its practice of financing projects which are in direct competition with other VHDA conventional projects already under development.

Recommendation (4). The authority should prepare and maintain written summaries detailing the selection criteria used to evaluate each multi-family proposal, how well the proposal met the criteria, and the rationale for final selection decisions. The summaries should serve as a written public record of the authority's financing decisions.

Recommendation (5). VHDA should consider limiting the amount of outstanding loan commitments awarded to any one developer. Such a provision would reduce the potential impact that a single borrower's default could have on the authority's finances and should signify that VHDA intends to encourage more participation by all developers.

Recommendation (6). VHDA should establish a goal to have minority developers, contractors, and subcontractors involved in at least three to five percent of its outstanding loan awards. Key elements to ensure that its goal is met include the development of a plan by VHDA to encourage the participation of minorities in the development process and a mechanism to monitor compliance with the goal.

Monitoring VHDA Rental Projects. State law grants VHDA the power to oversee the projects constructed with funds from its bonds. VHDA's oversight activities include evaluating property management, monitoring the financial and physical condition of each project, certifying tenant eligibility, and monitoring federal housing assistance payments for subsidized projects. VHDA housing management staff approve increases in rents for its conventional projects, and management agent fees for all projects.

JLARC found that the authority's control of rent increases and supervision of management agents have been inconsistent for some

owners and management companies. These inconsistencies reduce VHDA's ability to effectively control rents and management fees, directly affect the affordability of its rental properties, and could weaken VHDA's rental portfolio.

Weaknesses also exist in the internal operations of the Housing Management Division which, if continued, could negatively affect the authority's monitoring functions. These include the lack of formalized oversight policies and the failure to perform required project inspections.

Recommendation (7). VHDA should ensure that its oversight responsibilities for multi-family projects are implemented consistently. Precise criteria should be developed to identify the conditions under which rent increases will be granted. Guidelines should ensure that a management fee increase for "superior performance" is not granted to any agent who consistently violates the authority's housing management practices. Moreover, since such decisions directly affect who can be served by the authority's rental properties, VHDA's Board of Commissioners should approve increases in project rents and management fees.

Recommendation (8). VHDA should develop a written operations manual outlining prescribed housing management procedures. In addition, VHDA management should ensure that all required project inspections are completed in a timely fashion.

Single Family Home Loans (pp. 35 - 54)

Single-family home mortgages comprise two-thirds of the authority's lending activity. As required by federal law, VHDA's homeownership program serves low- and moderate-income persons purchasing their first homes. VHDA sets the eligibility requirements and determines the methods used to process loan applications and collect mortgage payments. The average cost of homes financed by VHDA in FY 1984 was $51,756, and the median household income was over $24,000.

Homebuyers Served by VHDA. Section 36-55.33:1(C2) of the *Code of Virginia* charges VHDA to make its loans only after determining that a loan "is not otherwise available from lenders upon reasonably equivalent terms and conditions. . . ." Despite statutory and regulatory provisions, VHDA does not have an adequate means for determining if loan applicants are eligible for conventional mortgages. Consequently, JLARC found that 2,888 (23 percent) of all VHDA's home loan commitments during the past four years, totaling $113.7 million, were made to applicants with sufficient income to qualify for conventional, private loans. Had VHDA excluded applicants qualified for conventional mortgages, more VHDA mortgage funds would have been available for persons unable to qualify for private mortgages.

JLARC's review also found that VHDA's sale price and income limits – the two principal eligibility requirements that VHDA uses to target its home loan program – need adjusting in order to more adequately reflect family size and geographic differences in housing markets. In addition, measures are needed by VHDA to better assist Virginians living in economically-depressed areas (designated as "targeted areas") and those families who qualify under the authority's eligibility guidelines but cannot afford the up-front costs associated with mortgage loans.

Recommendation (9). VHDA loans should be made only after verification that applicants are not qualified for "reasonably similar" mortgages from conventional lenders. Lenders originating VHDA loans should be required to make such a verification by computing the minimum income required for each applicant to qualify for a conventional loan at the current interest rates. VHDA should require that a worksheet with these calculations be submitted as part of each loan application. VHDA's loan officers should review the worksheets to verify eligibility for VHDA financing. Applicants that have sufficient income to qualify for conventional loans should be permitted to submit documents verifying that they were denied conventional financing for income reasons. Upon submission of such evidence, VHDA might

reconsider the application for further processing.

Recommendation (10). To recognize differences in housing costs and more equitably serve households across the State, VHDA should make additional distinctions within its sales price limits by separating the high-cost areas from other areas currently within the "remainder of State" category. The Board of Commissioners should adopt separate sales price limits for each of these areas. Sales price limits should be based on periodic surveys of home sales prices throughout the Commonwealth.

Recommendation (11). VHDA should adjust its income limits to better reflect geographic differences in area median incomes. VHDA should divide areas with high median incomes from other areas currently grouped with the "remainder of State" category. The Board of Commissioners should adopt separate income limits for these high-income areas.

Recommendation (12). VHDA should establish a separate income limit for one-person households. The Board of Commissioners may also wish to reimpose a limit on the amount of loans available for single-person households equal to their proportion of the State population.

Recommendation (13). VHDA should utilize additional methods to increase the commitment of loans in rural and inner-city areas. The authority should become involved in additional training for VHDA-approved lenders in these areas, increased promotional efforts, preparation and distribution of detailed maps and inventories of eligible neighborhoods, and exploration of innovative financing techniques for home rehabilitation loans. Appropriate exceptions to the authority's underwriting standards should also be developed to account for special circumstances that may exist in rural and inner-city areas.

Recommendation (14). VHDA should establish a program to assist lower-income applicants with paying the costs of taking out a home loan. To this end, the authority might consider setting aside a portion of its fund balances to assist eligible families with down payments, application fees, mortgage insurance, and closing costs. The assistance could be offered as a loan or a subsidy.

Processing and Collecting Mortgage Loans. In addition to establishing eligibility requirements, VHDA staff are also involved in reviewing and approving loan applications. VHDA-approved lenders are responsible for collecting monthly mortgage payments. VHDA's loan servicing staff establish collection policies and monitor lenders to ensure that the collection of mortgage payments is accurate and timely.

JLARC's review of these functions found that VHDA could process applications in a more timely manner. In addition, VHDA loan collection procedures – which are more aggressive than most other lenders – were found to have contributed to low loan delinquency rates. However, these procedures should be reexamined by the authority to ensure that they do not contribute to unnecessary foreclosures.

Recommendation (15). To expedite loan processing, VHDA should consider releasing mortgage funds at a rate that can be efficiently processed by staff, instituting computer and supervisory checks on processing durations, and providing additional training for lenders originating VHDA loans.

Recommendation (16). Although the authority's collection policies have contributed to its consistently low delinquency rates, VHDA should review its policies to ensure that they do not result in unnecessary foreclosures. The authority should seek the advice of its approved lenders on specific ways its collection policies might be modified.

Financing VHDA Programs (pp. 55 - 66)

The financial position of VHDA is reported by municipal bond experts to be among the best in the nation for state housing finance agencies. The authority is the eighth largest financial institution in Virginia in terms of assets. The authority's strong financial position has enabled it to obtain favorable bond ratings and attractive interest rates. Such a position also minimizes

the likelihood that the State's "moral obligation" pledge will ever be called upon to replenish the authority's bond reserves and suggests that a portion of the authority's fund balances exceeding $160 million could be used for additional housing purposes.

Moral Obligation Pledge. Virginia law clearly states that VHDA's bonds do not constitute a liability on the Commonwealth. However, State law contains a provision whereby the General Assembly is legally authorized, though not required, to appropriate State funds to replenish VHDA's capital reserve funds in the event that reserves are insufficient to meet its debt service requirements. Such a provision is commonly referred to as a "moral obligation" pledge in the municipal bond field.

JLARC staff reviewed the conditions under which the State might be called upon to back the authority's bond reserves. Given the existing level of bond security, favorable loan portfolio characteristics, and VHDA's overall financial strength, it appears highly unlikely that the State's moral obligation pledge will be called upon in the foreseeable future. Moreover, the authority's Director of Finance stated that "there is virtually no chance that VHDA will experience losses from a resolution which cannot be covered either by funds available in the resolution or . . . the authority's general fund." In addition, municipal bond analysts indicate that investors today place more emphasis on the financial record of the issuing authority than they did when the authority was created in 1972. Limiting the issuance of future bond debt that carries the moral obligation pledge would reduce the amount of bond debt viewed as a contingent liability aganst the State in the future.

Should the State decide to remove the moral obligation pledge from some or all future bond issues, it should convey to investors that such action does not represent a lack of faith in VHDA's bond activities. Rather, VHDA's secure financial position and its ability to stand alone enable the State to take such action.

Recommendation (17). The General Assembly may wish to amend Section 36-55.41(2) of the Code of Virginia to restrict the use of the State's moral obligation pledge on future single-family bonds unless prior approval is granted by the General Assembly. This action would reflect the practice which the authority has followed on single-family bonds since 1981, and would indicate the strength of these issues. Moreover, this action would limit the issuance of additional bond debt that would be viewed as a contingent liability against the Commonwealth.

Recommendation (18). VHDA should assess the effects of removing the moral obligation pledge from future multi-family bonds and report its findings to the General Assembly. Any recommended action should consider the additional costs to the authority and developers from structuring the bond issues without moral obligation, the alternatives available to compensate for removing the provision, and the potential impacts on future programs and clients.

Fund Balances. As of June 30, 1984, VHDA has accumulated $160 million in fund balances – a growth of $27 million from 1983. This represents the amount above the required levels of bond reserves and the authority's operating expenses, and includes one of the largest general funds of any housing agency in the country. Past investment earnings and VHDA's limited use of fund balances for programmatic purposes have contributed to the growth in the balances.

It appears, however, that the authority could now use a portion of the assets associated with the fund balances for additional housing programs without jeopardizing its strong financial position. Greater use of these funds would help to meet the continued housing needs of low- and moderate-income groups, and those with special needs, such as the physically and mentally handicapped. Use of fund balances can help to reduce the impact of federal cuts on Virginia's housing situation.

Recommendation (19). VHDA should make greater use of a portion of its fund balances to provide additional affordable housing, and to reduce the impacts of federal housing cuts. The assets associated

with the unallocated portion of VHDA's general fund balances (up to 20 percent) could be used for programs to meet the housing needs of low-income and disabled Virginians. The Board of Commissioners should review the appropriateness of the authority's general fund balance that is held as a contingency reserve. The board should establish the necessary contingency reserve at a level that promotes security for the authority's bonds while making the greatest feasible amount available for important housing programs.

Administration of the Authority (pp. 67 - 78)

VHDA is the primary source of State support for housing assistance programs in Virginia. It is essential that the authority properly manage its programs and resources to address the housing needs of low- and moderate-income Virginians. Three important ways in which VHDA can better manage its resources are by: (1) taking a lead role in planning and coordinating housing services; (2) including representation of client groups on the Board of Commissioners; and (3) ensuring that procurement practices conform to State requirements, that computer operations are effective and efficient, and that staffing levels and costs are appropriate.

Planning and Coordination. Revisions in federal housing programs and federal tax laws continue to have a significant impact on low-income housing programs in Virginia. Yet the 1984 report of the Governor's Commission on Virginia's Future cited a continued need for housing the poor, the physically and mentally handicapped, the elderly, and others not served by the private market. State and local housing agencies, including VHDA, need to coordinate their efforts to respond to the declining federal support and a continuing need for low- and moderate-income housing. In addition, VHDA needs its own long-range plan to ensure that its programs meet housing needs in the future. Such a plan would help to ensure that the authority is prepared to provide affordable housing even in the event of further reductions of federal support.

Recommendation (20). VHDA and the Department of Housing and Community Development should jointly develop a State housing plan. Such a plan should propose policies and programs in response to reductions in federal programs and the continued housing needs of low- and moderate-income Virginians. In addition, the plan should specify methods for coordinating the programs of State and local housing agencies on a continuing basis. The plan should be reported to the House and Senate General Laws committees.

Recommendation (21). A comprehensive assessment of housing needs in Virginia should be made by the Department of Housing and Community Development on a periodic basis. To ensure that special housing needs are identified, DHCD should coordinate its assessment with VHDA, the Department of Social Services, and the Department for the Aging. VHDA should cooperate with DHCD in financing this effort and use the results to tailor its programs accordingly. The needs assessment could be used to guide VHDA's planning efforts and as a resource for other housing service providers.

Recommendation (22). VHDA should continue its efforts to develop a long-term strategic plan for the authority. In particular, VHDA should ensure that new and existing programs meet the housing needs of persons who are not served by the private market. The plan should address the needs of those who have been most affected by federal housing cuts. VHDA should seek input from the Department of Housing and Community Development, the Department of Mental Health and Mental Retardation, the Department of Social Services, and the Department of Aging to ensure the plan addresses the housing needs of special groups such as the handicapped and the elderly. The plan should be used to direct and monitor the authority's efforts to fulfill its public mission, with specific criteria for evaluating VHDA's progress in meeting its goals.

Recommendation (23). VHDA should adopt a formal process for coordinating the development and administration of new programs. Mid-level managers directly

responsible for supporting anticipated new programs should participate in the preparation of an implementation plan. The plan should detail the administrative responsibilities of each affected section and the effects of the new program on staff workload. The Board of Commissioners and VHDA management should use the plan when considering the implementation of new programs.

Board Role and Composition. The Board of Commissioners is responsible for VHDA and its mission to provide housing for low- and moderate-income persons. To better assess the authority's ongoing performance in meeting its public mission, the board needs to monitor more closely the implementation and the effects of its policies. Moreover, to ensure broader public participation in the development of the authority's policies, appointment of board members representing recipients of housing services and the general public may be appropriate.

Recommendation (24). The General Assembly may wish to amend Section 36-55.28, Code of Virginia, to require that one of nine VHDA commissioners be a consumer member experienced in the housing problems of low- and moderate-income persons, and that a second be a "citizen member" with no financial interest in the real estate, banking, or building industries. This requirement could be made effective upon the expiration of the terms of two current members.

Managing Procurement, Data Processing, and Personnel. Sound finances, effective programs, and efficient operations are promoted by a strong management system. Overall, VHDA's management controls were found to be adequate. However, VHDA was not found to be in compliance with the intent of Virginia's competitive procurement requirements in its hiring of an auditing firm. In addition, JLARC found that VHDA placed inadequate priority on automating its operations, and has not approached data processing development in a consistent fashion. JLARC staff found no significant problems with staffing levels and salaries, though some minor adjustment in salary ranges may be appropriate.

Recommendation (25). VHDA should ensure that its contract for an annual external audit complies with the Virginia Public Procurement Act and is competitively awarded.

Recommendation (26). VHDA's top management should assume greater responsibility for prioritizing automation needs and providing the necessary resources to meet the demand for additional computer systems and refinements to existing systems. VHDA's computer operations section and the EDP committee should be involved in data processing development decisions.

In addition, VHDA staff should detail and document their requests for adjustments and additions to the authority's existing computer systems. Staff for whose use new systems are being developed should participate with the computer operations section in designing and adjusting the system to ensure that it efficiently and effectively performs the needed data processing functions.

I. INTRODUCTION

The Virginia Housing Development Authority (VHDA) was established in 1972 to help low- and moderate-income families obtain affordable, safe, and sanitary housing not available from private sources. Creation of the authority was a major recommendation of the Housing Study Commission in its report, Virginia's Housing Crisis. The report stated that "the basic housing problem in the Commonwealth is that there is not a sufficient supply of sound housing in suitable locations with adequate facilities for all the population at prices or rents they can afford." In particular, the commission found that "sound housing units available to low and moderate income groups are in critically short supply."

The new State housing finance authority was to address this problem by providing "a new source of State funds and facilitat[ing] the use of federal funds to assist low and moderate income families in obtaining a decent place to live." The authority's enabling legislation, in Section 36-55.25 of the *Code of Virginia* states:

> . . . there exists within this Commonwealth a serious shortage of sanitary and safe residential housing at prices or rentals which persons and families of low and moderate income can afford. . . . in order to provide a fully adequate supply of sanitary and safe dwelling accommodations at rents, prices, or other costs which such persons or families can afford and to stabilize or recover a necessary economic mix in urban areas, the legislature finds it necessary to create and establish a State housing development authority for the purpose of encouraging the investment of private capital and stimulating the construction and rehabilitation of residential housing to meet the needs of such persons and families or to stabilize such areas through the use of public financing.

VHDA has implemented its mandate in several ways. It offers below-market financing for the purchase of single-family homes and for the construction and rehabilitation of rental units. The authority also administers federal rental assistance programs such as rent payment subsidies. Through its conventional multi-family program it provides financing for the construction of apartments primarily for moderate-income Virginians. It has also been involved in several special activities such as low-interest financing of home energy improvements and participation in the Virginia Appalachian Housing Development Program.

As of December 31, 1984, a total of 32,334 families had received $1.2 billion in loans to purchase single-family dwellings. In addition, VHDA had

financed 31,935 rental units in 211 developments. The authority's activities have made it the eighth largest financial institution in Virginia in terms of its assets.

Historically, the federal government has taken the lead in developing and funding programs to house the nation's low- and moderate-income families. Federal programs have included public housing projects, rental subsidies, and mortgage loan insurance. Recent changes in federal housing programs, however, may affect the availability of affordable housing for low- and moderate-income Virginians. Cuts in the federal rental subsidy program have significantly reduced construction of additional rental housing for lower-income persons, and limited the availability of direct rental subsidies.

Since 1980, the federal government has also restricted the amount of mortgage revenue bonds that can be issued each year. Such bonds are used to finance VHDA's single-family loans. In 1984, Congress expressed its intent that priority be given to assisting lower-income families with these bonds. Legislation which authorizes the tax-exempt bonds will expire on December 31, 1987, unless continued by Congress. If the tax-exempt bonds are not continued, VHDA will have to provide home-ownership opportunities through taxable bonds or other financing mechanisms.

Given the changes at the federal level and the continued need for affordable housing opportunities in the State, VHDA's programs are likely to become more critical in providing housing to low- and moderate-income persons whose needs are not met in the private market. Although its programs will not be able to entirely fill the void, VHDA's strong financial position could enable it to fund additional programs and modify existing programs to reduce the impact of federal housing cuts.

VHDA PROGRAMS AND ADMINISTRATION

The authority is governed by a board of nine commissioners. Seven are appointed by the Governor for four-year terms; the State Treasurer and the board chairman of the Virginia Department of Housing and Community Development serve ex-officio. The Board of Commissioners is responsible for the authority's policies and reviews and approves all loan commitments and bond resolutions.

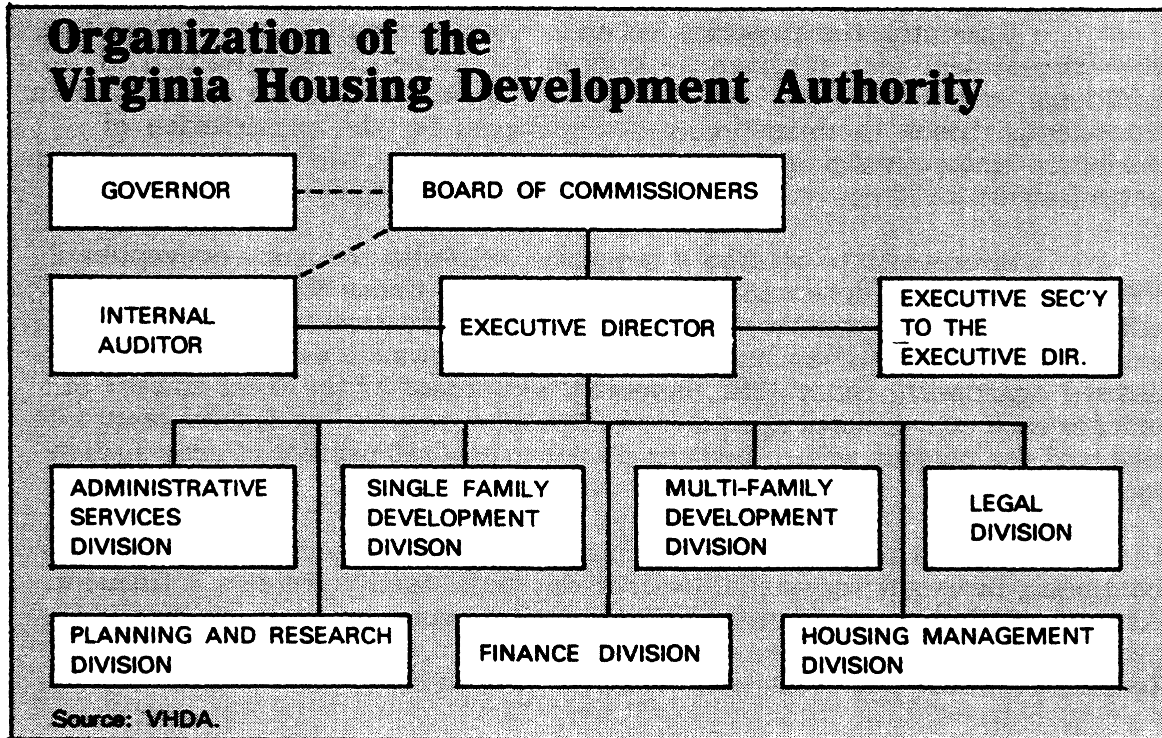
The Board of Commissioners appoints an executive director to manage and direct the authority's daily operations. Over 150 employees are organized into seven divisions to carry out VHDA's programs (Figure 1).

VHDA Housing Programs

VHDA offers a range of programs designed to serve a mix of low- and moderate-income persons. These include rental, home-ownership, and special programs.

Rental Programs. VHDA serves rental clients through two major programs. The majority of lower-income persons are served through rental

Figure 1



Source: VHDA.

subsides from Section 8 of the U.S. Housing Act of 1937 (42 U.S.C. 1437f). However, cuts in federal housing programs have limited the Section 8 subsidies to existing units. With the decline of federal programs for low- and very-low-income persons, the authority has become more involved in financing the development of non-subsidized rental projects aimed at serving moderate-income renters.

The Section 8 program is a rental assistance program through which the federal government makes direct rent payments for eligible households. Each eligible household is required to contribute 30 percent of its income toward rent; the remainder of the rent is paid by the federal government.

Federal law set the eligibility requirements for the Section 8 program. Only households defined by the U.S. Department of Housing and Urban Development (HUD) as having low and very low incomes (at or below 80 percent and 50 percent of area median income, respectively) may receive subsidies. Although rent subsidies will continue for existing units, recent reductions in the program mean that little, if any, funding will be available to subsidize additional, new apartments.

VHDA has financed the construction and renovation of 114 apartment projects to house over 11,000 households under the subsidy program and continues to administer the federal rent subsidies for existing units. In

addition, VHDA has worked with more than 60 localities to provide affordable rental housing for 6,300 families through the Section 8 Existing and Moderate Rehabilitation programs.

Currently, the authority has only one active multi-family program -- the conventional loan program -- that provides for the construction of additional, new rental units. Under this program, VHDA uses the proceeds from tax-exempt bonds to make loans to developers for the construction of moderate-income rental housing. As of November 1984, the authority had loan commitments on 30 conventional projects representing 5,000 units.

In contrast to Section 8 programs, eligibility to rent a conventional VHDA apartment is determined by the authority. Under VHDA policy, the adjusted incomes of persons desiring to live in conventional projects must not exceed seven times the annual rent and utility allowance associated with the desired apartment. Since 1982, however, 20 percent of the total number of units in each conventional apartment complex are required by federal law to be reserved for persons whose incomes do not exceed 80 percent of area median income.

In addition to its role of financing rental properties, VHDA has continuing oversight responsibilities for the multi-family projects it finances. As part of this oversight role, VHDA housing management staff inspect properties to ensure that they are well maintained, check project requests for federal assistance payments, and review tenant eligibility information.

Single-Family Programs. The authority's home-ownership program consists of direct loans to families to purchase new or existing homes, and to substantially renovate residential property. Federal legislation, which authorizes tax-exempt mortgage revenue bonds, restricts such programs to first-time homebuyers, and places upper limits on the purchase price of the home.

VHDA has chosen to set its sales price limits below the maximum federal ceiling and has imposed its own income limits on prospective mortgagors. The income and sales price limits vary according to regional housing costs and structure types.

Loans are currently made on a "first-come, first served" basis to qualified applicants. Potential homebuyers are screened by the authority's underwriters and by VHDA agents. These agents are participating lending institutions such as banks and savings and loans.

In response to congressional intent that the program serve more low-income families, VHDA has designated the first 5 to 10 days of each loan reservation period since August 1984 for applicants whose incomes are at or below 80 percent of the area median. Federal regulations also require that VHDA set aside 20 percent of the proceeds from each single-family bond issue for certain designated, low-income areas in the Commonwealth.

Special Programs. In addition to its regular housing programs, VHDA has been involved in other activities to meet the special housing needs of low-and moderate-income Virginians. Because of their limited nature, these

programs have only served a small number of persons. Examples of recent special programs include:

- the Virginia Energy Loan Program provides affordable financing for installation of storm windows, insulation, furnace replacement, or other energy-saving devices;
- the Virginia Appalachian Housing Development Program makes loans and grants to cover a developer's initial expenses and site development costs;
- the Rental Rehabilitation Grant Pilot Program, provides up to $5,000 per unit in federal grants to localities to offset the cost of moderate rehabilitation of rental properties; and
- the Rural Homesteading Program provides federal grants to rural homebuyers with less than $13,000 for the purchase of houses in need of significant rehabilitation and which have been foreclosed by the Farmers Home Administration.

Financing VHDA Programs

Financing for VHDA programs comes principally from the sale of two types of tax-exempt bonds: single-family mortgage revenue bonds and multi-family bonds. Because the bonds are exempt from federal and State taxes, VHDA can offer loans at interest rates below the private market. While no State-appropriated funds are involved, most VHDA bonds have been backed by the "moral obligation" of the Commonwealth.

Tax-Exempt Bonds. Mortgage revenue bonds, are used to finance VHDA's single-family loans. Federal law places restrictions on mortgagor eligibility, home purchase price, mortgage interest rates, and investment earnings. In addition, Congress limits the amount of mortgage revenue bonds that each state can issue, and allows the state to distribute the bonding authority among state and local housing agencies. In Virginia, the General Assembly has assigned 89 percent of the bond limit to VHDA, and 11 percent to local housing authorities.

Multi-family bonds are a form of industrial development bond and must adhere to certain federal restrictions on interest rates and investments. In addition, developments funded with tax-exempt bonds are required to fill 20 percent of their units with persons whose incomes do not exceed 80 percent of the area median. The amount of bonds a state can issue for rental housing are not subject to a federal cap.

As of June 30, 1984, VHDA had issued $1.86 billion in bonds. Of this amount, $1.62 billion was outstanding. Single-family bonds account for two-thirds of the bonds issued (Table 1). Bonds issued during the first six months of FY 1985 put VHDA's total over $2.2 billion.

"Moral Obligation" Backing. No State funds are used for the authority's programs and operations. In addition, Virginia law clearly states that VHDA's bonds do not constitute a liability on the Commonwealth.

Table 1

VHDA BOND ISSUES
(June 30, 1984)

Series	Dates	Number of Issues	Original Amount	Amount Outstanding
Multi-Family:				
Mortgage Purchase Bonds	1973	1	$53,140,000	$46,735,000
Mortgage Bonds	1975-1980	7	212,685,000	207,190,000
Housing Bonds	1979-Present	6	333,709,000	333,164,000
Single Family:				
Mortgage Bonds	1974-1978	5	230,820,000	178,190,000
Home Mortgage Bonds	1978-1981	6	517,000,000	437,518,000
Residential Mortgage Bonds	1982-Present	4	503,739,000	412,889,000
Other Financings	N/A	3	5,750,000	4,753,000
TOTALS		30	$1,856,854,000	$1,620,432,000

Source: VHDA.

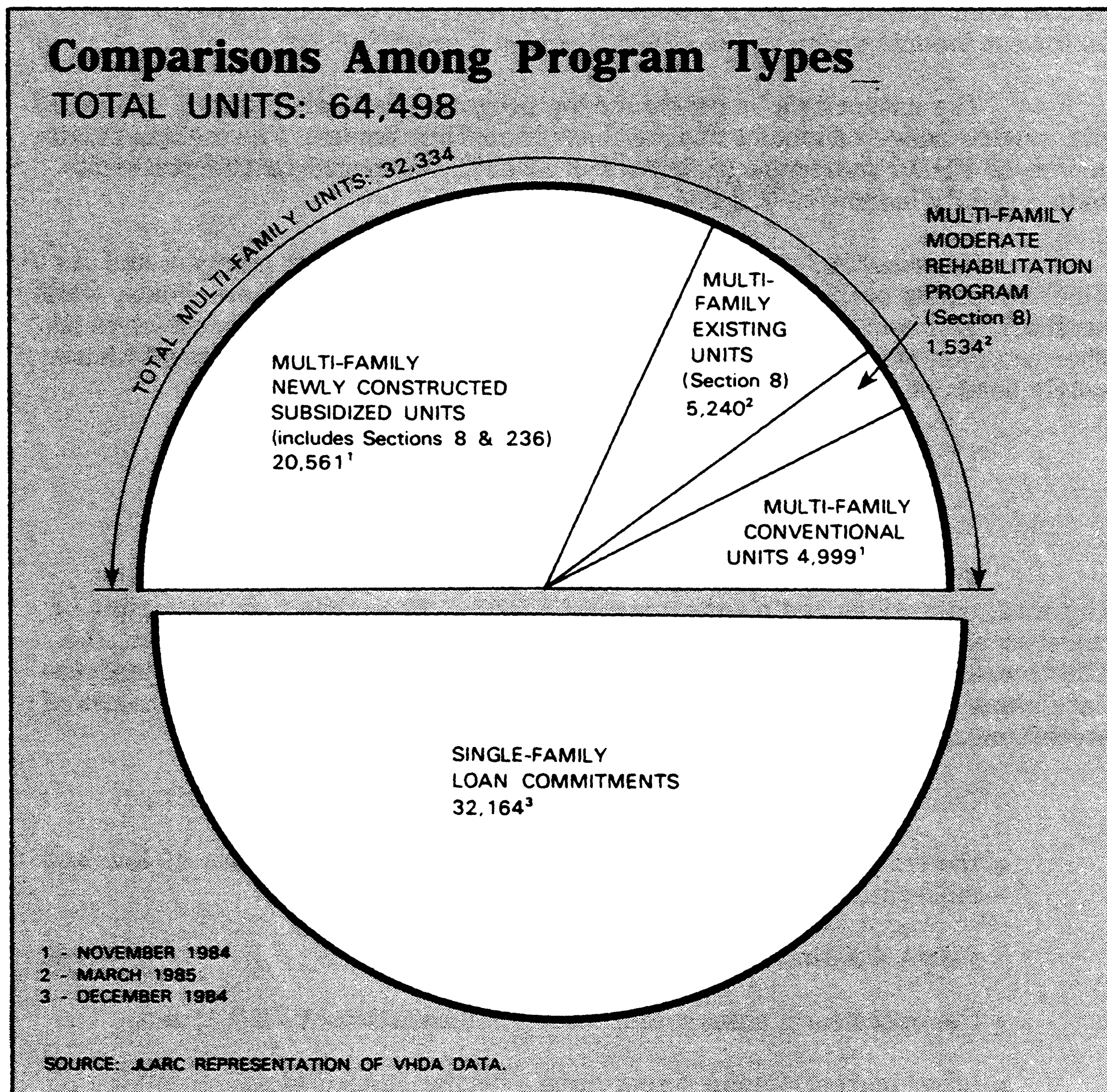
However, State law currently authorizes, but does not require, the General Assembly to appropriate general funds for VHDA's capital reserve fund should it become insufficient to meet debt service requirements. The Virginia Water and Sewer Assistance Authority and about one-third of the housing authorities in other states also carry a similiar "moral obligation" backing on their bonds.

Backing of this type provides additional security for the bonds and may result in more favorable interest rates and credit ratings. All of the authority's bonds, except single-family bonds issued since 1982, carry the moral obligation backing.

VHDA Program Recipients

More than 64,000 households have received housing assistance from VHDA programs (Figure 2). The households have ranged from those with very low incomes to those with incomes substantially above the area median. To date, about equal numbers have been served by single-family and multi-family programs. The decline in federal subsidy programs, however, suggests that growth in VHDA's rental programs will be slower than in single-family programs in the near future.

Figure 2



In large measure, the eligibility requirements for each program determine who the programs are able to serve. VHDA's enabling statutes do not specifically define "low" and "moderate" income. However, in some programs the authority is required to use federal income definitions to determine eligibility, and in others VHDA has established its own definitions of low and moderate income.

The lowest income persons served by VHDA live in federally subsidized rental units. Households occupying VHDA's Section 8 units have average incomes of between $4,500 and $6,300. This range is well below the federal definition of "very low income," i.e., 50 percent of the median income for all households.

The authority's conventional (non-subsidized) rental units have attracted a much wider income group. Although the average conventional project renter has an income of $19,715, many occupants have incomes that exceed the area median, and are among the highest income clients VHDA serves. The highest gross income for a household occupying a VHDA conventional unit in 1984 was $49,500. Conventional projects have not served the lowest income group to the extent Section 8 projects have.

The authority's home-ownership programs have also helped Virginians with a wide range of incomes to purchase their first homes. The median family income of VHDA mortgage recipients is $24,921 compared to the statewide median family income of $28,085 (Figure 3).

Households served by VHDA's conventional renter program and its home-ownership program tend to be small one- or two-person households, while the subsidized rental projects serve slightly larger families. In contrast to its other program recipients, the majority of VHDA's Section 8 apartments have female heads of household.

JLARC REVIEW

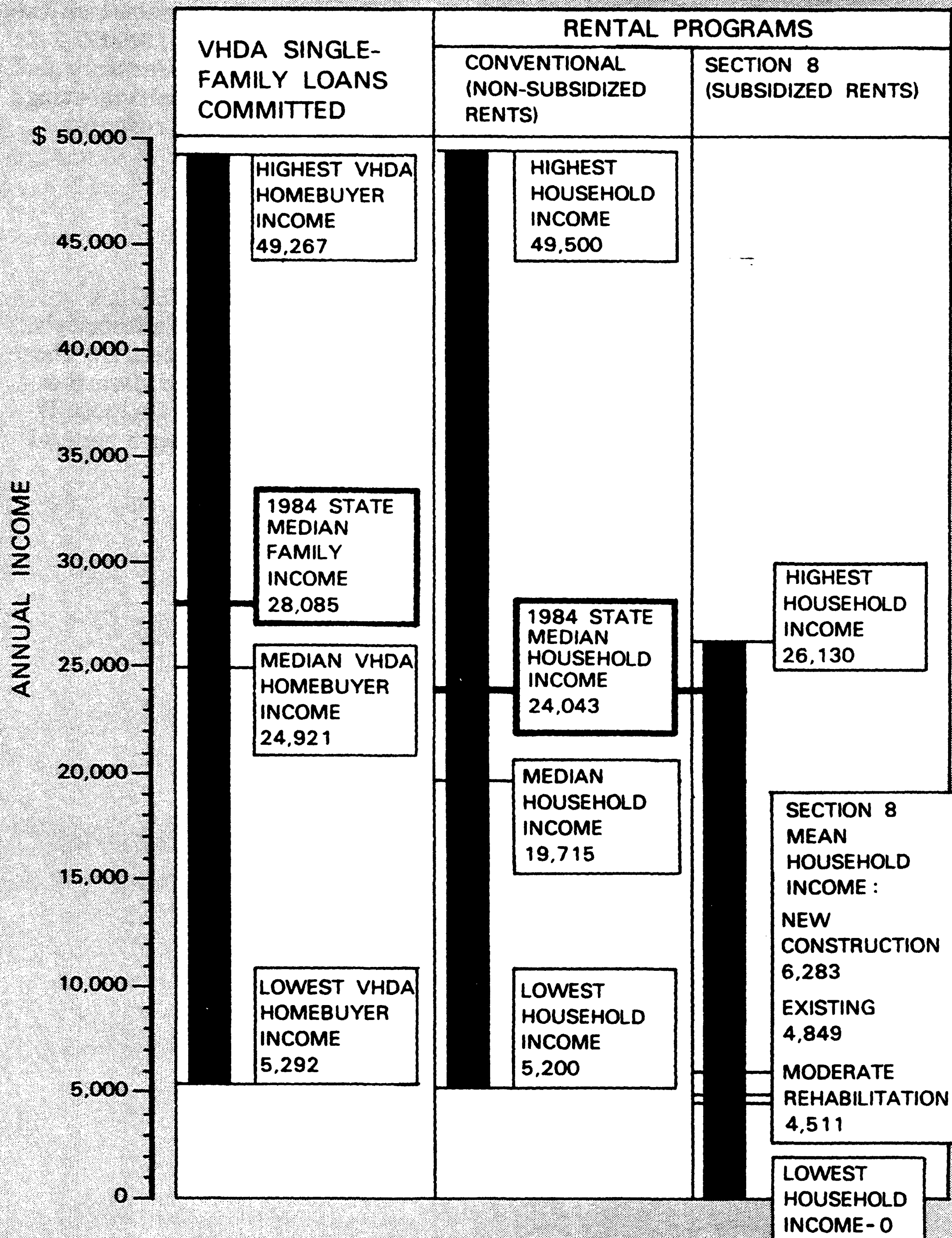
The 1984 General Assembly directed JLARC to evaluate the programs, operations and management of VHDA. The study was the result of concerns about the housing needs of low and moderate income families, the effectiveness of mortgage revenue bonds as a viable financing method, and the State's moral obligation to back VHDA's bond indebtedness. Specific points of interest mentioned in Senate Joint Resolution 7 are:

- the activities of VHDA supported by mortgage revenue bonds,
- the extent to which the programs have benefited persons of low and moderate income,
- VHDA's definition of low and moderate income,
- the operations, management and administration of VHDA, and
- other matters deemed appropriate by the JLARC staff.

Methodology

To carry out this review, JLARC staff collected and analyzed data from numerous sources. In-depth interviews were conducted with VHDA employees. JLARC staff also surveyed all nine members of the authority's

Figure 3



Board of Commissioners. Representatives of housing finance agencies in 10 states were interviewed. In addition, the staff interviewed and collected data from bond market experts and analysts, lending institutions, mortgage bankers, developers, federal housing specialists, and local housing authorities.

JLARC staff conducted an extensive evaluation of information on the authority's clients, loans, operations, and finances. Data from 35,000 automated records and 383 manual files were analyzed. Relevant statutory and regulatory provisions were reviewed, and staff attended several board meetings and public hearings. A more detailed explanation of the major research methodologies is contained in the technical appendix to this report.

Report Organization

This chapter has provided a general overview of VHDA's responsibilities, programs, and operations. Chapter II covers the authority's development of multi-family projects and its oversight responsibilities for those projects. Chapter III reviews VHDA's single-family programs and describes those persons who have directly benefited from those programs. Chapter IV reviews the authority's financial activities, and Chapter V deals with general administration and operations.

II. MULTI-FAMILY DEVELOPMENT AND MONITORING

In addition to administering federal rental subsidies, VHDA provides financing for the construction of new multi-family developments and continued oversight of its rental projects. As of November 1984, VHDA had awarded direct long-term mortgage loans for 153 multi-family projects. The authority had also provided 33 short-term loans for construction of rental housing for which another lender provided the long-term mortgage. During its first few years of operation, the authority also purchased the mortgages of 25 projects. Although most loans went to private developers, VHDA has also financed projects developed by non-profit organizations.

VHDA's multi-family projects have been sound investments and have provided safe and sanitary housing to a large number of Virginians. About 80 percent of the rental units financed to date have housed low and very-low income persons who receive federal rental assistance. Currently, the authority's multi-family program is focused on financing non-subsidized rental projects for moderate income persons. This change in emphasis, which has coincided with the dramatic reduction in federal housing programs, leaves the State without a program to add significantly to the number of rental units affordable to lower-income households.

Although VHDA's multi-family programs have provided affordable rental housing in the past, its current multi-family program may not provide the low-cost housing needed in the future. The authority's multi-family eligibility criteria could be modified to better target low income families. In addition, some improvements may be needed in VHDA's developer selection process to promote more open and competitive multi-family financing decisions. The authority's oversight of rental property management appears inconsistent. Other weaknesses in the housing management function include the lack of written monitoring procedures and incomplete inspections.

NEED FOR LOW AND MODERATE INCOME RENTAL HOUSING IN VIRGINIA

Historically, the housing needs of lower-income persons have been met through rental housing. A consultant to VHDA reported that 35 percent of the total households in the State were renters in 1980.

The private market has financed most of the rental units in Virginia. However, as of 1981, one-quarter of Virginia's rental housing stock was subsidized from either State or federal programs. VHDA-financed projects account for about 15 percent of the government-subsidized units.

The Governor's Commission on Virginia's Future reported in 1984 that "some recent shifts in the rental market . . . are making it harder for [low and moderate income] citizens to find suitable rentals at affordable prices."

These shifts include inflation and increased operating costs resulting in higher rents, the conversion of apartments to condominiums, and demolition of low-cost rental housing for commercial development. Furthermore, cuts in federal funding increase the need for the State to provide affordable apartments for lower-income persons and for groups with special housing needs.

While VHDA is currently attempting to meet the needs of the moderate-income tenants, particularly those living in urban and suburban markets, the authority has not fully addressed the rental housing needs of lower-income persons. In light of the cuts in federal programs and other shifts in the rental market, VHDA will need to assume a greater role in providing affordable housing to lower-income groups. Financing for additional programs is available from the authority's fund balances, which amounted to $160 million on June 30, 1984.

Housing for Lower-Income Persons

According to the 1981 report of the Virginia Rural Development and Capacity Building Advisory Council, 26 percent of all multi-family units in the State received assistance through either a construction or rental subsidy. As of 1981, VHDA had financed 15 percent of the total subsidized units occupied by low- and very-low-income households. The authority has provided below-market-rate loans to developers of subsidized units, and administers the federal Section 8 rental subsidy program.

However, the authority's involvement in rental projects for lower-income persons declined significantly during the 1980's. The decline is due largely to reductions in federal rent subsidies, termination of the federal construction program for new projects, and the authority's decision to concentrate on financing projects aimed at moderate-income renters. As a result, the State does not currently have a program to add significantly to the number of rental units affordable to lower-income families.

In addition, the authority no longer has a program that is specifically designed to produce rental housing for the elderly, even though this segment of the population continues to grow. To date, all of VHDA's elderly rental projects have been produced with federal housing assistance -- which is no longer available for new construction. Additional efforts are also needed to meet the growing demand for housing the State's physically and mentally handicapped. The report of the Governor's Commission on Virginia's Future cited both groups as being in need of additional housing assistance.

Moreover, the need for low-income rental housing continues to remain high. A December 1982 report issued by VHDA's Planning and Research Division projected that 203,000 Virginia households would be in need of low-income rental housing by 1985. This represents about eight percent of the total households in Virginia. JLARC staff found that nearly 12,000 households in 11 localities are on waiting lists for low-income rental housing.

Production of Low Income Housing. Since 1982, VHDA's funding for the production of new rental units which are affordable to lower-income persons has declined significantly (Table 2). The majority of subsidized units

produced since then have been tied to special federal subsidy allocations -- remnants of the Section 8 program. Continued cuts in federal housing programs leave the production of additional low-income units dependent on VHDA and other State and local efforts.

Table 2

VHDA MULTI-FAMILY PROJECTS

Fiscal Year	Subsidized (Section 8) No. of Projects	Subsidized (Section 8) No. of Units	Non-subsidized (Conventional) No. of Projects	Non-subsidized (Conventional) No. of Units
1974	7	800	1	219
1975	11	1,431	3	228
1976	4	728	3	615
1977	22	2,907	-	--
1978	23	2,543	-	-
1979	12	980	1	120
1980	23	2,447	2	1,776
1981	19	2,295	2	280
1982	23	1,733	2	16
1983	8	667	4	404
1984	3	517	9	896
TOTALS	155	17,048	27	4,544

Source: VHDA.

However, VHDA's only active multi-family development program finances the construction of conventional market-rent projects designed to serve "moderate" income Virginians. A moderate-income household, as defined by VHDA, is one which has an adjusted income less than seven times the gross annual rent on the apartment it wishes to occupy.

VHDA began financing this type of project as early as 1974. However, the majority of projects funded under the authority's conventional loan program have been constructed since the decline of the federal Section 8 program in fiscal year 1983. Recent federal tax laws require that projects funded with tax-exempt bonds since 1982 reserve a minimum of 20 percent of the total units for households with incomes not in excess of 80 percent of the area median. JLARC staff reviewed the characteristics of tenants served in VHDA's rental projects, and found that the rents charged in the authority's existing conventional projects exceed amounts which many lower-income persons could afford.

Affordability of Rents. Average rents and utilities paid for existing VHDA conventional one-bedroom and two-bedroom apartments are $407 and $459, respectively. If HUD guidelines, which limit living expenses to a

maximum of 30 percent of tenant income, are applied, the minimum annual incomes necessary to pay for such rents would be $16,280 and $18,360. This is significantly above the $4,500 to $6,300 average annual income of households currently occupying Section 8 apartments financed by VHDA. Several Section 8 households have no earned income, and many receive public assistance payments or retirement benefits. It is clear that these apartments are not generally affordable to most low-income tenants.

VHDA's own review of tenants currently occupying its conventional units found that all 12 projects had at least 20 percent of the units occupied by low-income households. Most of these units were built prior to the federal requirement that 20 percent of the units be reserved for low-income persons. However, VHDA's limits are set at 80 percent of the median income for a four-person household -- the maximum allowable by federal regulations. They are not tied to the actual number of persons occupying the apartment. For example, a one-person household and a four-person family would both qualify under the guidelines with incomes below $22,800 in Richmond, which is the standard for a four-person family for the area. If VHDA's income limits were adjusted for household size as permitted by State law, the percentage of current tenants considered to be low-income (80 percent or less of the area median) would drop significantly in each of the 12 VHDA conventional projects reviewed (Table 3).

Table 3

DETERMINATION OF LOW-INCOME STATUS IN CONVENTIONAL PROJECTS

Project	Location	Percent of occupants below IRS standard	Percent below if standard tied to household size
Williamsburg Estates	Pulaski Co.	45%	22%
Derbyshire	Essex Co.	55%	41%
Janna Lee	Fairfax Co.	80%	62%
Honeybrook	Richmond	58%	24%
Lafayette Manor	James City Co.	69%	43%
Rose Hall II	Virginia Beach	65%	29%
Rose Hall I	Virginia Beach	62%	30%
Marquis Villa	Norfolk	71%	31%
Chesapeake Heights	Chesapeake	86%	68%
Greenbrier Woods II	Chesapeake	72%	51%
Greenbrier Woods I	Chesapeake	79%	56%
Bramblewood	Richmond	50%	15%

Source: JLARC representation of VHDA data.

Other States' Programs. The need for affordable, low-income rental housing will continue to exist in Virginia. It is unlikely that private-sector financing, which has been insufficient in the past, or the authority's current conventional program alone will be sufficient. The experience in other states suggests that additional steps can be taken to help address this need.

VHDA officials indicate that it is not financially feasible today to construct rental projects to serve low- and very-low-income persons without federal subsidies to guarantee tenant participation. Although officials of housing finance agencies in the ten other states that JLARC staff contacted share these concerns, some have developed programs and financing mechanisms to produce additional apartments for lower income households. These efforts reduce the impact of federal housing cuts on lower income households and demonstrate that more could be done to assist low income renters in Virginia.

The North Carolina Housing Finance Agency, for example, recently announced the creation of a pilot program to provide rental subsidies for up to 200 rural households. Because its general fund balances were small, the agency received state appropriations to provide a monthly subsidy of $100 to each household. The housing agency will issue tax-exempt bonds to finance the construction of a minimum of five projects in rural areas to house the subsidy recipients.

Michigan's state housing authority has developed several approaches to assist lower-income renters. The authority contributes $1 million annually from its reserves to provide rent subsidies on eight percent of the units it finances. These funds assist tenants with incomes below 50 percent of the area median. In addition, the authority has earmarked $50 million in bond proceeds for developments in economically distressed areas at a significantly reduced interest rate. The Michigan authority has pledged up to $2 million annually from its future investment earnings to underwrite lower interest rates.

In Minnesota, the state housing agency is using $3.5 million in proceeds from prepaid mortgages to finance small projects (12-36 units) which have initial rents not exceeding federal estimates of fair market rates. The agency has also indicated a willingness to make very-low-interest loans available if necessary in order to produce family-oriented housing at the desired rent levels.

Massachusetts has taken steps to ensure that more lower-income persons are assisted. The state housing authority requires that 25 percent of its conventional projects be held for persons who qualify for federal rental subsidies (rather than the minimum 20 percent required by federal tax laws).

While programs such as these cannot meet the full range of rental housing needs of low-income persons, such initiatives are important in light of the reduction in federal aid to serve this group. Such efforts should be more actively pursued by VHDA.

Financing for innovative programs is available from VHDA's general fund and bond fund balances -- which totaled $160 million at the end of FY 1984. For example, use of $10 million annually from the authority's general fund could provide direct rental subsidies of $100 per month to more than 8,300

households. Chapter V of this report provides additional information about the authority's fund balances.

Recommendation (1). In light of the decline of federal programs and the rental housing needs which continue to exist for low- and very-low-income Virginians, VHDA should designate a portion of its substantial fund balances to make additional housing available for lower-income groups and those with special needs. VHDA might specifically consider:

- providing low- or no-interest loans to make the development of additional units feasible at rents that are affordable to low-or very-low-income persons;
- financing additional rental units for groups, such as the State's mentally and physically disabled and elderly persons, whose special housing needs may not have been adequately addressed;
- increasing the percentage of units reserved for lower-income persons in the authority's conventional projects from 20 to 25 percent;
- tightening income restrictions on the conventional units reserved for lower-income groups by establishing different standards based on tenant household size; and
- providing direct rental subsidies for lower-income tenants.

Housing for Moderate-Income Persons

VHDA's conventional rental program is designed to provide financing for non-subsidized, market-rent apartments for moderate-income persons. In contrast to subsidized projects, prospective tenants must only meet upper income eligibility tests in order to occupy VHDA's conventional units. VHDA's eligibility limits were found, however, to allow persons with relatively high incomes to occupy the units. The limits for most projects are above area median incomes and the authority's income limits for its home-ownership program. As a result, some households which are eligible to occupy a VHDA conventional apartment would be ineligible for a VHDA home mortgage loan. These indicators, and the limits imposed by other states, suggest that income limits for VHDA's conventional rental program could be reduced to better target lower income groups in need of rental housing.

Tenants Served. JLARC staff found a wide variation in the characteristics of households occupying VHDA conventional units. The variation reflects the broad range of persons eligible to occupy these units under VHDA regulations.

For example, the average gross annual income for VHDA conventional tenants was $19,715 in July 1984. This was significantly higher than the average income for VHDA's Section 8 tenants of about $6,000. Moreover, average incomes for conventional tenants varied for each project, from $14,963 in Chesapeake to $23,882 in Richmond. Individual tenant incomes ranged from $5,200 to $49,500.

The incomes reflect the occupations and household composition of VHDA's conventional tenants. Review of the authority's records shows that 46 percent of the tenants held white-collar professional or administrative jobs at the time they first rented VHDA apartments. In contrast to tenants in subsidized units, over half of the authority's conventional tenant households were headed by a white male and 47 percent of the units were occupied by single individuals.

Conventional Income Limits. To determine initial income eligibility, VHDA has established a "seven times test." This income limit is computed by multiplying the sum of the annual rent and a utility cost allowance by seven. For example, given the typical rent of $407 for a one-bedroom VHDA conventional apartment and utility cost allowance of $50, a tenant could have an income as high as $38,388 ($457 X 12 months X 7) and still be eligible to occupy the unit. If in two years, at the time of eligibility recertification, the tenant's income exceeds the seven times test by more than 20 percent, a minimal surcharge is added to the monthly rent.

As shown in Figure 4, all 18 conventional projects for which approved rent and utility allowances were available as of February 1985 have income limits which exceed the area median for all or most of their units. VHDA's limits permit persons or families with more than $40,000 income to be eligible for higher rent units in 12 of the conventional projects reviewed. In two cases, income limits associated with VHDA-approved rents are more than double the median household income in that area.

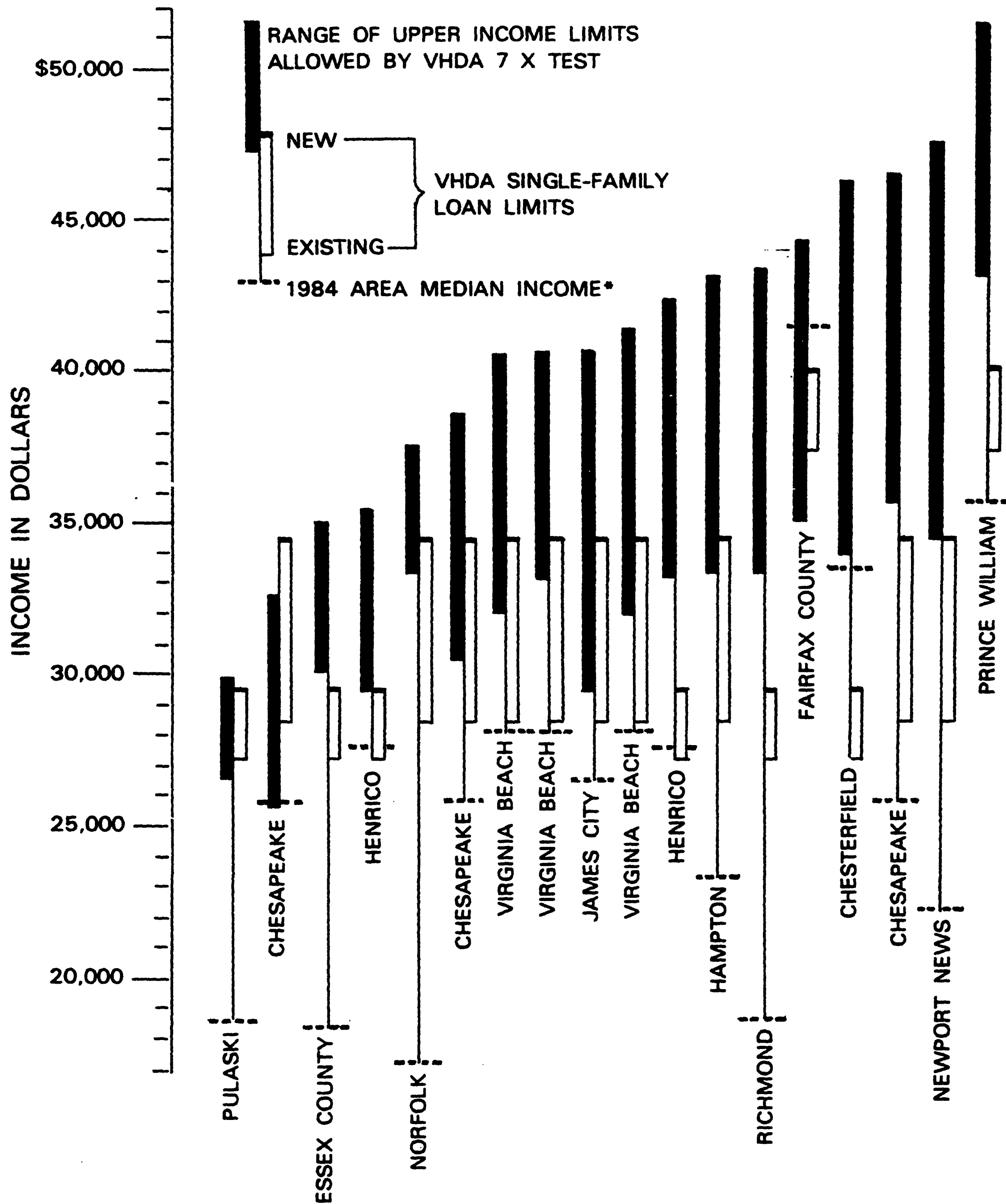
Moreover, maximum eligibility limits established by the seven times test for rental units in 17 of 18 conventional projects exceed the authority's single-family income limits for a newly-constructed home in the same area. For example, a Richmond household making $43,260 annually would qualify to live in a VHDA conventional apartment, but would have almost $14,000 more than the amount permitted to be eligible for a VHDA home loan. Income ceilings for every unit in eight of the conventional projects exceed single-family new construction income limits. Income ceilings for every unit in 15 projects exceed the authority's income ceilings for the purchase of an existing home -- which are lower than the new home limits.

Comparison to Other Standards. The Council of State Housing Agencies reported in 1983 that 26 state housing finance agencies were involved with conventional-type projects. While projects in each of these states must comply with federal requirements to reserve a minimum of 20 percent of the units for lower-income persons, eligibility requirements on the remaining units vary.

The Minnesota Housing Finance Agency, for example, uses the equivalent of a 5.5 times test to determine eligible income ceilings for its projects. Such a limit establishes eligible income ceilings that are considerably below those derived from VHDA's seven times test:

Minnesota: $450 (rent plus utilities) X 12 X 5.5 = $29,700
Virginia: $450 (rent plus utilities) X 12 X 7 = $37,800.

Figure 4



*TAYLOE MURPHY INSTITUTE DATA PROJECTED FOR THE JURISDICTION IN WHICH THE PROJECT IS LOCATED.

SOURCE: JLARC ANALYSIS OF VHDA DATA.

Maryland and North Carolina have both set the income limits on their non-subsidized rental units at the same level as their respective single-family mortgage loan limits. In Maryland, the limits are set at $28,000 for a one-person household and $33,000 for a family. North Carolina's "moderate income" limits are set at $29,100 for rural areas, $32,000 for urban areas, and $34,500 for large cities. In comparison, VHDA's maximum income limits range from $25,620 to $51,660.

Several state housing authorities have income limits that are tied to a percentage of median income. For example, Florida sets its income limit at 150% of the area median, and Nebraska's and Nevada's are set at 120% of the median.

JLARC staff evaluated the effects of two methods as possible replacements for the current seven times test: (1) lowering VHDA's seven times test to a 5.5 times test and (2) setting maximum tenant incomes at 120 percent of area median income -- a measure that has been used in the past to represent "middle or moderate income." Under either method, JLARC staff found that the revised income limits would not have affected the eligibility of the majority of persons now living in conventional projects. Therefore, even with stricter income limits, VHDA would likely continue to attract a sufficient number of renters to make its projects feasible. However, such a change would ensure that the authority better targets persons it is mandated to serve.

Reducing the seven times test to a 5.5 times test would still leave income ceilings above the median incomes of the areas in which the majority of the projects are located. Only eight percent of the tenants now residing in conventional projects would have been affected by the lower income limit change. Some projects have had up to 25 percent of their tenants with incomes in excess of the lower limit. However, the reduction would bring the conventional project ceilings closer to VHDA's home mortgage limits and help to ensure that higher-income persons who are ineligible for a VHDA home loan are not being served by the authority's rental projects.

If VHDA were to base eligibility on 120 percent of the area median income adjusted for household size, fewer households with incomes above the authority's home mortgage limits would qualify for conventional units. Fifteen percent of the total households residing in VHDA's conventional projects at the time of JLARC's review would have been ineligible if the standard had been set at this level. The impact on some projects would be greater. For example, 51 percent of the tenants residing in one Richmond project would have been ineligible if tenant income had been limited to 120 percent of the area median.

Recommendation (2). VHDA should replace the current seven-times test for determining eligibility for its conventional rental units with a standard that more closely approximates the authority's single-family loan limits and better targets the households which VHDA was mandated to serve. The authority could set its standard at 120 percent of the area median income for future conventional project tenants. This standard would lower income eligibility and would not be tied to a given unit's rent.

The authority's Multi-Family Development Division is responsible for processing and reviewing all multi-family new construction and permanent loan applications. The division recommends to the executive director and the Board of Commissioners which proposals should be financed.

VHDA appears to have made sound financial decisions in its selection of multi-family developments. Few projects have experienced prolonged periods of high vacancies and most have generated sufficient reserves for future maintenance and operating expenses. They have had strong market appeal.

However, improvements in the processes used to select projects and developers are needed. Key among the improvements are development and use of written selection criteria to guide selection decisions, and a specific limit on the number of proposals which may be selected from any one developer. These steps would assist the authority in justifying its selection decisions and avoiding the appearance of favoritism.

Project Selection Criteria

Although broad regulatory guidelines and *Code* provisions help guide the authority's multi-family financing decisions, VHDA has not developed specific selection criteria. The absence of written selection criteria has contributed to VHDA financing projects which have extraordinary development costs and rents. Such projects might experience possible marketing difficulties in the future. Specific criteria would help VHDA staff to determine objectively if an application satisfies the intent of statutory and regulatory guidelines.

Statutory Requirements. Section 36-55.39, *Code of Virginia,* clearly states that VHDA is not to finance any housing development unless it finds:

(1) that there exists a shortage of decent, safe and sanitary housing at rentals or prices which persons and families of low income or moderate income can afford within the general housing market area to be served by the proposed housing development.

(2) that private enterprise and investment have been unable, without assistance, to provide the needed decent, safe and sanitary housing at rentals or prices which persons or families of low and moderate income can afford or to provide sufficient mortgage financing for residential housing for occupancy by such persons or families.

(3) that the housing sponsor or sponsors undertaking the proposed development in this Commonwealth will supply well-planned, well-designed housing for persons or families of low and moderate income and that such sponsors are financially responsible.

(4) that the housing development, to be assisted . . . will be of public use and will provide a public benefit.

(5) that the housing development will be undertaken within the authority conferred . . . upon VHDA and the housing sponsor or sponsors.

State law also requires that VHDA give priority to projects which are well-planned and well-designed. Additional factors to be considered include:

- the comparative need for housing for persons and families of low and moderate income in the area proposed to be served;
- the ability of the applicant to construct and maintain the development;
- the existence of zoning and other regulations to protect the development against uses which could depreciate its future value;
- the availability of adequate parks, recreational areas, utilities, schools, transportation, and parking; and
- the existence of statewide housing plans.

VHDA's rules and regulations also contain general procedures for reviewing multi-family loan applications. The authority is to accept for processing those applications which "best satisfy" several factors. JLARC staff found that the factors deal in very general terms with the proposed site, development design and costs, and the applicant.

Lack of Specific Underwriting Criteria. VHDA has not translated statutory and general regulatory guidelines into a workable set of selection criteria. Several factors suggest that the lack of written underwriting standards has contributed to multi-family loans for some projects with unusually high development costs and rents. For example, a standard to govern the acceptable costs associated with constructing a project has not been established. Such costs are often expressed as "loan per unit costs."

In contrast to VHDA, North Carolina's housing finance agency has established a standard to govern loan per unit cost. Mortgages financed by the agency cannot exceed $35,000 per unit for projects other than congregate housing and high-rise structures.

VHDA maintains historical data on costs incurred in the construction of the projects it finances. This information is used by the authority to determine if a project's costs are within ten percent of the average costs for similar VHDA projects.

In the absence of a written standard for loan per unit costs, however, VHDA is not bound to accept only those proposals which are within the ten percent range. An analysis of historical cost data shows that the structure costs for 27 of the 119 projects which the authority had funded as of January 1985 exceeded the average costs for similar types by more than 10 percent.

Nine of these projects are located in the higher-cost Northern Virginia area. Furthermore, 13 projects exceeded the average costs for similar projects by more than 20 percent (Table 4).

Table 4

VHDA PROJECTS WHICH EXCEED AVERAGE HISTORICAL COSTS

Percent Above Average Cost Per Sq. Ft.	No. of VHDA Projects	Percentage of Total Projects
At or below the average cost	63	53%
1 to 10 percent above	29	24
11 to 20 percent above	14	11
21 to 30 percent above	7	6
31 to 40 percent above	4	4
41 to 50 percent above	2	2
TOTALS	119	100%

Source: VHDA construction cost data.

JLARC staff also reviewed the approved rents for 80 Section 8 family and elderly projects financed by VHDA between 1975 and 1984 to determine the variation in development costs. This analysis found that 29 percent of the authority's Section 8 projects had rents that exceeded the federal "fair market rents" for the same area and time period. Ten projects had rent levels that exceeded the published fair market rent by 20 percent or more.

The fair market rents represent HUD's determination of rents, including utilities and other essential expenses, "which would be required to obtain in a particular market area privately developed and owned rental housing of modest design with suitable amenities". HUD uses the fair market rents to ensure that rents in its subsidized projects are reasonable for the market. Any sponsor or lender, such as VHDA, seeking rents that exceed the fair market rent by 10 percent must receive an additional subsidy commitment from HUD's national office. VHDA requested and received such approval from HUD.

Although high rents do not directly affect most low- and very-low income tenants who reside in subsidized units, the additional rent costs are borne by taxpayers and generally reduce the amount of federal rental subsidy available for additional units.

JLARC staff also found that the lack of guidelines appears to have contributed to VHDA's financing of some projects with unusually high loan-per-unit costs and rents without an approval process to deal with such

cases on an extraordinary basis. JLARC staff reviewed all project applications which VHDA considered for financing during fiscal years 1983 and 1984 and found that certain projects were approved despite concerns of some VHDA staff. The following examples are illustrative of the costs of projects that could be developed without the safeguards which written standards would provide:

In July 1982, VHDA approved financing for the rehabilitation of a hotel, which is an historic landmark, in downtown Danville. Intended as elderly housing, this project had an unusually high loan cost per unit of $53,964. According to documentation in the file this is about $15,000 to $20,000 higher than costs for most other loans for elderly projects. Initial rents (plus utilities) for the project were $733 and $894 for one- and two-bedroom apartments, respectively.

Community demand for elderly housing in the area was considered to be high, with long waiting lists at other elderly developments. However, two members of VHDA's management team voted against financing the project, citing high rents and unit costs and a weak market. The latter concern was partly based on the fact that, about a year and a half earlier, VHDA had financed another elderly project (@ $32,600/unit) within walking distance of the project. Other authority staff members have indicated to JLARC that a newly-constructed project could have been financed at a much reduced cost.

* * *

A documented need for additional housing for the elderly was a contributing factor in VHDA's decision in 1983 to finance a Section 8 elderly project in Richmond's Church Hill area. VHDA approved a proposal for the substantial rehabilitation and new construction of a 299 unit project with rents of $607 for an efficiency apartment and $676 for a larger one-bedroom unit. Although VHDA certified to HUD the reasonableness of the contract rents, the project's rents are significantly above similar developments in that area and are comparable only to luxury elderly units in the more exclusive areas of Richmond. For example, two other Section 8 elderly projects sponsored by VHDA were already under construction in Richmond when the Church Hill project was approved. Rents on these two projects were 29 and 40 percent lower than the Church Hill project.

The Church Hill project's rents were only five percent above the federal fair market rent at the time the loan was made. However, material contained in the project file indicates that the authority recognized that the published fair market rent was excessively high. Yet,

VHDA awarded the loan at those rents. The following year, HUD discovered the error in its standard, and revised the relevant fair market rents significantly downward. As a result, the Church Hill project rents were more than 50 percent higher than the 1984 market standard.

A review of development files found indications that some of VHDA's non-subsidized projects were also approved with rents that appear to be above comparable market rates and outside those affordable by the target population VHDA is mandated to serve. For example, VHDA financing was committed in 1983 to the second phase of a project in Hampton with a $100 difference between the rents for one- and two-bedroom units -- compared with a $30 to $50 difference in the market generally. In a second case, VHDA approved a Northern Virginia project even though proposed rents exceeded those of two recently completed "luxury" apartments in the area. VHDA projects such as these could experience delays in attracting renters because of high rents.

Potential Marketing Difficulties. The security of a multi-family loan is contingent upon the rental project's success in the marketplace. This is particularly true of non-subsidized projects such as VHDA's conventional developments. According to VHDA and industry representatives, location is a key factor since it is "the one element of a real estate deal that cannot be changed."

VHDA has been successful in financing projects in good locations. High occupancy rates in most of the projects attests to the authority's success. A JLARC staff review of project files did, however, identify some recent cases in which the authority financed multiple projects in areas where other VHDA projects were under development. These projects will be in competition with each other from the start. Written underwriting standards could help to ensure that these situations do not occur.

In 1983, for example, VHDA approved financing of three conventional projects within a few miles of one another in the Virginia Beach area. A fourth was selected in 1984, even though it was in "very close proximity" to one of the three projects approved the previous year. All four projects had similar rent levels and amenities which would likely appeal to the same potential tenants.

The Church Hill project cited earlier is another example of a potential marketing problem. The project was approved for financing even though VHDA's market analysis found that the project would have to attract about 20 percent of the elderly market in order to achieve a sufficient occupancy level. According to VHDA marketing staff, an attraction, or "capture", rate of more than 10 percent generally indicates that the project could experience occupancy difficulties.

These same selection practices have occurred in other areas of the State. Although demand may be high in a given area, such as Virginia Beach, the authority's market analyses have raised concerns about the possibility of longer than normal rent-up periods as the result of projects being in close proximity to one another.

Recommendation (3). In light of its public responsibility to serve low- and moderate-income Virginians, VHDA should participate in projects with rents affordable to those income groups. VHDA should develop and use written criteria to review and select proposals under its conventional loan program. Written selection criteria -- developed before proposals are accepted for review -- should ensure that uniform consideration is given to each proposal, and should serve as a guide to prospective applicants. The authority may wish to reconsider its practice of financing projects which are in direct competition with other VHDA conventional projects already under development.

Inadequate Record of Selection Decisions. Until recently, VHDA did not keep a written record of its loan financing decisions. Now, the multi-family development staff prepares an in-house "selection summary" to document each decision. However, the information in the summaries reviewed by JLARC staff was found to be vague, and appeared to reflect the staff's preliminary thinking, rather than the final decision. Two examples are illustrative:

> *The selection summary for the Tidewater area indicates that applications for two of the projects in the pool are "somewhat removed from the major residential areas, but are proximate to them. Both sites are considered acceptable but competitively not as advantageous as" four other proposals submitted. However, the authority chose one of these projects to finance over four others considered by its own staff to be better proposals. No written record documents why this decision was made.*

* * *

> *Three proposed developments in the Peninsula area were each identified in the multi-family selection summary as being "located adjacent to an existing or proposed...public housing project." The selection summary stated VHDA's concern that "the proximity to adjacent public housing was considered a prohibitive market factor". However, one of the projects was selected for VHDA financing.*

In each of these two examples, a proposal with less desirable characteristics was chosen over applications deemed superior by VHDA. In neither case, however, was there any written documentation for the final decisions.

Recommendation (4). The authority should prepare and maintain written summaries detailing the selection criteria used to evaluate each multi-family proposal, how well the proposal met the criteria, and the rationale for final selection decisions. The summaries should serve as a written public record of the authority's financing decisions.

Developer Selection Process

The process for selecting developers should be open, encourage participation by all developers, and provide adequate opportunities for minority participation. However, JLARC staff found that VHDA's current practices give the appearance of discouraging open participation and competition for the authority's loans.

Although VHDA has made loans to about 70 private developers, 35 percent of all projects financed as of November 1984 were sponsored by six developers. Only four projects were totally or partially sponsored by minority developers.

Multi-Family Loan Awards. The JLARC staff review of all VHDA direct and construction loan commitments to private sponsors through November 1984 revealed that a small group of developers account for a significant portion of the projects selected. Thirty-five percent of VHDA's multi-family loans, representing 41 percent of the total dollar loan amount, have been awarded to six developers. The number of loans awarded to three developers account for 28 percent of the total selections and 21 percent of the total dollar amounts awarded (Table 5). Projects sponsored completely by non-profit organizations -- representing less than five percent of the total loan amount awarded to date -- were excluded from this analysis. While not all experienced developers are interested in becoming involved with government-financed projects, these figures raise questions about the openness of VHDA's loan award process.

These findings are supported by the telephone responses of 20 developers surveyed by JLARC staff. It was the feeling of some developers that the authority's process tends to be closed to certain developers. Among the comments from the JLARC staff survey were the following:

> It is general knowledge in the industry that VHDA tends to stay with the same developers. You can get through to VHDA if you are on a first name basis with them. A lot more could be done with affordable housing if they acknowledged more developers. Otherwise, we would be more active participants.
>
> * * *
>
> We have not submitted proposals the last two times because it appeared the same people were coming away with the money. It just wasn't worth our time.
>
> * * *
>
> VHDA already feels like it has enough developers.
>
> * * *
>
> Either VHDA doesn't like me or they don't like my proposals. . . .

VHDA has a good program. I would like to participate. . . It would be much better if they had definite [selection] criteria rather than competing over a small amount of money. . . .

* * *

Table 5

DEVELOPERS RECEIVING VHDA LOANS

Developers	Loan Dollars: Total Received	Loan Dollars: Percentage	Projects Financed: Number	Projects Financed: Percentage
National Housing Partnership*	$ 82,546,371	13%	5	3%
Fralin & Waldron, Inc.	65,116,821	10%	21	13%
Amurcon Corporation of Va.	45,540,728	7%	13	8%
Crico Ltd.	28,435,338	4%	11	7%
Bush Development Corp.	23,252,290	4%	5	3%
Lipnick and Associates	20,286,866	3%	2	1%
Leventhal & Sidman Partnership	19,071,211	3%	3	2%
Oxford Equities, Inc.	17,619,478	3%	5	3%
First Service Corp. & Assoc.	14,869,487	2%	2	1%
Miller & Steingold Partnership	13,080,092	2%	4	2.5%
Mazur, Inc. and Associates	10,745,084	2%	4	2.5%
All Others	296,697,276	47%	83	53%
TOTALS	$637,261,042	100%	158	100%

*Private corporations established by the federal government

Source: VHDA information for multi-family loans.

VHDA has taken some steps that could improve the situation. For example, VHDA is using mortgage bankers to attract new developers to its Conventional Loan Program. However, this action has had only limited impact in broadening the group of developers being selected. For the period from July 1983 to November 1984, 41 percent of the proposals selected by the authority for conventional loan financing were sponsored by the same group of six developers.

Limitations on Loan Amounts. State and federal laws limit the amount that a private lender can lend to any single borrower. In Virginia, statutes prohibit a State chartered bank from lending more than 15 percent of its total capital and surplus to any person, association, or corporation.

Such limits are intended to reduce the consequences that a single borrower's default could have on the lending institution. While these statutory provisions do not directly apply to VHDA, the safeguards provided by the limits could be useful for the authority. As of November 1984, the three largest developers represented 13, 10, and 7 percent, respectively, of the total loan amount awarded by VHDA to date.

Lending limits are used by other housing finance agencies. Michigan's housing finance authority has recently established limitations for one of its multi-family programs. Michigan limits outstanding commitments to any one borrower to a maximum of $25 million. VHDA had four developers with total loans over that amount by November 1984.

Recommendation (5). VHDA should consider ways to open participation of its selection process. In this regard, VHDA should consider limiting the amount of outstanding loan commitments awarded to any one developer. Such a provision would reduce the potential impact that a single borrower's default could have on the authority's finances. Moreover, such a limit would signify that VHDA intends to encourage more participation by all developers.

Minority Participation. The federal government requires that VHDA assure that developers meet federal affirmative action and equal opportunity requirements in the hiring of contractors and subcontractors and in the selection of tenants. No such requirement exists for the selection of minority developers. VHDA reports that it has financed only one project with a minority developer and three others with minority partners.

In contrast to VHDA, HUD has a fair market plan to encourage the participation of minority developers, contractors, and subcontractors. The HUD plan has a goal to include at least the same proportion of minority participants as exists in the State population.

To monitor this goal, HUD requires the developers who work directly with it to submit a plan on minority participation in the development process. In addition, HUD requests that local and State agencies such as VHDA, which receive federal housing funds, voluntarily submit similar documentation annually. According to HUD officials, VHDA has not submitted such a plan to date.

HUD also requires that local housing authorities establish a goal for encouraging minority participation in the development of rental projects. This goal is for 20 percent of the dollar value of all construction contracts using federal monies to be awarded to minority contractors. Some local authorities allow the level of minority participation to vary from contract to contract depending on the nature of the work to be performed and the availability of minority enterprises in the market.

In addition, the Governor has urged that all State agencies voluntarily establish a goal of purchasing at least three to five percent of all goods and services from minority-owned firms.

Recommendation (6). VHDA should establish a goal to have minority developers, contractors, and subcontractors involved in at least three to five

percent of its outstanding loan awards. Key elements to ensure that its goal is met include the development of a plan by VHDA to encourage the participation of minorities in the development process and a mechanism to monitor compliance with the goal.

MONITORING OF VHDA RENTAL PROJECTS

State law grants VHDA the power to oversee the multi-family projects constructed with funds from its bonds. The authority's Housing Management Division is responsible for oversight activities including evaluating property management, monitoring financial and physical conditions of each project, certifying tenant eligibility, and monitoring federal housing assistance payments for subsidized projects. The division approves increases in rents for conventional projects, and management agent fees for all projects.

JLARC staff found several problems that could weaken the authority's oversight role. These problems stem from the apparent inconsistent treatment of some owners and management agents, and deficiencies in oversight procedures.

Inconsistent Treatment of Owners and Agents

VHDA has taken several steps to ensure proper oversight and monitoring of rental projects. These include periodic inspections and on-site reviews, development of an "early warning system" to detect vacancy and financial problems, and training in the authority's regulations for property management companies.

It appears, however, that the authority's control of rent increases and supervision of management agents have been inconsistently applied for some owners and management companies. These inconsistencies reduce VHDA's ability to effectively control rents and management fees, directly affect the affordability of its rental properties, and could weaken VHDA's rental portfolio.

Controls Over Rents. Once a conventional project is approved to accept tenants, the authority's housing management staff assumes responsibility for approving rent increases. VHDA has no control over rental adjustments for Section 8 projects, which are set by HUD guidelines. The authority currently has no specific written guidelines on when a rent increase might be justified. Rather, housing management staff review each request for a rent increase based on the project's budget, operating expenses, and dividend distribution to limited partners. The decision to approve a rent increase rests with the director of the Housing Management Division.

Most of the rent increases granted to VHDA's 11 conventional projects reviewed by JLARC staff appear to be reasonable. However, JLARC staff found that rent increases granted to two projects appeared to be contrary to the authority's mission to maintain rates affordable to low and moderate income persons. In one, the increases have moved the project's rents to near the top of the market. For the other project, cashflow generated by existing rents did not warrant an increase.

A large conventional project in Richmond has applied for and received 10 rent increases since it opened in 1976. Since then, rents have increased between 67 and 92 percent (7.4 and 10 percent annually) on one-bedroom and three-bedroom units, respectively. The housing management director reports that the increases were granted to cover project losses and the conversion of the heating system in the first few years of operation. However, the project's rents are now among the highest charged by a VHDA conventional project (ranging from $365 to $470), are comparable to those of much newer developments, and are near the upper end of the local rental market.

* * *

Recent rent increases granted to a Tidewater project were characterized in VHDA files as "unjustifiably high" given the project's large cashflow. The owners requested a 10 percent increase on each unit to be effective January 1984. One reason given for the increase was the cost of restraining the development's exterior. The housing management director approved a somewhat reduced increase for the property. According to information contained in the authority's project files, however, the "substantial operating reserves" and large cashflow for both phases of the development suggest that an even smaller increase should have been approved, particularly for the older phase of the project. Phase I had a net cashflow of $49,000 for the first nine months of 1983 bringing its total operating reserves to $259,000. Phase II had a small cashflow deficit of $3,200 for the same period. This is because a "debt service differential" of about $25 per unit per month exists between the two phases as a result of lower construction and financing costs on Phase I.

As a result of the approved increase, Phase I will continue to have an unusually large cashflow and operating reserve for a VHDA project. Such reserves can be used for additional project improvements and expenses, limited distributions to general partners, and as part of the prepayment of the mortgage loan. In addition, restraining of the development's exterior -- given as a reason for requesting the 1984 rent increase -- had not been done as of April 1985 according to VHDA officials.

Controls Over Management Agents. Management agent firms are responsible for the day-to-day operations of VHDA's projects. Project owners choose their management agent firms, but VHDA has established performance standards which agents are expected to meet.

Since a management agent's fee is paid from project expenses, he or she is subject to review and approval by VHDA's Housing Management Division. In contrast to rent increases, the authority has control over management fees for all of its projects. In addition to automatic fee increases tied to rent increases, an owner or management agent may request that VHDA approve an incentive bonus for "superior performance" in managing the project. The authority's policies permit the approval of one-fourth of one percent annually (up to a total of two percent) if the agent is found by VHDA staff to be providing superior performance.

Division staff periodically assess each management agent's performance and review financial records to ensure that fees paid correspond to those approved. A JLARC staff review of 18 housing management files found that the authority's controls have not always been applied consistently to all management agents. In the following example, management-fee increases were granted to a project that was repeatedly in noncompliance with the authority's housing management policies.

During the Fall of 1983, VHDA staff discovered that the owner/management agent of a Southside Virginia project had withdrawn fees in excess of the authorized amount. According to correspondence in the project file, the agent had previously violated this and other provisions of housing management agreements. Evidence also exists that VHDA's Housing Management Division had previously approved annual fee increases for the agent that were greater than the 1/4 percent limit allowed by policy.

The project's community room has been used by its owner for overflow conference space and luncheon meetings when a nearby hotel that he owns has been full. The use of any part of the project for the benefit of nonresidents is inappropriate under the authority's regulatory agreement with the development. Although VHDA notified the owner of this fact in June 1982, the authority subsequently approved the use of federal Section 8 subsidy monies to improve the facility for public use. A complaint was filed as recently as September 1984 that the project's community room was still being used for nonresident purposes.

Despite these concerns and against the written advice of the assistant division director, the director of Housing Management approved an even higher than requested fee increase for the agent. The increase, which the division director suggested was granted as part of the authority's new fee structure, put the project near the top of the percentage of management fees charged to any VHDA Section 8 elderly project, and could be perceived as a reward despite repeated violations of the authority's policies.

There are other indications that some management agents have continued to carry out activities not normally allowed by VHDA. For example, one large management firm, which operates several of the authority's rental properties, has used project funds to pay expenses not customarily allowed, such as free rent for a property manager and purchase of a new truck used at only some locations. Although recent steps have been taken by VHDA to resolve the problems, the situation existed for several months and could likely have been resolved earlier if division officials had intervened. The absence of written operating procedures contributes to VHDA's delay in resolving these types of problems.

Recommendation (7). VHDA should ensure that its oversight responsibilities for multi-family projects are implemented consistently. Precise written criteria should be developed to identify the conditions under which rent increases will be granted. Guidelines should ensure that a management fee increase for "superior performance" is not granted to any agent who consistently violates the authority's housing management practices. Moreover, since such decisions directly affect who can be served by its rental properties, VHDA's Board of Commissioners -- rather than a division director -- should approve increases in project rents and management fees.

Weaknesses in Oversight Procedures

Weaknesses also exist in the internal operations of the Housing Management Division which, if continued, could negatively affect the authority's monitoring functions. These include the lack of formal oversight policies and the failure to perform required project inspections.

Absence of Written Procedures. In addition to not having formal policies for approving rent increases, the Housing Management Division does not have written policies for routine oversight activities. The absence of written procedures has led to inconsistencies and inefficiencies in the authority's housing management functions.

Housing management officials have been aware of the need for standardized procedures for several years. The authority's internal auditor cited the absence of an operations manual in three separate audit memos to housing management officials between June 1981 and July 1983. The purpose of such a manual, according to the auditor, would be to "provide the communication of management's expectations to the operating staff and should reduce inconsistency and inefficiency." The internal auditor also wrote that:

> [t]he documentation of standards, policies, and related operating procedures should provide a basis for a sound system of management review, identify gray areas between operating divisions, and give top management a level of confidence in the work performed by employees.

However, at the time of JLARC's review in the spring of 1985 -- nearly four years after the initial internal audit memo -- a written operations manual still did not exist. Interviews with housing management staff revealed that inconsistencies still exist in such important monitoring functions as

property inspection practices and tenant income verifications. Many of these differences could be avoided if standardized policies and procedures were developed. Division officials have indicated their intention to complete an operations manual by the summer of 1985.

Failure to Perform Required Inspections. VHDA inspection records for 1984 indicate that 70 percent of the required management and marketing reviews and physical inspections assigned to one housing management officer were not completed. These account for 12 percent of the total required inspections. Staff indicate that division officials are aware of the situation and yet have allowed it to continue for several years. Management's inattention to this problem has reportedly reduced the morale of other division staff and has weakened VHDA's oversight of some of its rental properties.

Recommendation (8). VHDA should develop a written operations manual outlining prescribed housing management procedures. In addition, VHDA management should ensure that all required project inspections are completed in a timely fashion.

III. SINGLE-FAMILY HOME LOANS

Single-family home mortgages comprise two-thirds of the authority's lending activity. As required by federal law, VHDA's homeownership program serves low- and moderate-income persons purchasing their first homes.

While extending the right of states and localities to issue tax-exempt housing bonds, Congress added the following language to the federal Deficit Reduction Act of 1984:

> State and local governments are expected to use their authority to insure qualified mortgage bonds and mortgage credit certificates to the greatest extent feasible (taking into account prevailing interest rates and conditions in the housing market) to assist lower income families to afford home ownership before assisting higher income families.

Although Congress clearly intended some means for prioritizing the mortgage assistance needs of lower-income families, no specific way to achieve this objective was set forth in federal legislation.

To implement Congressional intent, VHDA reserves funds for the first two weeks after it begins to accept reservations for mortgages for households with incomes at or below 80 percent of the area median. Thereafter, all persons with qualifying incomes can reserve a loan on a first-come, first-served basis.

This chapter reviews eligibility requirements for VHDA loans, presents an analysis of whom the authority's homeownership program serves, and examines options for adjusting the program to better serve the housing needs of low- and moderate-income persons. In addition, the authority's lending activities, loan approval process, and the collection policies are reviewed.

HOMEBUYERS SERVED BY VHDA

To receive below-market VHDA loans, prospective homebuyers must apply through VHDA-approved private lenders. More than 500 branch offices of about 130 lending institutions, including mortgage companies, banks, and savings and loans institutions, may originate VHDA loans.

In the loan origination process, the VHDA-approved lender is responsible for completing an application package which includes income tax returns, employment verification, credit reports, and real estate appraisals. The lender is also required to screen applicants to ensure they meet eligibility

requirements such as the first-time homebuyer restriction, and VHDA sales price and income requirements.

The loan application package is sent to VHDA for review of compliance with mandatory eligibility requirements. VHDA's loan officers must approve each loan application. The Board of Commissioners ratifies all loan decisions at its monthly meetings.

JLARC's review of clients served by VHDA suggests that several changes be considered to better target its single-family loan program to low- and moderate-income persons. Such efforts should include awarding loans only to those applicants who cannot qualify for conventional mortgages, and changing sales price and income limits to better reflect family size and geographic differences in housing costs. In addition, the authority could better assist households living in economically-depressed areas and lower-income groups which cannot afford the up-front costs of mortgage loans.

Eligibility Requirements and Clients

Of the major public and private mortgage programs currently available to Virginia homebuyers, VHDA is the only one that serves strictly first-time homebuyers. VHDA places limits on the income, assets, and debts of homebuyers; purchase price ceilings on the home; and restrictions against business-related uses.

The 1980 federal Mortgage Subsidy Bond Tax Act, which regulates state and local use of tax-exempt mortgage revenue bonds, establishes many of the general eligibility requirements which VHDA must follow. The authority has imposed additional requirements on its home loans which are more restrictive than federal limits, and other governmental and private mortgage programs.

Loan Requirements. Federal law requires that at least 90 percent of the loans made from each bond issue be awarded to persons who have not owned a home within the last three years. To meet this requirement, VHDA makes loans only to persons purchasing their first home. As permitted by federal law, however, VHDA does not require applicants for loans in low income, targeted areas to be first-time homebuyers.

Federal regulations do not restrict the income of homebuyers receiving mortgages made from bond proceeds. Virginia, like most states, has set maximum income limits. VHDA has established separate income limits for new, existing, and substantially rehabilitated homes in different parts of the Commonwealth (Table 6). These limits attempt to reflect differences in housing costs and income levels across the State.

The authority has also established debt ceilings for applicants. No more than 32 percent of an applicant's monthly income can be applied to shelter costs (i.e., loan principal and interest plus related taxes and insurance). Total monthly debt including shelter cost and credit installments cannot exceed 40 percent of a household's income.

Table 6

VHDA MAXIMUM ALLOWABLE ADJUSTED INCOMES AND SALES PRICES
(January 1984)

Geographic Area	New Construction		Substantial Rehabilitation		Existing Home	
	Income	Price	Income	Price	Income	Price
Northern Virginia Planning District	$40,000	$85,600	$40,000	$85,600	$37,500	$79,000
Norfolk-Va. Beach Newport News MSA	$34,300	$73,100	$34,300	$68,300	$28,400	$58,500
All other areas	$29,400	$61,100	$29,400	$56,500	$27,200	$51,600

Source: VHDA.

Federal tax law prohibits mortgage loans for homes that exceed the U.S. Treasury Department's estimate of average area sales prices by 10 percent. In certain designated areas, loans may be used for homes selling up to 20 percent above the federal estimates.

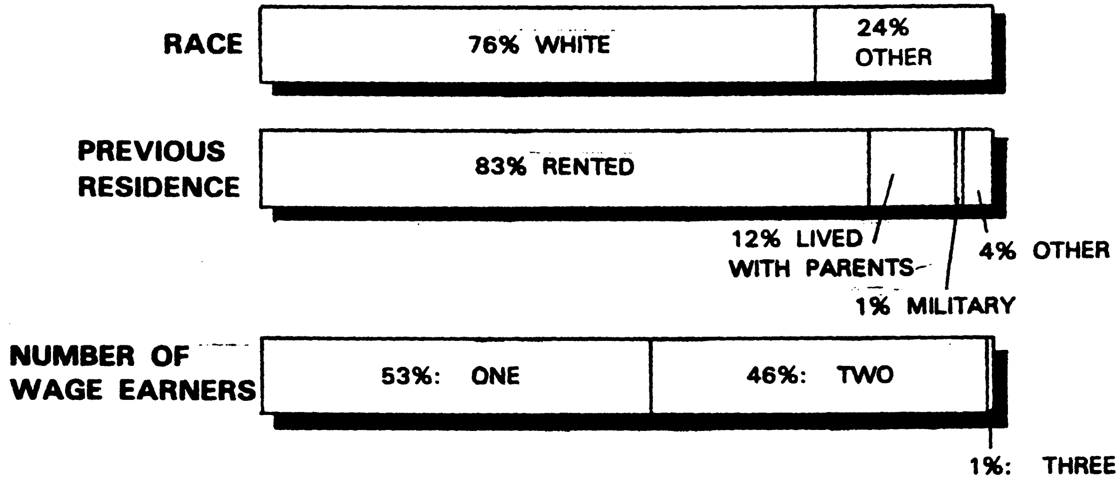
VHDA has chosen to establish its sales price ceilings below the allowable federal maximum. Current sales price limits range from 52 percent to 85 percent of the federal ceiling. Limits for new and substantially rehabilitated homes have been set above those for existing homes. According to VHDA officials, these higher rates are designed to meet VHDA's statutory mandate to stimulate "the construction and rehabilitation of residential housing." The rates also reflect the generally higher prices of new and rehabilitated homes.

VHDA policy, in compliance with federal requirements, prohibits the use of loans for business-related purposes. For example, the purchase of duplexes or other multiple-unit dwellings is not permitted, and no portion of the home can be used for a person's business. VHDA homebuyers are required to occupy the home they purchase.

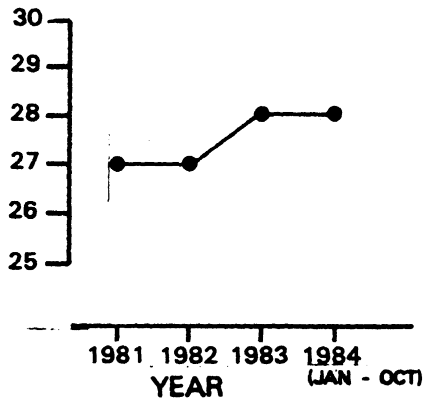
Profile of Homebuyers. Eligibility requirements influence directly the households served by VHDA's programs. The JLARC staff review of homebuyer characteristics found that VHDA mortgagors had a median annual gross income of $24,232 during the first 10 months of 1984, compared to the statewide median family income of $28,085 (Figure 5). Households contributed an average 25 percent of their income to pay average monthly mortgages of $492. Income and mortgage amounts varied considerably in different regions of the State, and reflected increases in recent years in housing costs, interest rates, and wages.

Figure 5

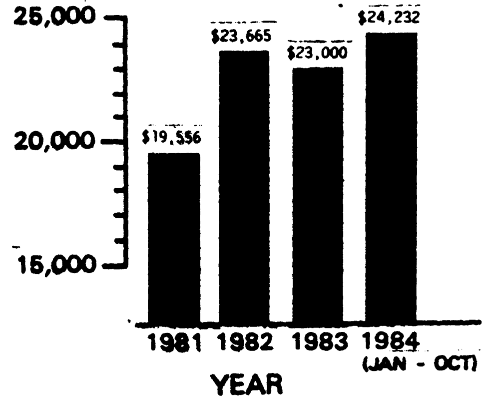
Characteristics of Single-Family VHDA Loan Recipients (1981 - 1984)



AGE



MEDIAN INCOME



SOURCE: JLARC REPRESENTATION OF VHDA DATA

Between August 1980, and October 1984, 45 percent of VHDA loans were made to "low-income" persons, with incomes at or below 80 percent of the area median. The percentage of loans awarded to low-income persons reached a high of 67 percent in 1980 when the VHDA interest rate was 9.35 percent. Loans to low-income persons comprised only 33 percent of all loans in 1982 when VHDA interest rates were above 13.5 percent and income limits were raised. In contrast, six percent of VHDA's loans between 1980 and 1984 were made to persons with incomes above 120 percent of the area median.

Eighty-three percent of VHDA homebuyers previously lived in rental housing. The average age of homebuyers was 28 years. One-person households received 26 percent of the total loans made during the period. Two-person and three-or-more person households received 36 percent and 38 percent, respectively. Fifty-three percent of the households had one wage earner, while 46 percent had two incomes. Three-fourths of all households receiving VHDA loans from 1980 to 1984 were white, and 24 percent were minority households.

Profiles of Homes Purchased. The average cost of homes financed by VHDA in FY 1984 was $51,756. Sales prices ranged from about $12,000 in Petersburg to $85,600 in Northern Virginia. The typical home financed by VHDA during the past four years was of modest size, ranging from 1,000 to 1,400 square feet. Seventy-nine percent of the homes were detached structures, with townhouses and condominiums comprising 15 and 6 percent, respectively.

Since 1980, 52 percent of the homes financed were newly-constructed. Loans for existing houses accounted for 45 percent, and three percent were for substantially rehabilitated houses. These proportions have remained fairly constant since 1980. In 1982, fluctuating economic conditions and changes in VHDA eligibility requirements resulted in two-thirds of the loans going to purchase new homes.

A majority of VHDA loans have been for the purchase of houses in the five largest metropolitan areas of the State. Between August 1980 and October 1984, 71 percent of all loan commitments were for houses in the Richmond, Southeastern Virginia, Northern Virginia, Peninsula, and Roanoke planning districts. About 60 percent of the State's total population live in these areas. The remaining areas of the State accounted for 29 percent of the total loans committed.

Compliance With Eligibility Requirements. The authority's lending practices appear to adhere to mandatory eligibility requirements related to income, sales price, down-payment, and first-time homeownership. In a review of 12,721 computerized loan records, JLARC staff identified 380 cases where the records appeared to indicate that loans were made contrary to the eligibility requirements. Detailed review of one-third of these cases revealed that all but nine of the apparent inconsistencies were data entry errors. Only for nine loans did it appear that VHDA had not complied with its eligibility requirements.

VHDA has recently implemented additional quality controls to further strengthen the underwriting process. Loan officers and the assistant director will meet quarterly to review interpretations of the underwriting

manual. Senior loan officers will also review loan rejections to ensure the authority's standards are consistently applied. In addition to these efforts, VHDA's computer system should be programmed to check each loan commitment for compliance with mandatory requirements.

Clients Potentially Eligible for Conventional Loans

Although VHDA is in compliance with all other eligibility requirements, it does not adequately screen loan applications to determine if homebuyers are qualified for conventional mortgages. State law clearly directs VHDA mortgage funds to be made available to households that cannot secure private mortgage financing at affordable prices. Statutes list several factors that VHDA is to consider when determining eligibility for its programs. Among these is "the ability of such persons and families to compete successfully in the normal private housing market and to pay the amounts at which private enterprise is providing sanitary, decent and safe housing...."

Moreover, VHDA is specifically charged in Section 36-55.33:1(C2) of the *Code of Virginia* to make its loans only after determining that a loan "is not otherwise available from private lenders upon reasonably equivalent terms and conditions, and the VHDA resolution authorizing, or commitment for, such mortgage loan shall contain such a determination." The authority's rules and regulations (Rule 402) contain language similar to the statute.

Despite these statutory and regulatory provisions, VHDA does not have an adequate means for determining if loan applicants are eligible for conventional mortgages. Consequently, JLARC staff found that 2,888 (or 23 percent) of VHDA's loan commitments during the past four years were made to homebuyers with sufficient income to qualify for conventional, private loans. From August 1980 through October 1984, these loans accounted for $113.7 million in mortgage commitments that otherwise could have been made by private lenders. Had VHDA excluded applicants qualified for conventional mortgages, more VHDA mortgage funds would have been available for persons unable to qualify for private mortgages.

Inadequate Verification of Eligibility. Although VHDA is required by State law to make loans only after verifying that an applicant is not eligible for a conventional loan, VHDA loan officers do not routinely make such a determination. Loan officers told JLARC staff that they rely solely on lenders that originate the loans to determine that applicants do not qualify for conventional financing. The required checklist (VHDA Form 207) that lenders send to VHDA as part of each loan package includes the statement "that in the opinion of the lender, the applicant could not obtain a conventional mortgage loan to purchase the property." However, 10 of the 12 VHDA-approved lenders JLARC contacted reported that they do not actually make this determination. Rather, lenders indicate that the following scenerio routinely occurs:

> *Applicants typically request a specific type of loan upon the advice of real estate agents -- in most instances the one with the best available interest rate and terms. This is frequently a VHDA loan. If an applicant requesting a VHDA loan meets the sales price, income, and other*

requirements, the lender sends the loan package to VHDA for review and approval without having determined if the applicant qualifies for a conventional loan.

JLARC Analysis of VHDA Loan Commitments. To determine the extent to which VHDA's lending practices have resulted in loans that are not in compliance with statutory requirements, JLARC staff examined the records of 12,721 loan commitments made between August 1980 and October 1984. The analysis found that 2,888 (23 percent) of the households had sufficient gross income to qualify for conventional mortgages. JLARC used historical interest rate data for Virginia provided by the Federal Home Loan Bank Board to determine prevailing market interest rates at the approximate time that each homebuyer applied to VHDA.

With the underwriting guidelines used by private lenders, JLARC staff calculated the minimum income each of the 12,721 households would have needed to qualify for the specific loan amount requested. If actual income exceeded this minimum, then the applicant was judged to have sufficient income to qualify for a conventional mortgage.

JLARC's analysis was based on three assumptions:

(1) *A conventional, 30-year fixed-rate loan would be "reasonably equivalent" in terms and conditions to a VHDA loan.* Although graduated-payment and adjustable-rate mortgages with low initial interest rates have emerged as prevalent financing mechanisms in the private mortgage market, JLARC used only the interest rate for 30-year fixed-rate mortgages to calculate monthly principal and interest payments.

(2) *The taxes and insurance portion of the monthly shelter cost payments would be the same for VHDA and conventional loans.* This assumes that the loan amount and property value -- upon which such expenses are based -- would be the same regardless of the type of loan.

(3) *Applicants could meet all other eligibility requirements needed (such as credit worthiness and employment record) to qualify for a conventional loan.* These requirements are similar for VHDA and private loans.

Differences between minimum down-payment requirements for conventional and VHDA loans were not used to determine if applicants had sufficient incomes to qualify for conventional mortgages. It was not feasible for JLARC staff to determine retrospectively if each applicant had accumulated sufficient assets to pay, at most, $750 more for the minimum conventional mortgage down-payment than the minimum required for a VHDA loan. During the period of JLARC's analysis, VHDA required a minimum down-payment of at least two percent of the first $25,000 of the sales price and five percent of the balance for a home loan, and a minimum of five percent of the purchase price for a condominium. Federal guidelines for the conventional market require a minimum downpayment of five percent of the total sales price, although individual lenders may require more.

Loans to purchase substantially-rehabilitated homes were not included in the JLARC staff analysis because of their unique nature. These accounted for less than five percent of VHDA's total loan commitments made during this period. A complete description of JLARC's analysis is contained in the technical appendix to this report.

High Income Ceilings. Most of VHDA's loan commitments to homebuyers eligible for conventional mortgages occurred after February 1983, when VHDA recalled bonds with high interest rates. The authority had raised its income limits to make higher interest loans available, but never reduced the limits to correspond to the lower interest rates of succeeding bond issues. Thus, in recent years, higher income households have been eligible for VHDA loans.

VHDA sets income limits at levels it considers necessary for applicants to afford homes within its sales price limits. Interest rates are an important factor in determining loan "affordability." As VHDA's rates increased to a high of 13.85 percent in 1982, higher incomes were needed for families to afford the monthly mortgage payments. Therefore, the authority's income limits were increased accordingly.

When interest rates on conventional loans declined dramatically from a high of 18.3 percent to below 13 percent in late 1982, VHDA's loan rates of 13.85 and 13.7 percent were no longer attractive to most prospective homebuyers. VHDA income limits were increased from $3,000 to $5,000 above the level necessary to purchase homes at the sales price limits. The purpose of this action was to expand the income groups eligible for VHDA loans and avoid recalling the bonds. Although VHDA's interest rates subsequently stabilized below 11 percent in 1983 and 1984, VHDA has not decreased its income ceilings. As a result, JLARC staff found that many of the VHDA homebuyers potentially qualified for conventional loans had incomes far in excess of the minimum amount required to qualify for those loans. Fifty percent had incomes that were more than $2,500 above the required conventional minimum income, while ten percent had more than $7,000 above the required minimum.

Effect on Loan Foreclosures. Screening out applicants qualified for conventional loans would reduce the median income of VHDA homebuyers, and would ensure the authority serves a lower income group overall. JLARC tested the potential impact of such action on the authority's mortgage foreclosure rate. Only loans made from 1980 bond proceeds were used in this analysis because more recent issues had insufficient numbers of foreclosures for valid comparisons. JLARC staff found that VHDA loan commitments to homebuyers not qualified for private mortgages had a slightly lower foreclosure rate (4.1 percent) than those found eligible for conventional loans (5.5 percent) (Table 7).

Furthermore, JLARC staff found that VHDA homebuyers with lower incomes generally had no greater rates of foreclosure than those with higher incomes. Less than one percent difference existed between the median income of VHDA homebuyers that defaulted on their loans and those that did not. JLARC staff also found little difference between the percentage of homebuyers' incomes used for mortgage payments for those whose loans were not foreclosed (median of 25.4 percent) and those whose loans were foreclosed (median of 24.3 percent).

Table 7

FORECLOSURE RATES AMONG VHDA HOMEBUYERS QUALIFIED AND NOT QUALIFIED FOR CONVENTIONAL MORTGAGES
(1980A and B Series Loans)

Loan Status	VHDA Homebuyers Deemed Qualified for Conventional Mortgages		VHDA Homebuyers Deemed Not Qualified for Conventional Mortgages	
Foreclosed	16	(5.5%)	115	(4.1%)
Not Foreclosed	131	(94.5%)	2,703	(95.9%)
TOTALS (n = 3255)	276		2,834	

Source: JLARC analysis of VHDA loan foreclosures.

JLARC's findings are confirmed by those of other studies regarding the relationship between a mortgagor's income and the risk of home loan default. A 1983 Merrill Lynch study of housing authority bonds found that household income had little relationship to the incidence of loan foreclosure. In addition, a 1984 nationwide study of 400,000 home loans insured over a 10-year period conducted by Investors Mortgage Insurance Corporation found that a homebuyer's debt service ratio (i.e., total mortgage costs plus other debt obligations divided by income) was not related to the risk of default on fixed-rate mortgages.

Recommendation (9). VHDA loans should be made only after verification that applicants are not qualified for "reasonably similar" mortgages from conventional lenders. Lenders originating VHDA loans should be required to make such verifications by computing the minimum income required for each applicant to qualify for a conventional loan at current interest rates. VHDA should require that a worksheet with these calculations be submitted as part of each loan application. VHDA's loan officers should review the worksheets to verify eligibility for VHDA financing. Applicants that have sufficient income to qualify for conventional loans should be permitted to submit documents verifying that they were denied conventional financing for income reasons. Upon submission of such evidence, VHDA might reconsider the application for further processing.

Sales Price and Income Limits

Although State law provides general guidelines for VHDA to consider in determining eligibility for its programs, the authority has substantial latitude to decide who qualifies as having "low and moderate income." Section 36-55.26(q) of the *Code of Virginia* lists factors VHDA is to consider when targeting its programs:

- total income available to meet housing needs;
- family size;
- cost and condition of existing housing;
- ability of applicants to secure affordable housing from the private market; and
- if appropriate, federal program standards based on income limits.

The authority's enabling statutes do not specifically define "low" and "moderate" income. Rather, VHDA uses sales price and income limits to define the clients its home loan program will serve.

JLARC staff reviewed sales price and income limits and the criteria used in setting them. In general, VHDA appears to consider factors appropriate to its mandate when setting sales price and income limits. Some adjustments in the limits are needed to better reflect geographic differences in housing costs and incomes. The limits could be set to better target low and moderate income families not otherwise eligible for private mortgages.

Sales Price Adjustments. VHDA has established different sales price and income limits for three areas of the State: Northern Virginia, Tidewater, and the remainder of the State. The categories are intended to reflect differences in housing markets and incomes. However, the wide disparity among average sales prices and incomes in the areas currently grouped within the "remainder of State" suggests that additional categories are needed. The categories would better reflect differences in high and low cost housing markets.

The range in the cost of new homes in the "remainder of State" area was documented in a recent consultant survey of average home sales prices in several Virginia markets (Table 8). The survey shows that average sales prices range from 83 percent to 166 percent of the VHDA sales price limit. In contrast, the consultants' survey found VHDA's sales price limits for Tidewater to be 98 percent of that area's average price for new homes. The disparity among the average sales prices in different areas currently grouped within VHDA's "remainder of State" area suggests that additional groups should be developed.

Recommendation (10). To recognize differences in housing costs and more equitably serve households across the State, VHDA should make additional distinctions within its sales price limits by separating the high cost areas from others currently within the "remainder of State" category. The Board of Commissioners should adopt separate sales price limits for each of these areas. Sales price limits should be based on periodic surveys of home sales prices throughout the Commonwealth.

Adjustments to Income Limits. VHDA sets income limits by estimating the income necessary for applicants to purchase a home at VHDA's sales price limits. JLARC staff found that adjustments are needed in the authority's current income limits. Specifically, VHDA's three categories for income limits do not adequately reflect area differences in family income. In

Table 8

VHDA "REMAINDER OF STATE" SALES PRICE LIMITS
COMPARED TO ACTUAL SALES PRICES

Locality[1]	Average 1983 Sales Price for a New Home	Average Sales Price as a Percent of VHDA's Limit[2]
Charlottesville	$ 69,137	13%
Danville	50,736	83%
Fauquier Co.	101,250	166%
Frederick Co.	55,272	90%
Fredericksburg City	79,833	131%
Lynchburg	56,846	93%
Richmond City/Petersburg	68,569	112%
Roanoke	69,786	114%
Spottsylvania Co.	65,421	107%
Winchester	84,166	138%

[1]List includes all areas in the remainder of State category surveyed by consultant.

[2]VHDA sales price limit for remainder of State is $61,100.

Source: 1984 consultant sales price survey for VHDA.

areas where VHDA's income limits are above the area median, JLARC found the smallest proportion of loans committed to low-income persons and the largest proportion to persons with sufficient incomes to qualify for conventional mortgages.

By not accounting for differences across the State, VHDA's income limits appear to be inconsistent with measures of household wealth, such as median income. In some areas of the State, VHDA's current limits target households with incomes above 150 percent of the area median. In other areas, only households with incomes below the median can qualify for a VHDA loan. For example, persons with up to 129 percent of the Tidewater area median income can qualify for VHDA loans on new homes in that area, while only those applicants with less than 93 percent of the median are eligible in Northern Virginia.

Even greater differences exist among the areas included in VHDA's "remainder of State" category. Eligible families in Fredericksburg, for example, are those with less than 95 percent of the area median income, compared to those having up to 155 percent of the median income on the Eastern Shore.

VHDA has been most successful in serving low-income persons in areas where the income limits are set at or below the area median income. In 1984, 60 percent of the VHDA's new home loan commitments in Northern Virginia, where limits are set at 93 percent of area median income, were made to applicants with incomes at or below 80 percent of the median. In Tidewater, where VHDA's income limits for the purchase of a new home are set at 129 percent of area median income, only 21 percent of the authority's loans were made to low-income persons during 1984. Among the remaining areas of the State, the Richmond Regional planning district had the highest percentage (59%) of VHDA new home loans for low-income persons in 1984, while none of the 32 new home loan commitments made in the Lenowisco, Mount Rogers, Rappahannock-Rapidan, Northern Neck, and Accomack-Northampton planning districts went to applicants with incomes below 80 percent of the area median.

Recommendation (11). VHDA should adjust its income limits to better reflect regional differences in area median incomes. VHDA should divide areas with high median incomes from other areas currently grouped within the "remainder of State" category. The Board of Commissioners should adopt separate income limits for these high income areas.

Adjustments for Family Size. VHDA is required by State law to consider family size when determining the eligibility for its programs. Although it allows for income to be adjusted slightly for family size, a large proportion of the authority's home loans are made to one-person households.

In April 1980, VHDA's Board of Commissioners adopted a policy to limit the number of loans to single persons to 17 percent of the total. The limit was based on the proportion of single-person households in the State at the time of the 1970 census. The policy also restricted single-person households from purchasing a home with more than two bedrooms. In 1981, the board adopted separate sales price limits for single-person households which were approximately 12 percent below the sales price limits for families.

In an attempt to avoid a bond recall in 1982, the board waived all single-person loan restrictions. The purpose was to attract as many homebuyers as possible. The restrictions have not been reimposed, even though the VHDA's loan rates have remained consistently below the market rate since.

When VHDA's 17 percent allocation to single persons was in effect, 21 percent of VHDA's loan commitments were made to single-person households. After VHDA waived the requirement, 28 percent of the households receiving VHDA loans were single-person. Only 22 percent of the State's households were single-person in the 1980 census.

VHDA's income limits are the same for single individuals and families, though a family's housing needs are likely to be greater than those of an individual. As a reflection of family size, VHDA does permit a $1,000 deduction from gross income for each person in the household. Up to $2,500 of a working spouse's earnings may also be deducted.

In contrast to VHDA, housing finance agencies in three of 10 states contacted have established separate income ceilings for single-person

households. Maryland, for example, has a gross annual income limit of $28,000, compared to a $33,000 limit for a household of two or more persons. Massachusetts' limit for a single-person household is $29,000, or $6,000 less than the ceiling for a two-person household. The limits in California are set as a percentage of area median income. Single-person households in California may gross up to 20 percent above the area median, two- and three-person households 35 percent above, and four- or more-person households 50 percent above.

Recommendation (12). VHDA should establish a separate income limit for single-person households. The Board of Commissioners may also wish to reimpose a limit on the amount of loans available for single-person households equal to their proportion of the State population.

Targeting Funds for Special Needs

In several areas of the State, and for certain groups, it is particularly difficult to finance the purchase of a home. Special provisions are needed to assist Virginians living in economically-depressed "targeted areas." Additionally, VHDA may need to assist those who qualify under the authority's eligibility guidelines but cannot afford the up-front costs associated with mortgage loans.

Loans for Rural and Inner-City Targeted Areas. Private lenders have historically had difficulty making loans in depressed real estate markets such as those in rural and inner-city areas. While VHDA has provided some mortgage funds in these areas, additional efforts are needed. VHDA financing is particularly critical in these areas since they have not been adequately served by the private market. Yet less than six percent of VHDA loan commitments over the last four years were made in targeted inner-city and rural areas.

Recognizing the special needs of these areas, federal law requires that 20 percent of the lendable proceeds from each bond issue be held for one year for loans in targeted areas. VHDA divides this allocation for targeted areas into a separate allocation for each of the 19 targeted areas. The allocations are managed by "targeted-area administrators" such as planning district commissions, local redevelopment and housing authorities, local planning offices, and community development departments. These individual allocations are based on population and the amount each area used in previous bond issues. VHDA may also make additional awards for special projects. The targeted area administrators designate which VHDA-approved lenders in their areas will be responsible for receiving and processing applications for targeted area loans.

In general, targeted-area administrators have begun to use more of their allocations as interest rates have declined. Only two percent of the targeted-area allocation from the 1981A bond issue (at a 13.7 percent interest rate) was used, while 38 percent of the targeted area allocation from the 1983B bond issue (at a 10.61 percent interest rate) was lent.

The amount used by targeted areas varies considerably. In Norfolk, Portsmouth, and Alexandria, for example, a large portion of the allocations are

typically used by homebuyers. In other targeted areas, such as those within the Lenowisco and Cumberland Plateau planning districts, only a small proportion of the areas' allocations are regularly used.

The authority has made some attempts to promote lending in rural and inner-city targeted areas. Prior to the federally required allocation to targeted areas, VHDA initiated an Urban Preservation and Infill program that set aside mortgage funds for inner-city areas. VHDA staff have visited various areas of the State to conduct promotional workshops. VHDA has also advertised relatively unknown programs with rehabilitation-related purposes such as the energy conservation program.

Based on their experience with the program, targeted-area administrators and lenders in both rural and urban areas suggested to JLARC staff additional measures to facilitate VHDA lending in targeted inner-city and rural areas. These include:

- special training programs for staff of VHDA-approved lenders to acquaint them with all the detailed requirements of the targeted-area program,

- closer contact between VHDA and the lender regarding the status of loan applications,

- additional assistance to promote VHDA's programs in targeted areas including advertising and speaking to interested groups,

- preparation and distribution of detailed maps and street inventories to identify eligible targeted areas,

- exploration of other methods to finance the rehabilitation of homes, particularly those of present homeowners,

- adjustment of property standards in rural areas such as relaxing the VHDA requirement for eligible properties to be located on State-maintained roads, and

- more lenient application of underwriting standards so that marginal credit risk persons might be accepted or exceptions granted for unique circumstances such as periodic and temporary lay-offs in coal mining areas.

Recommendation (13). VHDA should utilize additional methods to increase the commitment of loans in rural and inner-city areas. The authority should become involved in additional training for VHDA-approved lenders in these areas, increased promotional efforts, preparation and distribution of detailed maps and inventories of eligible neighborhoods, and exploration of innovative financing techniques for home rehabilitation loans. Appropriate exceptions to the authority's underwriting standards should also be developed to account for special circumstances that may exist in rural and inner-city areas.

Assistance for Lower-Income Persons. Many lower-income persons who can meet VHDA's eligibility requirements may be unable to take advantage of the authority's financing because they have insufficient cash to cover

up-front expenses associated with purchasing a home. These costs include application fees, closing costs, mortgage insurance, and a minimum five percent down-payment. These costs totaled $4,800 -- $2,600 for five percent down-payment and $2,200 for additional loan application and closing costs -- on an average VHDA home purchased for $52,000 in 1984.

Given the authority's fund balances (as discussed in Chapter IV), VHDA may now be able to assist lower-income families with these up-front expenses. While it is important that homebuyers have an equity interest in the home, VHDA could provide financial assistance to help with loan processing charges. The assistance might cover application and closing fees, for example. A set-aside of as little as $2 million for such a program would provide 1000 qualified families with $2,000 towards up-front loan costs.

Recommendation (14). VHDA should establish a program to assist lower-income applicants with paying the costs of taking out a home loan. To this end, the authority might consider setting aside a portion of its fund balances to assist eligible families with mortgage insurance, and other closing costs. The assistance could be offered on a loan or subsidy basis.

PROCESSING AND COLLECTING MORTGAGE LOANS

In addition to establishing eligibility requirements, VHDA single-family staff are responsible for reviewing and approving loan applications. VHDA-approved lenders are responsible for collecting monthly mortgage payments. VHDA's loan servicing staff monitor lenders to ensure that collection of mortgage payments is accurate and timely.

From a review of these functions JLARC staff found that VHDA could process applications in a more timely manner. In addition, VHDA's loan collection procedures -- which are more aggressive than most other lenders -- were found to have contributed to low loan delinquency rates. However, these procedures should be re-examined by the authority to ensure that they do not contribute to unnecessary foreclosures.

Processing Loan Applications

Concerns have been raised about the time that it takes VHDA to approve a home loan. Some processing delays may be beyond VHDA's control, while others appear to be affected directly by the authority's underwriting capabilities. While VHDA has recently taken measures to reduce loan processing time, additional measures are needed to assist loan officers in regularly meeting processing standards.

JLARC staff reviewed the processing of 9,345 loans for which automated records were available. The review focused on the duration between five key points in the process: (1) the phone reservation of funds by the private lender; (2) VHDA's receipt of the application; (3) the authority's loan decision; (4) the mailing of the loan commitment to the applicant; and (5) the final loan closing.

VHDA has limited control over two of the more time-consuming periods in the process: (1) the time between the phone reservation and the submission of the loan application by the lender, and (2) the time between the commitment letter and the loan closing. VHDA's Single-Family Division has, however, set a processing standard of 10 days for the period from receipt of the application at VHDA to the decision on commitment of the loan. JLARC staff found that 65 percent of the authority's loans did not meet this 10-day standard. For about nine percent, it took VHDA more than 30 days to review and make a decision on the loans.

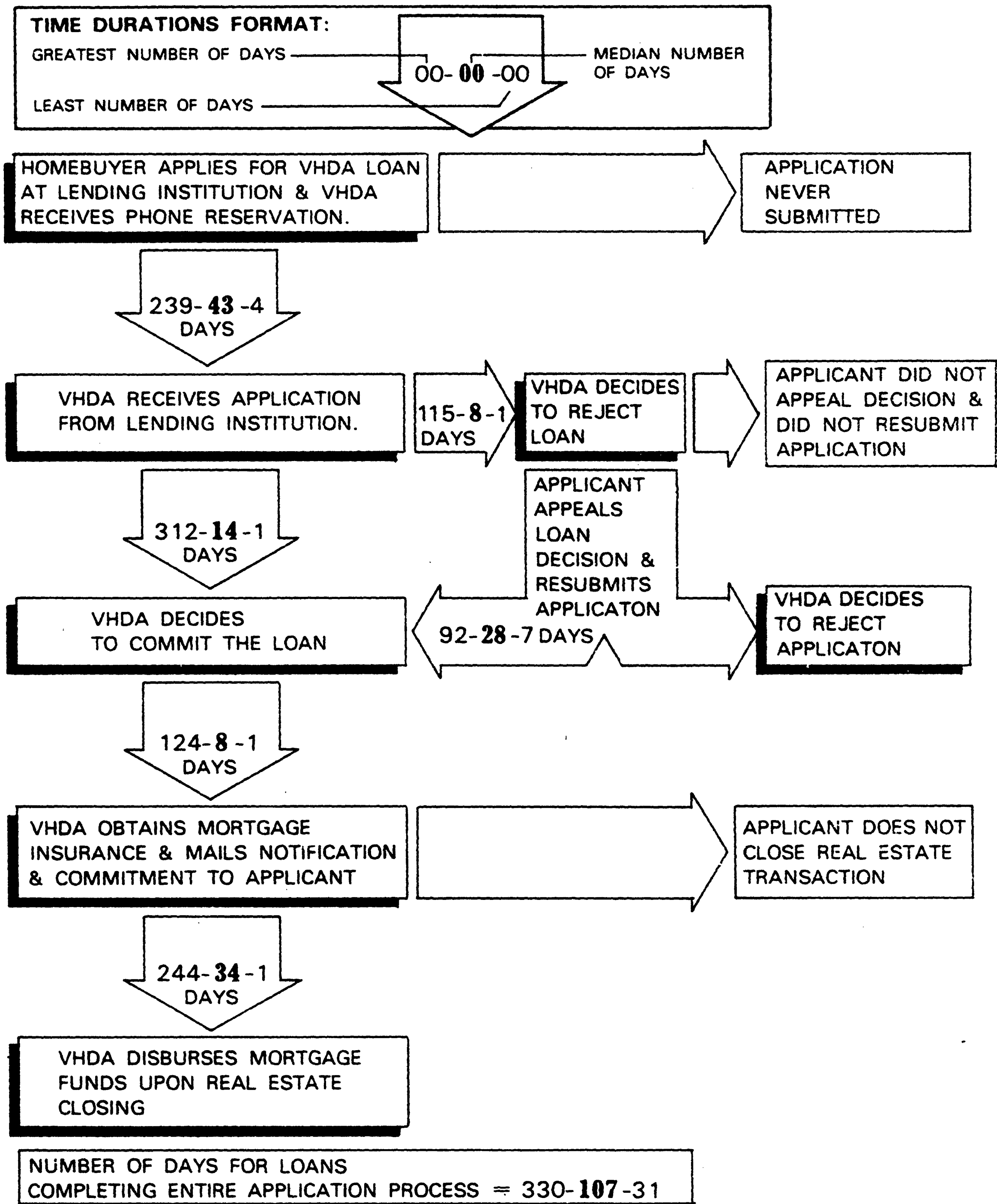
For 53 percent of the applications, VHDA did not meet a five-day standard for the time between the commitment decision and the mailing of the commitment documents to the lender. Almost 40 percent of the loans took at least 10 days. Overall, JLARC staff found that half of the VHDA loan applications committed during the period of August 1983 to October 1984 took more than 107 days to process from initial reservation to final closing. Twenty-five percent took over 140 days to complete (Figure 6).

Delays in processing VHDA mortgage applications can have negative impacts on prospective homebuyers as illustrated in the following example:

> *In early 1985, an individual living in a targeted area of Richmond had taken out a $40,000 short-term construction loan from a conventional lender for the rehabilitation of a home. The individual planned to obtain a permanent home mortgage from VHDA to repay the construction loan.*
>
> *Eight weeks after the loan application had been sent to VHDA, one of the authority's loan officers called to inform the applicant's lender that the loan was approved and that commitment documents would soon be mailed. Two and a half weeks later, however, the commitment package still had not been received from VHDA.*
>
> *The delay was costly for the applicant because she was paying approximately $100 per week in interest charges on the construction loan while awaiting the VHDA commitment documents. Without these documents the permanent loan could not be closed and the construction loan could not be repaid.*

Several factors contributed to the delays in VHDA's loan processing during the period reviewed by JLARC. VHDA released one of its largest bond issues ($163 million) in late 1983, prior to the expiration of the federal Mortgage Revenue Bond Subsidy Act. Because of uncertainty over whether Congress would continue to permit states and localities to issue tax-exempt housing bonds, VHDA did not hire additional loan processing staff. As a result, VHDA's six loan officers processed over 6,500 loans during fiscal year 1984, or about twice the volume of the previous year. Once Congress extended the authority to issue mortgage revenue bonds in the summer of 1984, VHDA released another large bond issue and hired additional new lending staff.

Figure 6



NOTE:
NUMBER OF DAYS WITHIN INDIVIDUAL PHASES OF THE LOAN PROCESS INCLUDE LOANS THAT DID NOT COMPLETE THE ENTIRE PROCESS, - THEREFORE, THE SUM TOTAL OF INDIVIDUAL PHASES DOES NOT EQUAL THOSE THAT COMPLETED THE ENTIRE PROCESS.

SOURCE: JLARC ANALYSIS OF VHDA LOAN PROCESS (AUGUST 1983-OCTOBER 1984)

VHDA has recently taken other steps to increase its loan processing efficiencies including:

- hiring three loan officers and three loan paralegal staff,
- generating computer-printed commitment letters,
- requiring lenders to receive private mortgage insurance prior to sending the application to VHDA,
- establishing maximum times for other parts of the process handled by its approved lenders, and
- investigating methods to better even out the flow of loan applications.

Confident that these actions will reduce processing times, the authority has reduced its underwriting standard for the time between receipt of the application to notification of the commitment from 15 days to 8 days. However, the authority's plan to issue a record amount of single-family bonds in 1985 will require additional steps to ensure efficient processing of loans.

Recommendation (15). To expedite loan processing, VHDA should consider releasing mortgage funds at a rate that can be efficiently processed by staff, instituting computer and supervisory checks for processing durations, and providing additional training for lenders originating VHDA loans.

Collecting Mortgage Payments

VHDA has consistently maintained low loan delinquency rates. Favorable lending laws in Virginia, careful underwriting of loans, and aggressive VHDA loan servicing policies have been credited with keeping rates low. Concerns have been raised, however, that the authority's collection efforts are too aggressive. JLARC staff found that VHDA's collection practices are more stringent than most other lenders. Although these practices have been successful in keeping delinquency rates low, the authority's policies might result in unnecessary foreclosures.

Comparison of Rates. A 1983 report by Merrill Lynch found that VHDA had the lowest delinquency rate and eighth lowest foreclosure rate for all state housing agencies in the country. In addition, VHDA's delinquency rates are about half the rate of all Virginia and national lenders. While VHDA's foreclosure rate is also below national averages, it is slightly higher than the rate for all single-family loans made in Virginia, and is almost three times greater than the foreclosure rate for conventional loans in Virginia (Table 9). During 1984, VHDA foreclosured on 116 of its 24,171 loans (0.48 percent).

Comparison of Collection Policies. According to VHDA staff, the authority's more aggressive collection policies are designed to contribute to the attractiveness of its bonds to investors. In support of its policies, VHDA reports that about 37 percent of the loans that enter the foreclosure process

Table 9

1984 DELINQUENCY AND FORECLOSURE RATES

	Virginia			National	
	VHDA	All Loans	Conventional	All Loans	Conventional
Average delinquency rate as a percent of total loans	2.01%	4.34%	4.05%	5.66%	3.85%
Average rate of loans in the foreclosure process as a percent of total loans	0.25%	0.17%	0.07%	0.68%	0.45%

Source: VHDA, National Mortgage Bankers Association.

are fully reinstated before the borrower loses the home. However, VHDA's more stringent collection practices appear to have contributed to higher foreclosure rates than those for conventional loans in Virginia.

A comparison of the authority's collection policies indicates that they are more stringent than other lenders in the following ways:

- VHDA permits lenders to assess a late penalty on the mortgagor earlier and at a slightly higher rate than other lenders,
- VHDA commences foreclosure proceedings earlier than some other lenders, and
- VHDA requires that its approved lenders complete the foreclosure process within four months after delinquency occurs and holds its lenders liable for any interest due on loans that are past the fourth month of delinquency - unless an extension is granted.

JLARC staff discussions with six of the largest approved lenders that collect and service VHDA loans identified the following concerns about the authority's collection policies:

- VHDA appears to be less willing than other lenders to accept "forebearance" plans in which the borrower temporarily suspends a portion or all of the payments on the condition that future payments will make up the difference.
- VHDA's requirement that the foreclosure process be completed in four months gives lenders little latitude to arrange special payment plans for deserving borrowers.

- VHDA seems unwilling to consider a reinstatement within five days of the foreclosure date. (However, VHDA staff indicated to JLARC that the authority will consider reinstatement at any time prior to actual foreclosure).

- Unlike some other State housing finance agencies, VHDA does not usually work directly with delinquent borrowers to develop repayment plans for those that might have a legitimate need to temporarily adjust monthly payments.

All six of the lenders contacted by JLARC agreed that VHDA's collection expectations are clear and consistently applied. They reported that VHDA is relatively inflexible in the application of its policies in exceptional cases. Consequently, these lenders report that the authority's collection policies have resulted in a much higher portion of delinquent VHDA loans going into foreclosure than the conventional loans in their portfolios.

From a financial standpoint, it is more important for VHDA to maintain low delinquency rates than low foreclosure rates, although both are an indication of a strong loan portfolio. High delinquency rates would adversely affect the authority's cashflow. In the case of foreclosures, VHDA typically recovers the full value of the loan through private mortgage insurance payoffs and/or resale of the home.

JLARC staff did not evaluate individual VHDA foreclosure decisions to determine if any of the borrowers might have been able to reinstate their loans had VHDA been willing to risk forebearance plans. However, because the authority's foreclosure rate is three times higher than the conventional rate in Virginia, VHDA needs to ensure that its collection policies do not prevent delinquent borrowers from reinstating their loans when possible.

Recommendation (16). Although the authority's collection policies have contributed to its consistently low delinquency rates, VHDA should review its policies to ensure that they do not result in unnecessary foreclosures. The authority should seek the advice of its approved lenders on specific ways its collection policies might be modified.

IV. FINANCING VHDA PROGRAMS

The financial position of the Virginia Housing Development Authority is reported by municipal bond experts to be among the best in the nation for state housing finance agencies. The authority is the eighth largest financial institution in Virginia in terms of assets. According to the experts, VHDA's financial management practices have contributed to its strong financial condition.

The authority's strong position has enabled it to obtain favorable bond ratings and attractive interest rates. Such a position also minimizes the likelihood that the State's "moral obligation" pledge would ever be called upon to replenish the authority's bond reserves. In fact, this suggests that current statutory provisions relating to the moral obligation pledge could be amended without significant impact on VHDA's future bond issues.

While VHDA has been extremely successful in accumulating funds necessary to secure its bonds, it has also accumulated large fund balances. The bond fund and the general fund balance together exceeded $160 million on June 30, 1984. Several factors suggest that a portion of the assets associated with these fund balances could be used to finance additional housing programs to serve low- and moderate-income persons. Given VHDA's strong condition, use of the funds should not jeopardize the financial integrity or security of the authority's bonds.

MORAL OBLIGATION PLEDGE

While no State-appropriated funds are involved in VHDA's programs and operations, most of the authority's bonds carry a provision which pledges the State's moral obligation to secure the bonds. This provision could result in the General Assembly being asked to appropriate funds for VHDA should its revenues ever be insufficient to meet its bond debt. The likelihood of this occurring in the foreseeable future is remote. As of March 31, 1985, VHDA had $1.95 billion of bonds outstanding, of which $1.19 billion carried the moral obligation pledge. None of the authority's single-family bonds issued since 1982 carry the moral obligation pledge. The authority's multi-family bonds, which accounted for 15 percent of the authority's bonds issued since 1982, continue to include the provision.

Legislative Basis for Moral Obligation

Virginia law clearly states that VHDA's bonds do not constitute a liability on the Commonwealth. However, Section 36-55.41(2), the *Code of Virginia*, directs Governor to submit in his budget:

> the sum, if any, required to restore each capital reserve fund to the minimum capital reserve fund requirement for such fund. All sums appropriated by the legislature for such restoration and paid shall be deposited by VHDA in the applicable capital reserve fund.

This provision has been interpreted by VHDA's bond counsel and others to mean that the General Assembly is authorized, though not required, to appropriate funds to replenish VHDA's capital reserve funds in the event that reserves are insufficient to meet its debt service requirements. Such a provision is commonly referred to as a "moral obligation" pledge in the municipal bond field.

Only one other public authority in the Commonwealth, the Virginia Water and Sewer Assistance Authority, has the moral obligation backing for it bonds. In addition, about one-third of the housing agencies in other states carry such a provision.

The moral obligation pledge serves as a final measure of security to the authority's bondholders, and has enabled VHDA to obtain favorable credit ratings and bond market rates. This was particularly important when housing bonds were new in the market. Today, however, municipal bond analysts indicate that investors are more comfortable with these bonds and place greater emphasis on the issuing authority's financial record than on contingent State liabilities.

Prospects of Invoking the Moral Obligation Pledge

JLARC staff reviewed the conditions under which the State might be called upon to back the authority's bond reserves. Given the existing level of bond security, favorable portfolio characteristics, and VHDA's overall financial strength, it appears highly unlikely that the State's moral obligation pledge will be called upon in the foreseeable future.

VHDA Bond Security. VHDA bonds are backed by a number of reserves established in accordance with State policy, VHDA regulations, and bond market's requirements. Those bonds which carry the moral obligation pledge are required by State law to establish capital reserve funds at least equal to the annual debt service due on the bonds. As of June 30, 1984, each of the authority's capital reserve funds were sufficient to meet the amounts required (Table 10).

According to the authority's Director of Finance, "there is virtually no chance that VHDA will experience losses from a resolution which cannot be covered either by funds available in the resolution or the funds available from the authority's general fund." Past experience with foreclosed properties, increasing bond fund balances, and the use of mortgage insurance provide a high level of security. The authority estimates that it could foreclose on 46 percent of its single-family mortgages and 20 percent of its multi-family loans "without a call upon VHDA's general fund or the capital reserve funds."

Should such an event occur, however, several forms of bond security would have to be exhausted before the General Assembly would be asked to

Table 10

VHDA CAPITAL RESERVE FUNDS

Bond Resolution	Capital Reserve Requirements*	Actual Amount In Reserves
Single family mortgage bonds	$18,016,000	$20,870,000
Home mortgage bonds	50,650,000	53,722,000
Multi-family housing bonds	28,856,000	28,943,000
Multi-family mortgage bonds	19,307,000	20,038,000
Mortgage purchase bonds	3,327,000	3,344,000
Residential mortgage bonds**	47,662,000	49,751,000

*Based on Amount of bond debt outstanding

**Does not carry moral obligation, so figures shown reflect debt service reserve requirements.

Source: VHDA.

appropriate funds (Table 11). Some forms of bond security are tied to individual loans. For example, mortgage loans financed with single-family bonds carrying the moral obligation pledge were required by VHDA to include either private mortgage insurance, FHA/VA insurance, or a 20 percent down payment. In addition, rental project reserves are set aside for on-going maintenance and operating expenses for each development.

Other security measures, such as bond pool insurance, have been established to serve a single bond issue. In addition, monies in the authority's general fund and deferred fees are available as added security for any of VHDA's bonds.

Portfolio Characteristics. In addition to strong reserves, the authority's loan portfolio consists of high quality mortgages in both the single-family and multi-family programs. VHDA's single-family loan delinquency and foreclosure rates are among the lowest in the country for housing authorities. Delinquency rates are significantly lower than those experienced by private lenders in Virginia.

VHDA's single-family portfolio also includes mortgage loans which have a downpayment of twenty percent or more. Loans that do not, which represent approximately 95 percent of each new bond issue, are required to carry mortgage insurance to guard against default In addition, VHDA's average home loan amounts are small in comparison to the total amount made from a single bond issue. Therefore, an extraordinary number of loan defaults from the same bond issue would have to occur in order to create a significant cashflow problem for the authority.

Table 11

SEQUENCE OF CALLING UPON
ADDITIONAL SECURITY FOR VHDA BONDS

Type of Security	Available for Single-Family Bonds	Available for Multi-Family Bonds
1. Project and replacement reserves		X
2. Primary insurance (FHA, VA, or private mortgage insurance)	X	X
3. Pool insurance (available on newer issues)	X	
4. Excess monies in any fund or account in each bond resolution	X	X
5. General fund balances and deferred fees	X	X
6. Mortgage reserve fund (if any)	X	X
7. Capital reserve fund (on those with moral obligation) or	X	X
Debt service reserve (for those bonds without moral obligation pledge)	X	

Source: VHDA.

VHDA's multi-family loan portfolio has also been financially sound. Most of the rental projects financed by the authority to date have 30-year federal subsidy contracts associated with them. These contracts guarantee a continued cashflow to the project by ensuring that a significant portion of rents will be paid from the federal treasury. More than 60 percent of VHDA's rental projects are federally subsidized. Furthermore, 16 percent of the authority's multi-family mortgages carry federal loan insurance.

Overall Financial Strength. To assess VHDA's overall financial strength, JLARC staff contacted several well-respected municipal bond research and investment firms and national bond rating companies, including Merrill Lynch, Standard and Poors, John Nuveen & Co., Wheat First Securities, and Prescott, Ball and Turban. JLARC found that the authority is regarded as being among the best agencies of its kind in the nation.

General strengths were said to include the experience of VHDA's financial managers, the authority's favorable bond record, and substantial fund balances. The following comments were typical of those shared with JLARC staff:

> VHDA continues to turn in a strong financial performance at a time when many state housing finance agencies are

experiencing cash flow stringency due to prepayment shortfalls. This has been achieved mainly due to moderate mortgage spreads and to the timing of bond issues.

* * *

[VHDA's single-family bond programs] have to date been of consistently high credit quality, an opinion we hold of only ten agencies.

* * *

. . . our research department viewed the Authority as one of the strongest housing finance agencies in the country and that the chances were extremely remote that the Commonwealth would ever be called upon in connection with any moral obligation provision of VHDA's bonds.

* * *

The Authority's A+ bond rating is very high for housing issues . . . we consider VHDA to be among the best in the nation.

* * *

VHDA is exceptionally well-managed financially . . . has a long active history in the bond market, and is able to provide substantial security to its bondholders.

Continuation of "Moral Obligation" Pledge

Given that VHDA has developed an extremely strong financial position and is unlikely to need State appropriations, the moral obligation pledge has diminished in importance since 1972 when the authority was created. Therefore, it appears that such a pledge could be removed from most, if not all, of VHDA's future bond issues without jeopardizing the authority's financial position or bondholders' security. This action would, however, reduce the amount of bond debt viewed as a contingent liability against the State and give the General Assembly greater control over the issuance of bonds carrying the moral obligation pledge in the future.

Projection of Future Moral Obligation Debt. As of 1984, the authority's outstanding moral obligation debt totaled $1.11 billion. If VHDA were prohibited from issuing any additional bonds carrying the State's moral obligation pledge, the outstanding debt would be significantly reduced to about $553 million by the year 2000.

If the authority continues to issue multi-family bonds with the moral obligation pledge at the current rate of $60 million annually, the total outstanding moral obligation bond debt is projected by VHDA to remain at the

current level of $1.2 billion through the year 2000. Any optional or special bond redemptions by the authority would reduce the amount outstanding in either case.

Effects on Future Bonds. Prohibiting the use of the moral obligation pledge would have no impact on VHDA's future single-family bonds. At VHDA's own discretion, bonds have not carried the provision since 1981. Rather, the authority has increased the level of primary mortgage insurance and in some issues added the security of mortgage pool insurance to offset the moral obligation pledge. These bonds continue to attract investors and receive favorable ratings from the nation's largest bond rating companies.

Removing the moral obligation backing from future multi-family bonds could have a more significant effect. Unlike single-family bonds, the authority's multi-family bonds continue to carry the moral obligation provision. According to VHDA officials, this is in part due to the limited availability of, and associated costs for mortgage insurance for rental projects. In some cases, for example, loan guarantors will not insure loans for more than 15 years.

Currently, the authority's only rental financing program is for conventional market-rent projects which are very sensitive to loan interest rates. Without federal rent subsidies or mortgage insurance to guarantee cashflows, and moral obligation backing to ensure a favorable bond rating, the authority may be unable to obtain bond prices which will make the developments financially feasible.

Should the State decide to remove the moral obligation pledge from future bond issues, it should convey to investors that such action does not represent a lack of faith in VHDA's bond activities. Rather, VHDA's secure financial position and its ability to stand alone enable the State to take such action.

Recommendation (17). The General Assembly may wish to amend Section 36-55.41(2) of the *Code of Virginia* to restrict the use of the State's moral obligation pledge on future single-family bonds unless prior approval is granted by the General Assembly. This action would reflect the practice which the authority has followed for single-family bonds since 1981, and would indicate the strength of these issues. Moreover, this action would limit the issuance of additional bond debt that would be viewed as a contingent liability against the Commonwealth.

Recommendation (18). VHDA should assess the effects of removing the moral obligation pledge from future multi-family bonds and report its findings to the General Assembly. Any recommended action should consider the additional costs to the authority and developers from structuring the bond issues without moral obligation, the alternatives available to compensate for removing the provision, and the potential impacts on future programs and clients.

FUND BALANCES

As of June 30, 1984, VHDA has accumulated $160 million in fund balances -- a growth of $27 million from 1983 (Table 12). This represents the amount above the required levels of bond reserves and the authority's operating expenses, and includes one of the largest general funds of any housing agency in the country. Past investment earnings and VHDA's limited use of fund balances for programmatic purposes have contributed to growth in the balances. It appears that the authority could now use a portion of the assets associated with the fund balances for additional housing programs. Greater use of these funds would help to meet the continued housing needs of low- and moderate-income groups, and those with special needs, such as the physically and mentally handicapped. Use of fund balances can help to reduce the impact of federal cuts on Virginia's housing situation.

Table 12

VHDA FUND BALANCES
(June 30, 1984)

	Assets	Liabilities	Fund Balances
VHDA General Fund	$126,648,708	$39,951,373	$86,697,335
Multi-Family:			
Mortgage Purchase Bonds	46,849,058	46,897,538	(48,480)
Mortgage Bonds	215,824,889	207,275,506	8,549,383
Housing Bonds	342,820,302	331,344,910	11,475,392
Single Family:			
Mortgage Bonds	202,265,860	182,414,958	19,850,902
Home Mortgage Bonds	473,015,211	452,543,548	20,471,663
Residential	441,116,097	428,055,812	13,060,285
Energy Conservation and Rehab Bonds	4,923,271	4,149,749	773,522
TOTALS	$1,853,463,396	$1,692,633,394	$160,830,002

Source: VHDA.

Bond Fund Balances

A bond fund is created for each of the authority's bond issues. The fund balance reflects any earnings which are available after expenses associated with the issue as well as any contribution from the general fund. The funds for each issue are aggregated into a single fund for each of the authority's seven active bond resolutions. As of June 30, 1984, the fund balances for the bond funds totaled $74 million.

Growth of Bond Fund Balances. In recent years, the authority's bond fund balances have increased at a rate of more than $25 million per year. A significant portion of the growth is the result of favorable investment earnings, particularly on bonds issued during the 1970's. For example, reserves from bonds which were issued at six or seven percent were placed in high yield investments, such as treasury notes and certificates of deposit. The excess earnings -- the amount above expenses and required security levels -- accrued to the fund balances. The limited programmatic use of these funds by the authority enabled the balances to grow.

Since 1980, federal restrictions on investment earnings from tax-exempt bond proceeds have made it more difficult to accumulate large fund balances on newer issues. However, older housing authorities like VHDA continue to generate substantial funds from pre-1980 issues.

Use of Bond Fund Balances. Earnings from bonds may be used only in accordance with the parameters enumerated in the relevant bond documents. In general, excess funds derived from single-family mortgage prepayments or investments can be used for additional loans or to call bonds. Multi-family loan prepayments must be used to call bonds.

Certain provisions in the bond resolutions permit the authority to transfer a portion of bond fund balances to its general fund. This action, which has occurred from time to time, enables VHDA to use the funds for other purposes. For this reason, it is necessary to look at balances in the bond funds and the general fund to get an accurate picture of the authority's total fund balances.

General Fund Balances

The authority's general fund is reported by several investment companies to be among the largest in the country. The general fund is used to pay for salaries and operating expenses, and has also been used for limited program purposes. Since 1982, it has been VHDA policy to designate 80 percent of the general fund balance as a contingency reserve in the case of a bond default. It may now be appropriate for the authority to reconsider this policy and make increasing use of its general fund money for additional housing opportunities. This could be particularly important for the multi-family program where federal cuts have greatly impacted housing opportunities for lower-income groups.

Size and Composition of the General Fund. Between 1980 and 1984, VHDA's general fund balance grew from $25.5 million to $86.7 million. The general fund was cited in a 1984 report by one municipal bond research

company as being "more than sufficient to fund bond principal maturities for all eight of the authority's programs for the next two fiscal years."

VHDA projects the fund balance will increase by 250 percent to $299 million over the next five years, and to $1.2 billion by the year 2000 (Table 13). The projection assumptions include that there will be future pay-outs for bond issuance costs, and that no single-family bonds will be issued after 1990 as a result of increased federal restrictions.

Table 13

GROWTH IN VHDA'S GENERAL FUND BALANCE

Year	Ending Balance	Allocated Portion	Unallocated Portion
1984	$ 94,700,000	$ 75,760,000	$ 18,940,000
1985	117,300,000	93,840,000	23,460,000
1986	144,300,000	115,440,000	28,860,000
1987	175,600,000	140,480,000	35,120,000
1988	211,600,000	169,280,000	42,320,000
1989	252,560,000	202,048,000	50,512,000
1990	298,960,000	239,168,000	59,792,000
1991	358,100,000	286,480,000	71,620,000
1992	425,100,000	340,080,000	85,020,000
1993	498,700,000	398,960,000	99,740,000
1994	578,100,000	462,480,000	115,620,000
1995	664,600,000	531,680,000	132,920,000
1996	758,200,000	606,560,000	151,640,000
1997	859,500,000	687,600,000	171,900,000
1998	968,800,000	775,040,000	93,760,000
1999	1,087,100,000	869,680,000	17,420,000
2000	1,214,400,000	971,520,000	242,880,000

Source: VHDA projection.

Several sources contribute to the projected growth, including investments on which there are no earnings restrictions, and an average transfer of $36 million from bond fund balances. VHDA's projections assume that annual bond fund balances will be held at a constant $89.2 million after the transfer of funds to the general fund. Most of the general fund balance is held in financial assets, although about two percent of the funds's value is associated with the authority's real estate holdings.

A portion of the financing fees which the authority receives when making loans is also placed in the general fund. These deferred fees are pledged as additional security for any VHDA bond to the extent they are available. As of June 30, 1984, the authority had deferred fees of $6.7 million (in addition to the $86.7 million general fund balance). The authority estimates

that the amount of deferred fees, which is included in the general fund balance, will grow by $1.5 million annually through the year 2000.

Use as a Contingency Reserve. Although no liens exist on the fund, 80 percent of the general fund balance has been designated by the board as a "contingency reserve" for the authority's bonds. However, no assurance is given by the authority that monies in the general fund will be available for use by any particular program at any given time.

VHDA's Board of Commissioners adopted this policy in February 1982:

> There is hereby created within the General Fund of the Authority a contingency reserve . . . in the amount of $47,000,000 as of December 31, 1981. Such amount shall be adjusted monthly thereafter to an amount equal to 80% of the General Fund balance, except that such amount shall not be reduced without approval by the Commissioners of the Authority.

The board took this action shortly after the authority was forced to "call" bonds as a result of a quickly changing mortgage market.

The remaining 20 percent is unallocated and may be used for any lawful purpose of the authority, including additional housing programs. As of December 31, 1984, $76 million had been designated as a contingency reserve and $19 million remained unallocated. As shown in Table 13, the authority projects the allocated portion will grow to $972 million, and the unallocated amount to $243 million by the year 2000.

While creation of the contingency reserve may have been appropriate in 1982, the authority may now need to reconsider the policy of designating 80 percent of the general fund balance as a contingency reserve. Reducing the amount to 50 or 60 percent of the balance would significantly increase the funds available for additional housing programs -- at a time when federal cuts threaten to limit the expansion of programs to serve lower-income groups. Such a change appears appropriate given VHDA's strong financial position, the growth in fund balances, and the more stable economic conditions of the past three years. The authority should make use of the unallocated portion, at a specified level, for housing purposes.

Other Uses of the General Fund. In addition to paying salaries and operating expenses, the authority has also used the general fund for limited program purposes. General funds have been used to finance several small programs including the Appalachian Regional Commission Grant Program, the Moderate Rehabilitation Loan Program, the Virginia Energy Loan Program, the Rural Conventional Program, the Rural Homesteading Program and part of the Multi-Family Construction Participation Loans. Some miscellaneous home loans have also been made out of the general fund.

Recently, general fund proceeds have been used to cover the upfront costs associated with issuing new single-family bonds. Use of the funds is necessary because of recent federal restrictions on the payment of such expenses. The payments are considered to be a loan from the general fund, and

are expected to be paid back once the debt associated with the particular bond issue is retired. The authority estimates such contributions will equal about $7 million for each of the next several years. Through August 1985, VHDA had made $19 million in such contributions.

Use of Fund Balances for Housing Programs

The experience of other state housing finance agencies indicates that greater use of fund balances could be made for housing purposes. In Virginia, VHDA's growing unallocated general fund balances could be used to reduce the impact of federal cuts in rental housing programs and to provide additional homeownership opportunities for low- and moderate-income persons.

Other States Use of Fund Balances. In contrast to Virginia, housing finance agencies in several other states have made significant use of fund balances to finance housing programs. The Kentucky Housing Corporation, for example, has used about $5 million in annual investment earnings to make very low interest loans in some rural areas, and to provide financing for a public-private venture to redevelop a blighted neighborhood in Louisville. Kentucky's finance director indicates that his agency is willing to risk a loss of potential investment earnings in order to accomplish these important public purposes.

Connecticut's housing authority has similarly used $35 million, or about half, of its fund balances for such programs as:

- growing equity mortgage loans for newly-constructed homes,
- pilot single-family construction program,
- pilot multi-family construction program,
- revolving loan funds for non-profit housing organizations,
- energy assistance programs, and
- loans to multi-family developers.

In addition, the Connecticut authority set aside the remaining $41 million in its fund balances as a reserve for losses and cashflow deficiencies.

Michigan's housing authority is contributing $1 million annually from fund balances to provide rent subsidies for some very-low-income tenants. It has also pledged up to $2 million annually from future investment earnings to underwrite a low interest rate for projects in economically distressed areas of the state.

Use of VHDA Fund Balances. VHDA has projected an average annual growth of $70 million in its general fund balances. This amount includes investment earnings and transfers from the bond fund balances. A portion of the assets associated with general fund balances could be used for additional housing programs in Virginia, while maintaining a substantial contingency reserve.

Part of the authority's fund balances could be used to finance initiatives in rental housing for lower-income groups and those with special needs, including:

- providing low or no interest loans for the development of additional rental units at rents affordable to low- and very-low-income persons,

- financing additional rental units for mentally and physically disabled persons, or others whose special housing needs have not been adequately addressed, and

- providing direct rental subsidies for lower-income tenants as is done in some states, including Michigan and North Carolina.

For example, use of $10 million annually would provide direet rental subsidies of $100 per month to more than 8,300 low-income households.

Additionally, the funds could be used for programs to make home ownership affordable for lower-income groups and those living in targeted rural and inner-city areas. The authority's fund balances could be used to reduce the initial expenses associated with purchasing a home, for example. VHDA could require lower down payments and offer assistance with loan processing and closing costs. These costs amount to $4,800 on the purchase of an average $52,000 single-family home. If the authority contributed $2.4 million towards paying half of these charges--or $2,400--it could assist 1,000 households that might not otherwise be able to purchase a home.

Recommendation (19). VHDA should make greater use of a portion of its fund balances to provide additional affordable housing, and to reduce the impacts of federal housing cuts. The assets associated with the unallocated portion of VHDA's general fund balances (up to 20 percent) could be used for programs to meet the housing needs of low-income and disabled Virginians. The Board of Commissioners should review the appropriateness of the proportion of the authority's general fund balance that is held as a contingency reserve. The board should establish the necessary contingency reserve at a level that promotes security for the authority's bonds while making the greatest feasible amount available for important housing programs.

V. ADMINISTRATION OF THE AUTHORITY

VHDA is the primary source of State support for housing assistance programs in Virginia. It is essential that the authority properly manage its programs and resources to address the housing needs of low- and moderate-income Virginians. Three important ways in which VHDA can better manage its resources are by: (1) taking a lead role in planning and coordinating housing services; (2) including representation of client groups on the Board of Commissioners; and (3) ensuring that procurement practices conform to State requirements, that computer operations are effective and efficient, and that staffing levels and costs are appropriate.

PLANNING AND COORDINATION

The General Assembly has set forth "safe, sanitary, and affordable housing" as a policy goal for the Commonwealth. To meet this goal, plans for administering and coordinating the State's housing programs must be developed where none currently exist. This is now particularly important because of recent cuts in federal housing programs. Planning for VHDA's programs must be improved to ensure the authority meets its intended purposes.

Planning and Coordination at the State Level

Revisions in federal housing programs and federal tax laws continue to have a significant impact on housing programs in Virginia. These revisions will reduce federal support of low-income housing programs. Yet the Governor's Commission on Virginia's Future has reported a continued need for housing the poor, the physically and mentally handicapped, the elderly, and others not served by the private market. State and local housing agencies, including VHDA, need to coordinate their efforts to respond to declining federal support and a continuing need for low- and moderate-income housing.

Need for Statewide Coordination. An effective mechanism to ensure coordinated planning among State and local housing agencies does not exist. Without such coordination, the various housing assistance programs may not be serving persons with the greatest need, and may not provide the full range of services necessary. The primary participants in housing programs at the State level include VHDA, the Department of Housing and Community Development (DHCD), and the Department of Social Services (DSS).

DHCD provides technical assistance to sponsors of housing for low- and moderate-income persons, counseling in landlord-tenant relations, planning assistance, and housing information and data services. The department also administers federal "nonentitlement" block grants which may be used by

localities for planning, housing rehabilitation, economic development, and community facilities projects.

The Department of Social Services administers three federal programs related to housing: community service block grants, the Neighborhood Assistance Act, and the weatherization program. These programs assist low-income persons, particularly the elderly and the handicapped, to obtain housing and improve living conditions. DDS also provides auxiliary grants from the State funds to persons residing in licensed homes for adults.

Although State law establishes a coordinating mechanism between VHDA and DHCD, the authority does not have a formal link with other State agencies. The Departments of Social Services, Mental Health and Mental Retardation, and Aging often serve Virginians in need of low cost housing.

At the local level, redevelopment and housing authorities are a principal source of housing assistance. The local agencies are political subdivisions of the Commonwealth, but are created by local governments and are subject to local control. They issue tax-exempt bonds to finance housing projects and administer a number of federal, State, and local housing programs. Local housing authorities have been established in about 30 localities. VHDA is the "State redevelopment and housing authority" for all other areas.

There is currently no formal coordination among VHDA and local redevelopment and housing authorities. Such coordination could be valuable in ensuring that low and moderate income persons receive adequate housing services. In addition, it would reduce the potential for duplication between VHDA's financing and programmatic efforts and those provided by localities.

Inadequate Assessment of Need. The Governor's Commission on Virginia's Future reported in 1984 that "[i]nadequate market data will continue to result in a supply of housing that fails to meet needs and demands" and "will cause financial hardships for some builders and housing shortages for some people." The most recent comprehensive assessment of statewide housing needs was completed nine years ago by the State Department of Housing and Community Development. This study has not been fully updated since.

VHDA periodically conducts housing market studies, but these are not intended to be comprehensive housing needs assessments. The market studies are limited in scope and are used to determine in which areas of the State it is economically feasible to build multi-family projects.

Improved planning and coordination among State and local agencies continues to be necessary. Periodic assessments of housing needs would facilitate planning and coordination of programs and would permit evaluation of progress made in addressing housing needs.

Recommendation (20). VHDA and the Department of Housing and Community Development should jointly develop a State housing plan. Such a plan should propose policies and programs in response to reductions in federal programs and the continued housing needs of low- and moderate-income Virginians. In addition, the plan should outline specific methods for coordinating the programs of State and local housing agencies on a continuing

basis. The plan should be reported to the House and Senate General Laws committees.

Recommendation (21). A comprehensive assessment of housing needs in Virginia should be made by the Department of Housing and Community Development on a periodic basis. To ensure that special housing needs are identified, DHCD should coordinate its assessment with VHDA, the Department of Mental Health and Mental Retardation, the Department of Social Services, and the Department for the Aging. VHDA should cooperate with DHCD in financing this effort and use the results to tailor its programs accordingly. The needs assessment could be used to guide VHDA's planning efforts and as a resource for other housing service providers.

Planning and Coordination within VHDA

Because of its essential role in providing funds for low and moderate income housing, VHDA needs a comprehensive, long-range plan to ensure that its programs meet housing needs in the future. To properly implement these plans, VHDA needs to better coordinate implementation and administration of its programs.

Comprehensive, Long-Range Planning. In response to the possible expiration of the federal legislation authorizing tax-exempt bonds, VHDA began in 1984 to explore the need for a comprehensive long-range plan. Although such a plan would have been useful over the past decade, declining federal support for housing programs and the growth in size and scope of the authority's programs reinforce the urgency and importance that the plan be developed at this time.

Most of VHDA's housing programs are tied to direct federal aid or indirect tax reduction incentives permitted under federal tax laws. As a result, a number of programs in Virginia have been affected by declining federal support. For example, no additional apartments for low-income persons will be built or subsidized from the federal Section 8 program. Some plans for federal tax reform include reductions in the financial incentives for investors in multi-family construction projects. In addition, the federal law authorizing the issuance of tax-exempt housing bonds expires on December 31, 1987, unless continued by Congress.

An important purpose of the plan would be to ensure that the authority is prepared to provide affordable housing even in the event of significant reductions of federal support. The plan should guide the use of the authority's resources to meet its mandate to provide housing for low- and moderate-income Virginians. Specifically, it should address these questions:

- How can the authority's programs be prioritized to serve those most in need of housing assistance when resources are scarce?
- What contingent financing mechanisms are available to VHDA in response to possible changes in federal programs?
- What additional programs can VHDA develop with funds it has generated?

- How can the authority project and meet future staffing and capital needs?

A committee comprising the executive director and the seven division directors of VHDA was established in October 1983 to clarify the authority's mission and goals. Specifically, the committee reviewed the groups the agency serves, its financial status, and its relationship and responsibilities to its employees. This committee served as a good first step, but a successful planning process for the authority will require the full support of the board, the executive director, and staff at all levels.

Program Coordination and Development Within VHDA. To ensure proper implementation of a long-term plan, improved internal planning and coordination are necessary. While some efforts have begun in this area, more are needed.

Concerns over the piecemeal addition of small, special programs and the corresponding administrative impacts on staff prompted the formation of an ad-hoc group of mid-level managers at VHDA in early 1984. Members of the group reported to JLARC staff that several small programs had been implemented without provisions for the increased workload and administrative complexities associated with them. The addition of even a small program can affect a number of the authority's functions. For example, the solar grant program, which had made 210 loans as of July 1984, required that new accounting procedures be prepared, computer programs written, internal audit guidelines developed, servicing requirements added, and investment funds segregated.

Although the group may have raised organizational sensitivities to the operational impact of new programs, the effectiveness of the mid-management committee as a planning tool has not yet been realized. Though sanctioned by top management, the group has no formal reporting responsibility to management. Therefore, its concerns and insights on the implementation of new programs are not necessarily relayed to the management committee which approves the programs. The concerns which prompted the group's formation continued to be expressed in interviews with JLARC staff.

One principal concern of the group has been addressed. Until recently, no single employee had been assigned responsibility for coordinating and administering new programs. Rather, the programs were added to the current responsibilities of certain staff. In May 1985, VHDA hired an employee to manage two of the special programs -- rental rehabilitation and rural homesteading.

Recommendation (22). VHDA should continue its efforts to develop a long-term strategic plan for the authority. In particular, VHDA should ensure that new and existing programs meet the housing needs of persons who are not served by the private market. The plan should address the needs of those who have been most affected by federal housing assistance cuts. VHDA should seek input from the Department of Housing and Community Development, the Department of Mental Health and Mental Retardation, the Department of

Social Services, and the Department for the Aging to ensure the plan addresses the housing needs of special groups such as the handicapped and the elderly. The plan should be used to direct and monitor the authority's efforts to fulfill its public mission, with specific criteria for evaluating VHDA's progress in meeting its goals.

Recommendation (23). VHDA should adopt a formal process for coordinating the development and administration of new programs. Mid-level managers directly responsible for supporting anticipated new programs should participate in the preparation of an implementation plan. The plan should detail the administrative responsibilities of each affected section and the effects of the new program on workload. The Board of Commissioners and VHDA management should use the plans when considering the implementation of new programs.

BOARD ROLE AND COMPOSITION

The Board of Commissioners is responsible for VHDA and its mission to provide housing for low- and moderate-income persons. To better assess the authority's performance in meeting its public mission, the board needs to monitor more closely the implementation and the effects of its policies. To ensure broader public participation in the development of housing policies, appointment of members representing recipients of housing services and the general public may be appropriate.

Role of the Board

By law, all powers of the Virginia Housing Development Authority are vested in the authority's Board of Commissioners. Section 36-55.29, of the *Code of Virginia* directs the board to employ an executive director to "administer, manage, and direct the affairs of VHDA, subject to the policies, control and direction of the commissioners." Given this grant of authority, VHDA's board is classified as a "supervisory" board under Section 9-6.25, of the *Code*.

As VHDA's governing body, the board is responsible for adopting policies and regulations for the operation of the agency. The board establishes eligibility requirements for VHDA programs, adopts the agency's budget, approves or ratifies all bond issues and loans, and submits to the Governor an annual report on the operations and financial status of the authority.

In response to a JLARC staff telephone survey, board members indicated that they generally interpreted their role as providing policy guidance to the authority. However, members have different interpretations of the level at which they should be involved in specific functions of VHDA. Five members reported that the board needed to be more involved in promoting the authority's programs. Six members reported a desire to be more involved in planning, while three felt the board should receive more information on all applications for multi-family project loans. In contrast, four of the members reported that the board was too involved in personnel matters.

As noted previously in this report, improved monitoring of board policies is warranted to ensure they achieve intended outcomes. For example, eligibility requirements for single-family and conventional multi-family programs do not adequately target low- and moderate-income persons who cannot otherwise obtain housing in private market. Selection of multi-family developers by VHDA staff also deserves closer scrutiny by the board to ensure broad participation by project developers.

Absence of Clientele Representation

The VHDA board has nine members. State law stipulates that the Governor appoint no more than three persons from any one commercial or industrial field. The seven members appointed to VHDA's current Board of Commissioners are current or former employees of the real estate, construction, and banking industries. Two members -- the Chairman of the State Board of Housing and Community Development and the State Treasurer -- serve on the board by virtue of their positions.

The interests typically represented on the board ensure that decisions will be based on the knowledge and experience of relevant professions. However, representatives of the general public and of persons in need of housing assistance would add valuable perspectives to board policies. Nine other states and the District of Columbia require that at least one member of their housing finance boards have a consumer-related affiliation (Table 14).

In Virginia, the General Assembly has recognized the importance of providing consumers with an opportunity to serve on state boards and commissions. Approximately 200 positions on State agency boards are reserved for citizen members. In 1984, the General Assembly enacted Section 9-6.24 (iii), of the *Code of Virginia*, to clearly define "citizen members," "consumer members," or "representatives of the public" as persons that do not have a "direct or indirect financial interest, except as a consumer, in the subject area of the board or commission."

Recommendation (24). The General Assembly may wish to amend Section 36-55.28, of the *Code of Virginia*, to require that one of nine VHDA commissioners be a consumer member, experienced in housing problems of low- and moderate-income persons, and that a second be a "citizen member" with no financial interest in the real estate, banking, or construction industries. This requirement could be made effective upon the expiration of the terms of two current members.

MANAGEMENT OF PROCUREMENT, DATA PROCESSING, AND PERSONNEL

Sound finances, effective programs, and efficient operations are promoted by a strong management system. Competitive procurement is a key element in the management system. It ensures equal opportunity for participation by all qualified vendors and professions and may reduce costs in government programs. However, VHDA was found not to be in compliance with competitive procurement requirements.

Table 14

OTHER STATES WITH CONSUMER-RELATED REPRESENTATION ON THE STATE HOUSING AUTHORITY BOARD

State	Total Number on Board	Number of Consumer Representatives	Consumer-Related Representation
California	11	2	Members must be residents of the authority's housing or persons experienced in counseling, assisting or representing tenants.
District of Columbia	9	2	Members must have community or consumer interests.
Florida	9	4	Members must represent the public at-large and cannot represent the building, banking, construction labor industries.
Louisiana	11	1	Member of the Louisiana Housing Council.
Maine	7	1	At least 1 member must be from subsidized housing.
Michigan	7	1	Member must be from a social interest group.
New Hampshire	9	2	Members must be from the general public who are not bankers, contractors, or engaged in the real estate business
North Carolina	13	1	Member must be a community planner.
Ohio	7	1	Member must be a community planner.
Texas	10	1	Member must be experienced in housing problems of persons of low and moderate income.

Source: 1982 Survey of State Housing Finance Agencies, Council of State Housing Finance Agencies.

Automation of data processes is also important because it increases speed and accuracy in routine activities and improves the agency's ability to deal with complex data compilation and reporting requirements. JLARC staff found, however, that VHDA has placed inadequate priority on automating its operations, and has not approached data processing development in a consistent fashion.

Personnel is a third important management consideration. Proper staffing levels and salaries are necessary to provide for competent staff and reasonable administrative costs. JLARC staff found no significant problems in staffing levels or salaries, though some minor adjustment in salary ranges may be appropriate.

Procurement of External Audit Services

External and internal audits help to ensure VHDA's financial integrity and compliance with policies and procedures. Since its creation in 1973, VHDA has retained Peat, Marwick, and Mitchell for its external audits. The authority has a letter agreement to continue employing this accounting firm without the use of a competitive process. This relationship appears to violate the Virginia Public Procurement Act. In addition, the Board of Commissioners -- in whom all the powers of the authority are vested -- has had limited participation in the procurement and approval of VHDA's annual arrangement with the auditors.

Provisions of the Procurement Act, which apply to political subdivisions such as VHDA, exempt contracts for professional services entered into prior to January 1, 1983, from the requirements of the law. The staff of the attorney general's office indicate that if the terms of such a contract include the option to continue the contract under the same terms and prices, then competitive negotiation is not required. However, if the terms or price of the contract change, or include a provision which allows for these changes, then the option is in effect an agreement to enter into a second contract. In such a case the provisions of the Procurement Act would be applicable and the contract should be awarded on a competitive basis.

Since December 1982 -- one month prior to the effective date of the Procurement Act -- VHDA has had a letter agreement with the accounting firm to "continue to serve the authority as its independent accountants and auditors." The agreement further states that the charges will be based on the "standard hourly rates as from time to time in effect." [The accounting firm has conducted VHDA's annual audit each year since under the agreement.]

VHDA has not used a competitive selection process because it maintains that each annual audit is a continuation of the original agreement, and not subject to the Procurement Act. JLARC's discussions with the Attorney General's staff, however, indicates that VHDA's interpretation may be in error. An assistant attorney general stated that the letter agreement may circumvent the intent ofthe Procurement Act -- to foster competition whenever possible. Furthermore, he indicated that the letter agreement represents a commitment to make a contract each time auditing services are needed and, therefore, procurement of the services should be by competitive selection.

Although Section 36-55.30(6) authorizes the authority to "make and execute contracts and all other instruments and agreements necessary or convenient for the exercise of its powers and functions," the Board of Commissioners has had a limited role in approving the contract with the auditors. In a recent interview with JLARC staff, the chairman of the board's audit committee reported that he was not aware of discussions with other accounting firms to conduct VHDA's audits. He also reported that he had not participated in the annual audit agreement, though he has been a member on the board since September 1981.

Since the time of JLARC's review, the board has taken action to ensure that future audits will be competitively negotiated and the selection approved by the board. The board recently requested staff to prepare a proposal to solicit bids for the FY 1986 audit.

Recommendation (25). VHDA should ensure that its contract for an annual external audit complies with the Virginia Public Procurement Act and is competitively awarded.

Automating VHDA Processes

VHDA's computer system adds speed and accuracy to the routine processing and reporting of financial and client information. Although a major part of the authority's financial, administrative, and programmatic operations have been automated, improvements in existing systems and automation of additional activities are needed. Top management needs to establish priorities for the development of remaining systems. In addition, management should ensure that the automated systems conform to the operational needs of the agency.

Establishing Automation Priorities. Currently, VHDA's computer operations section determines the order in which functions will be automated. The priorities are based on the computer section's workload, the perceived importance of the request, and the complexity of the computer programming tasks involved. Some major functions, such as preparing the general accounting ledgers, validating the capital reserve fund, and monitoring requirements on home loans, have not been automated.

An EDP steering committee was formed in 1984 to assist in setting systems development priorities. The committee consists of mid-level managers from several areas within the authority and is chaired by the computer operations manager. The committee has met infrequently thus far.

While this mid-level committee could be useful, additional steps in setting priorities may be needed. For example, the current committee responsible for scheduling the development or improvement of VHDA's automated systems does not include any of the top-level management team. Top management is best qualified to determine which functions or processes are most in need of automation. Only the management team can decide whether additional resources, such as computer hardware and programs or additional staff and expertise, are justified given other agency needs and priorities.

Designing Computer Systems to Meet Users' Needs. In interviews with JLARC staff, administrative and program employees at VHDA reported that some computer systems already developed do not properly perform intended functions. As a result, the systems do not always meet the staff's data processing needs, and in some cases impede routine processing.

As reported to JLARC staff, differences between the users' needs and the capabilities of the system have occurred frequently. VHDA's internal auditor has recommended that staff document and date their EDP requests in order to reduce this problem. Although the process may be improving, the users still need to be more actively involved with the computer section as systems are developed and tested.

Recommendation (26). VHDA's top management should assume greater responsibility for prioritizing automation needs and providing the necessary resources to meet the demand for additional computer systems and refinements to existing systems. VHDA's computer operations section and the EDP committee should be involved in data processing development decisions.

In addition, VHDA staff should detail and document their requests for adjustments and additions to the authority's existing computer systems. Staff for whose use new systems are being developed should participate with the computer operations section in designing and adjusting the system to ensure that it efficiently and effectively performs the needed data processing functions.

Staffing and Salaries

Because it is a political subdivision, VHDA's personnel management practices and salary scales are not required to conform to the State's personnel system. Rather, VHDA has established its own personnel practices which more closely mirror those in private industry, particularly in the area of employee benefits. JLARC's review of VHDA programs and operations found no significant problems with the authority's current staffing levels. While the authority's salary ranges are generally set above those in the public sector, a cap on actual salaries of $75,000 has been imposed by the board. Given VHDA's competition with private industry for qualified employees, actual salaries appeared reasonable. Some minor adjustment of salary scales may be appropriate.

Staffing Levels. VHDA currently has 158.5 budgeted staff positions available to carry out its activities. The number of permanent positions has grown at a modest rate of 3.5 percent annually since FY 1981. Any increase in staffing levels must be approved by the Board of Commissioners.

Current staff are divided into seven divisions. Over one-third of the authority's employees are assigned to the Single-Family Division, which processes home loan applications and monitors the collection of mortgage payments (Table 15). More than one-fourth are assigned to the Housing Management Division, which oversees the financial management conditions of VHDA's multi-family projects and administers the federal Section 8 programs. Both of these divisions handle large volumes of paperwork manually, and their

Table 15

VHDA STAFFING LEVELS

Division	Number of Positions
Office of the Executive Director	5
Single-Family	57
Housing Management	45
Administrative Services	19.5
Finance	12
Multi-Family Development	9
Planning and Research	6
Legal	5
TOTAL	158.5

Source: VHDA.

workload is directly affected by additions to the authority's loan portfolio. Automation and processing efficiencies currently under review should reduce the need for additional staff in these two divisions. The JLARC staff review of the programs and operations of the other divisions found no significant staffing problems.

Employee Salaries. As a housing finance agency, VHDA frequently competes for experienced employees with private sector organizations, such as lending institutions, investment firms, and real estate corporations. As a result, salaries for VHDA staff have generally been set above those of other governmental agencies in Virginia, but below those of the private sector. In addition, the authority's Board of Commissioners has, for the past several years, required that no employee's wages -- including that of the executive director -- exceed the Governor's salary of $75,000.

Salary scales established by the board are based on recommendations in periodic salary surveys conducted by consultants. The salary surveys are updated annually by VHDA personnel staff, and are the basis for annual adjustments. The most recent survey was presented to the board in May 1985. VHDA salary levels were set at the midpoint between the public and private organizations surveyed (Table 16).

The survey included public sector organizations, such as the Commonwealth of Virginia, several local governments in the Richmond area, the Virginia Education Loan Authority, and state housing finance agencies in Connecticut, Illinois, Michigan, New Jersey, Tennessee, and Wisconsin. Private sector firms in the survey included several large banking and mortgage companies in Virginia.

Table 16

VHDA SALARY GRADES
(effective July 1985)

Grade Level	Examples of Positions Included in Grade	Range
--	Executive Director	$68,688
14	Director of Finance, General Counsel	$57,000 - $84,900
13	All other Division Directors	49,700 - 74,100
12	Investments Manager, Controller	43,400 - 64,200
11	Internal Auditor	37,800 - 55,900
10	Computer Manager, Finance Manager	33,000 - 48,500
9	Multi-family Development Officer	28,700 - 42,200
8	Collection Manager	25,100 - 36,600
7	Construction Inspector	21,900 - 32,000
6	Accountant	19,200 - 27,800
5	Paralegal	16,600 - 24,100
4	Loan Servicing Assistant	14,500 - 20,900
3	Administrative Secretary	12,700 - 18,300
2	Receptionist	11,100 - 15,900
1	Mail Clerk/Messenger	9,600 - 13,700

Source: VHDA.

APPENDIXES

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APPENDIX A

1984 SESSION

LD4025101

SENATE JOINT RESOLUTION NO. 7

Offered January 11, 1984

Prefiled January 10, 1984

Requesting the Joint Legislative Audit and Review Commission to evaluate the programs, operations, and management of the Virginia Housing Development Authority.

Patrons--Babalas, Willey, Andrews, and DuVal; Delegates: Pickett, Manning, Quillen, Ball, Watts, and Bagley, R. M.

Referred to the Committee on Rules

WHEREAS, the Virginia Housing Development Authority is a public instrumentality of the Commonwealth of Virginia created by statute to issue tax exempt revenue bonds to obtain funds to make deeds of trust/mortgage loans and purchase existing deeds of trust/mortgage loans, thereby increasing the supply of credit and reducing the cost of financing for qualified sponsors and individuals; and

WHEREAS, concerns have been raised by the United States General Accounting Office, the Congressional Budget Office, and the Treasury Department concerning the cost and effectiveness of mortgage revenue bonds as a policy instrument; and

WHEREAS, the United States Congress has not voted to extend the sunset provision contained in the Mortgage Subsidy Bond Tax Act of 1980, with the result that authority for states to issue tax exempt mortgage revenue bonds expires as of December 31, 1983; and

WHEREAS, the Virginia Housing Development Authority was established in 1972 by the enactment of §§ 36-55.24 through 36-55.52 of the Code of Virginia to assist persons and families of low and moderate income in obtaining sanitary and safe residential housing; and

WHEREAS, the outstanding deed of trust/mortgage revenue bond debt of the Authority is considered a "moral obligation" of the Commonwealth in that the Governor is required to report to the General Assembly should there be a need for general funds to replenish the reserve fund established by the Authority to meet debt service payments; and

WHEREAS, the moral obligation debt of the Authority presently exceeds 1.5 billion dollars; and

Senate Joint Resolution 7

WHEREAS, the Joint Legislative Audit and Review Commission is the duly constituted program audit and performance evaluation agency of the Virginia General Assembly, which is authorized under §§ 30-58.1 and 30-68 of the Code of Virginia to review the operations, effectiveness, and efficiency of executive, judicial, legislative, and other constitutionally or statutorily created entities of the Commonwealth; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Joint Legislative Audit and Review Commission is requested to evaluate the programs and operations of the Virginia Housing Development Authority with special attention to: (1) the mortgage revenue bond supported activities of the Authority; (2) the extent to which the Authority's programs have benefited persons and families of low and moderate income; (3) the definiton of low and moderate income persons and families used by the Authority; (4) the operations, management, and administration of the Authority; and (5) such other matters as may be deemed appropriate.

The Commission shall complete its work and report to the General Assembly and Governor before the 1986 Session; however, the Commission shall report on its progress prior to the 1985 Session in such form as the Commission deems appropriate.

APPENDIX B

TECHNICAL APPENDIX SUMMARY

JLARC policy and sound research practice require a technical explanation of research methodology. The full technical appendix for this report is available upon request from JLARC, Suite 1100, General Assembly Building, Capitol Square, Richmond, Virginia 23219.

The technical appendix includes a detailed explanation of the special methods and research employed in conducting the study. The following areas are covered:

1. Client Characteristics Profile. Summary information of the persons served by VHDA programs was compiled from the authority's automated and manual records. JLARC reviewed income and other demographic information from 12,721 single-family home loan commitments, 6,379 Section 8 tenant records with demographic information and 10,722 with income information, and 1,607 conventional projects' tenant income records. In addition to the review of these automated records, JLARC reviewed a sample of 110 records of occupants living in VHDA's conventional projects and VHDA-supplied summary information on all tenants in Section 8 existing and moderate rehabilitation units.

2. Analysis of Home Loan Commitments. JLARC reviewed income and mortgage information on all 12,721 home loan commitments from VHDA's 1980A through 1983B series loans to determine if the homebuyers had sufficient income to qualify for a conventional private market mortgage. Federal Home Loan Mortgage Corporation underwriting standards and market interest rate data provided by the Federal Home Loan Bank Board were used to compute the minimum income required to qualify for a private market mortgage.

3. Loan Foreclosure Analysis. The foreclosure rate, mortgagor incomes, and shelter cost ratios associated with 3,283 loan commitments from 1980A and 1980B series loans were reviewed by JLARC to compare income-related factors and foreclosures.

4. Loan Processing Analysis. JLARC analyzed 9,345 single-family loan reservations from the 1983B and 1984A bond issues to evaluate the efficiency of VHDA's loan processing capabilities.

5. Multi-Family Development Review. In order to evaluate VHDA's project selection procedures, JLARC reviewed all project loan applications from fiscal year 1983 and 1984, application logs back to 1980, and information on rental projects and developers for all 211 projects selected by VHDA through November 1984.

6. Board Survey. Using a structured telephone questionnaire, JLARC interviewed the authority's 9 commissioners. Question areas included perceptions of VHDA's operations, clients served, and the level of board involvement in the authority's major functions.

7. Telephone Survey of Other States. JLARC interviewed staff at 10 other state housing finance agencies selected for their comparability with VHDA and its programs. Question areas included eligibility requirements, financing techniques, development practices, and innovative programs.

APPENDIX C

AGENCY RESPONSES

As part of an extensive data validation process, each State agency involved in a JLARC review and evaluation effort is given the opportunity to comment on an exposure draft of the report.

Appropriate technical corrections resulting from the written comments have been made in the final report. Page references in the agency responses relate to the exposure draft and may not correspond to page numbers in the final report.

Included in this appendix are responses from the following:

- Department of Housing and Community Development
- Virginia Housing Development Authority

AUG 27 1985

COMMONWEALTH *of* VIRGINIA

NEAL J. BARBER
XXXXXXXXXXX

DEPARTMENT OF
HOUSING AND COMMUNITY DEVELOPMENT

Fourth Street Office Building
205 North Fourth Street
Richmond, Virginia 23219-1747
(804) 786-1575

August 23, 1985

Mr. Ray D. Pethtel, Director
Joint Legislative Audit and
Review Commission
Suite 1100
General Assembly Building
Richmond, Virginia 23219

Dear Ray,

I am writing to provide comments on pages 110 through 118 of the exposure draft of your study on the programs and operations of the Virginia Housing Development Authority (VHDA).

The description of the Department of Housing and Community Development's (DHCD) housing related activities is accurate.

Recommendations 20 and 21 call for DHCD and VHDA, in coordination with other State agencies, to assess the housing needs in Virginia and to prepare a State housing plan. DHCD agrees with the need for such an assessment and a housing plan. Recognizing that federal financing for low-income housing is declining, the DHCD proposed to the Committee on Housing for the Disabled that DHCD and VHDA re-examine the State's role in the development and financing of low-income housing. We propose to carry out this effort in the 1986-88 biennium, and believe the effort is compatible with recommendations 20 and 21.

Thank you for sharing portions of the study relating to DHCD with us. If you need additional information, please let me know.

Sincerely,

Neal

Neal J. Barber
Director

clt

cc: Mr. Rob R. Blackmore
Mr. Paul J. Grasewicz
Mr. John Ritchie, Jr.

SEP 0 6 1985

VIRGINIA
HOUSING
DEVELOPMENT
AUTHORITY

JOHN RITCHIE, JR.
Executive Director

13 SOUTH 13TH STREET • RICHMOND • VIRGINIA 23219-4188 • TELEPHONE 804/782-1986

September 6, 1985

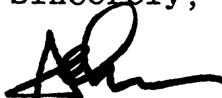
Mr. Ray D. Pethtel
Director
Joint Legislative Audit and
Review Commission
910 Capitol Street
Suite 1100
Richmond, Virginia 23219

Dear Mr. Pethtel:

You will find enclosed two copies of Virginia Housing's revised response to the JLARC exposure draft.

Best wishes.

Sincerely,



John Ritchie, Jr.
Executive Director

JRJr:mb

Enclosures

RESPONSE TO EXPOSURE DRAFT

Set forth below are the comments and response of the Virginia Housing Development Authority ("VHDA") to the exposure draft of the report of the Joint Legislative Audit and Review Commission ("JLARC") entitled "Review of the Virginia Housing Development Authority," dated August 1, 1985. In reviewing these comments, several points should be kept in mind. The first point is that VHDA is primarily a financing authority rather than an agency established to administer grant programs. When VHDA was originally established, the Commonwealth provided it with an initial cash advance on the expectation that it be repaid. This VHDA has done. The Commonwealth has never subsidized VHDA nor has it asked or required VHDA to carry out its statutory purposes through use of the Commonwealth's or VHDA's own funds. As such, from its very inception, VHDA was expected to be financially independent and self-supporting. The benefits that VHDA was to bestow on low and moderate income families were and are to be derived by virtue of its financial strength and the governmental functions conferred on it by the General Assembly which permit it to issue below market tax-exempt debt obligations in the national capital markets. VHDA brings this low cost capital back to Virginia to provide safe and sound housing for low and moderate income Virginians. In this regard, both VHDA's financial integrity and its status as a political subdivision of the Commonwealth are necessary ingredients which permit it to pass on its interest savings to these low and moderate income families. Any erosion of VHDA's financial strength by requiring it to use its own financial sources to make grants would make its financings riskier for investors and therefore would increase the interest costs of any VHDA financing. This would make VHDA far less effective in providing below market loans to those who would not otherwise be able to afford housing.

An undercurrent which runs through the report is the recognition of this tension which exists in all of Virginia Housing's programs between the goals of targeting the program to serve Virginians most in need of the housing assistance and operating the program in a fiscally responsible manner which will ensure the long-run financial integrity of Virginia Housing and avoid any financial embarrassment to the Commonwealth.

Private market forces are also a reality of the environment in which Virginia Housing operates. Virginia Housing raises its capital in the private market and lends it to developers or to homebuyers through real estate lending institutions which are operating in the private market. Everyone who does business with Virginia Housing asks the question, "Does this make good business sense for me," or, more crudely, "Is this the best deal I can get?" While persons who do business with Virginia Housing may be sympathetic to the public purposes of Virginia Housing's programs, there are very few persons who will do business with Virginia Housing if they believe they can make

more money elsewhere, and there is no one who will do business with Virginia Housing if they believe they will lose money.

For example, when Virginia Housing had HUD Section 8 rental subsidy funds available, it was able to target its multi-family loans to very low income families, and developers still found it economically attractive to do business with Virginia Housing. Without the subsidy funds, the targeting must be significantly relaxed for the program to make economic sense for the developers to participate in the program. Likewise, in the single family program, it would be theoretically possible to target the program much more specifically to different markets and types of borrowers. This targeting would require significant increases in time and paperwork ("red tape" in other words) by the lenders who participate, however. These lenders have seen an increase from 30 to 90 documents for a single family loan because of federal requirements. It is uncertain how much more documentation they are willing to accept. We presently hear complaints that they are not making money on the program. We must also be concerned about slowing down the processing of the loans since this is one of the most frequent criticisms.

In summary, VHDA can, because of its unique political and financial position, make it economically attractive to private persons and businesses to participate in programs which will provide housing for persons who would not otherwise be able to afford it. It cannot, however, completely overcome the inherent dichotomy between fiscal soundness and its desire to target for assistance those persons most in need of the benefits it can confer. It is important to remember that the greater the need for assistance, the greater the costs and associated risks in providing it. This imposes inherent limitations on the ability of an entity with finite financial resources to assist those most in need of assistance over a long period of time. Therefore, despite VHDA's sincerest desires and efforts, only if a long term commitment is obtained from an entity with financial resources far greater than those of VHDA can significantly more be done to target lower income families for greater assistance than is presently being provided.

A. Multi-Family Development.

Recommendation (1). The first section of the multi-family report focuses on the shift in VHDA's multi-family new construction/substantial rehabilitation activity coincident to the demise of the Section 8 New Construction/Substantial Rehabilitation Program. On page 18 the report states:

> "While VHDA is currently attempting to meet the needs of the moderate income tenants, particularly those living in urban and suburban markets, the Authority has not fully addressed the housing needs of lower income persons."

It is true that most of VHDA's assistance for new construction/substantial rehabilitation has recently been directed to

moderate-income projects in urban and suburban locations. This is because the federal government has eliminated its deep subsidy housing programs which enabled VHDA to serve low income Virginians with new construction/substantial rehabilitation. This is a reflection of changed national priorities which are now emphasizing serving low and very-low income housing needs through moderate rehabilitation and the use of existing housing resources. New construction is to be focused on meeting renter household growth and expanding the housing stock in markets experiencing low vacancy rates.

VHDA has attempted to serve low and very-low income housing needs within the framework of these new national priorities by aggressively making use of all available forms of subsidy assistance and by coordinating VHDA's resources with those of other state agencies. This is reflected in VHDA's fiscal year 1985 activities which included:

- Commitment of permanent financing for 424 units under the Section 8 Moderate Rehabilitation Program, and 45 units under the Section 8 Substantial Rehabilitation Program (the latter a rural project).

- Commitment of permanent financing for construction of 184 units, of which 39 were to be subsidized under the HUD HODAG Program to serve very-low income families.

- Implementation of the Rental Rehabilitation Program serving small cities and rural areas. VHDA is administering this grant/rent subsidy program despite lack of administrative funding in order to assure the availability of rehabilitation assistance for very-low income rental housing in nonmetropolitan areas. To date, VHDA has allocated grant funds and rental subsidy monies to nine jurisdictions. Funds presently available will support the rehabilitation of over 300 very-low income units, and the addition of over 300 section 8 certificates to VHDA's existing housing program.

- Commitment of loans to finance energy improvements in 1,016 units of existing low-income housing. VHDA uses grant funds from the Solar Energy and Energy Conservation Bank to write down the interest costs of loans for energy improvements to both multi-family and single-family housing. Such efforts are critical to the continued viability of some older low-income housing projects.

- Implementation of a rural conventional program to expand the rental housing stock in small cities and towns. Three loans have been committed to date.

- Administration of the Appalachian Housing Program. In fiscal year 1985, VHDA-administered funds supported the construction of 229 low income rental units in rural southwest Virginia.

- Commitment of financing from VHDA's General Fund to support the substantial rehabilitation of 27 low-income rental elderly units in Giles County. This assistance was coordinated with CDBG funding through DHCD.

- Continued coordination with Community Service Boards and state human resource agencies to package funding for group homes for the mentally ill and mentally retarded. In FY 85, VHDA committed permanent financing for a 12 unit group home in a rural locality.

Through these programs, VHDA has been able to broaden the group of renter households it is able to serve. Taking production of these programs into account, in FY 1985, 1,497 (45%) of the 3,309 multi-family rental units for which VHDA committed financial assistance served exclusively low and very-low income households in urban and suburban locations, while an additional 337 units (10%) served households in rural areas. Less than half (1,475 units--45%) served moderate income households in urban or suburban locations (Winchester and Fredericksburg are counted as "urban locations").

On page 21, the report states that:

> "VHDA's own review of tenants currently occupying its conventional units found that 11 of the 12 projects had at least 20 percent of the units occupied by low income households."

It goes on to state on page 22 that:

> "If VHDA's income limits were adjusted for household size as permitted by state law, the percentage of current tenants considered to be low income (80 percent or less of the area median) would drop significantly in each of the twelve VHDA conventional projects reviewed."

In fact, under VHDA's present low income standard, over 50 percent of the tenants in all 12 projects qualify as low income. Adjusting for household size the percentage does fail. However, 11 of the 12 projects still have over 20% of the units occupied by low income persons, with the average for all 12 projects being 38%.

On page 19, the report states that the Authority presently lacks an elderly rental program and needs to do more to support the development of group home facilities. VHDA recognizes the special housing needs of the elderly and handicapped and is attempting to address those needs within the constraints of existing resources. VHDA committed financing for two low-income rural elderly projects in fiscal year 1985 and presently has two loans for urban elderly congregate care facilities in processing under the Authority's conventional program. It should also be noted that projects which are not classified as elderly nevertheless

serve a considerable number of elderly tenants in their own right. Moreover, VHDA has committed financing for group home facilities in each of the past four fiscal years and remains receptive to future proposals. Finally, VHDA continues to be an active participant on state level committees dealing with this issue.

Recommendation (2). The report also states that the Authority unnecessarily permits higher income persons to occupy its conventional projects, thus reducing the benefit to lower income persons. As a remedy, the JLARC staff recommends changing the current "seven times" income limit to "5.5 times" rent plus utilities or to 120% of area median.

The present limit was adopted after careful consideration of alternatives and was based on limits adopted by several other state housing finance agencies. The limit is intended to prevent any tenant from getting a free ride (i.e., paying less than 14% of gross income for shelter), while not unnecessarily restricting the marketing of units. VHDA has always believed that long-term benefit to low and moderate income tenants was best assured through underwriting, i.e., establishing locations, amenities and rents, rather than through rationing of access to units.

VHDA agrees that the existing income limit is not the only alternative available. Nevertheless, because low and moderate income tenants do in fact represent the overwhelming majority in VHDA's conventional projects, VHDA sees no reason to change this standard at the present time. While VHDA is willing to consider the alternatives proposed in the report, it has the following concerns.

First, a lowering of the income limit could discourage developer participation in the program to the detriment of low income tenants. This is true because VHDA is not the sole source of tax-exempt financing in Virginia. Several local housing authorities are aggressively offering tax-exempt financing to developers of conventional multi-family projects outside the local authorities' home jurisdictions in competition with VHDA. Some of these authorities have considerably more liberal standards in regard to rent levels and low income benefit than does VHDA. For example, the Harrisonburg Redevelopment and Housing Authority (HRHA) has provided financing commitments for 1,304 conventional units in Prince William County alone. One HRHA project in Prince William, Stoney Ridge, is immediately adjacent to Dale Forest Apartments financed by VHDA. Both projects are in initial lease-up. The rent for one-bedroom units at Dale Forest is $450 compared to $510 at Stoney Ridge; the rent for two-bedroom units at Dale Forest is $495 compared to $585-$600 at Stoney Ridge. Thus, it is clear that VHDA, through its underwriting standards, is going to much greater lengths than are some local authorities to assure that its projects serve low income persons. Developers are cognizant of these differences and actively shop for the best

deal. VHDA has attempted to balance the need to keep its program competitive with its mission to serve low income persons.

Second, VHDA is not convinced that changing the income limit would have the effect of targeting a lower income group or substantially lowering the average tenant incomes. It could, however, make the projects more difficult to rent, if marketing difficulties occurred, by eliminating some eligible renters.

Recommendation (3). JLARC makes several administrative recommendations regarding selection/underwriting criteria, recordkeeping, developer participation and minority participation, each of which deserve brief comment.

The first of these recommendations involves the development of written selection and underwriting criteria which will establish a decision matrix of values to govern the selection and underwriting process. JLARC goes on to cite several examples of underwriting decisions which, it concludes, point to the need for such a system. The use of decision systems and written criteria such as recommended can be useful in organizational environments where the decision making process must be strictly controlled. This may occur where there is a concern about the ability of the underwriters to make decisions that further and are in accord with the objectives of the organization. Such is not the case at VHDA. Moreover, although VHDA would be willing to discuss the matter further, it believes that its multi-family lending record should indicate that an adequate system of written selection criteria has been established in its Procedures, Instructions and Guidelines. In this regard, VHDA attempts in its selection process, to foster a competitive atmosphere so that proposals do not merely meet minimum standards but compete against each other for selection.

Recommendation (4). JLARC next recommends that VHDA should prepare written summaries of the selection criteria used in the selection process. Selection summaries detailing final selection decisions and the basis for these decisions are prepared and have been since 1981. Nevertheless, VHDA agrees that a review of this process may yield some improvements and is initiating such a review.

Recommendation (5). The JLARC staff has found that "VHDA's current practices appear to discourage open participation and competition for the Authority's loans." The report does not identify the practices in question. In fact, VHDA makes every effort to invite open participation. Public announcements of VHDA's proposed financings and invitations for proposals are published in all major newspapers well in advance of each bond issue. Since the inception of the conventional program, VHDA has been pleased to select proposals from the "new" developers in each round of financing.

The project selection process employed by VHDA is open to anyone who wishes to participate. However, the process is competitive and frequently the competition is keen. VHDA seeks to select only the best proposals available. VHDA would not consider selecting an inferior project simply to permit a particular developer to participate in our program. VHDA also strongly recommends against the establishment of any arbitrary system that would permit such selections to occur.

Given the fact that VHDA's primary goal in project selection is the quality of the proposal, it is not at all unusual to find that some developers are more successful than others time after time. This phenomenon is common in any competitive environment. There is certainly no reason to believe it would be otherwise in this situation.

VHDA is cognizant of the risks associated with allowing outstanding loans to one developer to become excessive. For this reason, VHDA's Board established a policy in 1977 of re-evaluating its position whenever an individual developer's outstanding construction loan commitments equal or exceed 25% of the total outstanding construction loans. This practice is still observed.

To extend such limits beyond the construction phase would serve little or no purpose. Once a project is successfully completed and occupied, the risk of loan loss is vastly diminished.

Recommendation (6). The JLARC staff's final recommendation involved establishing a percentage goal and a plan as well as monitoring procedures for increasing minority participation in the development of its multi-family projects. In its loan documents, VHDA requires the developers and contractors to conform to federal and state laws and regulations prohibiting discrimination. VHDA is certainly interested in encouraging minority participation and will review and consider the JLARC recommendations on this matter.

B. Monitoring of VHDA Rental Projects.

Recommendation (7). Controls Over Rents. JLARC staff stated that most of the rent increases granted to eleven conventional projects reviewed appeared to be reasonable; however, rent increases granted to two projects appeared to be contrary to VHDA's mission to maintain rates affordable to low and moderate income persons.

In the first citing, the large conventional project in Richmond is Bramblewood Estates, VHDA's first large conventional (338 units) in this area. Attached are the rent schedules (Exhibit 1) over each of the last five years which show a modest increase each year. Also attached is a survey of rental comparisons (Exhibit 2) in the area as of January 1, 1985, which indicates that the rents for units in Bramblewood Estates are substantially below those of comparable developments. The expenses at Bramblewood have remained constant since the conversion of the heating system from oil to gas in 1981. However, $183,000 has been spent to restain, recaulk and replace siding since 1981. It should be noted that the owners of Bramblewood have never received a distribution of cash.

The second project cited was a Tidewater project--Greenbrier Woods I & II located in Chesapeake, Virginia. The JLARC staff reported the owners' request for a ten percent increase per unit to be effective January 1984. VHDA granted the request for the increase, effective January 1, 1984, which was less than they asked for and only for the reasons given in Exhibit 3.

The explanation for the delay in staining the development is offered in Exhibit 4. If this information does not fully answer the concerns of JLARC's staff, VHDA would be willing to discuss the matter further.

Controls Over Management Agents. The JLARC staff cited the owner of a Southside Virginia project who had withdrawn fees in excess of the authorized amount and had done so on previous occasions. When VHDA discovered that this was occurring, its staff directed the owner to return the excess funds to the project's operating reserves, which the owner did. This problem with the owner no longer exists.

The JLARC staff also stated that the Housing Management Division had approved annual fee increases for the agent that were greater than the one quarter of one percent limit allowed by policy. The statement is incorrect, however, perhaps because of some confusion caused by VHDA's change from annual to a biannual review of management contracts and from a percentage of rent to a dollar fee per unit method of compensation for management agents. This per unit method which has been adopted by many housing finance agencies avoids problems of unintended increases in management

fees when rents increase and achieves greater equity in management fees between high and low rent markets.

With respect to other aspects of JLARC's recommendations, the recommendation that the Board of Commissioners approve all rent increases and increases in management fees would cause a significant change in the role of the Board of Commissioners and the staff. The Board establishes policy for VHDA and charges the staff with the responsibility for administering this policy. The staff will, however, review with the Board the policy on rent increases, increases in management fees and the implementation thereof.

The JLARC staff also cited a complaint from residents of one development that their community room was being used for public meetings. VHDA contacted the owner and the residents concerning this matter and was able to negotiate a mutually agreeable resolution of this problem. One subsequent complaint was received from a single resident which was also resolved by VHDA. Moreover the use of subsidy monies to provide restrooms for the community room, which was also alluded to in the report, was done as a convenience for the residents.

With regard to other activities of management agents not authorized by VHDA, whenever VHDA has discovered such unauthorized activities, they have been corrected. For example, the property manager cited as not paying rent was dismissed, and the charges for the new truck were reimbursed to the locations which did not get the benefit of its services.

Weaknesses in Oversite Procedures.

Recommendation (8). The Report correctly identifies the need for a written operations manual to prevent inconsistencies and inefficiencies in VHDA's Housing Management function and to provide standardized policies and procedures. VHDA has now completed such a manual which has been reviewed, approved and is in use by the staff at this time.

The citations of failures to perform project inspections appear to arise from a misunderstanding of the process. VHDA would like to meet with the JLARC staff to review this process in order to correct this misunderstanding.

C. Single Family Home Loans.

The JLARC staff concluded on page 64 "...VHDA does not have an adequate means for determining if loan applicants are eligible for conventional mortgages. Consequently, the JLARC staff found that 2,888 (or 23 percent) of VHDA's loan commitments during the past four years were made to homebuyers with sufficient income to qualify for conventional, private loans." VHDA was quite surprised by this conclusion and would like very much to discuss with JLARC the analysis upon which it is based.

Income is only one criterion in determining if a borrower is eligible for conventional financing. VHDA's lower downpayment during the past years of approximately 2% along with lower closing costs, such as points, allowed homebuyers that did not qualify for conventional financing to purchase a home through VHDA. On a $50,000 loan, the borrower's closing costs can amount to as much as $2,000 less than needed to close a conventional loan. Since VHDA has a net worth limitation of $20,000, $2,000 is a substantial amount of money in this context. JLARC indicates in its report that it realizes income is only one criterion in determining eligibility, however, this important point was not mentioned in the summary. Therefore the conclusion that 23% had incomes sufficient to qualify for conventional financing is misleading since these other factors are not considered or mentioned.

Many of the JLARC staff's recommendations such as serving lower income applicants and providing more funds for inter-cities and rural areas cannot be achieved because of private mortgage insurance (PMI) requirements. Because of record losses in 1983 and 1984, PMI companies have changed their underwriting requirements so that they severely affect VHDA's efforts to achieve its mandate. Even though PMI companies' experiences with VHDA have been excellent, VHDA is charged the same premium as lenders with historically high losses. VHDA is also required to use the same underwriting requirements as those lenders. Further, the rates charged all lenders in Virginia, which has historically low default rates, are the same as in states with high default rates. VHDA has had to adopt several underwriting requirements which restrict its ability to serve low and moderate income applicants in order to obtain PMI insurance. As a result, it now takes approximately $2,000 more to close a typical VHDA loan than it did prior to the changes by the PMI companies. There are indications that PMI companies will eventually stop accepting gift letters as a source of downpayment. Gift letters, especially with the age group VHDA serves, are an important source of funds necessary to close a mortgage loan. Recent changes by the Federal National Mortgage Association (FNMA) in the criteria it uses in determining whether it will purchase mortgages in the secondary market suggest the PMI companies will further restrict the type of loans which they will insure. <u>In order to operate our single family program and to better serve low and moderate income applicants, VHDA suggests that the JLARC staff recommend legislation be introduced which will allow VHDA to create a subsidiary mortgage</u>

insurance company to insure its loans. VHDA would be glad to discuss this with the JLARC staff.

Recommendation (9) addresses the report's conclusion that VHDA had made loans to households who by virtue of their income, appeared to be qualified for conventional financing. It suggests that lending agents complete additional forms or worksheets verifying that the applicants do not qualify for conventional financing by virtue of their income.

As noted above, income is only one criterion in determining eligibility. Others include cash available to meet downpayments and closing costs, ability to meet mortgage debt payments as well as other debt obligations in excess of six months duration, creditworthiness, job stability, location or type of property. Failure to meet any of these requirements could disqualify an applicant for conventional financing. VHDA does not want its financing resources made available to households who qualify for conventional financing. Perhaps a more practical alternative to requiring lending agents to complete additional worksheets, however, would be for VHDA's loan underwriters to complete the form or worksheet based on their knowledge of the conventional mortgage market. VHDA has tried to keep the administration of its programs as simple as possible. Nonetheless because of the numerous requirements established by federal laws regulating tax-exempt Mortgage Revenue Bonds, the number of documents required per loan, has increased from 30 to 90, a 200% increase, since 1980. VHDA's efforts have been directed at decreasing th number of documents lenders must process and where possible, VH has tried to assume additional tasks especially those which can be easily computerized. Not only does this reduce the training required for agents, as well as decreasing the complexity of our programs, but it mitigates the need to increase lenders' origination fees, costs which must normally be assumed by the borrower.

Recommendations (10) and (11) suggest that adjustments to sales prices and income limits should be made to better reflect differences that exist in different regions of the state and that sales price limits should be based on periodic surveys of home sale prices throughout the Commonwealth. VHDA agrees that certain areas of the state could have adjustments made but VHDA would like to discuss with JLARC the practical difficulties in establishing separate price and income limits for additional areas in the Commonwealth.

Recommendation (12) suggests reinstituting both separate income limits for one-person households and the limit on the amount of loans made available to this group.

VHDA currently has separate income limits for one-person households via its adjustments to income. Because VHDA's income limits and sales prices have not changed appreciably over the last several years, it has become increasingly difficult to serve families at the existing income limits; relatively more one-perso

households fall within these limits. VHDA therefore expects that by adjusting its income limits to more adequately serve families, establishing a separate lower income limit for one-person households, which is different from the current differential, will not be necessary. Relating the number of loans available to one-person households on the basis of their proportion of the state's population is not necessarily an equitable way to allocate loan funds. It would be more equitable to relate the loans to the percent of single-person households in need of housing assistance. Presently VHDA is providing approximately 28% of its loans to these groups. Most importantly, because the state's ceiling amount of bonds has been significantly increased, VHDA has sufficient funds on hand to serve all applicants and other eligible households are not being deprived of VHDA's assistance because of the volume of loans being made to one-person households. If the availability of funds becomes limited, as it was when VHDA imposed limits on loans to one-person households previously, VHDA would consider imposing such a limit again.

Recommendation (13) suggests that VHDA take steps to increase the commitment of loans in rural and inner-city areas, including making exceptions to its underwriting standards.

VHDA has and will continue to take steps to increase the utilization of funds in these areas. VHDA is required to set aside 20% of its lendable bond proceeds to be used in "targeted" areas. VHDA has worked extensively with localities to have additional targeted areas designated by the Treasury as one method to increase the utilization of these funds. Recently, the Treasury has refused to grant the addition of more targeted areas in Virginia and other states. VHDA has recently instituted monthly computer generated reports to localities detailing the usage of funds set aside for their use and $15,000 in grant funds from VHDA's general fund to four cities to enable them to develop and implement innovative ways to promote the usage of targeted area funds. Should this pilot program prove successful, VHDA intends to consider extending it to other localities and sharing new approaches which are generated in the pilot programs. VHDA has cooperated with several cities in the production of promotional literature for these funds.

VHDA is perhaps unique in that it allocates targeted area funds to localities and allows them to formulate programs and utilize local resources to complement these funds and enhance their use. As localities and lending agents have become familiar with these programs and, importantly, as interest rates have decreased, the utilization of these funds has increased. VHDA agrees with the JLARC recommendation that it continue to seek ways to increase the utilization of funds in these areas. The attached chart and map (Exhibit 5) breaks down VHDA's loan production for several geographic areas for a period of three years. These data indicate that in the rural areas of the state, VHDA has provided an equitable share of funds in the past. In order to assure that VHDA continues to serve low income rural households, VHDA has

aggressively pursued and is currently implementing the Rural Homesteading Program which combines the resources of HUD, the Farmer's Home Administration and VHDA to serve lower income families, (those with income less than $13,000) with home ownership opportunities.

Recommendation (14) suggests that VHDA consider using its fund balances to assist eligible families with costs of taking out a home loan such as downpayments, closing costs, etc.

While a program of this sort could provide assistance to lower income households, as noted above, it appears it will be necessary to develop an alternative to private mortgage insurance before VHDA could do this. In VHDA's solar grant program, private lenders report that PMI companies are becoming more reluctant to allow the grant funds to reduce the borrower's equity investment. With respect to loans that VHDA finances with solar grants, the PMI companies have refused to lower the premium, as they normally would if the loan to value ratio were decreased. Given this response, neither relaxing our credit standards nor using VHDA generated funds to assist with closing costs appear to be possible until VHDA can develop an alternative to private mortgage insurance, an effort which is currently under way.

Recommendation (15) addresses loan processing recommendations.

VHDA agrees with these recommendations and is currently working on ways to provide for a smoother flow of loan funds and loan processing. VHDA has managed to raise funds in such a manner that funds have been available continuously since July, 1984. Such availability of funds has had a major effect of smoothing out the flow of mortgage lending by removing the burst of pent-up demand which previously accompanied bond issues. VHDA expects to be able to continue this in the future. However, as VHDA depends on Agents and PMI Companies to do much of the loan processing, the actual production of loans may still experience a "stop" and "start" phenomenon, which may be outside VHDA's control.

Recommendation (16). In summary of the findings with regard to collections and foreclosures, the report states:

> "Concerns have been raised, however, that the Authority's collection efforts are too aggressive. JLARC staff found that VHDA's collection practices are more stringent than those of most other lenders. Although these practices have been successful in keeping delinquency rates low, the Authority's policies might result in unnecessary foreclosures."

The JLARC staff supports this assertion by citing that VHDA has experienced a foreclosure rate that is almost three (3) times greater than the foreclosure rate for conventional loans in Virginia even though the JLARC staff acknowledges that these

figures are well below national averages. The JLARC staff recommends that:

"VHDA should review its policies to ensure that they do not result in unnecessary foreclosures. The Authority should seek the advice of its approved lenders on specific ways its collection policies might be modified."

While VHDA has no objection to proceeding as the JLARC staff has recommended, there were certain aspects of the report which VHDA believes merit further discussion. VHDA's responses are listed below:

The report states that VHDA lenders assess a late penalty on the mortgagor earlier and at a slightly higher rate than most other lenders. The VHDA form of note permits its agents to assess a late charge of five percent (5%) after ten (10) days; however, it is VHDA's understanding that few, if any, of its agents do enforce this provision. Five percent (5%) has been approved by the FHLMC and is generally accepted in the industry. Although many lenders allow a fifteen (15) day grace period rather than ten (10), it is highly unlikely that this has ever resulted in an unnecessary foreclosure.

The report states that VHDA seems unwilling to consider a reinstatement within five (5) days of the foreclosure date. Standard procedure is to encourage reinstatement up to the date of foreclosure. VHDA is not aware of any instance in which it has exercised its legal right under the deed of trust to refuse reinstatement within five (5) days of the advertised foreclosure sale.

The report states on page 86 that VHDA's foreclosure rate is "almost three (3) times greater than the foreclosure rate for conventional loans in Virginia." This statement, although accurate, seeks to compare VHDA directly with all private conventional lenders in Virginia. This may not represent a reasonable comparison due to several differences between VHDA's lending practices and those of private industry. For example:

- VHDA places a ceiling on income and assets. Private lenders place a floor on these.
- VHDA limits the maximum assets of a borrower. Private lenders limit the minimum.
- VHDA concentrates its lending heavily in high loan to value loans (95%-97%). Private lenders generally do not.
- VHDA's portfolio is comprised of families and individuals whose average annual income is below the median income for the state. VHDA is mandated to provide loans to low and moderate income Virginians. Private

lenders actively seek to avoid such loans by their underwriting criteria. VHDA, for example, allows thirty-two percent (32%) of gross income to be for shelter and forty percent (40%) of gross income for total debt. Private lenders typically only allow twenty-eight percent (28%) and thirty-six percent (36%), respectively. In this way, and in many others, private lenders reduce the risk of foreclosure significantly, whereas VHDA exposes itself to higher risk of foreclosure in order to make its funds available to those individuals who cannot secure loans with private lenders.

A far more meaningful comparison of foreclosure rates would be one between VHDA and its peer group of other housing finance agencies. The JLARC staff on page 95 of its report makes such a comparison as follows:

"VHDA's single-family loan delinquency and foreclosure rates are among the lowest in the country for housing authorities."

The report states that VHDA's collection practices are more aggressive than other lenders. VHDA has structured its collection practices to be commensurate with what VHDA knows about its borrowers. The typical VHDA borrower has limited resources to call upon in the event of financial problems. VHDA has found that it is normally difficult or impossible for them to reinstate a loan once two (2) or three (3) payments are due. Consequently, VHDA concentrates its collection effort in the first thirty (30) to forty-five (45) days of delinquency. By doing so, VHDA believes it has successfully prevented many borrowers from entering foreclosure.

The report states that six lenders surveyed questioned our collection and foreclosure policies. VHDA considers foreclosure action based upon written recommendations from these lenders. The lender is charged with the responsibility of investigating each delinquency and determining the reason. It then offers recommendations to VHDA. A recent survey of these recommendations revealed that in over fifty percent (50%) of the cases, the lenders recommended foreclosure because of the borrower's disregard for obligations. In other words, in the lender's opinion, reinstatement was extremely unlikely due to the borrower's disregard for his obligations or his inability to make payments on the mortgage loan.

The report states that the lenders surveyed suggested that VHDA contact delinquent borrowers directly. It is standard procedure in the industry for the servicing agent to make and maintain contact with delinquent customers. Investors such as VHDA do not directly correspond with the borrowers. One reason for this is that lenders are expected to have a professional collection staff, trained and experienced in

this field. They are expected to professionally counsel these borrowers and make every effort to cure the delinquency. Direct contact by VHDA would serve no purpose, and might, in fact, confuse the issue.

In summary, it is the function of the Single-Family Servicing Department to maintain and protect the integrity of the residential loan portfolio. Delinquency rates and foreclosure rates are the barometer by which the success of these efforts is measured. These rates have been verified by JLARC staff with several well respected municipal bond research and investment firms and national bond rating companies. VHDA's policies are based on those that had been historically proven to be successful in the mortgage industry. VHDA has in the past reviewed these policies from time-to-time, and, therefore, has no objection to JLARC's recommendation that they be reviewed again. VHDA would welcome any suggestions its lenders may offer in an effort to further reduce both its delinquency and foreclosure rates.

D. Financing VHDA Programs

Comments on Factual Matters.

Generally, VHDA believes that considerably more emphasis should be given to both the contingent liabilities of the general fund and the fact that the projections of growth in the general fund balance are by no means certain, particularly after taking into account these contingent liabilities. Some of these contingent liabilities are included in comments #2 and #3 below.

In the comments set forth below, suggested changes and additions to the language in the report are indicated by underlining.

1. Summary, page 12, third sentence of first full paragraph and page 91, first sentence of last paragraph.

   Comments made by the Director of Finance regarding the financial strength of VHDA did not take into account the recommendations of the JLARC report, many of which would have the effect of lessening the financial strength of VHDA. VHDA suggests the following sentence be added.

   "Moreover, the Authority's Director of Finance stated that 'there is virtually no chance that VHDA will experience losses from a resolution which cannot be covered either by funds available in the resolution or . . .the Authority's general fund." (Such statement was based upon VHDA's current financial position and practices and did not take into account the financial effects of any of the recommendations of this report, some of which would tend to lessen the financial strength of VHDA.)"

2. Page 101, second sentence, second full paragraph. VHDA suggests the following be added:

   The projection further assumes that there will be no major arbitrage, investment, or loan losses or loss of income related to bond calls. It further assumes there is no additional legislation which would adversely affect the economics of bond issues. In addition, the projection assumes that each bond maturity will be outstanding until its maturity date or sinking fund date and that no bonds will be called from prepayments. It should be noted that recent bond structures provide that much of the increase in fund balances will be represented by mortgage loans instead of cash and investments. Accordingly, that portion of fund balances which is in the form of mortgages will not be available for other purposes. It should be noted that, as fund balances increase, the amount of debt outstanding related to those fund balances also increases.

3. Page 105, carry-over paragraph. VHDA suggests the following paragraphs be added:

> In the event federal legislation precludes the issuance of additional bonds, the general fund will remain the source of payment for all operating expenses until the final maturity date of existing bonds in 2022. Such expenses increase every year because of inflation and other factors.
>
> Because substantially all bond issues are general obligations of VHDA , the general fund is a source of payment for any shortfalls in any of the bond resolutions. Such shortfalls may be created by losses in market value of investments, loan losses, arbitrage losses and bond redemption losses. VHDA is currently experiencing arbitrage losses in several series of bonds.
>
> In addition, the general fund would be the source of funds in the event scheduled mortgage prepayments required for debt service fail to materialize or in the event that disbursements are required to fund overcommitments of bond issues. Scheduled prepayments currently are $20 million per year and overcommitments of bond issues currently exceed $76 million. The general fund is also used as a source of funds to cover late payments to tenants and mortgagors by the federal government.

4. Page 106, end of first full paragraph. We request that the following paragraph be added:

> It should be noted that while carrying out the programs discussed above, the three state HFA's of Kentucky, Connecticut and Michigan use the state's moral obligation on their issues. In addition the Connecticut moral obligation is generally interpreted as requiring the state to make up shortages in the capital reserve funds without any additional legislative action.

Comments on Recommendations (1), (14), (17), (18) and (19):

In summary, Recommendations 17 and 18 concern limitation of use of the moral obligation pledge for single family and multi-family bonds, respectively, and recommendations 1, 14 and 19 recommend that VHDA provide low or no interest loans or direct rental or other subsidies and that it utilize at least 20% of its fund balances to "provide additional affordable housing".

With regard to the use of the moral obligation pledge, VHDA has given careful attention to avoid abuse of the privilege and indeed has, of its own volition, elected not to use it when VHDA could achieve substantially the same rates without it. Since

1981 the Authority has utilized the pledge for less than 15% of its issues, all multi-family. Market conditions change rapidly however, and VHDA wishes to maintain the option of using the moral obligation in the event its use could benefit the people VHDA wishes to serve.

With regard to the use of the moral obligation for multi-family issues, it should be noted that to our knowledge VHDA is the only housing finance agency in the country which has been able to provide a significant unsubsidized multi-family mortgage program without having to obtain external credit support. Such support is costly and usually limits the effective term of the financing to ten or twelve years. VHDA's program provides 30 year financing, thereby greatly increasing the chances that such housing will be maintained as rental units for a longer period of time. The moral obligation, coupled with VHDA's own financial strength and operating record, has been an important factor in obtaining the bond ratings for the multi-family bond issues financing this program. In summary, VHDA strongly recommends that the use of the moral obligation not be curtailed for either single family or multi-family issues. In VHDA's opinion, such removal of the right to use the moral obligation will be interpreted by some as a lack of confidence by the state in the Authority, regardless of any statement that accompanies such removal.

VHDA agrees with the goal of the suggestions in Recommendations 1, 14 and 19, which is to provide more affordable housing in Virginia. VHDA further agrees that disbursements from the gene al fund for such purposes may be appropriate under certain circumstances and have made such disbursements. However, such goal and such disbursements must be accomplished in a sound financial manner. VHDA's financial goal is not only never to call upon the moral obligation but also never to experience financial difficulties which would embarrass the Commonwealth in any way. It should be noted that VHDA's reputation and record for conservative professional financial management have been essential in working with the financial community to accomplish its goals. In its most recent single family issue, which was rated A-1 by Standard and Poor's and Aa by Moody's, VHDA was able to obtain a lower effective interest rate than an Ohio Housing Finance Agency issue rated AAA by both agencies which was being offered at the same time. VHDA believes its reputation and record have been in keeping with the philosophy and image of the government of the Commonwealth and have made a positive contribution to the image of the Commonwealth. VHDA feels that, in view of the numerous contingent liabilities of the general fund, some of which are enumerated in comments 2 and 3 of this memorandum, it is premature at this time to expend substantial amounts of monies from the general fund for subsidies or low cost loans. While many are quick to suggest that VHDA use its fund balances to subsidize rents, none have been willing to offer a commitment to come to the aid of VHDA in the event that such actions jeopardize bond ratings or create financial difficulties in the future. The Co missioners of VHDA are charged with the dual responsibility of

both providing socially desirable programs and maintaining the financial integrity of a large financial institution. The latter responsibility must be given particular attention today in view of the continual threat of legislation which would prohibit the further issuance of tax-exempt bonds.

In considering recommendations such as 1, 14 and 19 it should be kept in mind that the same type of thinking that has created financial difficulties for the Social Security system must be carefully avoided. Initially that system was also intended to be self-supporting. Its current difficulties have been brought about by offering socially desirable benefits it cannot afford. Specifically, the problems were created by commitment of expenditures for socially desirable goals based upon current fund balances without proper regard for future liabilities related to those fund balances. Just as in the Social Security system, while cash may be available at VHDA today for additional benefits, the depletion of funds today could cause the organization to be unable to meet its obligations in the future. In this respect the existence of the contingent liabilities discussed in comments 2 and 3 of this memorandum should be re-emphasized. While VHDA agrees that subsidies from general fund balances may be appropriate in the future, VHDA strongly recommends that such subsidies or low cost loans contained in recommendations 1, 14 and 19 not be undertaken at this time. The general fund serves as a source of security for substantially all VHDA issues. A strong general fund balance results in lower mortgage rates for all home buyers and lower rents for all tenants. It makes the bond buying public more receptive to innovative techniques which VHDA uses to sell bonds with lower rates. In addition, the general fund enables VHDA to sell small unsecured bond issues for special programs such as the Moderate Rehabilitation Programs and the Virginia Energy/Solar Bank Program.

A self-supporting organization the size of VHDA will be unable to make a dent in replacing the massive amount of funds previously provided for deep subsidy by the Section 8 program. VHDA currently disburses over $70 million per year in federal rental subsidies. Both rating agencies, Standard and Poor's and Moody's, have informed us that actions taken by the Authority which would deplete fund balances or increase risk could result in a lowering of the ratings of outstanding bonds. Such reductions in ratings would reduce the market value of the holdings of VHDA bondholders and increase the cost of borrowing for future issues.

Regarding the use of fund balances for the making of loans, VHDA believes that there is general agreement among those knowledgeable in the operations of housing finance agencies that the most efficient source of principal for loans is tax-exempt bonds. Even if the interest rate is to be written down by the use of external funds, as is the case in VHDA's single family buydown program, it is more efficient to make the initial loans from tax-exempt bond proceeds and then apply the buydown funds or subsidies rather than to use general fund monies to make low cost

loans. It should be noted, however, that VHDA has not hesitated in the past to utilize funds from its general fund to make mortgage loans in those instances in which federal or state law has precluded the issuance of tax-exempt bonds for such purposes or for those programs which are not of sufficient size or duration to justify a bond issue. As noted in the JLARC report, VHDA regularly contributes general fund monies to make single family bond issues feasible. It has contributed $19 million for such purposes through the 1985 A Residential Mortgage issue and anticipates that such contributions from the general fund will approximate $7 million annually in future years. It has designated $3 million for the Rural Conventional Program and expects to use $400,000 annually for the Rural Homesteading Program. The general fund has also funded over $14 million in multi-family loans which were not taken out by GNMA prior to the maturity date of the VHDA notes financing them and has funded over $14 million in single family construction loans. Tax-exempt bond financing for the latter was precluded by federal law in 1981.

Administration of the Authority.

Planning and Coordination with Other Agencies

Recommendation (20) suggests that VHDA and DHCD jointly develop a state housing plan which would be submitted to the House and Senate General Laws Committees annually. The plan would provide specific methods for coordinating programs of State and local housing agencies. VHDA agrees that such cooperation is helpful in light of the significant decrease in federal housing programs. Presently, VHDA has both formal and informal relationships with state housing agencies. In addition, VHDA has a working relationship with state and local housing agencies via joint administration of and participation in several housing programs. These programs include the Appalachian Regional Commission Housing Development Program (ARC), the Community Development Block Grant Program, the program of housing for mentally ill and mentally retarded, the Rental Rehab Program, the Section 8 Existing and Moderate Rehabilitation Program, the Urban Preservation and Infill/Targeted Area Program, the Solar Grant Program, the Dislocated Worker Program and the Rural Homesteading Program. In addition, VHDA has cooperated with DHCD and local redevelopment and housing authorities in the allocation of the state's ceiling amount of bonds on behalf of localities who had allocations but who did not choose to issue bonds themselves.

Recommendation (21) suggests that DHCD perform a comprehensive assessment of housing needs in Virginia, to be financed in part by VHDA. It then suggests that VHDA and other housing providers could use such a document in their planning efforts.

VHDA is currently undertaking, as part of its strategic planning efforts, a more comprehensive assessment of statewide housing needs.

VHDA regularly meets with representatives of the Department of Mental Health and Mental Retardation, Social Services, and the Department of the Aging as participants in various statewide housing forums and as resources in the development of its own programs.

Recommendation (22) suggests that VHDA continue its long-term strategic planning efforts and that it seek input from other agencies who serve Virginians in need of housing assistance. VHDA agrees with this recommendation.

Recommendation (23) suggests that VHDA improve its internal process for developing and implementing new programs. VHDA agrees with this recommendation.

Appointment of Commissioners.

Recommendation (24). "The General Assembly may wish to amend Section 36-55.28, Code of Virginia, to require that one of nine

VHDA Commissioners be a consumer member experienced in the housing problems of low and moderate income persons, and that a second be a "citizen member" with no financial interest in the real estate, banking or building industries."

Under present law, the Governor may appoint a "consumer member" and "citizen member" if he so desires. VHDA believes that its Commissioners, past and present, have in fact represented the public at large because the members of the Board, as presently constituted, regard themselves as citizens. To require that certain interest groups be represented on the Board will implicitly suggest that other members do not have the same responsibility to represent these groups. This could have the effect of reducing the representation of citizen/consumer interests as well as inhibit the cooperation and consensus-building among the Commissioners which the present system has fostered. In addition, it is unclear whether any real distinction can be made between a "citizen" representative and a "consumer" representative. Therefore, not only does it seem unnecessary to appoint two such consumer or citizen members, it also appears possibly to be counter-productive to appoint any such member.

Competitive Procurement Requirements.

Recommendation (25). The report states that "...VHDA was found not to be in compliance with the intent of Virginia's competitive procurement requirements in the hiring of an auditing firm." VHDA shares JLARC's concern that the requirements of Virginia's Public Procurement Act be satisfied. However, it should be noted in this regard that the letter agreement with the auditors, Peat, Marwick, Mitchell & Co., was executed after consultation with both VHDA's in-house and outside counsel. Thus, the letter agreement's compliance with the Procurement Act is a matter of legal interpretation. In any event, VHDA is now in the process of selecting an auditor through the competitive processes required by the Public Procurement Act. Therefore, VHDA believes that it is inaccurate to state that it is not in compliance with the intent of the competitive procurement requirements.

Electronic Data Processing.

Recommendation (26). The recommendations relating to electronic data processing are being reviewed and necessary adjustments will be made.

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