

**REPORT OF THE
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMISSION**

**Final Report:
Review of the Virginia
Housing Development Authority**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



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Preface

The Virginia Housing Development Authority (VHDA) is an independent public authority created by the General Assembly in 1972 to address shortages of adequate housing for low and moderate income households in Virginia. House Joint Resolution 731, approved by the 1999 General Assembly, directed the Joint Legislative Audit and Review Commission (JLARC) to study the programs administered by VHDA as well as the organization and management of the authority.

This study found that VHDA's performance in terms of generating revenue and achieving financial strength has been excellent and that the authority appears to be generally well managed. However, the authority's performance in meeting its statutory mission has not reflected its full potential and needs improvement. JLARC staff reached this same general conclusion in its review of VHDA 15 years ago.

Several concerns related to VHDA's single family and multifamily programs are identified in the report. Thirty-nine percent of the recipients of VHDA single-family loans would have qualified to receive private market loans, and neither private lenders nor VHDA make an effort to verify whether a borrower would have qualified for a reasonably equivalent private market loan. In addition, VHDA single family loan products provide only small benefits to borrowers and generally offer the same level of assistance to both moderate and low income households. The study also found that while the multifamily program has been successful in financing multifamily projects, the rents charged are often not affordable and the distribution of projects around Virginia does not reflect the State's housing needs. The report contains recommendations to address these concerns.

The study also found that the Section 8 program has not been adequately managed. VHDA's decision to ignore a U.S. Department of Housing and Urban Development policy directive issued in 1995 resulted in the loss of a large amount of federal Section 8 assistance to Virginia and the opportunity to house a significant number of additional families. In addition, VHDA needs to improve the financial and technical support provided to administrative agents who administer the program locally and improve the efficiency of the program at the State level. Recommendations to improve the Section 8 program are provided.

The study further concluded that VHDA has financial strength that could be better utilized without jeopardizing its impressive bond ratings. VDHA has developed sizable fund balances because it annually generates more income from mortgages and investments than its expenditures. However, VHDA's highest priority appears to be maintaining a strong financial position instead of fully utilizing its financial strength to provide assistance to low and very low income households that could most benefit from the authority's assistance. Recommendations to better utilize VHDA's financial strength are also provided.

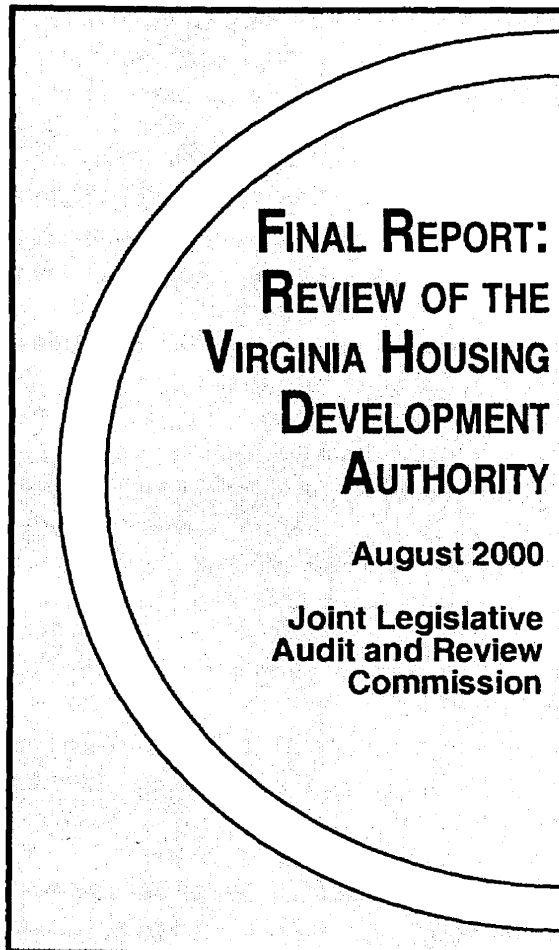
On behalf of the Commission staff, I would like to express our appreciation for the cooperation and assistance provided by VHDA staff and local housing authorities during this review.



Philip A. Leone
Director

August 3, 2000

JLARC Report Summary



The Virginia Housing Development Authority (VHDA) was established by the Virginia General Assembly in 1972 as the State's housing finance agency. The General Assembly created VHDA in order to address shortages of adequate housing for low and moderate income households in Virginia. According to VHDA's mission statement, its mission is "to help our fellow Virginians obtain safe, sound and decent housing otherwise unaffordable to them."

VHDA operates as an independent public authority. It does not rely on General Fund money to fund its operations and programs as a result of its ability to issue tax-exempt bonds created by the federal gov-

ernment and allocated to the State of Virginia. Instead, VHDA generates revenue through the sale of bonds and the issuance of mortgage loans.

House Joint Resolution 731, approved by the 1999 General Assembly, directs the Joint Legislative Audit and Review Commission (JLARC) to evaluate whether VHDA is addressing the housing needs of low and moderate income Virginians and is administering its programs in accordance with the statutory intent set forth in §36-55.25 of the *Code of Virginia*. The resolution also expressly requests that JLARC examine VHDA's administration of the federal Section 8 program. This is the second of two reports that have been prepared to meet the study mandate. This report addresses the issues raised by the mandate. The interim report primarily provided organizational and financial background about VHDA.

Overall, VHDA's performance in terms of generating revenue and achieving financial strength has been excellent, but its performance in meeting its statutory mission (and its own mission statement) has not reflected the authority's full potential and needs improvement. Evidence contained in the report indicates that in each of its major programs, VHDA could do more to accomplish its statutory mission without compromising its ability to remain financially strong. VHDA's Board of Commissioners and executive leadership need to be willing to bring about more balance in the priorities that are given to the objectives of financial strength and the authority's statutory mission, and need to strive to achieve excellence in both regards. The current executive director has made greater efforts to involve stakeholders than has been done in the past, but VHDA needs to continue involving customers in planning and implementing its pro-

grams. Recommendations to address needed improvements in VHDA programs are included throughout the report.

VHDA Is Financially Strong and Well Managed

VHDA has impressive financial strength and is generally well managed. VHDA has achieved a strong financial position through its bond and loan management and currently is one of the top-rated housing finance agencies in the country, receiving AA+ and Aa1 general obligation bond ratings from Standard and Poor's and Moody's Investors Services, respectively. The authority generally has a professional and competent staff that effectively manages and implements its programs. Through the Section 8 and federal low income tax credit programs as well as other programs, VHDA has assisted many households in obtaining housing that otherwise would be unaffordable.

Single Family Programs Serve Households that Could Be Served by the Private Market and Could Do More to Assist Low and Moderate Income Households

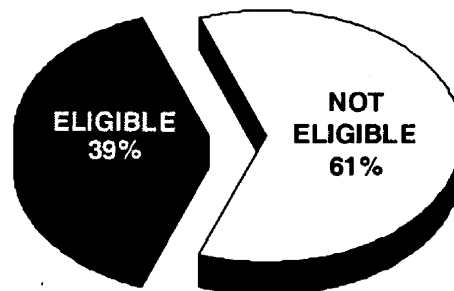
The single family loan program is VHDA's largest program, and single family loans constitute approximately two-thirds of the total dollars financed by VHDA. How-

ever, VHDA could do more to meet its statutory mandate to assist households that cannot be served by the private market through its major single family programs. Neither the private lenders that originate VHDA loans nor VHDA staff make an effort to verify whether a borrower would qualify for a private market loan with reasonably equivalent terms before providing a VHDA loan. The figure below shows that 39 percent of the recipients of VHDA single family loans likely would have been eligible for loans through the private market.

VHDA appears to provide loans that are competitive with the private market in order to maximize the number of loans it provides, and gives less consideration to the amount of the assistance provided by the loan products. In addition, VHDA makes little effort to differentiate between low and moderate income borrowers and provides the same level of assistance to households in both income categories through its standard products.

The interest terms on VHDA loans are only slightly more attractive than private market rates and provide only small benefits to borrowers. For example, the interest rate for VHDA's standard 30-year fixed rate mortgage product is only one-half percent less than the average market rate, which results

**Estimated Percentage of VHDA Borrowers Who Would Have Been Eligible for a Private Market Loan
January 1998 - April 2000**



in a total savings over a seven-year loan period of only \$2,800. According to VHDA's policy analyst, VHDA loan recipients typically stay in their homes approximately seven years, after which the loan is repaid in full. For this program, VHDA generally sets interest rates at the highest possible rate while still keeping its product attractive to first-time homebuyers. Likewise, VHDA's Step Rate program, which offers the borrower a substantially reduced interest rate for the first two years of the loan and an interest rate fixed at one-half percent more than the rate available for VHDA's standard insured product for the remainder of the 30-year loan period, does not offer significant advantages over a standard 30-year, fixed rate loan for most of the loan period.

VHDA needs to review its single family loan program to assess how the program can be improved to better meet VHDA's mission. In addition, VHDA should develop one or more loan products, targeted specifically to low income households, that provide substantially more assistance than financing provided by the private lending market.

VHDA Manages Its Multifamily Programs Well and Serves Low and Very Low Income Households, but Its Policies Do Not Adequately Promote Affordable Housing

VHDA has been successful at financing the development of safe and decent multifamily housing. Multifamily projects that receive financing from VHDA are subject to a rigorous underwriting process before a loan can be approved and then receive regular inspections from VHDA's asset management staff through the length of the loan. This has resulted in VHDA's ability to keep the number of properties on which it must foreclose to a minimum.

JLARC staff found that most families served by these multifamily projects have incomes ranging from poverty level through

low income, with the median income served by projects receiving federal low income tax credits at slightly below 50 percent of the area median family income. While VHDA effectively targets low and very low income households with its multifamily programs, it does not make any additional effort to encourage affordable rents for projects that it finances.

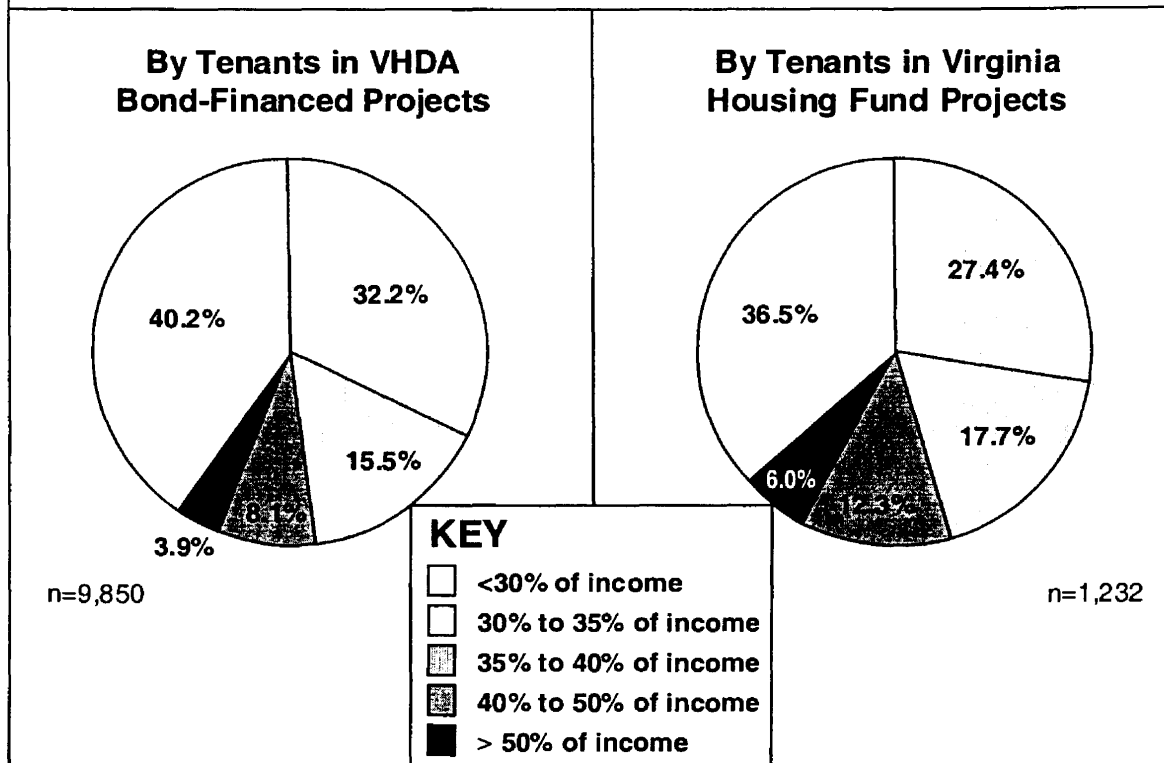
The *Code of Virginia* calls for VHDA to provide "residential housing at prices or rentals which persons and families of low and moderate income can afford." However, more than half of the residents of projects supported by VHDA loan financing that JLARC staff reviewed face a significant housing cost burden by having to pay rents over the generally accepted standard for housing affordability. According to this standard, housing costs, including either rent or mortgage payments as well as the cost of utilities, should not exceed 30 percent of a household's income. The majority of tenants in VHDA-financed projects pay over 30 percent of their incomes for rent and utility payments (see figure on next page). Currently, VHDA does not provide incentives that would encourage developers of the projects it finances to lower rents to a level that would be affordable to more tenants.

VHDA should conduct a fundamental review of the processes by which rents are set for the projects it finances. VHDA also needs to evaluate how it could provide incentives to developers to offer more affordable rents.

Multifamily Financing Does Not Adequately Address State Housing Needs

According to JLARC staff analysis of Virginia Center for Housing Research data, more than one-fourth of all households in Virginia live in housing that is unsafe, indecent, or unaffordable. The housing needs faced by these households vary greatly among the different regions of the State.

Percentage of Income Paid for Rent, With \$26 Utility Allowance



This is due to factors such as: the variance of land and development costs across the State, a significant diversity among the median incomes in Virginia's localities, and major differences in local culture and housing style preferences across Virginia localities.

While projects that have received financial support from VHDA are located in all regions of the State, VHDA has not proactively sought to match its financing to the sizeable and differing housing problems and needs that exist in each region of the State. VHDA has not conducted an analysis of what specific housing needs exist across the State or how it best can meet these needs through its multifamily programs. VHDA periodically should conduct a comprehensive analysis of the housing needs in all regions of the State. VHDA should use the results of this analysis to proactively design and administer programs that will address housing needs in each re-

gion. In addition, to ensure that VHDA pays greater attention to the housing needs of different areas of the State, the General Assembly may wish to consider amending §36-55.28 of the *Code of Virginia* to require that the Governor appoint no more than two persons from any one area of the State to the VHDA Board of Commissioners.

VHDA Has Not Fully Utilized Funds Allocated for Section 8

The Section 8 Certificate and Voucher program, administered by the United States Department of Housing and Urban Development (HUD), provides rental subsidies to reduce the rent burden of very low income and poverty level households. Since 1977, VHDA has had the primary responsibility for administering a major portion of the tenant-based Section 8 funds that are allocated by HUD to the State of Virginia. The \$65 million in Section 8 funds that VHDA receives

annually from HUD is allocated among 75 local administrative agents that administer programs in 89 localities. Some local housing authorities in Virginia also administer their own Section 8 contracts directly with HUD. VHDA's administration of this program has provided a valuable service to many localities that do not have the capacity to operate a Section 8 program independently.

In July 1995, HUD issued a policy directive changing the manner in which Section 8 budgets were to be managed by agencies that administered contracts with HUD. While most of the local housing authorities in Virginia that administer their own Section 8 contracts began complying with this policy directive well before VHDA, VHDA made a decision not to comply with this directive until FY 1999. This resulted in the loss of a large amount of federal Section 8 assistance to Virginia and the opportunity to house a significant number of additional families in the State. In fiscal years 1996 through 1998, VHDA did not use a total of \$30 million of available funds to provide housing assistance. An expert retained by VHDA estimated that in FY 1998, VHDA could have funded 2,445 additional housing units had it complied with HUD's directive. In the future, VHDA should ensure that it maximizes the use of federal Section 8 funds provided to the State to help house very low income Virginians.

VHDA Needs to Ensure that Local Section 8 Administrative Agents Are Adequately Supported and Equitably Treated

The administration of the Section 8 program needs to be improved, in terms of the financial and technical support provided to local agents, as well as in terms of improving efficiency and reducing expenditures at the State level. Of the administrative fees VHDA receives from HUD to pay for the administration of the Section 8 program across the State, VHDA retains a percent-

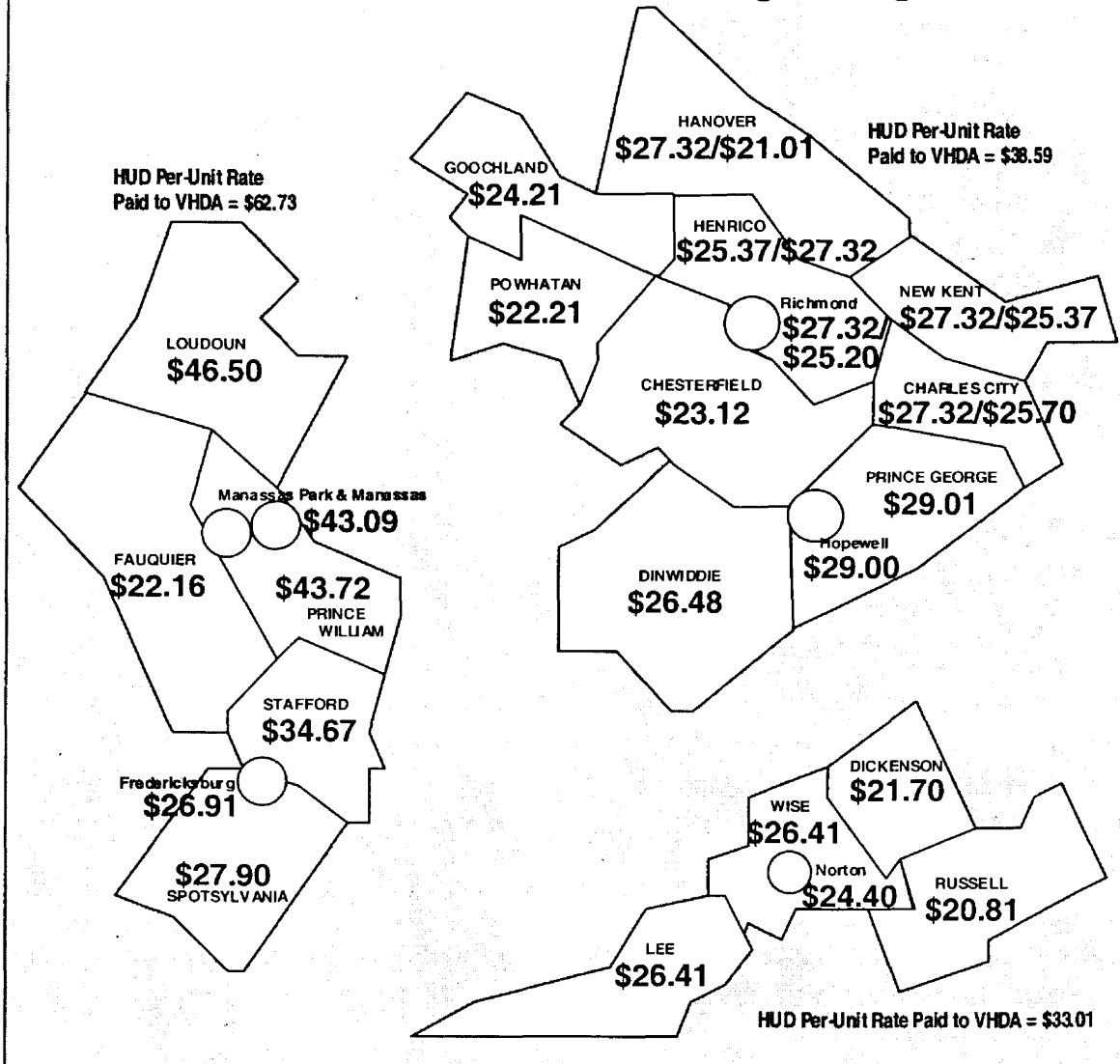
age of the fee provided for each unit and allocates the remainder to the local administrative agent responsible for the unit. VHDA has complete discretion as to the percentage of the administrative fee that is allocated to each local agent, and in recent years has allocated these fees based on an informal fee negotiation process. As a result, administrative fees have not been allocated to local agents in either an appropriate or equitable manner.

There is often a wide range in the fee rates received by local agents within the same geographic area, although HUD pays the same per-unit fee to VHDA for units within these same geographic areas (see figure on next page). In order to ensure a fair and equitable distribution of administrative fees, VHDA should discontinue its current process of verbal negotiation and should implement a formal policy that will ensure a fair and equitable distribution of these fees.

Along with the inequitable fee structure, there are other aspects of the Section 8 program that need improvement. VHDA lacks an automated Section 8 tenant data transmittal system, and instead hires personnel to handle extensive paper records and key data received from local agents. In addition, VHDA recently transferred in-house the system by which rent checks are written to landlords and tenants. This payment disbursement system is inadequate and has resulted in overpayments and underpayments to landlords, checks sent to incorrect addresses and wrong persons, and increased administrative expenses associated with the recovery of overpayments that should have been unnecessary.

VHDA needs to take measures to improve efficiency and reduce excess expenditures. VHDA should make the development of a Section 8 automated data transmittal system and an effective payment disbursement system high priorities and commit the necessary resources to develop these systems.

Section 8 Administrative Fees Paid to Neighboring Localities



VHDA also needs to accurately assess the funds needed to administer the Section 8 program efficiently and maximize the proportion of the administrative fees provided to local agents. A majority of local agents have indicated that they feel they receive insufficient administrative fees and have reported operating deficits for FY 1999.

Since assuming the position in June 1999, the current executive director of VHDA appears to have recognized many of the concerns identified in this review of the Sec-

tion 8 program and is taking some steps to address them. One of the steps taken by the director has been to hire a consultant to review the program.

VHDA Has Financial Strength that Should Be Better Utilized

While VHDA enjoys a strong financial position, this review indicates that the authority could do more to fulfill its mission to help households obtain safe and sanitary housing that otherwise would be un-

affordable. Instead, VHDA's highest priority appears to be maintaining a strong financial position and impressive bond ratings. VHDA has developed sizeable fund balances because it annually generates more income from mortgages and investments than it has expenditures. These fund balances appear to exceed the level needed for a housing finance agency to maintain "top tier" financial status. In fact, a financial consultant retained by JLARC found that as of December 31, 1999, the authority's fund balance exceeded the minimum threshold for Standard & Poor's top tier rating by \$737 million.

VHDA has used less than its full financial strength to provide assistance to low and very low income households that could most benefit from the authority's assistance. VHDA targets households at the lower income levels which are not currently being served by VHDA's traditional programs with the Virginia Housing Fund (VHF). A portion of the excess funds raised from the profits of VHDA's traditional single family and multifamily programs are transferred to the authority's general fund and then to the VHF to provide lower interest rate loans for mortgages and projects that otherwise would not be funded. However, only a portion of VHDA's profits from its traditional programs are reflected in the amount of funds that VHDA contributes to the VHF each year. The total amount of VHF money loaned in single family mortgages during the past 13 years in which the VHF has been in existence is equal to only one-fourth of the amount loaned in traditional single family mortgages in 1999. Likewise, the total amount of VHF money used for multifamily loans during the past 13 years is less than one-third of the amount loaned in fiscal year 1999 for traditional multifamily loans.

VHDA contributes \$20 million annually to the VHF. VHDA derives the amount of its annual contribution from the periodic retention of a financial consultant to evaluate how

much the authority can contribute to the VHF without adversely impacting its financial strength. A financial consultant retained by JLARC reviewed these conclusions and found that VHDA could allocate a substantially higher annual amount to the VHF, an annual contribution which would exceed \$34 million. In addition, although VHDA's financial consultant expected that interest generated by VHF loans and investments would remain in the VHF and would be separate from the recommended annual contribution to the VHF, VHDA annually has included its interest contribution as part of the \$20 million it allocates to the VHF each year. In 1999, this resulted in an effective reduction of VHDA's net contribution to the VHF from \$20 million to about \$12 million.

The JLARC staff review of VHDA found that there is unmet need for housing for the low and very low income populations that the VHF targets, and that there is a strong demand for VHF loan dollars. VHDA should take these and other relevant factors into consideration and should modify its current process for determining the amount of funds that should be allocated to the VHF. In addition, VHDA should leave all interest generated from VHF investments and mortgages in the VHF. VHDA should contribute the maximum amount feasible annually to the VHF without having an undue adverse impact on VHDA's financial strength.

Executive Salaries Are Comparatively High

VHDA's executive salaries are based almost exclusively on a comparison to private financial market salaries. As a result, while VHDA staff salaries overall appear in line with salaries for comparable positions in other agencies, VHDA executive base salaries are high in comparison to other independent agencies in the State, as well as to housing finance authorities in other states. While VHDA compares itself to the private market for purposes of setting salaries, the

authority models other benefits provided on the public sector, and executive level staff turnover has been extremely low. However, due to continuing concerns about the competitiveness of salaries at VHDA, the authority recently retained a consultant to evaluate its salary structure. As a result of this consultant's recommendations, VHDA recently has implemented new higher salary ranges for some positions.

**VHDA Could Better Fulfill
Its Mission and Needs
Some Legislative Oversight**

While VHDA is financially strong and generally well managed, based on this review of VHDA programs, it is apparent that VHDA could use more of this financial strength to further its mission. Generating revenue and maintaining impressive financial strength appears to be a higher priority

for the authority than fulfilling its statutory mission to help provide housing to those otherwise unable to afford it. The authority could use more of its financial strength to lower interest rates in its single-family program, encourage lower rents in its multifamily program, and contribute more to the Virginia Housing Fund. VHDA needs to examine its current philosophy and programs and make modifications that will better balance its emphasis on financial strength with its public mission.

Establishing some additional oversight and accountability to the General Assembly will help to ensure that VHDA is adequately focused on fulfilling its mission. The General Assembly may wish to consider directing the Housing Study Commission to play an oversight role in VHDA's financial analysis and in administration of the Section 8 program.

Table of Contents

	<u>Page</u>
I. INTRODUCTION	1
VHDA Mission and Organization	1
VHDA Financing	5
VHDA Housing Programs	7
Housing Need Exists in Virginia	11
JLARC Review	17
Report Organization	20
II. Single Family Loan Program	21
VHDA Single Family Mortgage Lending	21
VHDA's Single Family Program Could Provide More Assistance to Low and Moderate Income Households	33
VHDA Should Address Needs of Households Not Served by the Private Market	37
III. Meeting State Low Income Housing Needs Through Multifamily Programs	43
VHDA Multifamily Programs Are Well-Managed	44
VHDA Multifamily Programs Serve Low and Very Low Income Households, But Its Policies Do Not Adequately Promote Affordable Housing	50
Multifamily Financing Does Not Adequately Address State Housing Needs	58
State Law Does Not Ensure Diverse Geographic Representation on the VHDA	64
IV. Section 8 Program	67
Virginia's Tenant-Based Section 8 Program	67
VHDA Has Not Fully Utilized Funds Allocated for Section 8	71
VHDA Needs to Improve Administration of the Section 8 Program	75
VHDA Needs to Review Turning Over Units to Local Agents with Sufficient Administrative Capacity	85
V. VHDA's Mission	87
VHDA Has Financial Strength That Should Be Better Utilized	87
Executive Salaries Are Comparatively High	94
Conclusion: VHDA Could Better Fulfill Its Mission	99
APPENDIXES	103

I. Introduction

House Joint Resolution 731, approved by the 1999 General Assembly, directs JLARC to study the programs administered by the Virginia Housing Development Authority (VHDA) as well as the organization and management of the authority. VHDA was created by the General Assembly in 1972 as a separate political subdivision for the purpose of providing safe and sanitary housing that families of low and moderate income can afford.

HJR 731 specifically directs JLARC staff to examine a number of issues regarding VHDA. The resolution directs JLARC to evaluate whether VHDA is addressing the housing needs of low and moderate income Virginians and is administering its programs in accordance with the statutory intent set forth in §36-55.25 of the *Code of Virginia*. This section of the *Code of Virginia* is the authority's enabling legislation and directs VHDA to stimulate investment in construction and rehabilitation of affordable residential housing. The resolution expressly requests that JLARC examine VHDA's administration of the federal Section 8 program. This program provides rental assistance to very low income households and is administered in some areas of Virginia by VHDA. HJR 731 also directs JLARC to review the performance, operation, management, and organization of the authority. A copy of HJR 731 is provided as Appendix A.

This is the second of two reports that have been prepared to meet the study mandate. This report focuses on VHDA's administration of the federal Section 8 program, as well as issues related to the performance, operation, management, and organization of VHDA. An interim report primarily provided organizational and financial background about VHDA.

VHDA MISSION AND ORGANIZATION

The *Code of Virginia* sets forth the mission of VHDA in the authority's enabling legislation and provides the authority with a broad array of powers to fulfill it. The authority has a staff of approximately 300 employees in six divisions. The divisions are under the direction of an executive director, who is appointed by a governing board.

Statutory Mission

The Virginia Housing Development Authority was established by the Virginia General Assembly in 1972 as the State's housing finance agency. The authority's enabling legislation, §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 that it is 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, to provide construction and mortgage loans and to make provision for the purchase of mortgage loans and otherwise.

VHDA was established by the General Assembly as a separate political subdivision within the Department of Housing and Community Development under the Secretary of Commerce and Trade for purposes of §36-55.51 of the *Code of Virginia*. VHDA operates as an independent authority. It does not rely on General Fund money, but instead generates revenue through the sale of bonds and the issuance of mortgage loans. The *Code of Virginia* gives the authority a broad range of powers to carry out its statutory mandate, including the powers to:

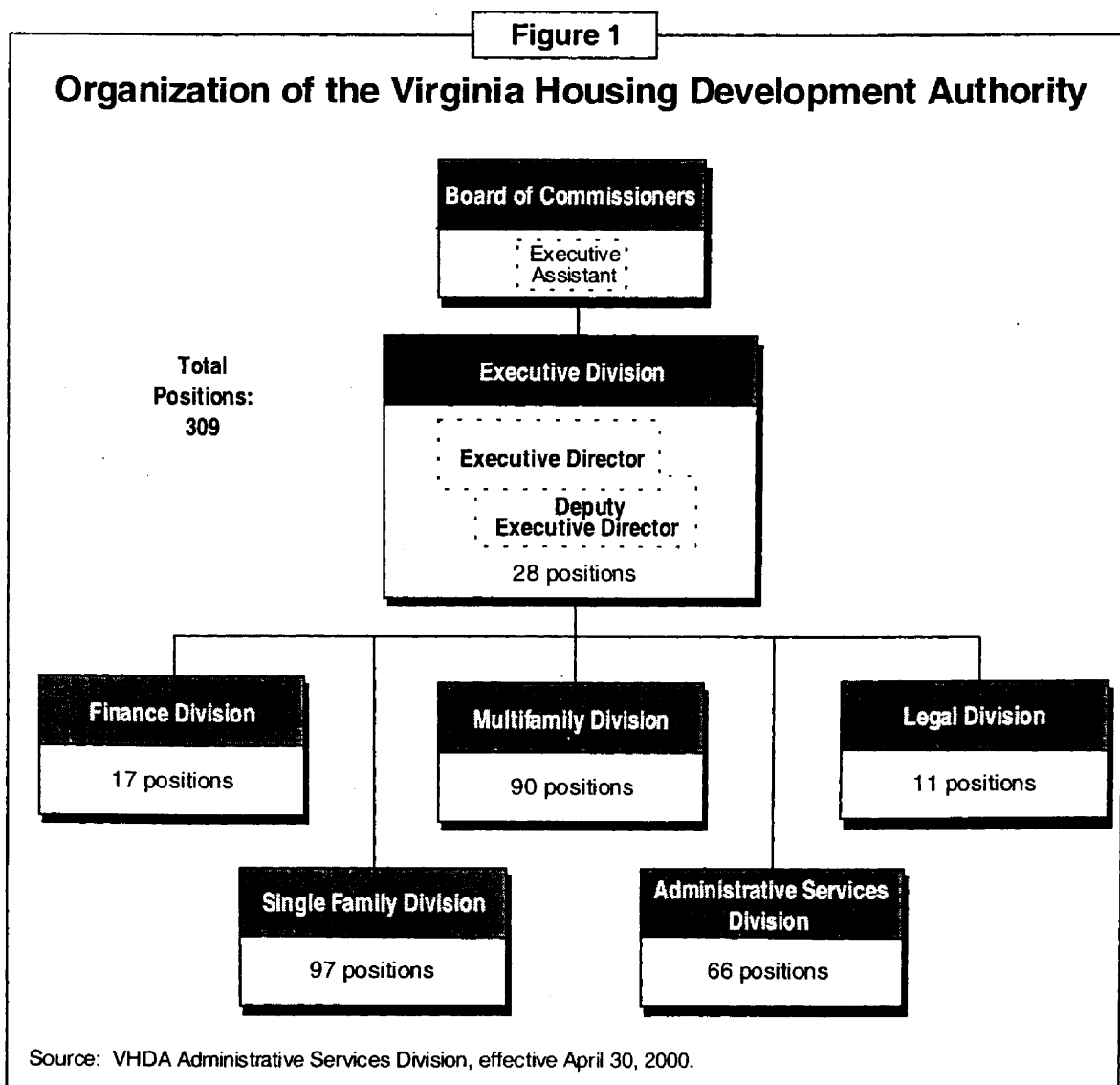
- borrow money and issue bonds and notes;
- acquire and sell real or personal property;
- lease or rent any dwellings, houses, or accommodations;
- employ architects; engineers; attorneys; accountants; housing, construction, and financial experts; and other advisors, consultants, and experts as necessary;
- insure mortgage payments of mortgage loans for persons of low and moderate income;
- make and enter into contracts and agreements with mortgage lenders for the servicing and processing of mortgage loans;
- assess and collect fees and charges in connection with agreements made by VHDA;
- enter into agreements with owners of housing developments eligible for federal low income tax credits;
- invest in, purchase, or make commitments to purchase securities or other obligations secured by or payable from mortgage loans or issued for the pur-

pose of financing or otherwise assisting residential housing of low and moderate income families; and

- acquire, develop, and own multifamily housing.

VHDA Organizational Structure

The Board of Commissioners is the governing body of VHDA. The authority staff that administer VHDA and its programs are organized into an executive division and five operational divisions. Each of these divisions is staffed by a director who reports to VHDA's deputy executive director. These division directors also comprise an executive committee. Figure 1 shows the organizational structure of VHDA.



Board of Commissioners. The powers of VHDA are expressly vested by the *Code of Virginia* in the Board of Commissioners. This governing Board is comprised of ten members. Seven members are appointed by the Governor for four-year terms and are eligible for one reappointment. The only limitation on the appointment of these seven members is that the Governor may appoint no more than three persons from any one commercial or industrial field.

One member of the Board is selected by the Board of Housing and Community Development to serve as its representative. The remaining two members are the State Treasurer and the director of the Department of Housing and Community Development (DHCD). The treasurer is a full voting member, but the director of DHCD is an *ex-officio*, nonvoting member.

The commissioners select a chairman and vice-chairman from among themselves. The Board performs most of its work through a committee structure which includes Audit, Bond, Counsel Selection, Multifamily/Virginia Housing Fund, Budget, Legislative, and Personnel committees. VHDA recently created the temporary position of executive assistant to the Board, which is held by the previous executive director of VHDA.

VHDA Executive Division. The executive division is led by the executive director of VHDA. The executive director is selected by the Board of Commissioners to manage and direct the affairs of VHDA subject to the policies, control, and direction of the commissioners. The current executive director assumed her position in June of 1999. The executive director also serves as the secretary to the Board. The executive division includes the deputy executive director as well as three departments: internal audit; quality, planning, and research; and communications. Twenty-eight positions are assigned to this division.

VHDA Operational Divisions. All of the remaining functions of VHDA are grouped into five divisions. The largest division at VHDA is the single family division. This division has responsibility for administering the single family loan program. There are 97 positions in this division. Forty-seven of these positions are involved with loan originations, and 42 support loan servicing. Five positions are responsible for ensuring loan compliance.

The other programmatic division is the multifamily division. Several major programs are housed in this division, including the multifamily loan program, the federal low income tax credit program, and the Section 8 project-based and tenant-based programs. Of the 90 positions in this division, 24 work in the area of development, and 24 work in asset management. The special programs department, which administers the Section 8 tenant-based program, has 25 positions. There are an additional 12 employees that work in the multifamily finance department. The remaining five positions comprise the multifamily division management team.

The administrative services division primarily supports the other divisions within VHDA. Within this division, there are three departments: support services,

human resources, and information technology. There are 66 positions in this division. Approximately two-thirds of these positions are in the information technology department.

The two other divisions are the finance and legal divisions. The finance division has primary responsibility for bond issues, manages the proceeds of bonds and other VHDA monies, provides accounting functions, and prepares VHDA's financial statements. The legal division closes multifamily loans, prepares loan documents for the bond issues, and provides other legal advice. The finance and legal divisions have 17 and 11 positions, respectively.

VHDA FINANCING

VHDA is a financially self-sufficient organization that is able to pay for its own costs of operation. Revenues are generated through the financing of loans, principally using proceeds raised through bond sales. VHDA's bond resolutions enjoy strong financial ratings, and the authority appears to consistently maintain financial stability.

Financing VHDA Programs

Financing for VHDA programs comes principally from the sale of bonds. VHDA issues three main types of bonds. Alternative minimum tax (AMT) bonds, also referred to as private activity bonds, are tax-exempt bonds. Federal law limits the amount of new tax-exempt private activity bonds each state is allowed to issue annually. The limit is generally \$50 per capita, which translates into \$337 million for Virginia. State law allocates 41 percent of this amount to housing programs. Twenty-seven percent is allocated to VHDA and the remaining 14 percent to local housing authorities.

VHDA also issues tax-exempt refunding bonds, which are not limited by a cap. The proceeds of these bonds are used by VHDA to retire outstanding bonds or to make funds available for new mortgage loans. In addition, VHDA issues taxable bonds, which carry market rates. With the issuance of tax-exempt bonds, VHDA is able to pay a lower bond rate to investors than is possible with taxable bonds, because investors do not have to pay federal income taxes on the interest.

The primary way in which VHDA generates funds is by charging a higher interest rate on its mortgage loans than the yield it pays investors on its bond issues. For single family tax-exempt bond issues, VHDA may set no more than a 1.125 percent differential (known as the spread) between the yield on the bonds it issues and the yield on the mortgage loans it finances. For tax-exempt multifamily bond issues, the spread may be no more than 1.5 percent. VHDA also generates revenue through loan origination and application fees, which are included in the spread limitations, as well as through investments. In general, VHDA cannot retain earnings on investments of bond proceeds in excess of the related yield on the bonds.

Both the single family and multifamily programs historically have been funded from the issuance of tax-exempt bonds. However, as a result of the Tax Reform Act of 1986, which placed a cap on the amount of tax-exempt private activity bonds allocated to Virginia, and new limitations on the issuance of refunding bonds, VHDA increasingly has been issuing taxable bonds to fund additional loans. In the single family program, VHDA is able to make a substantial amount of new mortgage loans by recycling repayments of principal on existing mortgage loans and by the issuance of refunding bonds.

The only major programs administered by VHDA that are federally funded are the Section 8 project-based and tenant-based programs. VHDA receives administrative fees from the United States Department of Housing and Urban Development (HUD) to pay for the cost of administering the tenant-based Section 8 program.

Financial Rating

VHDA is in a strong financial position. VHDA generally receives high debt ratings by Standard & Poor's and Moody's Investors Services. Standard & Poor's and Moody's currently give the authority AA+ and Aa1 general obligation debt ratings, respectively. These are the highest bond general obligation ratings currently provided to any state's housing finance organization. VHDA's multifamily housing bonds, rental housing bonds, and Commonwealth Mortgage Bonds (single family bonds) receive AA+ and Aa1 debt ratings from Standard & Poor's and Moody's as well.

One of the primary reasons for VHDA's strong financial position appears to be the sizable fund balances that the authority has been able to develop. VHDA's success in generating revenue appears to be based largely on its ability to do a high volume of business and its criteria for underwriting loans. VHDA issues approximately \$1 billion of notes and bonds annually. In 1998, only California's housing finance agency issued more housing bonds. According to VHDA's strategic plan, it consistently has been among the top ten state housing finance agencies in the United States in terms of its level of single family and multifamily lending. Moody's states that other reasons for VHDA's strong bond rating include: the depth and breadth of its management team, high underwriting standards, and strong asset management.

Moral Obligation Pledge

The *Code of Virginia* includes a provision that authorizes the General Assembly to appropriate funds to replenish VHDA's capital reserve funds in the event that reserves are insufficient to meet the debt service requirements. This provision is referred to as the "moral obligation" pledge. The *Code of Virginia* limits the amount of the moral obligation pledge to \$1.5 billion. Single family bond issues have not been issued with the pledge since 1981, and no single family loan issues with the pledge are currently outstanding. Several multifamily bond issues are still secured by the moral obligation pledge. However, VHDA recently stopped securing multifamily bond issues

with the pledge because it has reached the \$1.5 billion cap established by the *Code* for VHDA, and VHDA's financial strength is such that the absence of the pledge is not likely to adversely affect bond costs.

VHDA HOUSING PROGRAMS

VHDA administers multiple programs that assist with the provision of housing to families in Virginia with household incomes ranging from moderate to poverty level. VHDA's primary activity is providing financing for affordable housing both for the purchase of single family homes and the development of multifamily rental units. The authority also administers a major portion of the federal Section 8 subsidies allocated to the State by HUD.

Single Family Loan Program

VHDA's single family loan program provides loans to qualified home buyers. VHDA offers several categories of loans to first-time homebuyers. The single family division offers standard 30-year fixed rate mortgage loans (at approximately one-half percent below the market rate) and two other types of loans intended to reduce the costs of ownership in the short term. The Step Rate loan program reduces the interest rate in the first two years of the mortgage loan but then raises the interest rate one-half percent greater than VHDA's standard 30-year rate for the remaining years of the loan. In addition, VHDA offers the FHA PLUS program that allows homebuyers to finance their down payment and closing costs through a second mortgage.

Most of the single family loans are originated and serviced by private lenders. However, VHDA staff review each loan to ensure that it meets VHDA's underwriting criteria. VHDA may require the private lender to purchase any loan that the authority determines does not meet its criteria.

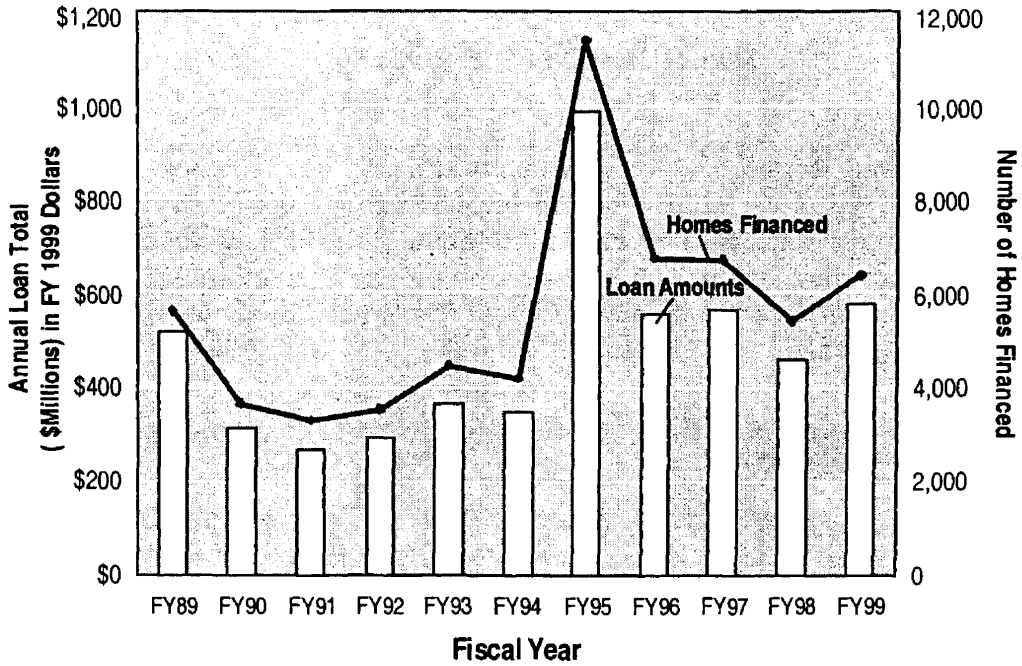
As of June 1999, VHDA had financed approximately 120,000 single family mortgages. VHDA financed approximately 6,400 single family loans in FY 1999, totaling \$578 million. This was more than twice the amount loaned for multifamily projects. Figure 2 shows the number of loans made as well as the total amount loaned annually over the last 11 years.

Multifamily Program

VHDA's multifamily division administers loans to non-profit and for-profit developers to build, rehabilitate, and maintain multifamily housing for low and moderate income families. Funds are raised to provide these loans through VHDA's issuance of tax-exempt and taxable bonds. (Figure 3 shows how much in bond proceeds went to fund the various types of multifamily financing from FY 1995 to FY 1999.)

Figure 2

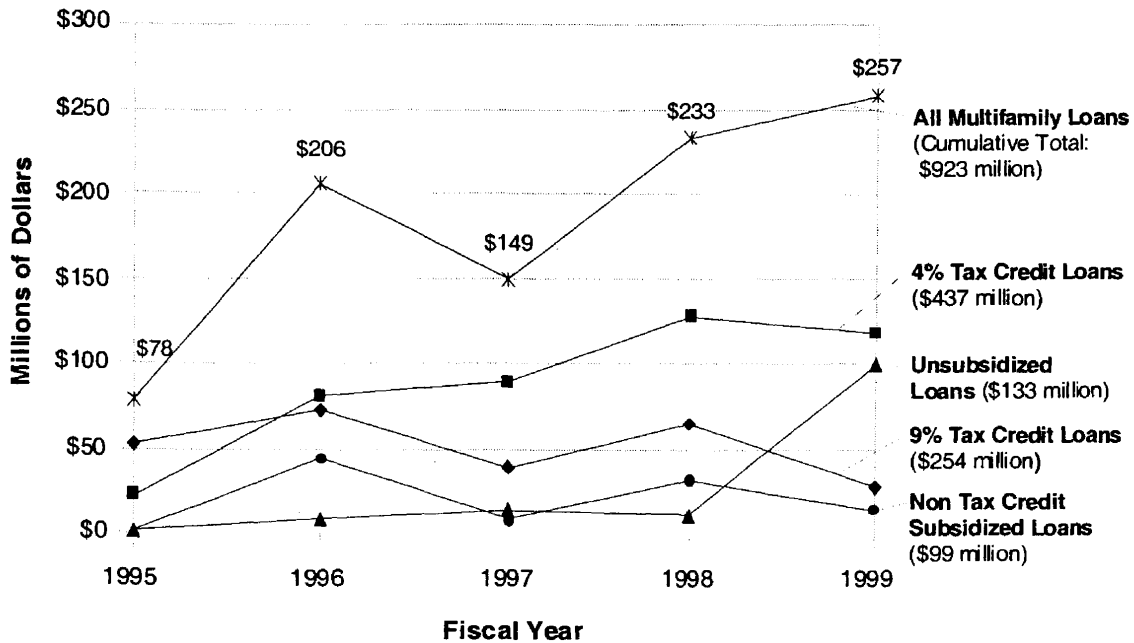
Single Family Loan Production, FY89 to FY99



Source: VHDA Single Family Data.

Figure 3

Multifamily Loan Program Amounts FY 1995 to FY 1999



Source: JLARC analysis of VHDA data.

Three major types of financial support are available through VHDA's multifamily division: loans from tax-exempt bond funds (or in most instances tax-exempt funds blended with taxable bond funds) which may be combined with four percent federal low income tax credits, loans from taxable bond funds, and nine percent tax credits.

VHDA's issuance of tax-exempt alternative minimum tax (AMT) bonds finances \$92 million in loans for multifamily projects annually. Because the interest on these bonds is exempt from federal income taxes, VHDA pays a lower interest rate on these bonds to investors. Often, VHDA will blend funds raised from the sale of taxable and tax-exempt bonds, enabling VHDA to spread its funds raised from the sale of tax-exempt bonds among more properties. In FY 1999, VHDA raised \$26 million from the sale of taxable bonds for this purpose.

Projects that receive at least 50 percent of their financing from tax-exempt bonds usually qualify for a four percent federal low income tax credit. The addition of the four percent tax credit allows developers to raise equity for their projects and makes this type of financing package particularly attractive and in high demand by developers. This additional equity raised from the sale of tax credits allows developers to offer lower rents. A project that receives this kind of financing must lease a minimum of 20 percent of its units to tenants whose incomes are 50 percent or less of the area median family income (AMFI), or at least 40 percent of the project's units to tenants whose incomes are 60 percent or less of AMFI. VHDA requires that tenants occupying the remaining units have incomes that do not exceed 150 percent of AMFI.

VHDA also funds some multifamily properties solely through taxable bonds. In FY 1999, \$98 million was allocated for this purpose, and loans financed with these funds were awarded to 16 properties. This is a large increase from the funds that have been allocated for this purpose in previous years – between 1995 and 1998, a total of \$35 million in taxable bond proceeds was allocated. The only income requirement for these properties is that owners rent all available units to tenants with incomes of no more than 150 percent of the area median family income.

Developers may also apply for nine percent federal low income tax credits to raise equity for projects. These nine percent tax credits are available to developers on a competitive basis. They are extremely valuable because they can be sold to private investors to raise equity for a project. This additional equity allows developers to lower rents for units in a project. Such a credit can be worth as much as 70 percent of the value of the development over ten years. Approximately \$8.5 million in nine percent tax credits was awarded to a total of 40 projects in 1999.

The nine percent tax credits generally are combined with loans from taxable bond funds. Many projects that receive tax credits through VHDA also receive financing through VHDA, although some projects receive loans from local governments or other funding sources. Until FY 1999, almost all projects financed with loans from taxable bond funds received nine percent tax credits; however, in FY 1999, half of the projects that received loans from taxable bond funds did not receive nine percent tax credits.

Projects that receive nine percent tax credits are subject to the Internal Revenue Service tax credit income requirements. Specifically, either a minimum of 40 percent of the units must be rented to tenants at or below 60 percent of AMFI, or at least 20 percent must be rented to tenants at or below 50 percent of AMFI. Any non-tax credit units within projects that also receive VHDA taxable loan financing must be occupied by tenants with incomes that do not exceed 150 percent of AMFI.

In addition, there are two other types of multifamily project financing available from VHDA. The issuance of tax-exempt refunding bonds produces \$20 million annually to be used for multifamily tax-exempt refunding loans.

Twelve loans financed by these bonds were awarded in FY 1999. These bonds are issued by VHDA to finance 20 to 30-year loans that replace short-term loans issued by local bond issuers, which are usually local housing authorities. At least 20 percent of the units in these projects must be occupied by tenants with incomes of less than 80 percent of AMFI.

VHDA has also occasionally issued 501(C)(3) bonds on behalf of non-profits to finance multifamily projects. These are tax-exempt bonds that do not count toward the cap on the State's allocation of the tax-exempt AMT bonds but may only be issued for the benefit of charitable organizations.

VHDA currently has 744 closed loans in its multifamily portfolio. In FY 1999, VHDA committed to make 63 loans in the principal amount of \$282 million.

Virginia Housing Fund

In 1987, VHDA established the Virginia Housing Fund (VHF) to better meet affordable housing needs in hard-to-serve situations or locations. The VHF has been capitalized from net revenues generated from other VHDA programs. As of February 2000, VHF had a cumulative capitalization of \$172 million, and VHDA currently contributes \$20 million to the fund every year.

The fund's primary stated purpose is to serve elderly, disabled, and homeless persons as well as to serve families in need of affordable housing not being served by other housing programs. With VHF money allocated for multifamily loans, VHDA restricts eligibility for the loans to non-profit, minority, and rural developers.

In three of the last four fiscal years, approximately two-thirds of the loan funds provided from the VHF have been used for low interest loans for single family home ownership. The remaining funds have been allocated to provide loans for multifamily developments. Most of the money provided is in the form of loans with a five percent interest rate.

Section 8 Programs

VHDA has responsibility for administering a major portion of the Section 8 funds that are allocated by HUD to the State of Virginia. The Section 8 programs provide for subsidies to reduce the rent burden for very low income or poverty level households (50 percent or less of median income). Section 8 assistance is provided through both project-based and tenant-based programs. Under the project-based program, the subsidy provided is tied to the rental unit and remains with the unit after a family moves out. In contrast, under the tenant-based program, the subsidy is provided to the household and remains with the household if the family chooses to move.

Under the project-based Section 8 program, HUD pays the owners of Section 8 multifamily rental developments the difference between 30 percent of each tenant's income and the unit's rent. VHDA provided the financing for many of these Section 8 multifamily projects and assumed responsibility for administering the rent subsidies for units in these developments. The project-based program was phased out during the mid 1980s, and the last project-based Section 8 development was constructed in Virginia in 1986. However, the owners of the project-based multifamily developments entered into contracts with HUD to provide Section 8 housing. The terms of the contracts range from 15 to 40 years. Therefore, most of these developments are still serving Section 8 tenants, and VHDA is still administering subsidy payments to project-based Section 8 rental units. Currently, there are approximately 13,000 project-based Section 8 rental units administered through VHDA in the State, and the owners of these projects received approximately \$77 million in subsidy payments in FY 1999.

The tenant-based Section 8 program is a subsidy program that provides financial assistance to very low income households in the form of certificates or vouchers to reduce their rent burden. Individuals or families who receive vouchers or certificates are then required to contract with a landlord who wishes to participate in the Section 8 program. With both the certificate and voucher programs, participants are required to pay 30 percent of their income in rent, and the subsidy, which also includes a utility allowance, funds the difference between this amount and the fair market rent for the unit.

VHDA administers the tenant-based Section 8 program through contracts with HUD. VHDA receives approximately \$65 million annually, which is then allocated to 89 localities around the State to provide subsidies for approximately 11,900 families.

HOUSING NEED EXISTS IN VIRGINIA

Based on 1990 census data, there are 2,292,806 households in Virginia. Of these, 33 percent are renter households, and the remaining 67 percent own their own homes. In every planning district across Virginia, the majority of households live in single family residences.

According to JLARC staff analysis of Virginia Center for Housing Research (VCHR) data, between one-fifth and one-third of the households in each planning district, and more than one-fourth of all families in the State, do not live in housing that is safe, decent, and affordable. Households with very low incomes and incomes below the poverty level have the highest incidence of such housing problems, although some households within all income ranges live in housing that is unsafe, indecent, or unaffordable. Recent studies and JLARC staff analysis of housing data show that there is a significant need for safe, decent, and affordable housing in localities across Virginia. However, the nature of the housing needed to solve these problems varies among the different regions of the State.

Housing Programs Are Generally Designed Around Income Categories

Programs to address the needs of low and moderate income persons generally target specific smaller income designations within this group. These income designations are based on percentages of the HUD calculation of area median family income (AMFI). This HUD formula has been developed for calculating eligibility for Section 8 housing and is also used to determine compliance with occupancy requirements for tax credit projects and projects funded from tax-exempt bonds. The AMFI is adjusted annually and varies substantially by location. For example, as of March 2000, the HUD AMFI for a family of four in the Richmond metropolitan area was \$59,500. In Northern Virginia, it was \$82,800, while in Wise County, the HUD AMFI was \$30,200. Many federal and State housing programs categorize moderate and low income households based on the AMFI (Table 1). Housing research institutions, such as the Virginia Center for Housing Research, also use these designations to analyze housing need.

With incomes at or below 30 percent of AMFI, households can be classified as at the poverty level. These households generally require rental assistance, and developers of projects serving this population generally need substantial subsidies in order to finance these projects. VHDA programs that serve this income category include the Section 8 programs and the special needs projects supported by the Virginia Housing Fund.

Households with incomes between 31 and 50 percent of the AMFI are considered to be in the "very low income" group. These households generally live in multifamily residences. In order to be affordable, rents for these households must be below market rent. The median incomes of households served by most of VHDA's multifamily programs fall in the upper end of this income category.

"Low income" households have incomes that range from 51 to 80 percent of AMFI. Within this income category are some households that can afford homeownership with financial assistance. VHDA's single family programs serve households in this category. Other households in this income category are not able to afford their own homes, nor can they afford market rents. VHDA serves those households below 60 percent of AMFI through its administration of federal low income tax credits and multifamily loans financed by tax-exempt bonds.

Table 1

Categories of Incomes Generally Used by HUD		
Income Level	Percentage of Area Median Family Income	Income Range in Richmond, VA for Family of Four
Moderate	81-115	\$47,610 – \$68,430
Low	51-80	\$29,760 – \$47,600
Very Low	31-50	\$17,860 – \$29,750
Poverty	30 or below	\$0 - \$17,850
HUD defines the upper limit of "moderate income" as 95 percent of median income for some programs.		
Source: HUD FY2000 Income Limits.		

While there appears to be general consensus as to the lower limit of 81 percent for "moderate income" households, the upper limit for "moderate income" varies among some housing programs. The Department of Housing and Community Development (DHCD), in its 1996-2000 Consolidated Plan, as well as the Virginia Center for Housing Research, use an upper limit of 95 percent of AMFI for this income category. Many HUD programs and mortgage revenue bond requirements use an upper limit of 115 percent of AMFI. Affordable housing programs for the "moderate income" category are generally targeted to the first-time homebuyer market. More than one-half of VHDA's single family loans go to moderate income households.

Virginia Households Face Significant Housing Problems

Across Virginia, 28 percent of all households face housing problems, according to a Virginia Center for Housing Research study based on 1990 census data. Housing problems are defined as any of the following: occupied units which lack a complete kitchen, units which lack complete plumbing, overcrowded units (with more than 1.01 persons per room), or units that cost more than 30 percent of the occupying household's income. Of these measures of housing problems, cost burden is the most prevalent in Virginia households.

Housing problems are faced by households in all regions of the State. The percentage of households in each planning district that live in unsafe, indecent, or unaffordable housing ranges from 19.7 percent of households in the Central Virginia planning district to 33.5 percent of households in the Hampton Roads planning district (Table 2).

Table 2

Planning Districts Ranked by Percentage of Households with Overall Housing Problems

Hampton Roads	33.5%	Middle Peninsula	26.5%
Northern Virginia	32.7%	Lenowisco	26.4%
Accomack-Northampton	32.0%	Richmond Regional	25.5%
RADCO	27.9%	Cumberland Plateau	24.5%
Thomas Jefferson	27.7%	Lord Fairfax	24.4%
Southside	27.6%	Central Shenandoah	21.8%
New River Valley	27.5%	Mount Rogers	20.8%
Northern Neck	27.1%	Fifth	20.4%
Crater	26.8%	West Piedmont	20.3%
Piedmont	27.0%	Central Virginia	19.7%
Rappahanock-Rapidan	26.8%		

Note: Housing problems are defined as any of the following: occupied units lacking a complete kitchen, units lacking complete plumbing, overcrowded units, or units that cost more than 30 percent of the occupying household's income.

Source: JLARC staff analysis of data from a 1995 Virginia Center for Housing Research study.

Housing Problems Are Most Prevalent in the Lowest Income Categories. While housing problems are faced by households at all income levels, they are particularly prevalent in the lowest income categories. (A detailed breakdown of the incidence of housing problems by income category for both rental and owner households in each planning district is included in Appendix C.) Across the State, the incidence of housing problems among households below the poverty level is 72.1 percent. Among very low income households, the percentage of housing problems is 59.2 percent. Low income households face housing problems at a rate of 39.0 percent. For moderate income households (defined here as between 81 and 95 percent of AMFI), the rate of housing problems is 28.2 percent, and for upper income households (defined as over 95 percent of AMFI), the rate of housing problems is 12.2 percent.

Assessments of housing affordability generally are based on area median family income and fair market rent (FMR). The FMR is a calculation used by HUD as a standard for affordability of rental housing. The FMR is the 40th percentile of gross rents (rent plus utilities) for standard rental units (not including subsidized housing) occupied by recent movers in a local housing market. Rent is considered to be affordable if the cost, including utilities, does not exceed 30 percent of a family's income.

Two recent studies support the significant incidence of housing problems in Virginia among the lowest income categories. A 1999 study by the National Low Income Housing Coalition examined the income necessary for a family of four to afford

rental housing and estimated the number of renter households in each state for which the FMR would exceed 30 percent of the household income. The study found that of all the states, Virginia has the highest percentage of renters – 53 percent – that are unable to afford the FMR for a 2-bedroom apartment.

A study by the Virginia Center for Housing Research found that many families at or below the poverty level across Virginia pay rents that they cannot afford. The study determined that in 1996, Virginians in this lowest income group paid an average of 51.2 percent of their incomes for housing expenses. In some localities, such as the City of Petersburg and Westmoreland County, the study found that the average rent equaled or exceeded the incomes of renters. According to the study, renters in only four localities in Virginia paid on average below 30 percent of their incomes for housing.

Section 8 Waiting Lists Indicate Substantial Housing Need. Another indicator of housing need is the size of waiting lists for Section 8 housing maintained by administrative agents in localities around Virginia. This represents households below the poverty level that are in need of rental assistance but currently are not receiving it. Currently, all waiting lists for Section 8 vouchers from VHDA are closed, and in some localities, families have been unable to apply for Section 8 rental assistance for several years. Responses to a JLARC staff survey of administrative agents of Section 8 certificates and vouchers (including those who administer units either through VHDA or directly through HUD) indicated that there are currently more than 20,169 households on Section 8 waiting lists across the State. (Waiting lists in localities in which administrative agents did not respond to the JLARC survey are not included in this total.)

Housing Needs Differ Across Regions of the State

Housing needs vary greatly among the different regions of the State. This is due in part to the variance of land and development costs across the State. In addition, there is significant diversity among the median incomes in Virginia's localities – for example, the difference between the locality with the highest area median income for a family of four in the state and the locality with the lowest AMFI is \$56,500. There are also major differences in local culture and housing style preferences among the localities of Virginia, which range from small, rural counties to suburbs of Washington D.C.

Northern Virginia Faces Unique Housing Problems. According to Center for Housing Research data, 32.7 percent of Northern Virginia households live in unsafe, indecent, or unaffordable housing. With an area median income in 2000 of \$82,800, the residents of this area earn far more than the median incomes in the rest of the State, contributing to significantly higher rents in this region. Residents of Northern Virginia with incomes that would be at the median in most other areas of the State are unable to find affordable housing. With the fast-growing economy in this area, units that were once earmarked as affordable are now renting at market rates. For example, properties for which project-based Section 8 contracts are expiring are now being converted to market-rate units, rather than continuing to serve low income tenants.

The costs of land acquisition and new building construction are also higher in Northern Virginia than in the rest of the State. Several Northern Virginia developers and housing organizations told JLARC staff that these costs, in addition to the up-front costs required to apply for VHDA loans, make entry into the affordable multi-family housing market particularly difficult for Northern Virginia developers. There is also limited land available for new housing construction, particularly in the more urban areas of Northern Virginia.

Central Virginia Has Strong Affordable Housing Infrastructure. The housing problems within Central Virginia are more varied than in some other regions of the State. Around Charlottesville, housing problems stem from high land costs and a high demand for housing because of the rapid growth in the area. In the more urban areas of the region, such as Richmond and Petersburg, the current housing stock is in very bad shape, and there are a large number of households below the poverty level. According to VHDA's director of non-profit affairs, this region has a strong infrastructure and capacity to develop affordable housing, if sufficient funds were available.

Tidewater Has Highest Incidence of Housing Problems. The Hampton Roads planning district has the highest incidence of housing problems of all the planning districts in the State. According to the director of non-profit affairs at VHDA, the major housing concerns of non-profits in the Tidewater area are the needs of special populations. Specifically, housing concerns focus on single room occupancy and transitional housing, special needs housing, and military housing. A Tidewater non-profit housing organization also told JLARC staff of a significant demand for affordable rental housing in the area. Many households with incomes as high as 60 to 70 percent of the area median income are paying approximately 50 percent of their incomes in rent, according to staff of this non-profit.

Southside Is Severely Underserved. According to VHDA's director of non-profit affairs, the Southside region is severely underserved and is faced with a significant need for decent and affordable housing. The incidence of housing problems in households in the planning districts that make up Southside ranges between 20.3 and 27.6 percent. In addition, more than five percent of the households in two of the planning districts in Southside lack complete plumbing.

However, it is difficult to provide affordable housing in this region. VHDA's director of non-profit affairs also told JLARC staff that there currently are no non-profit housing organizations in the area and no significant housing advocates. One for-profit developer told JLARC staff about a company's experience in building a project in a Southside locality. This was a very difficult project to develop because households in the area had low incomes and credit problems, which limited the project's ability to lease up and become a viable community. Such experiences have led this developer and other for-profit developers interviewed by JLARC to gravitate to larger projects in more populous areas.

Southwest Virginia Faces Shortages. Incomes in Southwest Virginia are lower than in most of the rest of the State, but development costs are at least as high. By itself, this would cause some problems in the development of affordable multifamily housing, but this is exacerbated by the demand for smaller projects rather than the larger multifamily projects common to the suburban areas of the State. Smaller projects tend to have higher project costs, but because incomes are lower in this region, rents likewise must be lower. For example, according to VHDA's director of multifamily programs, rental units could be developed in a Southwest Virginia locality such as Galax to be rented at \$575 per month, but households in the area may be able to pay only \$400 per month.

The low incomes in Southwest Virginia also pose a problem for families looking to own a home. A family of four at 60 percent of median income in Dickenson County, which has the lowest area median income in the State, makes \$23,880 – an income that makes affording a home loan extremely difficult. In addition, more than five percent of the households in one of the planning districts in Southwest Virginia lack complete plumbing.

Northwestern Virginia Has Little Development Capacity. Many of the housing problems faced in the northwestern portion of the State are similar to those faced by Southwest Virginia, according to VHDA's non-profit affairs director. The major difference between the level at which housing needs are being addressed in the two areas is that there is much less development capacity in the northwestern localities. According to the non-profit affairs director, there are fewer housing problems in this region than in some other areas of the State, but one particular need is housing for new immigrants in low-paying jobs.

Eastern Virginia Households Face Housing Problems. More than 30 percent of the households in the Accomack-Northampton planning district face housing problems, and more than 25 percent of the households in the Northern Neck and Middle Peninsula face problems with unsafe, indecent, or unaffordable housing. In addition, more than five percent of the households in two of these planning districts lack complete plumbing.

JLARC REVIEW

This JLARC review of the Virginia Housing Development Authority provides an assessment of its single family and multifamily programs, its administration of the federal Section 8 program, and its management and finances in relation to its mission as defined by statute. A number of research activities were undertaken as part of this study in order to obtain a comprehensive understanding of VHDA's operations. These activities included: structured interviews, surveys, attendance at meetings and conferences, extensive document reviews and data analysis, an analysis of funding for the Virginia Housing Fund, and reviews of other states' practices.

Structured Interviews

Numerous structured interviews were conducted during the course of this review. Interviews were conducted with all seven appointed members of the VHDA Board of Commissioners and 28 VHDA staff members, based in both Richmond and Wytheville. VHDA staff interviewed included the executive director, the deputy executive director, and the directors of each of VHDA's operational divisions. JLARC staff also interviewed: (1) staff of for-profit development companies, non-profit development companies, local housing authorities, local Section 8 administrative agents, and six single family regional loan fund administrators located around the State; (2) community development officers at four banks and seven mortgage lenders that operate in Virginia; (3) staff of the Department of Housing and Community Development, including the executive director; and (4) U.S. Housing and Urban Development staff working in conjunction with VHDA's administration of the Section 8 program.

Surveys

A mail survey was conducted of all Section 8 local administrative agents in Virginia. Variations of this survey were sent to the following groups: (1) administrative agents that only administer Section 8 certificates and vouchers through VHDA; (2) administrative agents that only administer Section 8 certificates and vouchers through HUD; and (3) administrative agents that administer Section 8 certificates and vouchers both through HUD and VHDA. JLARC staff received 73 responses to this mail survey, for a response rate of 81 percent.

JLARC staff also conducted a salary survey of other State independent agencies. Responses were received from all six agencies that were surveyed.

Attendance at Meetings and Conferences

To gain an understanding of VHDA operations, JLARC staff observed seven monthly meetings of the Board of Commissioners and its subcommittees. JLARC staff also attended other VHDA meetings that pertained to specific research issues, including focus group meetings stemming from several General Assembly-mandated studies and a focus group meeting to discuss the 2000 federal low income tax credit allocation process. JLARC staff also attended two conferences addressing housing issues in Virginia to gain a background understanding of the housing needs faced by different regions of the State and the programs that are in place to address these needs.

Document Review and Data Analysis

In addition to interviews, analyzing surveys, and attending meetings and conferences, JLARC staff reviewed various documents and data from VHDA and other sources as part of this study. The following information was included as part of this review.

VHDA-Prepared Documents. The review of VHDA's organization and operations involved the collection and analysis of a number of VHDA-prepared documents. These documents included annual reports, annual financial reports, policy and procedure manuals, and staff position descriptions. JLARC staff also reviewed VHDA requests for proposals and procurement contracts. In addition, historical and current compensation and benefits data was reviewed.

Underwriting Standards Used by Other Single Family and Multifamily Lenders. JLARC staff reviewed the underwriting standards used by Fannie Mae and Freddie Mac, both multifamily lenders, as a comparison for the underwriting standards used by VHDA for its multifamily loans. JLARC staff also reviewed single family underwriting guidelines used by Fannie Mae.

Research on Housing Needs. A number of studies produced by the Virginia Center for Housing Research were reviewed in order to gain a greater understanding of the housing needs faced by households across Virginia. As part of this research effort, JLARC staff also reviewed "Out of Reach: The Gap Between Housing Costs and Income of Poor People in the United States," which is a study prepared by the National Low Income Housing Coalition, and census data.

Review of Applicable Statutes and Regulations. JLARC staff reviewed federal and State statutes and regulations which apply to VHDA's activities. These included: the *Code of Virginia*, VHDA rules and regulations, federal guidelines for the federal low income tax credit program, and federal eligibility requirements for the use of tax-exempt bond proceeds.

Correspondence Between VHDA, HUD, and Local Section 8 Administrative Agents. JLARC staff reviewed correspondence between VHDA, HUD, and local Section 8 administrative agents regarding HUD's recapture of Section 8 reserves. Correspondence between these groups involving the establishment of local administrative fees also was reviewed.

Section 8 Budget Data. JLARC staff reviewed VHDA Section 8 budget data for the last five fiscal years. This review was to assess how much of the Section 8 assistance allocated to VHDA by HUD over the last several years was not utilized.

Project and Tenant Data. JLARC staff collected and analyzed data on the multifamily projects that have been awarded by VHDA, as well as on the tenants served by these projects. JLARC staff reviewed and analyzed data on: (1) all multifamily projects that have been developed using loans financed by the issuance of taxable and tax-exempt bonds; (2) all multifamily projects that have received loans from the Virginia Housing Fund; and (3) all multifamily projects that have received either four or nine percent federal low income tax credits. JLARC staff also reviewed and analyzed tenant data for: (1) households in all multifamily projects that have received either four percent or nine percent tax credits through VHDA between 1995 and 1999, and (2) households in all multifamily projects that have received loans from the Virginia Housing Fund.

Single Family Loan Data. JLARC staff analyzed data for approximately 33,000 single family mortgage loans provided by VHDA between 1995 and 1999. This included an analysis of borrower and loan characteristics. In addition, an analysis of borrower eligibility for private market loans was conducted using data for approximately 12,500 single family mortgage loans provided by VHDA since January 1998.

Analysis of the Virginia Housing Fund

JLARC staff retained a consultant to help with its financial analysis of the Virginia Housing Fund. In 1996, CFX Incorporated (CFX) conducted an evaluation of the VHDA general fund and the amount of dollars in this fund that could be allocated annually to the Virginia Housing Fund without adversely affecting VHDA's financial strength. The accounting firm of Reznick, Fedder & Silverman (Reznick), which has significant experience in the field of housing finance, was hired by JLARC to evaluate the methodology, assumptions, analysis, and conclusions of the CFX study. Reznick was also asked to compare the projections developed by CFX in its analysis as to excess fund balances and surplus cash flow to the actual results through December 31, 1999. Reznick has prepared a report for JLARC detailing its analysis and its findings.

Other States' Information

JLARC staff also collected considerable information from other states. A survey was conducted by e-mail and telephone of other state housing finance agencies to collect basic information about their programs as well as the composition of their governing boards. In addition, JLARC staff conducted a more focused telephone survey of the single family programs in 16 states in order to learn more about the loan products and programs provided in those states. Finally, JLARC staff conducted a phone survey of four other state Section 8 programs to obtain comparative data on the operation of those programs.

REPORT ORGANIZATION

This report is organized into five chapters. Chapter II reviews VHDA's single family programs and assesses whether these programs are adequately serving low and moderate income families in Virginia. Chapter III evaluates the success of VHDA's multifamily programs in addressing housing needs across Virginia. Chapter IV discusses VHDA's administration of the Section 8 certificate and voucher program. Chapter V reviews the administration and financial management of VHDA, including the adequacy of the level of funding set aside for the Virginia Housing Fund.

II. Single Family Loan Program

The single family loan program is VHDA's largest program. Single family loans constitute approximately two-thirds of the total dollars financed by VHDA, and approximately one-third of all VHDA employees work in the single-family division. VHDA offers several loan products that primarily assist low and moderate income households.

In recent years VHDA has been able to achieve a high volume of single family loan production, and the program has generated a substantial amount of revenue for the authority. However, the major VHDA loan products provide small benefits to borrowers, and 39 percent of the loan recipients would have been eligible to obtain financing through the private market.

Within its single family program, VHDA needs to provide a greater balance between its loan production and profitability and its mission to serve those households otherwise unable to obtain safe and decent housing. The authority's enabling legislation states "that it is imperative that the supply of residential housing...be increased" to address the "serious shortage of sanitary and safe residential housing at prices or rentals which persons and families of low and moderate income can afford." The authority needs to develop loan products that provide beneficial financial assistance to more low income households that otherwise would be unable to buy a home.

VHDA SINGLE FAMILY MORTGAGE LENDING

VHDA makes mortgage loans to households of low and moderate income for financing ownership or rehabilitation of single family residential housing, including condominium units. VHDA has established four primary loan products, including standard insured loans, as well as the Step Rate, FHA Plus, and Flexible Alternative loans. In order to comply with federal requirements, VHDA has established maximum sales price and gross income limits that vary depending principally on location within the State. Over the last five years, the median mortgage amount of homes for VHDA loan recipients was slightly over \$83,000, and the median income was slightly more than \$35,000. In addition to its four primary loan products, VHDA also offers programs to borrowers such as low interest rate loans to lower income households and an educational program for first-time homebuyers.

VHDA Offers Four Primary Single Family Mortgage Loan Programs

VHDA offers four primary single family mortgage loan programs designed to assist low and moderate income homebuyers in obtaining an affordable mortgage. These

programs are the standard insured, Step Rate, FHA Plus, and the Flexible Alternative programs. The first three of these programs are restricted to first-time homebuyers because they are funded by tax-exempt Mortgage Revenue Bond proceeds. The Flexible Alternative program only uses proceeds from taxable bond sales and does not have the same first-time homebuyer restrictions. Each of these products offers different benefits to the borrower, ranging from a lower interest rate to financing downpayment and closing costs (Exhibit 1). Loans made from these four programs accounted for more than 32,000 VHDA single family mortgage loans from 1995 through 1999. Currently, most of these loans are originated and serviced by private lenders.

Standard Insured Loan Products. VHDA provides standard, 30-year, fixed rate single family mortgage loans similar to traditional loans available in the private market except at a lower interest rate and with benefits as shown in Exhibit 1. VHDA generally sets the interest rate for its traditional loans at approximately one-half percent below the average market rate available on the secondary market. Almost four-fifths of the 12,218 standard insured loans closed from 1995 to 1999 were insured by the Federal Housing Administration (FHA), Veterans' Administration (VA), or the Department of Agriculture's Rural Development program (RD). The remaining loans are insured by private insurance providers. The standard insured loans provide the borrower with a lock-in period of up to 120 days during which the terms of the loan, including the interest rate, will not change. Another 120 days is available for the lender to close the loan, plus an additional 60 days, if requested by the borrower.

Step Rate Program. The Step Rate program is a 30-year mortgage loan designed to assist the borrower by providing a substantially reduced interest rate for the first two years of the loan. To determine the interest rate amount for the first two years, VHDA increases its standard rate by one-half percent and then reduces that rate by two percent for the first year and one percent for the second year. In years three through thirty, the interest rate is fixed at one-half percent more than the rate available for VHDA's standard insured product. Generally this rate is equal to the market rate for conventional loans. Borrowers using a FHA insured loan can qualify at the first year rate, while conventional or VA insured loan applicants can qualify at the second year rate. More than 14,000 Step Rate loans have been closed since the program's inception in 1994, the most of any of VHDA's loan products during that time.

FHA Plus Program. The FHA Plus program, begun in early 1994 as a pilot program, was designed to reduce the amount of cash needed for up-front costs by first-time homebuyers. Under the program, VHDA provides an uninsured second mortgage that can not exceed three percent of the sales price to be used for downpayment and closing costs in conjunction with a FHA insured first mortgage. As part of the FHA insurance, borrowers are also able to finance the up-front costs associated with mortgage insurance. With this combination of loans, borrowers can obtain a loan-to-value ratio of as much as 103 percent.

Both mortgages have 30-year terms, and the associated interest rate for both is one-half percent greater than the standard VHDA rate. As a result, both rates are generally equal to the market rate for standard 30-year, fixed rate mortgages. In order

Exhibit 1

VHDA Single Family Mortgage Loan Products

Program	Standard Insured	Step Rate	FHA Plus	Flexible Alternative
Interest Rate*	½% less than market rate	Year 1 : 2% less than market rate Year 2 : 1% less Years 3-30: market rate	Market rate for both loans	½% more than market rate
Downpayment	Conv. – 5% FHA – 3% VA – 0% RD – 0%	Conv. – 5% FHA – 3% VA – 0% RD – 0%	Borrower must provide no less than 1% of sales price for first mortgage;	0%
Insurance Type	FHA, VA, RD, Conv.	FHA, VA, RD, Conv.	FHA	Uninsured
Points	Origination = 1% Discount = 1%	Origination = 1% Discount = 2%	Origination = 1% Discount = 1%	Origination = 1% Discount = 0-1.5%
Benefits	<ul style="list-style-type: none"> • Interest rate is ½% less than the market rate • Extended no cost lock-in period • No additional lender fees • No minimum loan amount 	<ul style="list-style-type: none"> • Reduced interest rate during the first two years of the loan • Extended no cost lock-in period • No additional lender fees • No minimum loan amount 	<ul style="list-style-type: none"> • Provides financing of downpayment and closing costs • Extended no cost lock-in period • No additional lender fees • No minimum loan amount 	<ul style="list-style-type: none"> • No mortgage insurance requirement and higher income and loan limits • Extended no cost lock-in period • Standard fees • No minimum loan amount

Note: *Benchmark interest rate is interest rate for a standard, 30-year fixed rate loan in the private market. Interest rates listed above represent VHDA targets. Actual differences may vary slightly as a result of changes in the available private market rate. Conv. – Conventional; FHA – Federal Housing Administration; VA – Veterans' Administration; RD – Department of Agriculture's Rural Development program. Expanded qualifying ratios and flexible underwriting guidelines are available for conventionally insured mortgage loans (which comprise less than 12 percent of VHDA's loans) as part of the 30-year, fixed rated and Step Rate programs.

Source: JLARC staff analysis of VHDA mortgage loan products.

to obtain a FHA Plus loan, a one percent origination fee and one discount point (each origination and discount point is equal to one percent of the loan amount) are required to be paid at closing, by either the borrower or seller. The borrower must be able to either pay one percent of the loan or have the equivalent of one percent of the loan amount in cash reserves. VHDA closed approximately 5,000 of these loans between 1995 and 1999.

Flexible Alternative Program. The Flexible Alternative program was first offered in early 1998 and is available to existing homeowners as well as first-time homebuyers. This program has higher maximum loan and income limits than VHDA's other programs. In addition, there is no mortgage insurance requirement which helps to reduce the monthly payment. According to VHDA staff, the Flexible Alternative program was in large part designed to address the high cost of single family housing in Northern Virginia. Slightly more than 900 Flexible Alternative loans have been closed since the program's inception. The interest rate for these loans is targeted at approximately one percent greater than VHDA's standard rate, and is about one-half percent higher than the market rate.

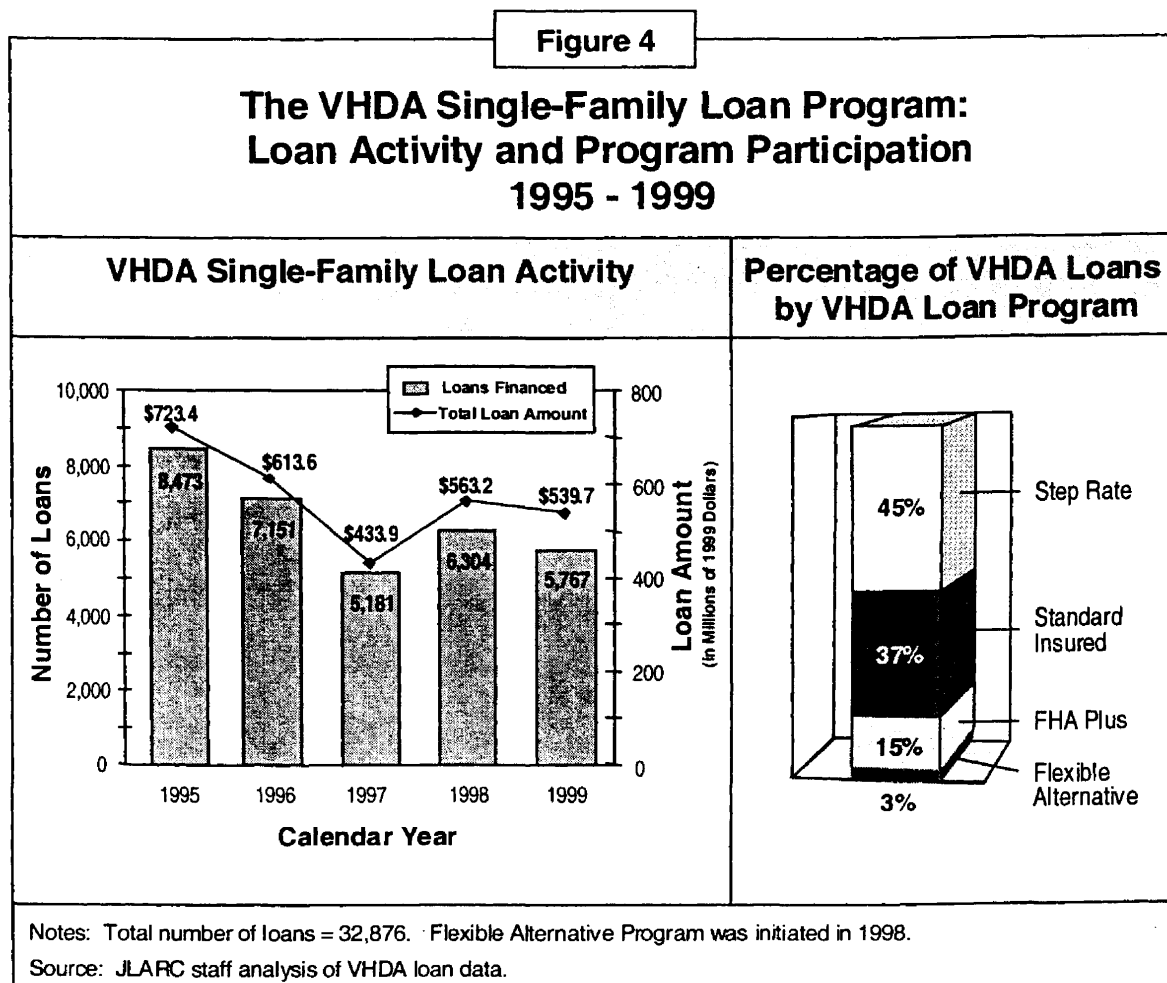
Loan Originations and Servicing. VHDA single family mortgage loans can be applied for in several different ways. More than 120 VHDA approved mortgage lending institutions in Virginia currently operate approximately 900 branches through which a prospective borrower can apply for a VHDA mortgage loan. Private lenders receive a fee of one percent of the sales price for each loan they originate. In addition, since 1997, VHDA has also operated two mobile mortgage vans to provide direct access to loan applications in hard-to-serve areas of the State. One van serves the southwestern portion of the State. The other van serves communities on the Eastern Shore and the Northern Neck. VHDA has recently expanded the mobile van service to Southside Virginia.

VHDA also provides servicing for approximately one-third of its loans. Servicing is provided for the remaining loans by 32 banks and other private lenders. Private lenders that service VHDA loans receive an annual servicing fee equal to three-eighths of one percent of the principal balance of the loan. VHDA has developed a plan to increase the amount of loans serviced in-house by an additional one-third which should substantially reduce the authority's servicing costs.

Profile of VHDA Single Family Mortgage Loan Activities

Since 1995, VHDA has closed almost 33,000 single family mortgage loans worth more than \$2.8 billion (Figure 4). VHDA mortgage loans have been made throughout all parts of the State, but predominantly in the urban areas. Two loan programs have accounted for 82 percent of all loans made by VHDA since 1995. The Step Rate program has accounted for 45 percent, or more than 14,000 loans, of all VHDA mortgage loans since 1995 (Figure 4). The VHDA 30-year, fixed rate standard insured program accounts for another 37 percent of all loans. Fifteen percent of VHDA's loans have been made through the FHA Plus program. Finally, Flexible Alternative loans, which began in 1998, have made up three percent of VHDA's loans.

VHDA loans have been made to households in every planning district in Virginia over the last five years. Almost two-thirds of VHDA's loan activity during that time has occurred in three planning districts (Figure 5). These planning districts are: Hampton Roads (31 percent), Richmond Regional (19 percent), and Northern Virginia (13 percent). In 1998, these three planning districts accounted for more than 59 per-



cent of the State's total population of greater than six million (according to Weldon Cooper Center for Public Service). Loan commitments in those three planning districts accounted for almost \$2 billion. Commitments to the rest of the State accounted for slightly more than \$1 billion during the same period.

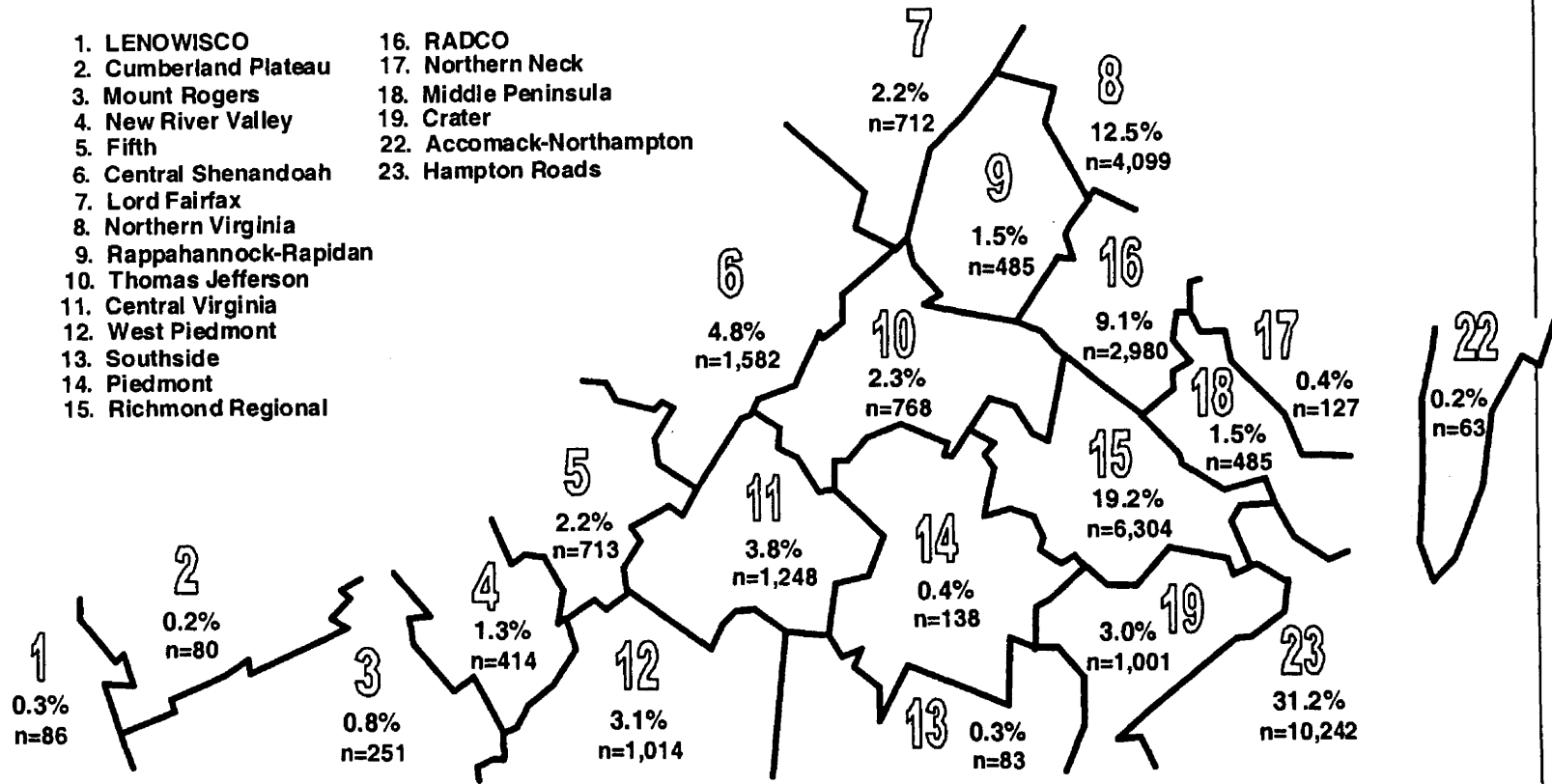
The percentage of delinquent VHDA loans increased during the period March 1995 through September 1999, and was comparable to the overall State delinquency rate. For example, in June 1995, the delinquency rate (one or more payments 30 days past due) for VHDA loans was slightly higher than 3 percent, or one percent less than the rate for loans originated in Virginia as a whole. However, by June 1999, the delinquency rate for all VHDA loans had increased to more than 6.5 percent, almost one and one-half percent more than the State rate. Although it is clear the delinquency rate for both VHDA and all State loans has increased, the rate for VHDA loans has grown more rapidly during that time.

On the other hand, foreclosure rates for VHDA loans appear to have been consistently lower than foreclosure rates for all loans statewide from June 1995 to June 1999. In fact, foreclosure rates for VHDA loans have remained less than approxi-

Figure 5

Distribution of VHDA Single-Family Loans by Planning District 1995 - 1999

- | | |
|-------------------------|--------------------------|
| 1. LENOWISCO | 16. RADCO |
| 2. Cumberland Plateau | 17. Northern Neck |
| 3. Mount Rogers | 18. Middle Peninsula |
| 4. New River Valley | 19. Crater |
| 5. Fifth | 22. Accomack-Northampton |
| 6. Central Shenandoah | 23. Hampton Roads |
| 7. Lord Fairfax | |
| 8. Northern Virginia | |
| 9. Rappahannock-Rapidan | |
| 10. Thomas Jefferson | |
| 11. Central Virginia | |
| 12. West Piedmont | |
| 13. Southside | |
| 14. Piedmont | |
| 15. Richmond Regional | |



Note: Total number of loans is 32,875. Percentages may not add to 100 due to rounding.

Source: JLARC staff analysis of VHDA loan data.

mately one-half of one percent during that time. This represents an average quarterly difference of almost one-half of one percent less than the statewide foreclosure rate.

Single Family Mortgage Loan Eligibility Requirements

Eligibility requirements for the single family mortgage loans offered by VHDA are primarily governed by section 143 of the federal 1986 Tax Reform Act, which regulates the use of state and local tax-exempt Mortgage Revenue Bonds. Although VHDA has relied increasingly on proceeds generated from the blending of taxable and tax-exempt Mortgage Revenue Bonds, loans made from blended proceeds are still subject to requirements of the 1986 Tax Reform Act. VHDA has established its own income and loan limits for Flexible Alternative loans, which are funded solely with taxable bond proceeds. Aside from these federal and VHDA requirements, a loan applicant also must meet VHDA's underwriting requirements, which include measuring the household's debt-to-income and credit worthiness.

Statutory Requirements for Tax-Exempt Mortgage Revenue Bonds. The federal government has established six basic eligibility requirements regarding the use of tax-exempt Mortgage Revenue Bonds. These must be met at the time a VHDA loan is closed and include:

- Residence requirement – the mortgaged property must become the principal residence of the mortgagor within 60 days;
- Prior ownership limitation – mortgagors must not have had ownership in any principal residence during the three year period prior to the execution of the mortgage;
- New mortgage requirement – bond proceeds cannot be used to acquire or replace an existing mortgage loan;
- Purchase price limitation – acquisition cost of a residence cannot exceed 90 percent of the average area purchase price, or 110 percent if the residence is in a targeted area;
- Mortgagor income limitation – mortgagor family income cannot exceed 115 percent of the greater of area median family income or statewide median income; and
- Assumption requirement – assumptions are allowed only if the residence requirement, prior ownership limitation, mortgagor income requirement, and purchase price limitations are complied with by the mortgagor.

In response to the federal purchase price limitation requirement, VHDA has established sales price limits for its single family mortgage programs (Exhibit 2). The maximum sales prices VHDA will approve range from \$74,700 to \$173,200 for loans

Exhibit 2

VHDA Single Family First Mortgage Programs Maximum Allowable Income Limits and Sales Prices				
Area	Gross Household Income		Sales Price / Loan Limits	
	2 or Fewer Persons	3 or More Persons	New Construction	Existing and Rehabilitated
Washington, D.C. – Virginia	\$68,700	\$79,500	\$173,200	\$171,800
Norfolk-Virginia Beach- Newport News	\$47,400	\$54,900	\$133,300	\$111,700
Richmond-Petersburg	\$50,000	\$57,900	\$142,100	\$114,500
Charlottesville	\$48,600	\$56,200	\$113,200	\$115,300
Danville	\$47,400	\$54,900	\$113,200	\$95,400
Kingsport-Johnson City-Bristol	\$47,400	\$54,900	\$113,200	\$74,700
Lynchburg	\$47,400	\$54,900	\$113,200	\$88,000
Roanoke	\$47,400	\$54,900	\$113,200	\$91,300
Clarke County	\$48,800	\$56,000	\$173,200	\$171,800
Culpeper, King George, and Warren Counties	\$47,400	\$54,900	\$173,200	\$171,800
King William County	\$49,400	\$57,200	\$113,200	\$95,400
Statewide (Other than Areas Listed Above)	\$47,400	\$54,900	\$113,200	\$95,400

Notes: These limits apply only to loans using tax-exempt Mortgage Revenue Bond proceeds. The Flexible Alternative program is not governed by these limits for income and sales price.

Source: VHDA.

financed from tax-exempt bond issuances. These limits are based on calculations developed by the U. S. Department of Treasury determining the average area median purchase price from the most recent 12 month period for which information is available. However, Treasury has not updated these limits since 1994.

Federal law requires that borrowers who receive loans from tax-exempt Mortgage Revenue Bond proceeds have gross family incomes no more than 115 percent of the applicable area median family income. For the majority of its loans, VHDA has established income limits of 110 percent for households of three or more persons and 95 percent for households with two or fewer persons. The maximum gross incomes VHDA will allow appear in Exhibit 2.

Eligibility Requirements for Taxable Bond Funded Loans. VHDA uses proceeds from the sale of taxable bonds to fund the Flexible Alternative program and is

therefore not restricted by U.S. Department of the Treasury requirements pertaining to tax-exempt Mortgage Revenue Bond issuance for this loan product. As a result, VHDA has established higher income limits for the Flexible Alternative program than for its other single family loan products. For example, the income limit in Northern Virginia is \$94,700 and \$68,900 in the Richmond area. The Flexible Alternative program has a loan limit of \$252,700, but no sales price limit. Moreover, no mortgage insurance is required with the loan.

Underwriting Requirements. VHDA also determines an applicant's worthiness for a loan using established underwriting criteria. Currently, about four-fifths of VHDA's mortgage loans are underwritten using a delegated process giving private lenders who originate the loans the underwriting responsibility. According to the loan program manager for VHDA's Single Family division, this delegated underwriting can reduce loan processing by up to two weeks. Once the loan has been closed, VHDA then performs a comprehensive review of the underwriting information.

The mortgage insurance providers used by VHDA for its loan products have established two debt-to-income ratio measures to determine whether the borrower will be able to meet the expenses involved in homeownership. The first of these measures compares an applicant's monthly housing expenses (the sum of principal and interest payments, escrow deposits, and any other payments required for subordinate financing) with that household's gross income. The second method compares total debt obligations (the sum of monthly housing expenses and any outstanding monthly debt payments with more than six months duration) with gross household income.

The qualifying ratios used to determine household eligibility depend on the type of mortgage insurance used by the borrower. The insurance providers require VHDA to use these ratios in underwriting its loans to be eligible for their insurance. Mortgage insurance for a VHDA loan is available through four sources: conventional private mortgage insurance companies, the Federal Housing Administration, the Veterans Administration, and the U.S. Department of Agriculture's Rural Development program. The qualifying ratios required by each insurance source are contained in Table 3.

Along with the qualifying ratios, the applicant's credit rating is a major factor used by underwriters when determining if an applicant qualifies for a loan. Generally, when reviewing credit ratings, underwriters analyze an applicant's history of repayment, current account balances, other recent inquiries into the person's credit, new accounts, and the age of any open accounts.

VHDA Single Family Mortgage Loan Borrower Profile

More than one-half of VHDA single family mortgage loan recipients have moderate incomes, based on HUD calculations of area median family income. The median gross income of households receiving VHDA loans was slightly more than \$35,000 in 1999 dollars (Figure 6). (The statewide average median gross income for

Table 3

Mortgage Loan Insurance Qualifying Ratios (Percent)

Type of Insurance	Monthly Housing Expense- to-Income Ratios	Total Obligations-to- Income Ratios
Conventional	32	40
Federal Housing Administration	29	41
Veterans' Administration	None	41
Rural Development	29	41

Note: Ratios for privately insured loans through the private market are 28 percent for the monthly housing expense-to-income ratio and 36 percent for the total obligations-to-income ratio. Lenders will accept higher ratios if borrower can demonstrate compensating factors impacting mortgage repayment but that cannot be used in calculation of the ratios.

Source: VHDA.

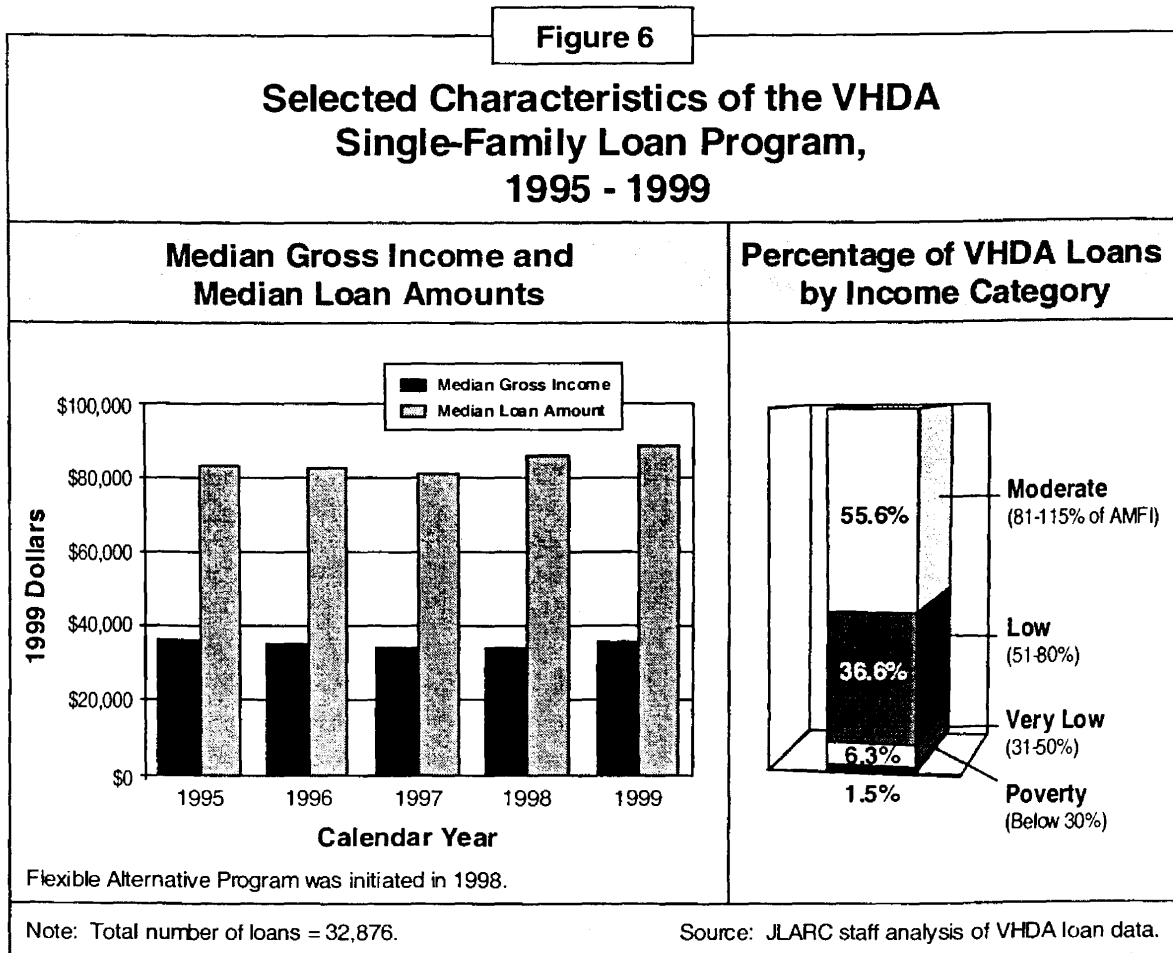
1995 through 1998 was more than \$43,000 per household in 1998 dollars.) Borrower's incomes ranged from more than \$6,000 to more than \$94,000 in 1999 dollars. As indicated in Figure 16, 55.6 percent of VHDA's single family mortgage loans went to households earning 81 percent or more of area median family income (AMFI), adjusted for household size, based on the HUD income categories discussed in Chapter I. Most of the remainder of the loans went to low income households (51 to 80 percent of AMFI).

The median mortgage loan amount during this time was slightly more than \$83,500 in 1999 dollars (Figure 6). The median interest rate for a VHDA loan was 6.5 percent. Of the loans made during those years, the minimum loan amount was approximately \$14,400 and the maximum was \$240,000, in 1999 dollars. More than three-fourths of VHDA loans were for detached dwellings. In addition, more than three-fourths of VHDA's loans were made for the purchase of existing homes, while 22 percent were for the purchase of newly constructed homes.

VHDA loan recipients generally have small households. Almost 90 percent of all VHDA loans (28,985 loans) have gone to households with three or fewer persons. Sixty-five percent of households (21,481) receiving loans had only one wage earner, and more than half (11,882) of those were single person households. Thirty-one percent of households (10,236) consisted of a married couple with dependents.

Virginia Housing Fund Provides for Additional Single Family Loans

As mentioned previously, VHDA established the Virginia Housing Fund (VHF) in 1987 as a way "to create new housing opportunities for lower income Virginians."



Since its inception, VHF has been used to provide approximately \$143 million in project financing for several single family mortgage loan programs.

The primary single family program associated with the VHF is the Single Family Regional Loan Fund (SFRLF). Implemented as a pilot project in 1993 for providing below market rate loans to first-time homebuyers, the SFRLF is administered by the Department of Housing and Community Development (DHCD), but receives most of its funding from VHDA. The SFRLF provides below-market-rate financing to low income first-time homebuyers. (Low income households have incomes 80 percent or less of area median family income.) Through the Virginia Housing Fund, VHDA has provided approximately \$43 million to finance approximately 780 mortgages since its inception. In FY 1997, the program was expanded statewide.

Funding for the SFRLF is provided from three primary sources: the VHF, the Virginia Housing Partnership Fund (VHPF), and federal HOME Investments Partnership Program funds administered by DHCD. Until recently, the SFRLF was a multi-layered fund with different lending terms and underwriting requirements for each of the different funding sources which proved confusing and required a substantial administrative effort to manage. Beginning in FY 2000, in an attempt to streamline the

earlier method and reduce the associated fees, the SFRLF financing process was modified, with funding from the VHPF and VHF creating a pool of \$16 million in loanable funds at a blended interest rate of 4.75 percent. In addition, DHCD uses \$2.5 million in HOME funds for downpayment and closing cost assistance. These funds are then distributed among 15 regional administrators, who also contribute some form of assistance, including grants and loans. For FY 2000, VHDA provided \$14 million from the Virginia Housing Fund at a five percent interest rate, which accounted for 88 percent of the mortgage funds made available.

Regional administrators include planning district commissions, non-profits, local governments, and other organizations. Several of these regional administrators have expressed overall satisfaction with the SFRLF. The regional lending focus increases access to the funds for a greater number of people.

Other single family programs have also been funded from VHF. These include: direct lending, funding to support the U. S. Navy single family housing program, and establishment of reserves to support second mortgages as part of the FHA Plus program. The VHF also has been used to provide lines of credit to non-profit groups such as Habitat for Humanity and the Federation of Appalachian Housing Enterprises, which in turn have offered low interest loans to low income families.

VHDA Offers Other Programs

Since 1993, VHDA has offered a homebuyer education program to provide first-time homebuyers the opportunity to become familiar with the homebuying process and homeownership responsibilities. The free, six-hour course is taught by trained, industry professionals and includes topics on budgets, credit, qualifying for a home loan, applying for a mortgage, and what to expect at closing. VHDA has discovered that delinquency rates typically are lower among borrowers who have successfully completed the program compared to those who have not. For example, since March 1995, the delinquency rate for VHDA borrowers completing the class has been 3.5 percent while those not taking the class have had a delinquency rate of almost five percent, based on VHDA's total portfolio of loans. VHDA offered 298 classes in more than 40 Virginia towns and cities in 1999, and almost 8,000 people successfully completed the program.

VHDA's homebuyer education program has been recognized for its success. In 1994, VHDA began partnering with HUD to run this program. According to VHDA staff, with HUD's consent the program has taken the place of the HUD Homeownership Education Learning Program in Virginia. In addition, the program has been approved by Fannie Mae, Freddie Mac, and several private mortgage insurers.

In addition to the homebuyer education program, VHDA has recently worked with two private lenders to offer small initiative programs directed at targeted populations. In both cases, a private lender has agreed to purchase a taxable bond issue at a

below-market yield, which has allowed VHDA to offer below-market interest rates to borrowers. In 1999, VHDA partnered with BB&T bank in the Tidewater area to offer \$5 million for 51 loans at 5.875 percent interest for certain Navy personnel. Income limits for these loans were set at 80 percent of area median income. Likewise, VHDA has begun partnering with First Market Bank to offer approximately \$5 million in loans over two years. These loans will be targeted towards police, fire, and rescue personnel in the City of Richmond in an attempt to change the mix of households in certain areas. The interest rate for these loans was established at 7.5 percent. Income limits for this program have been established at \$45,900 for one-person households and \$50,000 for two-person households.

VHDA'S SINGLE FAMILY PROGRAM COULD PROVIDE MORE ASSISTANCE TO LOW AND MODERATE INCOME HOUSEHOLDS

There is a need in Virginia for additional low interest rate financing to make home ownership more affordable for households that are not able to obtain financing through the private market. In light of this demand, VHDA could offer loan products with greater benefits through its standard programs. While VHDA loan products offer some small benefits to borrowers, the authority provides interest terms that are only slightly more attractive than the private market rate for a standard 30-year, fixed rate loan. VHDA single family loan products should provide greater benefits to borrowers, and the authority may not be setting interest rates as low as anticipated by the *Code*.

Need for Single Family Housing Exists in Virginia

As mentioned previously, studies have indicated there still exists a need for safe and sanitary housing in the State. Moreover, this need is not limited to households seeking rental housing. According to an analysis performed by the Virginia Center for Housing Research (VCHR) using 1990 census data, approximately one-third of all homeowners with incomes between 51 and 80 percent of area median income faced housing problems. These problems are defined as units costing more than 30 percent of the occupying household's income or units that are overcrowded, lacking a complete kitchen, or complete plumbing. Furthermore, VCHR staff have stated that the housing problem most likely to be associated with an owner-occupied unit is the cost burden. Therefore, it is incumbent upon VHDA to offer affordable single family housing to first-time homebuyers as a means of reducing the number of households facing housing problems.

Owner households within the 51 to 80 percent income category in the Northern Virginia, Hampton Roads, and RADCO planning districts appeared to be most affected by these housing problems within the State. In Northern Virginia for example, approximately 65 percent of households with incomes between 51 and 80 percent of the area median income had housing problems. Less urbanized planning districts were

also impacted by housing problems, but to a lesser degree. VCHR reported that approximately 24 percent of households with incomes between 51 and 80 percent of the median income in both the Southside and Piedmont planning districts had housing problems.

VHDA Mortgage Loan Products Could Provide Greater Benefits to Borrowers

VHDA offers several loan products with varying terms, but these products only offer small benefits to borrowers. VHDA restricts its ability to offer low interest rates because it blends a substantial amount of taxable bond proceeds with tax exempt bond proceeds in order to expand its pool of loan funds.

Interest Rate for Standard Insured Product Is Not Significantly Below Market Rate. The interest rate VHDA charges for its standard 30-year, fixed mortgage is not significantly below the private market rate for a comparable loan. Currently, VHDA targets the interest rate for its standard insured loans at only one-half percent less than the average market rate.

As Table 4 indicates, using current interest rates, the amount of money saved by a VHDA borrower as a result of a one-half percent difference in interest rates is only about \$2,800 over a seven-year period. According to VHDA's policy analyst, VHDA loan recipients typically stay in their homes approximately seven years, after which the loan is repaid in full. However, that amount doubles when the interest rate is lowered to a full percentage point below the market rate and nearly triples when the rate is lowered to one and one-half points below the market rate.

Table 4

Mortgage Loan Repayments Based on a One-Half Percent Difference in Interest Rates

	Market 8¼% Interest Rate	7¼% Interest Rate	7¼% Interest Rate	6¼% Interest Rate
Monthly Payment for a 30-Year, Fixed Rate Mortgage	\$713.70	\$680.59	\$648.07	\$616.17
Difference between Market Rate and Indicated Rate		\$33.11	\$65.63	\$97.53
Difference in Total Payments After a Seven-Year Period		\$2,781.24	\$5,512.92	\$8,192.52

Note: Assuming a \$100,000, 30-year fixed rate loan with five percent down and no origination or discount points. The prevailing market interest rate as of March 13, 2000 was 8¼ percent.

Source: VHDA and Bankrate.com

Other Programs Could Provide More Assistance. Although the Step Rate loan program offers an attractive initial interest rate, the borrower pays the market rate by the third year of the loan. Borrowers obtaining FHA insurance for a Step Rate loan can qualify at the initial loan rate, which is approximately two points less than the conventional market rate, and qualify at an interest rate one percent less than the market rate with conventional or VA insurance. However, the interest rate increases to the market rate for a standard 30-year, fixed rate loan in the third year of the loan and remains at that level for the life of the loan. Therefore, for 28 of the 30 years of the loan, the loan provides no advantage over a standard 30-year, fixed rate loan.

Another concern with the Step Rate product is the interest rate charged to borrowers. VHDA qualifies borrowers using FHA insurance at the initial lower interest rate. However, after two years, the rate has increased by two full percentage points, and the borrower's monthly payment has increased by approximately \$135 on a \$100,000 loan. Although the foreclosure rate on these loans has not been high, this sharp increase in the interest rate over a two-year period may impose a substantial burden on low income households beginning in the third year of the loan. While households may still have the same income at which they qualified for the loan, the interest rate on the loan starting in the third year is two percent higher than the initial rate, which may result in households being faced with higher housing costs.

In addition to the issues raised by the Step Rate program, the FHA Plus loan product offers initial benefits only to be eclipsed over the life of the loan. Borrowers are able to finance the downpayment and closing costs through a second mortgage, but VHDA sets the interest rate on both mortgages at the market rate for a standard 30-year, fixed rate loan, and the terms of both loans are for 30 years.

VHDA also has recently changed its policy regarding the payment of the discount point on VHDA loans. In the past, VHDA has required the seller to pay the discount point on a loan, which is typically equal to one percent of the loan amount. Recently, however, the VHDA Board of Commissioners amended this regulation. The amended regulation allows either the seller or the buyer to pay the discount point. VHDA staff explained this change by stating that when the single family housing market is tight, sellers often refuse to pay the discount point, which results in missed opportunities for VHDA borrowers to make home purchases. However, this action will probably result in borrowers having to pay the discount point, thereby increasing the cost of VHDA loans.

High Interest Rates Result of Extensive Blending. Prior to 1995, VHDA offered interest rates on its single family loans that were considerably below the average rate available in the private market. Since that time, however, VHDA has become more reliant on blending the proceeds from its tax-exempt Mortgage Revenue Bonds and taxable bond issues to produce larger amounts of loanable funds. Blending involves combining the proceeds from a tax-exempt bond issue with proceeds from a taxable bond issue in some proportion. Because VHDA is required to pay investors a substantially lower yield for tax-exempt bonds than taxable bonds, VHDA can loan tax-exempt bond proceeds at lower interest rates. When these funds are blended, however,

VHDA must set an interest rate on its loans that is between the tax-exempt and taxable rates in order to generate the return necessary to pay its taxable bond investors.

According to VHDA staff, VHDA uses this blending mechanism in part to respond to the authority's decreasing ability to issue tax-exempt bonds. This is a result of a federal law limiting the ability of state housing finance agencies to recycle loan pre-payments into additional loan funds to within ten years after the bond issuance. Several other states' housing finance agencies contacted by JLARC staff also use blending, but not to the extent VHDA does. In fact, in 1998 VHDA issued more taxable housing bonds than any other state housing finance agency, which it then used to fund blended loans for both single family and multifamily loan recipients.

While blending allows VHDA to provide a greater volume of loans, these blended loans are available to households at a rate not significantly below that offered in the private market. If VHDA blended lower amounts of taxable bond proceeds, it could reduce the interest rate provided through its loan programs. For example, the West Virginia Housing Development Authority uses only tax-exempt bond proceeds and is able to offer an interest rate for its standard insured product as much as one and one-half percent below the average rate in the private market while at the same time covering the cost of its operations. While fewer loans may be awarded with less blending, VHDA would be able to provide significantly better loan products than its current loan products, and would be able to provide greater housing assistance to low income borrowers.

Interest Rates May Not Be as Low as Anticipated by Statute. As a result of blending and the desire to maximize profitability, VHDA generally sets interest rates for its standard insured product at the highest possible rate while still keeping its product attractive to first-time homebuyers. This practice appears to be inconsistent with the purposes for which VHDA was established and should be reconsidered by VHDA in light of the spirit of the *Code of Virginia*.

In 1971 the Virginia Housing Study Commission, which recommended the establishment of a State housing authority, stated that VHDA funds "would be loaned at the lowest possible rates" for the purposes of financing low and moderate income family housing. Section 36-55.33:1(A)(3) of the *Code of Virginia* authorizes VHDA to establish and modify the interest rates it uses. The *Code* also emphasizes the need for VHDA to loan its funds at the lowest possible interest rates by stating:

[such] interest rates shall be established by HDA in its sole discretion at the lowest level consistent with HDA's cost of operation and its responsibilities to the holders of its bonds, bond anticipation notes and other obligations.

VHDA does not appear to be setting interest rates at the lowest possible level consistent with the cost of operation. In addition, rates are set higher as a result of blending. VHDA appears to set interest rates at levels that enable the authority to

generate revenue that exceeds its cost of operation. Therefore, VHDA's current practice of setting rates for its standard insured product at one-half percent below the rate available for a standard 30-year, fixed rate loan results in interest rates that may not be as low as anticipated by statute.

VHDA SHOULD ADDRESS NEEDS OF HOUSEHOLDS NOT SERVED BY THE PRIVATE MARKET

While VHDA is one of the leading housing finance agencies in the country in terms of loan volume and financial strength, the authority needs to provide greater assistance to households that are not being served by the private market. In fact, since 1998, 39 percent of the loan recipients likely would have been eligible for loans through the private market. Many other state housing finance agencies provide loan products with substantially better interest rates to lower income households. VHDA needs to focus more on its mission to provide assistance to households that otherwise would be unable to afford home ownership. Current loan products need to be modified, or new products need to be developed that will better serve low income households that are most in need of assistance.

Thirty-Nine Percent of VHDA Loan Recipients Would Have Been Eligible for Private Market Loans

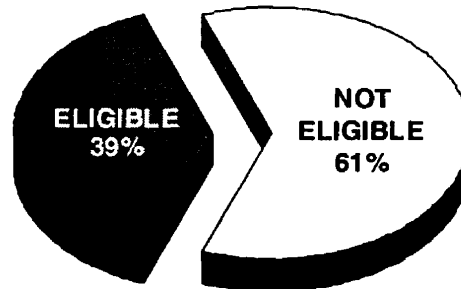
JLARC staff analysis of single family mortgage loans closed by VHDA over the last two years indicates that 39 percent of these loan recipients would have been eligible for single family loans through the private market. Based on loan data provided by VHDA and using the authority's methodological approach, JLARC staff analyzed more than 11,000 single family mortgage loans closed by VHDA in the last two-and-a-half years in its three mortgage revenue bond programs. This analysis indicates that 39 percent of borrowers who obtained such loans likely would have been eligible for a standard 30-year, fixed rate single family loan through the private lending market (Figure 7).

Eligibility was determined using the ratios for monthly housing expense-to-income and total obligations-to-income, and also a proxy measure for a borrower's ability to make a required downpayment. These 11,518 loans represent all of the loans closed under the standard insured, Step Rate, and FHA Plus programs between January 1998 and May 2000, excluding loans with missing or inconsistent data.

To perform this analysis for standard insured and Step Rate loans, adjustments were made to the qualifying ratios based on the difference in monthly payments resulting from the increased interest rate for a private market loan. If a borrower's total obligations-to-income and monthly housing expense-to-income ratios did not exceed the adjusted ratios calculated, the borrower was then considered to be eligible for

Figure 7

**Estimated Percentage of VHDA Borrowers Who
Would Have Been Eligible for a Private Market Loan
January 1998 - May 2000**



Note: Does not include loans from the Flexible Alternative or Virginia Housing Fund programs.

Source: JLARC staff analysis.

a private market loan. In addition, analysis of FHA Plus loans consisted of using a proxy measure for the borrower's ability to successfully make a three percent downpayment on a similarly valued property through the private market. If this measure exceeded the amount determined to be necessary to make a downpayment for a 30-year, fixed rate mortgage at a higher interest rate, the borrower was considered to be eligible for a loan through the private market.

Several private lenders that originate VHDA loans told JLARC staff that they make no effort to verify whether a borrower would qualify for a loan through the private market, despite the fact that they must sign a certification stating that the borrower was unable to obtain a private market loan under reasonably equivalent terms. According to an assistant director of single family programs, VHDA does not perform any independent verification of the originator's certification because it is difficult for VHDA to determine whether the terms and conditions in the private market were equivalent to those offered by VHDA at the time of a loan's origination. As a result of this lack of eligibility screening, borrowers who otherwise would qualify for private market loans receive VHDA loans. In fact, most lenders contacted indicated that they view VHDA's products as just another available mortgage loan product. Lenders made the following statements:

VHDA is another tool we have based on a borrower's background.

* * *

It is almost certain that if an applicant qualifies for a VHDA loan, they will also qualify for a private market loan as well.

Other State Housing Agencies Provide Lower Interest Rates to Borrowers

Based on a JLARC staff survey of other state housing finance agencies, it appears that many of these agencies offer mortgage loan products that provide lower interest rates to borrowers. For this study, JLARC staff contacted 16 state housing finance authorities. Twelve of the 16 were selected based on their high loan production for 1997 and 1998 and two were selected because of their high financial ratings. JLARC staff also contacted the housing finance agencies in North Carolina and Maryland because of their proximity to Virginia.

This survey found that the majority of these housing finance agencies set the interest rate for their standard 30-year, fixed product at least one percent below the prevailing private market rate in contrast to VHDA, which sets its rate at only one-half percent below the market. It appears that only two of the 16 other state housing finance agencies (New Jersey and Pennsylvania) set their interest rate for their standard 30-year loan product as close to the market rate as VHDA.

In addition, one state surveyed has established a step-rate product that provides substantially more assistance to the first-time homebuyer than the VHDA step rate program. The South Dakota Housing Development Authority (SDHDA) has created a program using only tax-exempt bond proceeds that provides an initial rate that is currently two and one-half percent below the market rate in the first year. The interest rate increases by only one-half percent per year over the next four years and remains fixed in years five through 30. The initial interest rate is one-half to three-fourths percentage points lower than the initial VHDA step rate. In addition, the rate increases by only two percentage points over four years instead of over two years as does the VHDA step rate product. Moreover, the final rate for the life of the loan is approximately one-half percent below the market rate, in contrast to the VHDA step program final rate, which is the same as the private market rate. The South Dakota Housing Development Authority allocates 40 percent of its bond funds to this step rate program.

One of the primary factors enabling other states to set lower rates than VHDA is that they do less blending of tax-exempt and taxable bond proceeds. Housing finance agencies pay a lower yield on tax-exempt mortgage revenue bonds and therefore can loan the funds out at a rate substantially lower than the market. In contrast, VHDA blends a substantial amount of taxable bond funds, which have a higher yield, with tax-exempt bonds. This increases the pool of loanable funds but necessitates that VHDA set a higher interest rate on loans from these proceeds.

In addition to reduced interest rates, some states have structured their primary programs to provide more benefits to low income households. The California Housing Finance Authority (CHFA) recently established a split interest rate for its standard 30-year loan product. Under the California program, low income households qualify for a substantially lower interest rate than moderate income borrowers. While moderate income borrowers currently receive a rate between one quarter and three-eighths percent below the market rate, low income households receive a rate between

seven-eighths and one-and-one-quarter percent below the market rate. According to CHFA's single family program director, the goal of offering two separate rates is to get more low income households into single family homes. The North Carolina housing finance agency also occasionally provides a split rate product in order to target specific income levels for mortgage loans.

The state of Michigan has focused its entire single family program on assisting low income borrowers, which are households earning 80 percent or less of median income. The Michigan State Housing Development Authority (MSHDA) has established a maximum household gross income of 80 percent of median for its single family loan programs. According to the executive director, this is consistent with the state's philosophy to help the borrowers with lowest possible income. In fact, the average gross income for MSHDA borrowers was 60 percent of area median family income. The executive director stated that MSHDA has made a decision that it will not compete with the private market, and instead has focused on providing financing assistance to low income households that cannot be served by the private market. The agency's standard 30-year loan rate is generally set at one point below the market rate.

VHDA Needs to Re-examine Role of Single Family Loan Program

VHDA needs to reexamine its current single family loan philosophy that emphasizes volume of loan production over the affordability of the product offered. Greater focus needs to be given to fulfilling VHDA's mission to help those for whom purchasing a home otherwise would be unaffordable. The authority needs to focus on the development of loan products designed to provide greater assistance to low income households who are most in need of assistance.

VHDA Currently Focuses on Loan Production and Loan Profitability. Currently, VHDA appears to have prioritized volume of production and profitability and has not placed sufficient emphasis on providing affordable loans to low and moderate income households in Virginia. The authority's emphasis on loan production is clear in its strategic plan. The first strength listed in its "summary of strengths" is that over the last five years, the authority has "achieved record levels of single-family...loan production." The second strength listed states that in recent years VHDA has "regularly been first or second among state HFA's in our level of single family...lending."

VHDA clearly has been successful in meeting its goal to achieve a high level of loan production. In 1998, only California closed more single family loans.

VHDA Should Focus on New Loan Products for Low Income Households. VHDA needs to reexamine its current philosophy and approach in the single family loan program. As part of this assessment, VHDA should focus on the development of one or more loan products that are specifically designed to better serve low income households in need of assistance to finance their first home.

Presently, households with incomes between 60 and 80 percent of the area median family income have the same single family loan products available to them as moderate income households with incomes as high as 110 percent of AMFI. For a family of four in Richmond, 60 percent of median income is \$35,700 while 110 percent of median income is \$65,450. Families in the low income range obviously have a far greater need for meaningful mortgage assistance than moderate income households making substantially more income. Yet VHDA does not have a loan product that provides significant assistance to this income group.

VHDA should examine how it can better serve this low income group with its loan products. It should consider options such as lowering the rate on its standard insured loans or offering a more generous step rate program such as the step rate program in South Dakota. VHDA needs to set aside a substantial portion of its bond funds to finance products specifically targeted to low income borrowers.

Recommendation (1). The Virginia Housing Development Authority should conduct a review of the single family loan program to assess how the program can be improved to better meet VHDA's mission. VHDA should present its findings to the Board of Commissioners with recommended modifications.

Recommendation (2). The Virginia Housing Development Authority should develop one or more loan products targeted to low income households that provide substantially more assistance than financing provided by the private lending market.

III. Meeting State Low Income Housing Needs Through Multifamily Programs

As discussed in Chapter I, more than one-fourth of all families in Virginia live in housing that is unsafe, indecent, or unaffordable. VHDA was established in order to address such shortages of adequate housing for low and moderate income households in Virginia. In fact, according to VHDA, its mission is “to help our fellow Virginians obtain safe, sound and decent housing otherwise unaffordable to them.”

VHDA has financed the development of safe and decent multifamily housing in all regions of the State. Multifamily projects that receive financing from VHDA are subject to a rigorous underwriting process before a loan can be approved and then receive regular inspections from VHDA’s asset management staff through the length of the loan. This results in financially successful projects that maintain good physical quality. Multifamily projects that have received four percent federal low income tax credits, nine percent tax credits since 1995, or Virginia Housing Fund (VHF) loans have been developed in two-thirds of Virginia’s localities.

VHDA has also been successful in serving low and very low income households with its multifamily programs. The median incomes served by the projects to which VHDA has awarded tax credits and VHF loans fall into the very low income category, below 50 percent of area median family income. However, a JLARC staff analysis of the rents charged to tenants in VHDA-financed units revealed that VHDA’s multifamily programs fund housing that is not affordable for more than half of the low and very low income households that occupy these units.

While VHDA has financed multifamily projects in all regions of the State, the authority has not made a concerted effort to proactively target its programs to meet diverse regional housing needs. The specific types of housing needs in different regions of the State vary significantly. VHDA does not perform needs analyses before allocating multifamily loans or tax credits, and as a result, housing needs in some regions of the State are being met to a much greater extent than those of other areas. A JLARC staff analysis of multifamily loans and tax credits awarded relative to housing need found no apparent correlation between the amount of funds VHDA has distributed to each planning district and the incidence of unsafe, indecent, and unaffordable housing in each district. To better meet the housing needs of Virginia’s citizens, VHDA needs to perform a comprehensive analysis of housing needs across the State on a regular basis and proactively design its programs to meet these needs. In addition, statutory changes should be considered to ensure that there is a diverse geographic representation on VHDA’s Board of Commissioners. With more diverse representation on the Board, the Board would be better equipped to direct VHDA’s staff to more effectively plan, design, and administer its programs to meet housing needs across the State.

VHDA MULTIFAMILY PROGRAMS ARE WELL-MANAGED

VHDA appears to be successfully meeting the first three elements of its mission statement by providing financing for the development of safe, sound, and decent multifamily housing. The authority has a strong record of keeping the number of multifamily properties on which it must foreclose to a minimum. In addition, VHDA monitors the projects it finances regularly to ensure that they remain in good physical condition. VHDA also does a good job in reaching all regions of the State with its multifamily loan and tax credit programs.

Management of VHDA Multifamily Projects Appears Successful

Multifamily projects that receive loan financing from VHDA are subject to a rigorous underwriting process, which includes site and market analyses and an analysis of the economic feasibility of the projects. A VHDA staff architect also reviews preliminary drawings, specifications, and site plans. Once a project has been approved, VHDA's multifamily asset management division monitors the project's success through regular inspections. Properties receive one or two physical inspections annually, as well as one management and marketing review which looks at aspects of each project such as staffing, vacancy rates, rent delinquencies, maintenance programs, and project finances. In addition, properties are inspected annually for compliance with federal and VHDA rules. Multifamily asset management staff also review property budgets and monthly operating expenses.

This extensive review to which each project financed by VHDA is subject results in projects that are financially stable. Since VHDA began using the proceeds of bond issues for multifamily programs, the authority has had to take severe financial action with only five multifamily properties: one was acquired by the authority through foreclosure; one was acquired by VHDA by deed in lieu of foreclosure; and three FHA-insured mortgage loans were assigned to HUD. This strong financial track record also applies to projects funded with Virginia Housing Fund loans. According to the assistant director of multifamily asset management, VHDA has not had serious financial problems with any VHF loans.

Not only is VHDA successful at ensuring the financial stability of the projects it finances, the authority also appears to be successful in maintaining the physical quality of its properties. Each multifamily property receives two physical inspections annually, unless a project is exempted specifically from the second physical inspection due to its previous success. The physical inspections consist of a review of up to ten vacant units within a property, as well as a review of the property's grounds. If problems are found requiring immediate attention, these deficiencies must be corrected within 30 days. All other problems must be corrected within a six-month period.

Through interviews with persons involved in affordable housing around the State, JLARC staff have been told that VHDA's physical oversight procedures have

been successful and that VHDA does a good job looking after its property portfolio. In its January 2000 analysis of VHDA's bond issues, Moody's Investors Service praised the authority's multifamily asset management activities. Moody's cited the low delinquency and foreclosure rates on projects financed by proceeds of Multifamily Housing Bonds as evidence of "VHDA's commitment and superior capabilities in underwriting and asset management."

Multifamily Loans Are Distributed to All Regions of the State

Through its multifamily division, VHDA awards bond-financed loans, loans from its general fund, and federal low income tax credits to developers to build rental housing for low and moderate income households. JLARC staff performed an analysis of the geographic distribution of these programs and found that multifamily projects have been developed in 83 of Virginia's 135 localities with financing from one of the following sources: four percent low-income tax credits, nine percent tax credits since 1995 (the year VHDA most recently gained administrative responsibility over this program), or the Virginia Housing Fund. At least one project has been developed from one of these funding sources in every planning district. However, more than 35 percent of Virginia's localities have not received financing from any of these sources to develop multifamily projects.

Tax Credit Projects Are Representative of Projects Financed with VHDA Loans. JLARC staff conducted analyses of the geographic distribution of VHDA's multifamily programs, the income levels served by these products, and the affordability of VHDA projects. In some cases, projects with city mailing addresses were considered to be located within that city for a geographic analysis, but may actually be located in a surrounding county. Based on the availability of tenant data, as well as overlaps between the recipients of VHDA's different multifamily financing programs, JLARC staff reviewed data available on: (1) each project which has received nine percent federal low income tax credits since 1995 (the year VHDA most recently gained administrative responsibilities over this program), (2) all projects which have received four percent federal low income tax credits, and (3) all projects funded with loans from the Virginia Housing Fund.

As discussed in Chapter I, there are two main types of multifamily loans offered by VHDA, for which funds are raised through VHDA's issuance of either taxable or tax-exempt bonds. Multifamily loans raised from the issuance of taxable bonds often are combined with the nine percent federal low income tax credits. These nine percent tax credits are available to developers on a competitive basis and then are sold to private investors to raise equity for a project. Sixty-seven percent of all projects funded with loans from taxable bonds since 1995 have also received nine percent tax credits. Therefore, the more extensive tenant data available for the nine percent tax credit projects was considered to be representative of the taxable bond-financed loan program.

In addition to providing loans from the issuance of taxable bonds, VHDA provides loans with funds from its issuance of tax-exempt Alternative Minimum Tax (AMT)

bonds. Because the interest on these bonds is exempt from federal income taxes, VHDA pays a lower rate on these bonds to investors. Often, VHDA blends funds from the sale of taxable and tax-exempt bonds to spread the amount of loanable funds raised from the sale of tax-exempt bonds among more properties. In most cases, at least 50 percent of the financing projects receive from these blended loans is from tax-exempt bonds. If this is the case, then the projects also usually qualify for a four percent federal low income tax credit. These tax credits also allow developers to raise equity for their projects. Ninety percent of all projects ever funded with loans from AMT tax-exempt bonds have received four percent tax credits. Therefore, the data from the four percent tax credit analysis was considered to be representative of the tax-exempt bond-financed loan program.

JLARC staff also included in its analysis all available data for Virginia Housing Fund multifamily projects. As discussed in Chapter I, the VHF was established in 1987 to better meet affordable housing needs in hard-to-serve situations or locations. The VHF has been capitalized from net revenues generated from other VHDA programs. Of the \$20 million VHDA has allocated annually in recent years, approximately \$7 million has been allocated each year to multifamily projects. These loans generally are restricted to non-profit, minority, and rural developers and may not exceed \$750,000. Some of these loans are used in conjunction with other VHDA financing programs as a layered subsidy. Many of the VHF projects are small and serve transient special needs populations. As a result, tenant data for some VHF projects was not available for JLARC staff analysis.

Nine Percent Tax Credits Are Distributed to Most State Planning Districts. Nine percent tax credits are awarded to multifamily developers on a competitive basis. Each year, VHDA develops a State qualified allocation plan for the federal low income tax credit program that establishes requirements for developers seeking these funds and sets forth the authority's priorities for the allocation of the tax credits available to the State. Applications for tax credits are submitted within specific allocation pools, which are designed to be reflective of the State's housing priorities as part of the State's qualified allocation plan. VHDA assigns point values to elements of the applicant projects, and only those projects for which the point total exceeds a threshold score are considered for a tax credit award.

For the 2000 competition, VHDA will award tax credits within a non-profit developer pool, a local housing authority pool, an at-large pool, and five geographic pools. Currently these geographic pools are divided as follows: a Northern Virginia pool (in 1999, there were two distinct Northern Virginia pools; these were merged for the 2000 competition), a Richmond Metropolitan Statistical Area (MSA) pool, a Tidewater MSA pool, a small MSA pool (for projects in smaller urban localities), and a rural pool. The credit dollars available for each geographic pool in the 2000 competition were determined based on the number of households in each pool area earning below the tax credit low income ceiling of 60 percent of AMFI, less the number of tax credit units that have already been produced in that pool area.

Based on these qualified allocation plan pools, tax credits have been allocated for projects in all but one planning district since VHDA became responsible for the nine

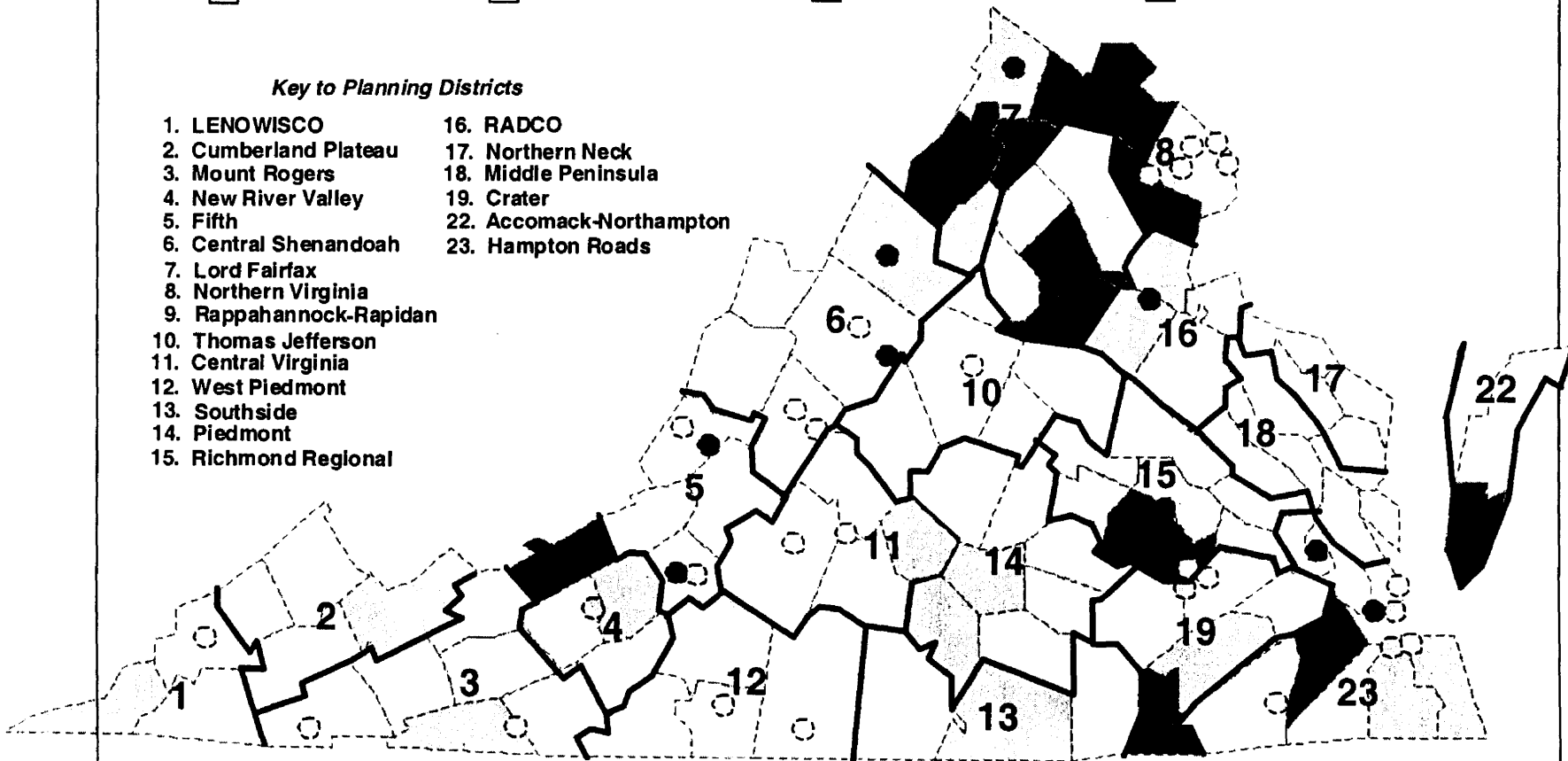
Figure 8

Nine Percent Tax Credits Per Household

Localities with Zero Lowest Third (1.5 to 13.4) Middle Third (14.3 to 29.4) Highest Third (30.4 to 431.1)

Key to Planning Districts

- | | |
|-------------------------|--------------------------|
| 1. LENOWISCO | 16. RADCO |
| 2. Cumberland Plateau | 17. Northern Neck |
| 3. Mount Rogers | 18. Middle Peninsula |
| 4. New River Valley | 19. Crater |
| 5. Fifth | 22. Accomack-Northampton |
| 6. Central Shenandoah | 23. Hampton Roads |
| 7. Lord Fairfax | |
| 8. Northern Virginia | |
| 9. Rappahannock-Rapidan | |
| 10. Thomas Jefferson | |
| 11. Central Virginia | |
| 12. West Piedmont | |
| 13. Southside | |
| 14. Piedmont | |
| 15. Richmond Regional | |



Source: JLARC staff analysis of VHDA data.

percent federal low income tax credit program in 1995. Figure 8 shows the distribution of nine percent tax credits (standardized per household) in each locality, based on the first year credit allocation amount. (As discussed in Chapter 1, this amount differs from the actual amount of tax credit funds received by projects in each locality because developers receive the full tax credit amount annually for ten years. These credits are then sold to private investors to raise equity for a project at a rate of as much as 70 percent of the credit amount.)

For localities which have been the beneficiaries of nine percent tax credits, the number of credits awarded per household ranges from a low of \$1.51 in Fauquier County to a high of \$431.10 in Fredericksburg. Only six localities have received more than \$100 in credits per household. The amount of tax credit dollars awarded to projects in Fredericksburg is much greater than in any other locality — Fredericksburg is the only locality that has received more than \$200 in nine percent credits per household since 1995.

Properties Financed by Tax-Exempt Bonds with Four Percent Tax Credits Are Limited to Few Regions of the State. Four percent tax credits are currently awarded by VHDA to developers on a first-come, first-serve basis. A project is not eligible for four percent tax credits unless at least 50 percent of its financing is from tax-exempt bonds. As a result, the availability of four percent tax credits is limited not by the amount of tax credits, but by the federal bond cap placed on tax-exempt bonds available to Virginia. Currently, the demand for tax-exempt bonds is greater than the amount of tax-exempt bonds available to Virginia for housing, so VHDA is considering instituting a plan for the allocation of loans financed by tax-exempt bonds. However, there are no geographical requirements associated with the allocation of these loans or the corresponding credits at this time.

As shown in Figure 9, only 26 of the localities in Virginia have received four percent tax credits. Projects that use four percent tax credits are generally located in the more urban localities of the State, including Northern Virginia, the Richmond metropolitan area, and Tidewater. The amount of credit dollars per household in localities that are home to projects that have received four percent tax credits ranges from \$1.73 in Chesterfield County to \$422.10 in Falls Church. Falls Church and Fredericksburg are the only two localities that have received more than \$100 per household in four percent tax credits.

Interviews with VHDA staff and several for-profit developers yielded some explanation for the limited number of localities that have received four percent tax credits. According to the VHDA development officer overseeing the tax credit program, multifamily projects financed by loans from a combination of tax-exempt bond funds and four percent tax credits are generally feasible only in large metropolitan areas. Instead, developers in non-urban areas generally use a combination of loans from taxable bond financing and the nine percent tax credits. In these non-urban areas, where lower incomes result in the need to provide lower rents, the difference in interest rates between the taxable bond-financed loans and the rates offered by VHDA for tax-ex-

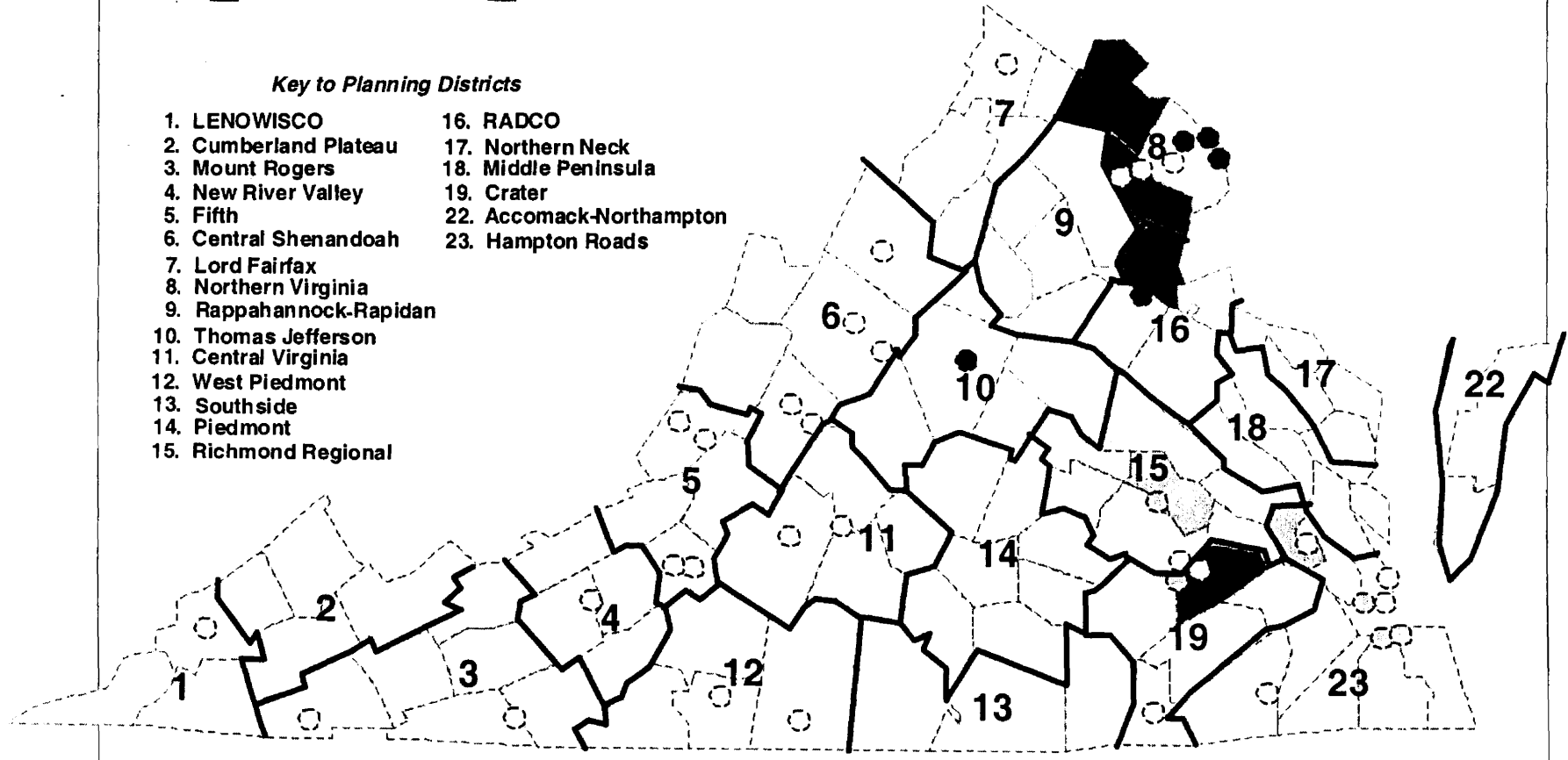
Figure 9

Four Percent Tax Credits Per Household

Localities with Zero
 Lowest Third (1.7 to 10.0)
 Middle Third (11.3 to 21.6)
 Highest Third (28.1 to 422.1)

Key to Planning Districts

- | | |
|-------------------------|--------------------------|
| 1. LENOWISCO | 16. RADCO |
| 2. Cumberland Plateau | 17. Northern Neck |
| 3. Mount Rogers | 18. Middle Peninsula |
| 4. New River Valley | 19. Crater |
| 5. Fifth | 22. Accomack-Northampton |
| 6. Central Shenandoah | 23. Hampton Roads |
| 7. Lord Fairfax | |
| 8. Northern Virginia | |
| 9. Rappahannock-Rapidan | |
| 10. Thomas Jefferson | |
| 11. Central Virginia | |
| 12. West Piedmont | |
| 13. Southside | |
| 14. Piedmont | |
| 15. Richmond Regional | |



Source: JLARC staff analysis of VHDA data.

empt bond financed loans does not make up for the smaller amount of equity that is earned by four percent tax credits as compared to nine percent tax credits. The lower rents do not provide sufficient cash flow for developers to repay the loans they could obtain using tax-exempt bond funds.

Properties in Each Planning District Have Received VHF Loans. Loans from the Virginia Housing Fund are allocated based on one of three criteria – a non-profit developer, a minority developer, or the development must be located in a rural area. These three criteria were developed so that VHF loans could be used to provide loans to persons or areas that otherwise might not benefit from VHDA's multifamily programs. VHF loans also have been used to provide housing for special needs populations, such as transitional housing and housing for mentally disabled persons, that often are not otherwise served by VHDA's traditional loan programs. In addition, due to a \$750,000 cap VHDA places on the amount of each VHF loan, the Housing Fund tends to support smaller projects than those funded through bond-financed loans.

Figure 10 shows the amount of VHF loan dollars received per household in each Virginia locality. VHF loans have gone to projects in each planning district and to projects in 57 localities. Of those localities in which projects have received VHF loans, the amount of VHF dollars per household that has been awarded ranges from \$0.79 in Accomack County to \$337.61 for Fredericksburg.

VHDA MULTIFAMILY PROGRAMS SERVE LOW AND VERY LOW INCOME HOUSEHOLDS, BUT ITS POLICIES DO NOT ADEQUATELY PROMOTE AFFORDABLE HOUSING

Using the same methodology described for the geographic distribution analysis, JLARC staff also performed analyses of the income levels served by VHDA's multifamily programs and the affordability of projects that have been financed by VHDA. Although a number of interviews with VHDA staff and stakeholders around the State indicated a belief that most households served by the tax credit programs earn between 50 and 60 percent of AMFI, JLARC staff found that the median income served by these projects is slightly below 50 percent of AMFI. In fact, in the areas of the State where multifamily projects have been financed, incomes ranging from poverty level through low income have been served.

While VHDA effectively targets low and very low income households with its programs, the projects it finances are not affordable to many tenants. Section 36-55.25 of the *Code of Virginia* states that VHDA was established "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 [of low and moderate income] can afford." However, the majority of households in units financed by VHDA pay more than the generally accepted housing payment standard for their rents.

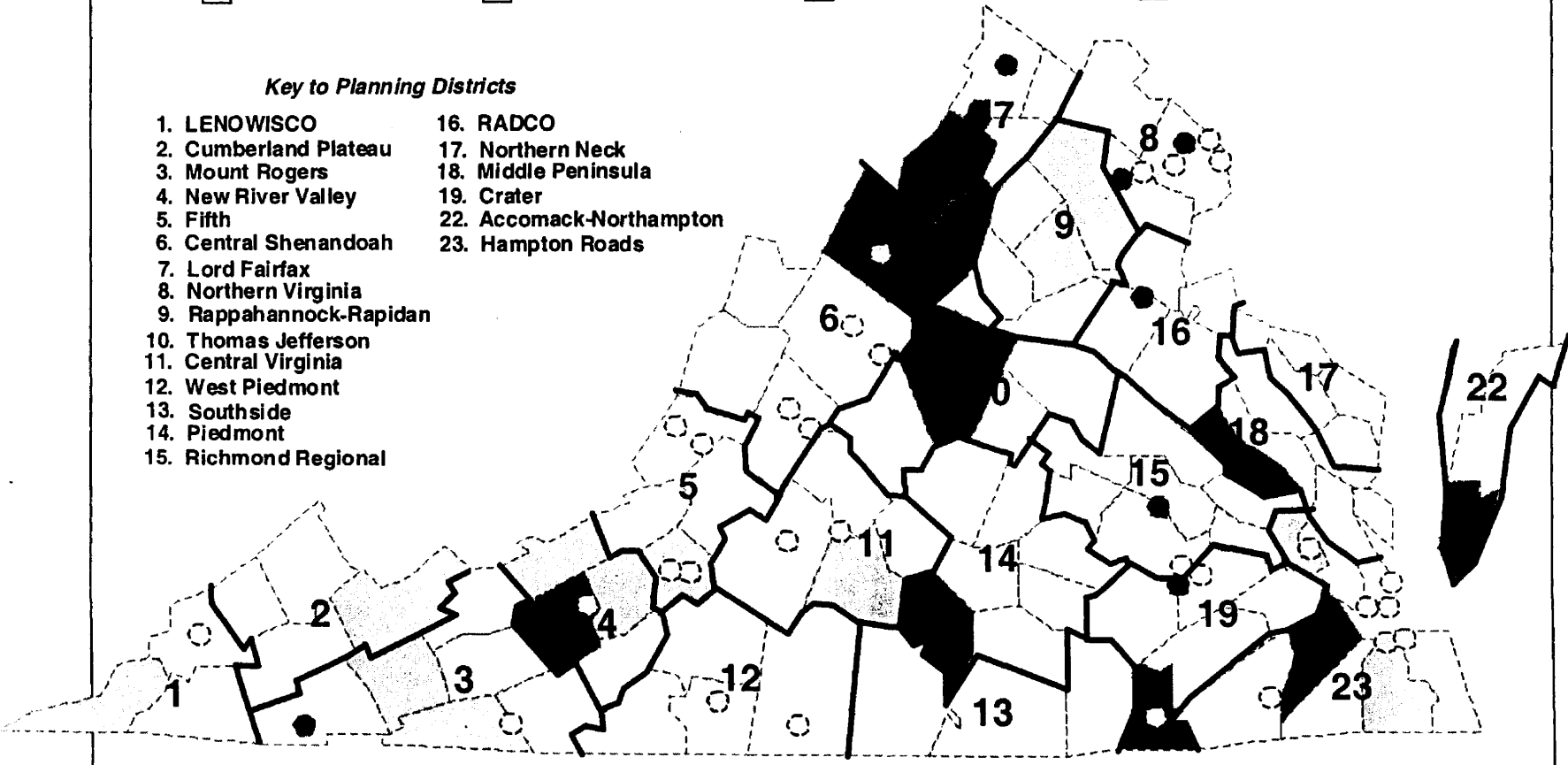
Figure 10

VHF Dollars Per Household

Localities with Zero
 Lowest Third (0.8 to 23.4)
 Middle Third (27.5 to 98.9)
 Highest Third (98.9 to 337.6)

Key to Planning Districts

- | | |
|-------------------------|--------------------------|
| 1. LENOWISCO | 16. RADCO |
| 2. Cumberland Plateau | 17. Northern Neck |
| 3. Mount Rogers | 18. Middle Peninsula |
| 4. New River Valley | 19. Crater |
| 5. Fifth | 22. Accomack-Northampton |
| 6. Central Shenandoah | 23. Hampton Roads |
| 7. Lord Fairfax | |
| 8. Northern Virginia | |
| 9. Rappahannock-Rapidan | |
| 10. Thomas Jefferson | |
| 11. Central Virginia | |
| 12. West Piedmont | |
| 13. Southside | |
| 14. Piedmont | |
| 15. Richmond Regional | |

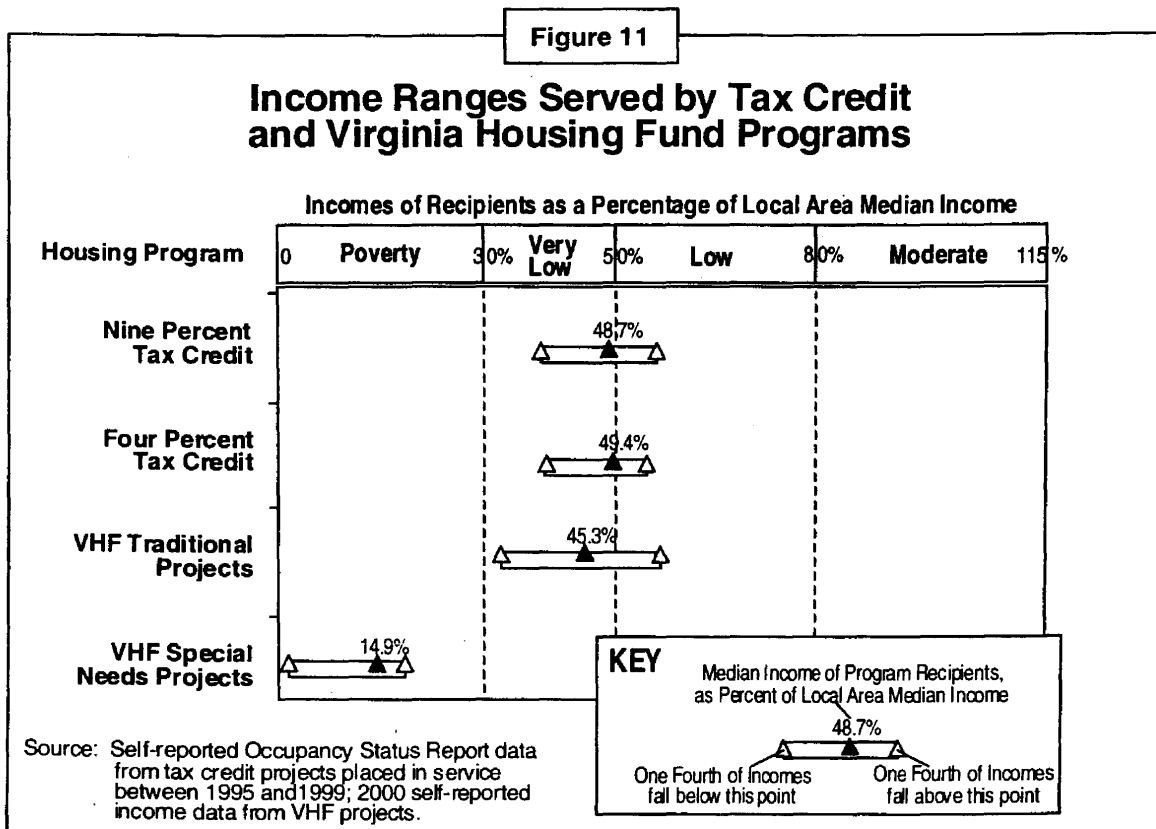


Source: JLARC staff analysis of VHDA data.

Multifamily Programs Effectively Target Low and Very Low Income Households

In a number of interviews with VHDA staff and with stakeholders across Virginia, JLARC staff were told that the majority of persons served by the tax credit programs administered by VHDA had “low incomes” between 50 and 60 percent of AMFI. A review of the incomes in tax credit projects shows that this is not the case. Instead, the median percentages of the area median income served by both the four percent and nine percent tax credit programs are below 50 percent and fall into the “very low” income category. VHF loans that provide family and elderly housing serve a slightly lower percentage of median income than the tax credit programs and reach a greater percentage of very low income persons. VHF loans that target special needs projects serve a substantially lower income group, with household incomes generally falling below the poverty level. Figure 11 shows the middle range of incomes served by each of these programs.

Nine Percent Tax Credit Program Serves Tenants with 48.7 Percent of Area Median Income. In order to assess the income levels served by projects funded by nine percent tax credits, which often were also financed by VHDA taxable bond-financed loans, JLARC staff reviewed the move-in incomes of tenants in the initial occupancy year of each tax credit project which began collecting tax credits (or was “placed in service”) between 1995 and 1999. Incomes were available for 10,218 households in units subject to tax credit requirements. These incomes were evaluated rela-



tive to the median income in the area in which each project was located for the year in which each household moved into the unit.

Before applying for tax credits, a developer must commit to having at least 40 percent of the tenants in a project earn 60 percent or less of AMFI or to having at least 20 percent of the tenants in a project earn 50 percent or less of AMFI. As a result, incomes in units subject to tax credit requirements generally do not exceed 60 percent of the area median income. The majority of tax credit developers appear to select the 60 percent standard. Often, developers choose to earn tax credits on all of a project's units and commit to having 100 percent of the tenants in their projects earn less than 60 percent of AMFI.

Based on the tax credit program requirements, the incomes in these projects could be clustered close to 60 percent of AMFI. However, they actually serve a lower income group. The median income of the households in these nine percent tax credit projects is 48.7 percent of AMFI. About one-fourth of households in nine percent tax credit projects earn less than 38.6 percent of the area median income.

JLARC's analysis of incomes in nine percent developments also revealed a difference in the incomes served in projects developed by for-profit developers, non-profit developers, and housing authorities. While the median income served by all three types of developers falls into the "very low" income category, for-profits serve a noticeably higher income level, although many more households are served by these for-profit developers. The median income of households in for-profit developments is 49.7 percent of AMFI, while the median income for households served by housing authorities is 37.1 percent of AMFI, and the median income for households in non-profit developments is 36 percent of AMFI.

Four Percent Tax Credit Program Serves Tenants with 49.4 Percent of Area Median Income. JLARC staff used the same methodology for calculating the incomes served by four percent tax credits as for nine percent tax credits. Income data were available for 6,127 households subject to tax credit requirements. Projects receiving four percent tax credits and loans financed by tax-exempt bonds are subject to the same low income ceilings as projects receiving nine percent tax credits. As a result, incomes in tax credit qualified units are generally below 60 percent of AMFI.

Projects receiving four percent tax credits also serve both low and very low income households. The median income of households in four percent tax credit projects is 49.4 percent of AMFI. One-fourth of the residents of these projects have incomes below 39 percent of AMFI.

Most projects that have received four percent tax credits have been developed by for-profit developers. However, even with only a few projects that have been developed by non-profits or housing authorities, the differences in incomes served by these different types of developers are noticeable. The median income of households in the for-profit developments is 49.8 percent of AMFI, whereas the median income in housing authority projects is 32.7 percent of AMFI and is 35.8 percent in non-profit developments.

Properties with VHF Financing Appear to Serve Low and Very Low Income Households. There is no low-income requirement for tenants in VHF-financed projects. The only income requirement is that household income may not exceed 150 percent of the area median income. However, the limitations on the size of VHF loans and the limitations on recipients of these loans generally result in these projects serving the lowest income populations.

VHDA was not able to provide JLARC staff with data on all VHF projects. However, based on data available for 118 units in special needs projects, which provide housing such as transitional shelters and housing for the mentally disabled, these projects were found to serve a median income of 14.4 percent of AMFI. One-fourth of the residents in these projects have no income. Data was available for 1,995 units in traditional VHF projects, which serve families and elderly households (some of which are also tax credit projects). These projects serve a median income of 44.8 percent of AMFI. The incomes served by these projects are similar to those served by the tax credit programs, but these projects reach a greater percentage of very low income persons.

Rents Charged for VHDA-Financed Units Create Cost Burden for Some Low and Very Low Income Households

Section 36-55.25 of the *Code of Virginia* contemplates that VHDA would address the shortage of sanitary and safe residential housing in Virginia and would provide this housing to low and moderate income households. As described in the previous sections of this chapter, VHDA's recent multifamily programs have had some success in both of these areas. VHDA has both increased the supply of multifamily housing in all regions of the State and has been effective in targeting persons of low and very low income through its multifamily programs. However, the *Code of Virginia* also calls for VHDA to provide "residential housing at prices or rentals which persons and families of low and moderate income can afford." In this respect, VHDA's multifamily programs have not been as successful. More than half of the residents of tax credit projects that are also supported by VHDA loan financing face a significant cost burden by having to pay rents that are more than 30 percent of their incomes.

Payment Standard for Affordable Housing Is 30 Percent or Below of Annual Income. The generally accepted standard for housing affordability is that housing costs should not exceed 30 percent of a household's income. Housing costs for this calculation include either rent or mortgage payments, as well as the cost of utilities. If housing costs exceed 30 percent, they are considered to be burdensome, and families generally have to reduce consumption of other necessary items in order to pay their housing expenses. This 30 percent standard is used both in housing research and in the implementation of rental assistance programs such as Section 8. Both the Virginia Center for Housing Research cost burden study and the National Low Income Housing Coalition rental affordability study discussed in Chapter I use housing costs of 30 percent of household income as their ceilings for rent affordability. The Section 8 certificate and voucher programs use 30 percent of household income as the maximum amount a household receiving Section 8 support is required to pay in housing costs.

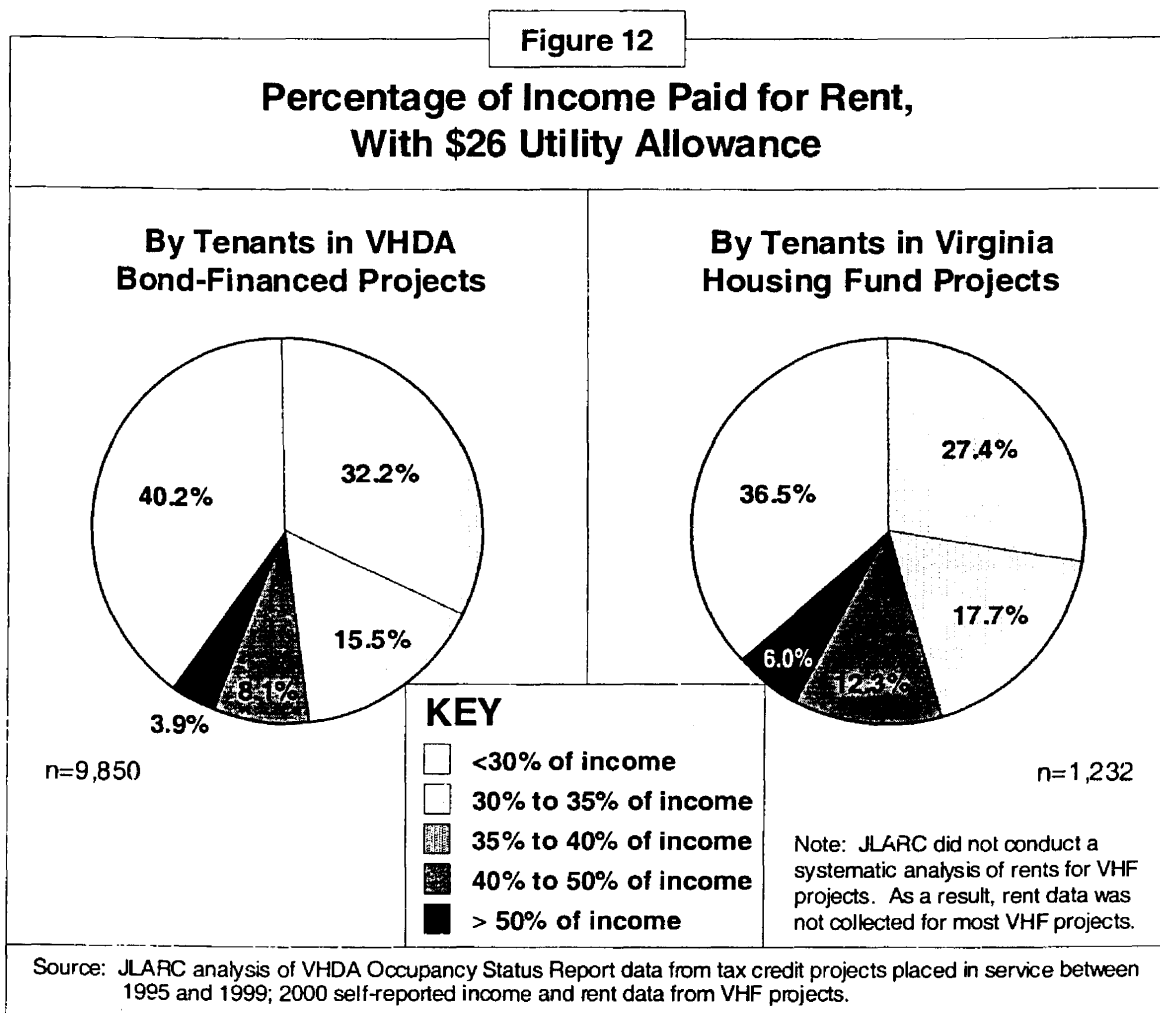
Majority of Tenants in VHDA Bond-Financed Units Face Housing Cost Burdens. To conduct an analysis of the housing burdens on tenants of VHDA-financed projects, JLARC staff restricted the data set used in the previous analyses to include only those tax credit projects which also have received loan financing from VHDA. Tenants in these projects receiving rental assistance from other sources, such as Section 8, were excluded from this analysis. JLARC's analysis of the affordability of VHDA-financed properties found that more than 51 percent of the households reviewed paid more than 30 percent of their incomes for rent to live in these properties. This percentage does not include the utility allowances that are generally included in the calculation of rent burden. While JLARC staff did not include full utility allowances in the calculation of rent burden, an estimation of the impact of utility costs has been conducted as part of this analysis. The lowest utility allowance for any unit included in this analysis was \$26 per month; the highest utility allowance was \$169 per month. These two allowance amounts have been used to develop a range of cost burdens faced by tenants of VHDA bond-financed units. Most utility allowances in VHDA units included in this analysis appear to fall closer to the middle of this range.

As Figure 12 shows, with a conservative utility allowance estimate of \$26, 59.8 percent of VHDA tenants pay more than the generally accepted payment standard for housing. Using the high-end utility allowance figure, 88.7 percent of VHDA tenants would pay more than 30 percent of their incomes for housing. The proportion of tenants paying more than 35 percent is between 27.5 and 69.2 percent, depending on the amount of the utility allowance. Between 12.0 and 42.9 percent of VHDA tenants pay more than 40 percent of their incomes for rent and utilities. In several instances, households are being charged amounts for rents and utilities that are higher than their incomes.

Tenants in VHF Projects Also Appear to Face Housing Cost Burden. While JLARC staff did not conduct a systematic analysis of the rents in VHF projects, rent burdens also appear to exist for tenants of these properties. Based on data available for 1,232 Virginia Housing Fund family and elderly units, 54.8 percent of households pay more than 30 percent of their incomes for rent alone. Incorporating the same range of utility allowances into this analysis shows that between 63.5 percent and 90.8 percent of VHF tenants pay more than 30 percent of their incomes for rent and utilities. Between 36 and 77.1 percent of the households in VHF properties face a housing cost burden of more than 35 percent of their incomes. The proportion of VHF tenants paying more than 40 percent of their incomes is between 18.3 and 56.9 percent, depending on the amount of the utility allowance. As with the properties supported by VHDA's bond financing, some households in these projects are being charged amounts for rents and utilities that are higher than their incomes.

VHDA Policies Do Not Encourage Affordable Rent Levels

While VHDA appears to successfully monitor tax credit projects to ensure that the rents in these projects meet federal low income tax credit program requirements, VHDA does not make any additional effort to encourage affordable rents for



these projects or for projects that it finances. VHDA loans with low income requirements have rent ceilings like those of the tax credit program, but there are no restrictions on project rents for VHDA loans without low income requirements, such as loans financed with taxable bonds and Virginia Housing Fund loans. For none of VHDA's multifamily projects are rents based on the actual household incomes of the projects' tenants. VHDA should reevaluate the processes by which rents are set for projects it finances.

Federally-Set Maximum Rent Levels Are Enforced for Tax Credit Projects. Federally-set maximum rent limits for projects that receive federal low income tax credits are based on a calculation of the number of bedrooms in each unit and a calculation of 30 percent of the maximum income limit permitted in a tax credit project. For example, if a development company elects to meet the occupancy requirement that 40 percent of its tenants be at or below 60 percent of area median income, then the maximum annual rent for each tax credit unit would be set at 30 percent of the income at 60 percent of AMFI, after the AMFI has been adjusted for number of

bedrooms in the unit. As a result, rents in these projects are not linked to the actual incomes of tenants living within the projects. The only income population for which rents in these projects are affordable are those close to the maximum income limit for each project. Projects that are financed by VHDA and which receive tax credits through VHDA serve households below the maximum income limit, but without lowered rents for lower income tenants, housing for these tenants is unaffordable, based on the 30 percent payment standard.

VHDA Loans with Low Income Requirements Have Maximum Rent Ceilings. VHDA loans that have specific requirements that a project include a percentage of low income tenants generally have maximum rent ceilings, although rents in these projects are not subject to review by VHDA staff. Tax-exempt projects have similar maximum rent ceilings as tax credit projects. Projects that have a requirement that 20 percent of the units be occupied by tenants with incomes below 80 percent of median income (known as "20/80 projects," a type of VHDA financing more common in the late 1980s and early 1990s) had a more stringent rent requirement in the program's early years, which has since been relaxed. A regulatory agreement between VHDA and a developer of a 20/80 project from 1992 stated, "If the rent, plus the cost of utilities (except telephone) as determined by the authority, for any unit subject to the income limit . . . would exceed twenty four (24%) percent of the median gross income for the area, such rent may not be established or charged without the prior written approval of the Authority." However, in 1998 VHDA informed owners of the 20/80 projects that they no longer needed to obtain prior approval from VHDA for changes in rent. According to VHDA's assistant director of multifamily asset management, VHDA currently only reviews rent increases for federally subsidized projects, such as Section 8 projects. In fact, the assistant director of multifamily asset management told JLARC staff that VHDA does not have the authority to make decisions about the rents of projects it finances and therefore may only provide advice to project owners on the effect of rent changes on project feasibility. This appears to be a self-imposed restriction that could easily be modified.

Remainder of VHDA Loans Have No Rent Requirements. There are no limitations on the rents that may be charged for all projects that do not have low income requirements, such as loans financed with taxable bonds and VHF loans, as well as units in tax-exempt projects which have not been set aside for low income persons. According to VHDA's assistant director of multifamily asset management, the only restrictions on rents for these projects are dictated by the market.

VHDA Should Encourage More Affordable Rents. Despite the large number of housing units produced around the State by VHDA and the array of incomes served by VHDA's programs, the authority currently is not providing affordable housing to many of the tenants it serves. The majority of tenants in VHDA projects pay rents that are above the generally accepted standard for rent affordability. VHDA only performs analyses of rents charged by its projects in terms of the effect of rent rates on project feasibility. No analyses are performed by VHDA as to the affordability of project rents for the low and very low income tenants who occupy these projects. While bonus

points are available to nine-percent tax credit project developers that impose lower rent limits, VHDA does not encourage developers of the projects it finances to lower rents to a level that would be affordable to more tenants.

In order to succeed in meeting its statutory mission to provide affordable housing, VHDA should reevaluate the processes by which rents are set for projects it finances. In addition, VHDA should reinstate the processes by which it reviewed rent increases to ensure that they remained reasonable and affordable. In notifying owners of 20/80 projects in 1998 that they no longer needed to obtain VHDA's approval for changes in rent, VHDA explained that this change was "intended to reduce the regulatory burden on our customers." While VHDA certainly has to ensure that developers receive a sufficient revenue through rents to make projects feasible, it also has an obligation to make the housing it finances affordable to the extent reasonably practicable. VHDA also should evaluate whether it has financial resources that it could use to provide incentives to developers for the provision of more affordable rents for the lower income households they are serving. Possible incentives may include further lowering interest rates or providing additional equity to developers through second mortgages.

Recommendation (3). VHDA should conduct a fundamental review of the processes by which rents are set for the projects it finances. In addition, VHDA should evaluate how it could provide incentives to developers to provide more affordable rents. Options that should be considered include further lowering interest rates on VHDA financing and providing additional equity to developers through second mortgages.

MULTIFAMILY FINANCING DOES NOT ADEQUATELY ADDRESS STATE HOUSING NEEDS

While projects that have received financial support from VHDA are located in all regions of the State, VHDA has not proactively sought to match its financing to housing needs across the State. VHDA has not conducted an analysis of what specific housing needs exist across the State and how it can best meet these needs through its programs. This is reflected in the distribution of VHDA dollars relative to the incidence of housing problems in each planning district. In order to best work towards the elimination of substandard living conditions in Virginia, VHDA should take into account the housing needs in each locality in designing its programs and in awarding project financing.

VHDA Does Not Perform Needs Analyses Before Awarding Funds

Most of the funds available through VHDA for multifamily projects are awarded on a first-come, first-serve basis. As long as funds are available, if a project meets the appropriate underwriting criteria for bond-financed programs, four percent tax cred-

its, or Virginia Housing Fund monies, then the project will receive a loan. For both bond-financed programs and four percent tax credits, these funds are awarded regardless of where the project is located or its target audience, except for any income requirements. Project location is a factor only to the extent that it affects the market for potential tenants. In the case of tax-exempt bonds, these funds are particularly limited – by the fall of 1999, the entire 2000 tax-exempt bond cap for housing had already been allocated. Hoping to meet the demand for tax-exempt bond-financed loans, VHDA staff have been working with the National Council of State Housing Agencies and members of Congress to raise the cap on tax-exempt bonds.

While loans from the Virginia Housing Fund are also awarded on a first-come, first-serve basis to projects that meet the program's underwriting criteria, they are limited to minority developers, non-profit developers, and projects located in rural areas. These three categories were chosen with the intention of meeting affordable housing needs that were not being met by VHDA's other housing programs. However, these categories were based on an analysis of the projects that had been served by other VHDA multifamily programs, rather than a comprehensive assessment of the housing needs that most needed to be addressed across the State.

As with loans financed by tax-exempt bonds, the demand for nine percent tax credits exceeds the available supply of credits. For the year 2000 tax credit competition, \$2.18 have been requested for every \$1.00 available. These nine percent tax credits are allocated on a competitive basis within five geographic pools, a non-profit developer pool, a local housing authority pool, and an at-large pool. These pools were designed to encourage the development of projects in different areas of the State, as well as to support the differing housing foci of non-profit developers and housing authorities. The size of these geographic pools is determined on the basis of the number of qualified income households, less the number of units within each pool that have been supported in previous years by nine percent tax credits. In addition, some points are awarded in the nine percent tax credit competition for projects which help meet a locality's housing needs and priorities, as well as for projects located in revitalization areas and for projects which give leasing preference to tenants on public housing or Section 8 waiting lists. While this current method of determining the size of the geographic pools begins to take into account housing need by awarding additional credits to areas that have not received as much tax credit support in previous years, the actual housing need within these geographic areas is not considered. In particular, several of the geographic pools, such as the pool for small MSAs and the rural pool, include a large number of localities from all over the State that present very different housing needs. Also, while the pool size takes into account previous nine percent tax credit support, it does not take into account the level of funding that has been received by particular regions from any other funding sources.

The only comprehensive analysis of needs in Virginia that VHDA has performed in recent years is an analysis of population growth in the State and how its funds have been allocated relative to growth. Based on this analysis, VHDA's loans appear to be following the pattern of growth in the State. Consistent with this, the director of multifamily programs told JLARC staff that he "would prefer the market

control distribution of the products, at least on the bond side.” However, as a State entity created to address the need for affordable housing across the State, the allocation of VHDA funds should be allocated not on the basis of population growth, but instead on the basis of the need for affordable housing.

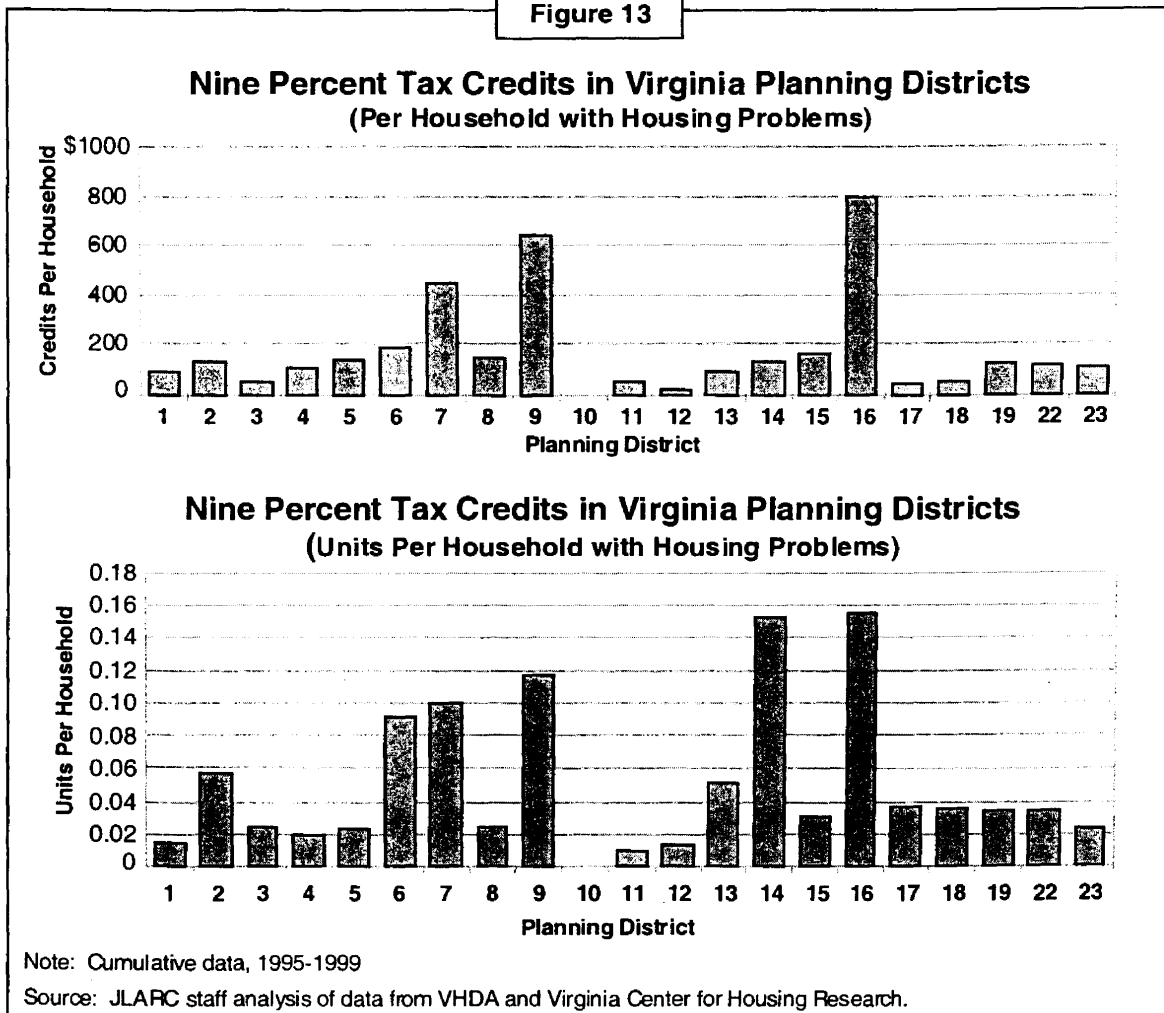
Distribution of Loans and Tax Credits Does Not Appear to Reflect Virginia Housing Needs

JLARC staff performed an analysis of multifamily loans and tax credits awarded to each planning district relative to the incidence of housing problems within each district. JLARC staff applied the same methodology to this analysis that was used in the geographical distribution analysis earlier in this chapter. Specifically, the distribution of tax credit projects was considered to be reflective of the distribution of bond-financed loans. While a complete analysis of both loan dollars and credits that have been awarded to projects in each planning district would show higher dollar per household amounts, JLARC staff expect that the relative distribution of dollars across planning districts would remain similar to the distribution presented here. Based on Virginia Center for Housing Research data, JLARC staff evaluated the amount of credits or loan dollars, as well as the number of units, awarded to each planning district. To standardize the data for analysis, the amounts were calculated per household with housing problems. Housing problems refer to a lack of complete plumbing, a lack of a complete kitchen, overcrowding, or a cost burden more than 30 percent of a household’s income. The most prevalent of these factors in Virginia is cost burden. The results of this analysis are presented in Figures 13 through 15.

If VHDA funding took into account the incidence of housing problems within each planning district, the bars in Figures 13 through 15 would be close to level, because a similar ratio of dollars and units to need would be served. However, this is not the case. In the case of nine percent tax credits that have been awarded since VHDA became responsible for the program in 1995 (Figure 13), several planning districts have received far more credits relative to housing need than the other districts, and the need met in a few planning districts is much lower than in the other districts. (Figure 8 lists each planning district and its corresponding number.) A particularly disproportionate amount of credits has been awarded to the planning districts surrounding Northern Virginia (Lord Fairfax (7), Rappahanock-Rapidan (9), and RADCO (16)). An analysis of the housing needs that exist in different areas of the State, as well as an analysis of how VHDA has already met these needs, could be particularly helpful in the future division of tax credit allocation pools. For example, one concern during the process for the development of the 2000 Qualified Allocation Plan was whether to merge the two Northern Virginia pools that had existed in the 1999 competition (a metropolitan and a non-metropolitan pool). Taking into account the distribution of credits in previous years relative to housing need might have helped to resolve this concern.

Figure 14 shows the distribution of four percent tax credits relative to housing problems in each district. While several for-profit developers told JLARC staff that four percent tax credits are most successful in Northern Virginia, it appears from this

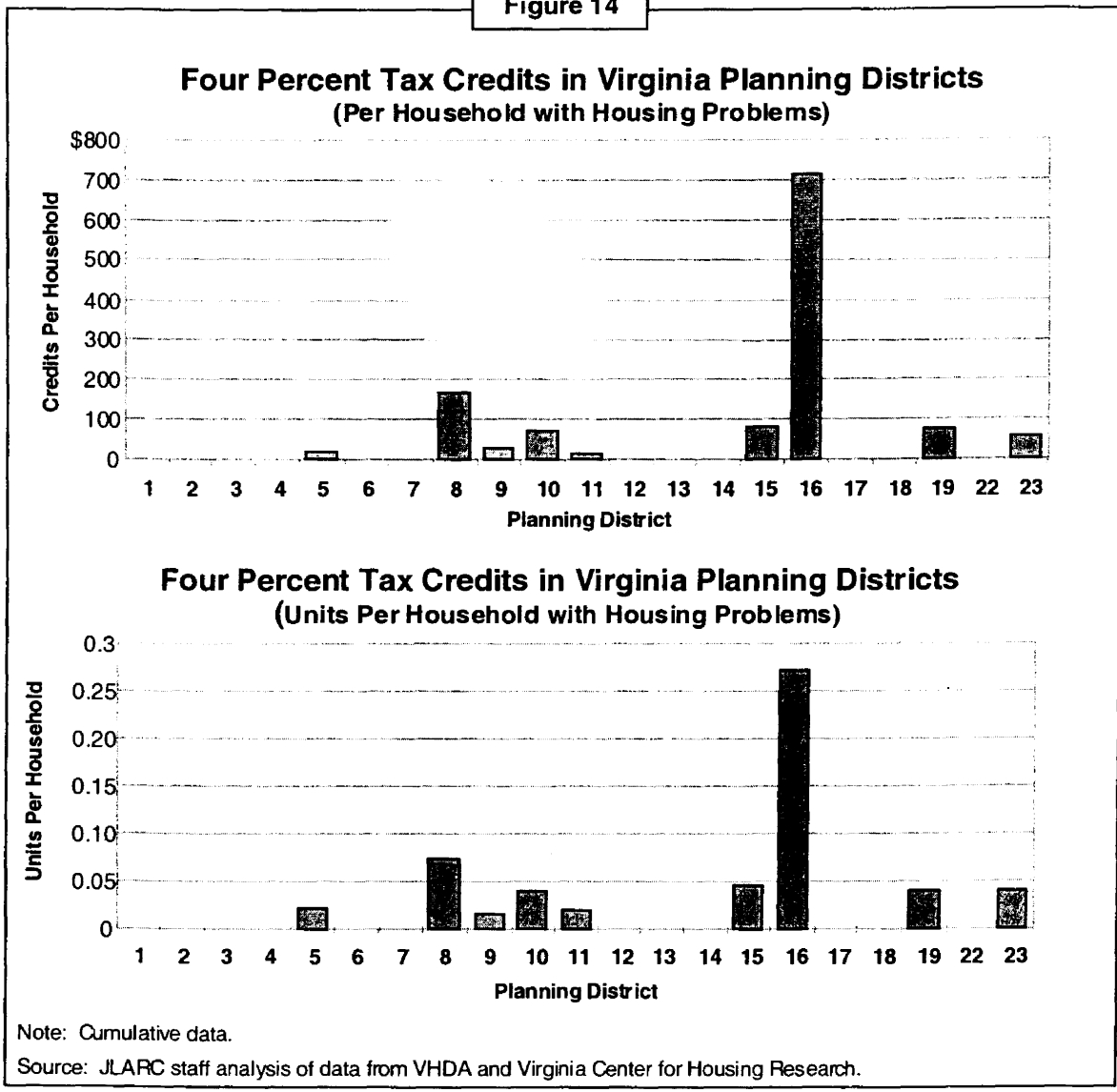
Figure 13



distribution that these credits are able to serve far more needs in the RADCO planning district than in the rest of the State. VHDA may want to evaluate why this program addresses the needs of households in RADCO to a much greater extent than in any other planning district. This evaluation might provide some insight into how this program could be adapted to also meet housing needs in other areas of the State.

The distribution of VHF multifamily loan dollars and units relative to housing problems in each planning district is shown in Figure 15. There does not appear to be any consistency among the levels of housing need met within each planning district by VHF programs. In addition, VHF loans do not appear to target areas of the State that are not being served by VHDA's traditional loan programs. While some VHF multifamily loan dollars are used in conjunction with VHDA's other financing programs to provide deeper layered subsidies to some developers, the remaining funds should be targeting other areas of the State. As shown earlier in this chapter in Figures 8, 9, and 10, 46 of the 57 localities receiving VHF loans also have received either nine percent tax credits since 1995 or four percent tax credits.

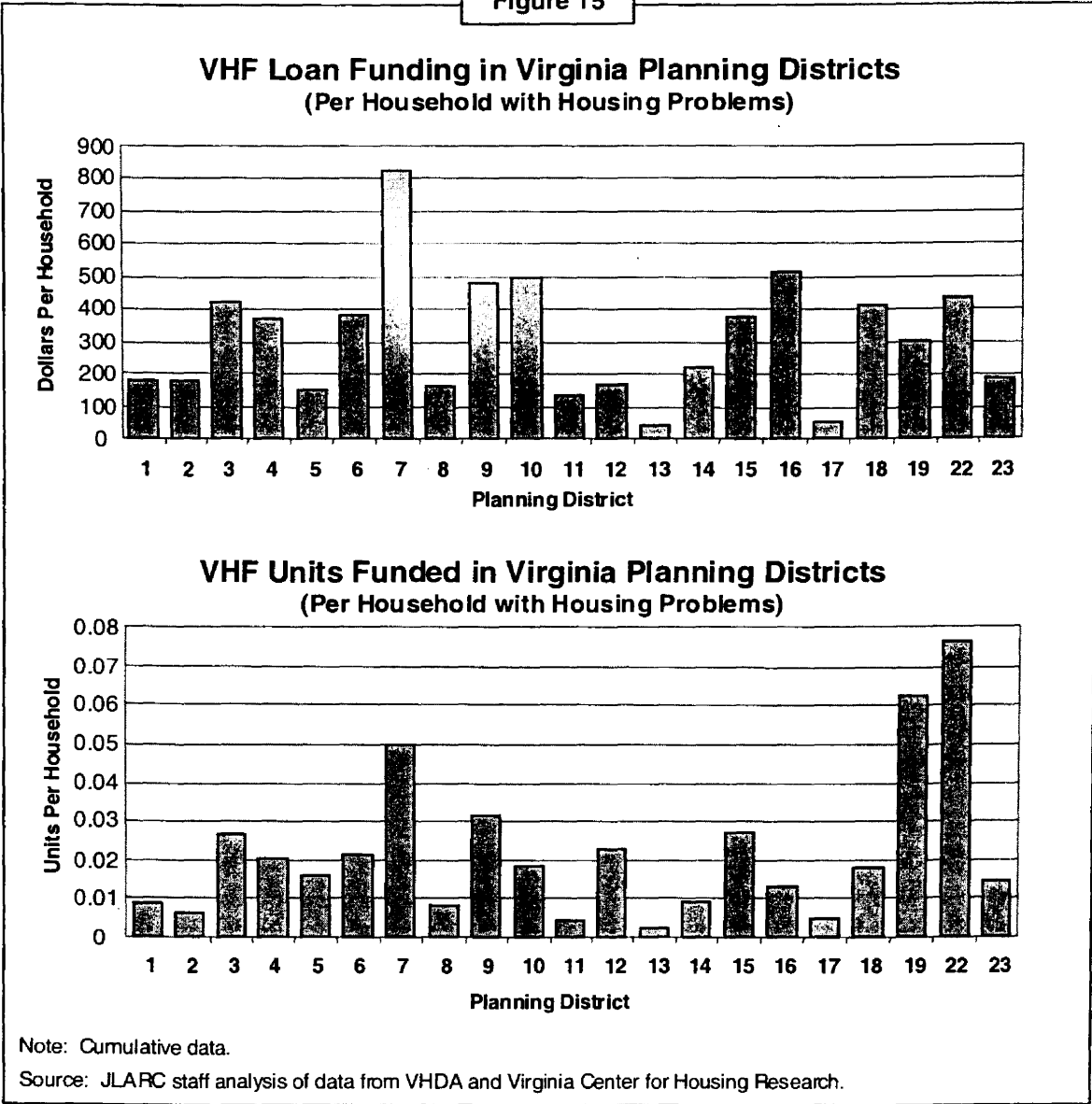
Figure 14



Figures 13 through 15 show that the planning districts in which VHF dollars address the greatest need are the same districts in which the greatest need is met by the four percent and nine percent tax credit programs. The RADCO planning district (16), the Rappahanock-Rapidan district (9), and the Lord Fairfax district (7) have received the largest amounts of nine percent credits relative to housing need, and the RADCO planning district has received the largest amount of four percent credits relative to housing need. These three planning districts are three of the top four planning districts in terms of receiving the most VHF dollars relative to housing need.

This inconsistent distribution of dollars relative to housing need and the duplication of needs met by other VHDA programs is particularly concerning for the Virginia Housing Fund. As stated in 13 VAC 10-120-20 (the VHDA regulations guiding the VHF) in addition to serving the elderly, disabled, and homeless, the highest priority

Figure 15



of the VHF should be to serve “families in need of affordable housing not otherwise being serviced by other housing programs.” Based on this JLARC analysis, it does not appear that VHDA has sufficiently taken into account the unmet housing needs in Virginia, particularly those that are not being served by other housing programs, in designing its VHF programs.

VHDA Should Proactively Design Its Financing Programs to Meet State Housing Needs

Section 36-55.25 of the *Code of Virginia* sets forth several purposes for the Virginia Housing Development Authority to exist in Virginia. One of the purposes specified in this section is that VHDA could provide financing “in order to help prevent

the creation and recurrence of substandard living conditions and to assist in their permanent elimination throughout Virginia.” Thus, VHDA should work toward reducing housing problems throughout the State. As shown in Figures 13 through 15, however, certain areas of the State receive substantially more support than other areas in addressing their problems. Substandard living conditions in some areas of the State appear to receive little attention from VHDA.

Chapter I described the various housing needs across Virginia. While different regions vary significantly in the types of housing problems they face and how best to address these problems, sizeable housing problems exist in each region of the State. VHDA has not taken these different housing problems into account in designing its multifamily programs. As the primary State source of financing for the development of housing for households between 50 and 115 percent of AMFI, VHDA is in the best position to determine the housing needs of these low and moderate income households. VHDA needs to perform its own analysis of these housing problems and then determine how it can best use its resources to help solve these problems. Specifically, VHDA needs to take a more proactive role in designing and administering programs that match the housing needs of persons in each region of the State. For example, the nine percent geographic pools could be redivided in order to target previously neglected areas of the State. Likewise, VHDA could consider lowering taxable interest rates in blended tax-exempt/taxable loans in order to make projects using four percent tax credits and tax-exempt bonds viable in more areas of the State. VHDA could also reevaluate the criteria for VHF loans to proactively target housing needs in the State that have thus far been neglected. Greater flexibility with VHF funds that will be discussed in Chapter V could also be used to target specific substandard living conditions.

Recommendation (4). VHDA should conduct a comprehensive analysis of the housing needs in all regions of the State periodically. VHDA should use the results of this analysis to design and administer financing programs that will match the housing needs of low and moderate income persons in each region of the State.

STATE LAW DOES NOT ENSURE DIVERSE GEOGRAPHIC REPRESENTATION ON THE VHDA BOARD

The powers of VHDA are vested in its Board of Commissioners. The ten members of the Board are responsible for the policies, control, and direction of the authority and its mission to provide safe, sanitary, and affordable housing to low and moderate income persons across Virginia. Three of the members of the VHDA Board of Commissioners serve on the Board by virtue of their positions elsewhere in State government. The remaining seven of the Board’s ten members are appointed by the Governor.

The *Code of Virginia* establishes only one requirement for the selection of the seven appointed members. This requirement – that no more than three of these mem-

bers can represent any one commercial or industrial field – encourages professional diversity among the Board members. However, it does not encourage representation of the housing needs of the different regions of the State. As a result, some areas of the State have been over-represented on the Board of Commissioners. As described earlier, the different regions of the State present varying needs, and VHDA has not been successful in meeting these specific housing needs in some regions. Addressing the diverse housing problems requires specific understanding of each regions' needs, and each region's housing problems may require unique solutions. To ensure greater attention to the housing needs of different areas of the State, representation on the VHDA Board from single geographic areas should be limited.

Some Areas of the State Have Been Over-Represented on the VHDA Board

As the statute guiding the composition of the VHDA Board is currently written, all seven appointed members of the Board could be from the same region of the State. Currently, the VHDA Board includes representatives from most regions of the State. However, both at the present time and in previous years, the Board has included a large number of representatives from the same area.

Several Board members told JLARC staff that they feel the Richmond area is currently over-represented on the Board. Northern Virginia, Tidewater, Southwest Virginia, and the northwestern portion of the State have one appointed representative each. The Richmond area, by contrast, is represented by three appointed members, as well as by two ex-officio members.

Over-representation of certain geographic areas has also been a problem in the past. For example, of the seven appointed members of the 1995-1996 Board, three were from the Richmond area, three were from Arlington, and one was from Tidewater. While membership on the Board has not been limited to one geographic area, in every year between 1990 and 1997, no more than one member of the Board was from any region of the State other than Tidewater, Northern Virginia, or Richmond.

Illinois and Minnesota Housing Authority Statutes Limit Representation from Single Geographic Areas

JLARC staff conducted a survey of other states' housing finance authorities to determine what requirements other states place on the composition of the boards governing their housing authorities. Both Illinois and Minnesota specifically limit over-representation of geographic areas on their housing boards. On its nine member citizen board, Illinois allows no more than three representatives from any one locality. Minnesota allows no more than two representatives from any area of the state on its seven-member citizen board.

Statutory Limit on Geographic Over-Representation Would Better Serve Public Interests

With the current statutory requirements for the composition of VHDA's Board of Commissioners, over-representation of any one occupational field is limited. This ensures, for example, that the Board membership does not include four multi-family developers, and results in a representation of many of the different stakeholders involved in providing affordable housing. VHDA, as well as the public interest, would be well served by similar limitations on the number of Commissioners from any one area of the State that could serve on the Board.

Representatives of more regions of the State would add valuable perspective to board policies. As previously discussed, the housing needs of Virginians vary significantly based on the area of the State in which they live. The high costs and limited land availability in Northern Virginia differ significantly from the lower incomes and available land in Southside Virginia. Likewise, the large suburban apartment complexes that might lease-up quickly in the Richmond area are not as welcome in Southwest Virginia.

Limiting the over-representation of members of the Board of Commissioners from any particular region of the State would allow for a more diverse representation of the State. This would ensure that the Board would maintain geographic diversity and bring to its deliberations a greater understanding of the differing housing needs across Virginia. As discussed in the previous section, VHDA needs to better design and administer its programs to match the housing needs of low and moderate income persons in each region of the State. With more diverse representation on the Board, the Board would be better equipped to direct the VHDA staff to administer such programs.

Recommendation (5). The General Assembly may wish to consider amending §36-55.28 of the *Code of Virginia* to require that the Governor appoint no more than two persons from any one area of the State to the VHDA Board of Commissioners.

IV. Section 8 Program

VHDA's administration of the statewide Section 8 program has provided a valuable service to many localities in Virginia that otherwise would not have the capacity to operate a Section 8 program independently. However, this review of the Section 8 program indicates significant problems with the administration of the tenant-based Section 8 program. VHDA has not used a substantial portion of the funds that HUD has allocated to VHDA during the last four years to fund rental subsidies to households with very low incomes and incomes below the poverty level in 89 localities around the State. A substantial amount of these unused funds was subsequently recaptured by the federal government.

In addition, several aspects of the program have not been adequately managed. VHDA's allocation of administrative fees to the local agents that handle the day-to-day administration of the program is inequitable. Moreover, the program is not effectively automated, and the fund disbursement system is inadequate. These problems have imposed a financial strain on the program. VHDA needs to take measures to improve the administration of the program and to ensure that Section 8 funds are used to the maximum extent reasonably practicable. VHDA also needs to address the request by some local administrative agents to administer their units directly through HUD. Based on this request by local agents as well as other concerns raised about the Section 8 program, the new executive director has retained a consultant to review the program.

As mentioned in Chapter I, VHDA also administers project-based Section 8 assistance in Virginia. However, the focus of this review is on the tenant-based Section 8 program because the project-based program has been terminated and is being phased out over time, and there do not appear to be significant problems with VHDA's administration of the remaining Section 8 multifamily projects.

VIRGINIA'S TENANT-BASED SECTION 8 PROGRAM

The Section 8 Certificate and Voucher program, established by HUD, provides rental subsidies to reduce the rent burden for very low income or poverty level households (50 percent or less of median income). Since 1977, VHDA has had primary responsibility for administering a major portion of the Section 8 funds allocated by HUD to the State of Virginia. VHDA maintains three contracts with HUD to administer more than \$65 million in Section 8 funds. With the exception of a portion of the administrative fees retained by VHDA, these Section 8 funds are allocated among 75 local administrative agents. VHDA is responsible for ensuring that all HUD guidelines and reporting requirements are met, while these 75 local agents carry out the day-to-day administration in programs of varying size in 89 localities. Based on the overwhelming number of families currently on local waiting lists, there appears to be substantial unmet need for Section 8 housing in Virginia.

Section 8 Certificates and Vouchers

The Section 8 Certificate and Voucher program is a tenant-based subsidy program that provides financial assistance to very low income households in the form of certificates or vouchers to reduce their rent burden. Individuals or families who receive vouchers or certificates from local Section 8 administrators are required to contract with a landlord who wishes to participate in the Section 8 program. With both the certificate and voucher programs, participants are required to pay 30 percent of their incomes in rent, and the subsidy funds the difference between this amount and the fair market rent for the unit, as well as a utility allowance. The only difference between certificates and vouchers, from the program participant's standpoint, is that with a certificate a tenant may only rent an apartment with rent at or below the fair market rent. In contrast, a participant with a voucher may rent a unit that exceeds the fair market rent but will only receive a subsidy for the difference between 30 percent of the participant's income and the fair market rent in the area. In October 1999, HUD merged these housing vouchers and certificates into one program referred to as the Housing Choice Voucher Program.

Program Structure

VHDA administers the tenant-based Section 8 program through three contracts with HUD. Through these contracts, the authority receives approximately \$65 million annually from HUD, which it then allocates among 75 administrative agents to provide subsidies for approximately 11,900 families. VHDA maintains a contract with the HUD Virginia State Office to provide rental assistance to approximately 10,100 families living in 84 Virginia localities. Rental assistance in five Northern Virginia cities and counties is provided through a contract with HUD's Washington D.C. field office and provides support to approximately 1,400 families. VHDA also manages a separate contract with HUD on behalf of the Cumberland Plateau Regional Housing Authority, through which subsidies are provided to 430 families in the Cumberland Plateau planning district.

Administering the VHDA tenant-based Section 8 program at the local level are 75 local administrative agents consisting of: local Department of Social Services (DSS) offices, public housing authorities (PHAs), other local government agencies, non-profit housing organizations such as community action program agencies, community service boards, centers for independent living, as well as private real-estate corporations. Of these 75 agents, 60 maintain contracts solely with VHDA, while 15 have contracts with both VHDA and HUD for tenant-based Section 8 assistance. Agents that directly maintain contracts with HUD include local redevelopment and housing authorities as well as independent agencies of local government that are certified as public housing authorities by HUD. An additional 15 local agents administer Section 8 contracts directly through HUD, with no assistance from VHDA.

The size of the programs administered by local agents varies substantially across the State. In localities with an active Section 8 program, the number of units administered through contract with VHDA ranges from as few as 19 in Poquoson to

more than 1,400 in Prince William County. Northern Virginia programs provide a large number of units. In addition, a number of agents in the Southwest, Central, and Tidewater regions maintain in excess of 600 units through the VHDA program. Staff size at agencies serving as administrative agents for the VHDA program ranges from fewer than one to as many as 10 full-time equivalent employees.

VHDA receives compensation from HUD for the administration of the Section 8 program. Monthly administrative fees are granted to the State based on the total number of units under contract and the localities in which the units are based. VHDA has the discretion to determine what percentage of these administrative fees each local administrative agent is eligible to receive to pay for administrative expenses. The percentage of the administrative fee that local agents receive per unit is not the same across the board. As a whole, VHDA currently retains approximately 34 percent of the administrative fees allotted by HUD for the units under contract in the State and distributes the remaining 66 percent of these fees among its 75 administrative agents.

VHDA and Administrative Agents Share Program Responsibilities

While HUD establishes program guidelines and reporting requirements for the overall administration of the program, administering the Section 8 program across the State is a collaborative effort between VHDA and its local agents. The authority is granted the discretion to determine what functions will be performed by the contracting administrative agents. The responsibilities of each partner are outlined within the Administrative Services Agreements (ASA) established between VHDA and each local agent participating in the program. Exhibit 3 outlines the contractual responsibilities of both the authority and each of its local agents under the ASA.

VHDA Contract Responsibilities. VHDA has responsibility for maintaining its Section 8 contracts with HUD and ensuring that all program guidelines and reporting requirements are met. The primary service VHDA provides to its administrative agents is the issuance of housing assistance payments and utility allowance subsidy checks to landlords and tenants. VHDA also handles the transmittal of tenant occupancy information to HUD. In addition, VHDA is required by HUD both to monitor the monthly disbursement of funds to program recipients as well as to perform periodic file reviews of local agents and unit inspections to ensure compliance with applicable program guidelines. The authority provides some technical support to local agents by interpreting HUD guidelines and answering agent questions. VHDA is also responsible for providing periodic training to its administrative agents. This training is usually provided by outside consultants hired by the authority.

VHDA Contract Requirements for Administrative Agents. Most of the day-to-day administration of the program is handled by the local agents who process applications, maintain waiting lists, recruit landlords, answer questions, conduct housing quality standards inspections, and issue HUD required tenant certifications and re-certifications. One of the major responsibilities of each local administrative agent is maintaining the local waiting list for the program.

Exhibit 3

Section 8 Program Responsibilities

VHDA Responsibilities	Local Agent Responsibilities
Execute Administrative Services Agreements with Local Agents	Publish and Disseminate Program Information
Disburse Monthly Housing Assistance and Utility Allowance Payments	Maintain Waiting Lists
Establish Utility Allowance Rates	Receive and Review Tenant Applications
Receive and Review Locality Records of Application, Income Verification, Rent Reasonableness, Utility Allowance, Housing Quality Standards Inspections, and Local Publications	Recruit Landlords
Provide Technical Support and Training to Local Agents	Approve Applicant Eligibility
Remit Tenant Occupancy Information to HUD	Annually Verify Tenant Income Information
	Maintain Local Utility Rate Data
	Determine Rent Reasonableness
	Inspect Units for Compliance with Housing Quality Standards
	Determine Amount of Rental Contribution Required by Family and VHDA
	Provide Assistance to the Family in Finding a Suitable Unit
	Notify Applicants of Acceptance or Denial
	Perform Annual Tenant Re-certifications
	Assist in the Administration of Portable (out-of-jurisdiction) Housing Vouchers
	Retain Records of All Application, Income Verification, Notification Letters, Housing Quality Standards Inspections
	Provide the Authority with Financial and Program Reports, Records, Statements, and Documents

Source: VHDA Administrative Services Agreements.

It is the primary responsibility of the local administrative agent to ensure that units receiving Section 8 rental assistance comply with housing quality standards requirements, both at initial occupancy and throughout the term of the lease. HUD regulations further state that local agents shall certify, for each unit under contract, that the rent is reasonable in relation to rents currently being charged for comparable units in the private, unassisted market. Administrative agents are further responsible for maintaining all written documentation of public notices issued by the agent, individual applicant information, income verification, and inspections. Agents are also responsible for providing annual financial and program reports as well as any records, statements, or documents that may be required by the authority.

Shortage of Section 8 Units

A survey conducted by JLARC staff of local Section 8 administrative agents indicated that there is an unmet demand for Section 8 rental assistance. Based on responses to the JLARC staff survey, there were at least 16,371 families on waiting lists for Section 8 housing assistance from VHDA local administrative agents as of December 31, 1999. Across Virginia, the number of families on waiting lists for available VHDA tenant-based certificates and vouchers ranges from as few as ten, in a Henrico County program that restricts eligible applicants to elderly and disabled individuals, to more than 1,100 in a Chesterfield County program with fewer eligibility restrictions. Based on responses to the JLARC staff survey, the average number of families on the waiting lists of localities that administer Section 8 solely through VHDA is 186.

The number of families on waiting lists does not indicate fully the level of demand for Section 8 assistance because some localities periodically close their waiting lists. According to data provided by JLARC survey respondents, the average length of time an eligible family must wait prior to receiving rental assistance payments ranges from three months to seven years for a VHDA assisted unit. The average wait for rental assistance in localities operating contracts solely through VHDA is 28 months. The wait for assistance is generally longer in Northern Virginia. This shortage of Section 8 funding appears to have been exacerbated over the last year as a result of a moratorium on the issuance of assistance to new families.

VHDA HAS NOT FULLY UTILIZED FUNDS ALLOCATED FOR SECTION 8

Over the last several years, VHDA has not fully utilized the Section 8 funds made available to the State by HUD. Approximately \$30 million in available funds was not utilized between 1996 and 1998. These funds, which could have helped to house hundreds of additional families, appear not to have been utilized because VHDA chose to build a sizeable program reserve and ignore a HUD policy directive instructing the authority to manage its budget by dollars available instead of by units in its contract.

Background on Section 8 Funding Management

Historically, VHDA and other housing authorities and housing finance agencies that administer the tenant-based Section 8 program through contracts with HUD managed the funds they received from HUD for Section 8 vouchers and certificates on a per-unit basis. HUD designated a specific number of units to receive Section 8 funding through an annual contributions contract (ACC) between HUD and the administering agency. The housing authority or housing finance agency then sought to ensure that a high percentage of the units specified in the contract were subsidized with Section 8 dollars without regard to the total amount of Section 8 funds that the agency would receive from HUD.

State and local administration of the Section 8 program on a per-unit basis historically has resulted in excess funding provided by HUD to administering agencies beyond the amount needed to fund the units established in the ACCs with HUD. This excess funding has occurred in large part due to the funding methodology used by HUD. HUD traditionally has calculated agency annual budget authority (available fund dollars) based on 100 percent of the fair market rents for units. However, many Section 8 recipients have some level of income and are able to pay some portion of their rent. These households do not require a subsidy for the full amount of their rent. Due to this funding methodology, most entities administering Section 8 programs received more annual budget authority than needed to fund their subsidies. As a result, all of their available annual budget authority was not used, and they accumulated large project reserves over time.

For many years, unused funds were allowed by HUD to accumulate in reserve accounts maintained by the housing authorities. However, in 1997 Congress directed HUD to recapture \$5.8 billion in Section 8 reserves nationally to provide funding for flood relief activities. As part of the national recapture in 1997, HUD took \$30.7 million from VHDA's unused reserves. In 1999 HUD recaptured an additional \$10.2 million from VHDA.

VHDA Ignored Program Directive

In July 1995, HUD issued a policy directive that required housing authorities and finance agencies in their annual contribution contracts to manage their Section 8 budgets based on annual budget authority (available fund dollars) instead of on a per-unit basis. This change in policy provided housing authorities with the opportunity to fund significantly more Section 8 units than allocated in their ACCs under the HUD funding methodology.

VHDA chose not to comply with the HUD directive. The authority continued to manage its Section 8 budget based on the number of units specified in the ACC instead of by total dollars available. According to the director of VHDA's Section 8 program, this decision was made in order to avoid a potential funding shortfall in future years. VHDA continued to follow this approach through the 1998 fiscal year. Not until FY 1999, four years after HUD issued the policy directive and under pressure from HUD, did VHDA begin to try to manage by budget authority instead of units and to utilize all of the funds that HUD made available to the State. Using this different management approach, VHDA was able to fund 1,800 more units in FY 1999 than in the previous year.

VHDA's Decision Resulted in Substantial Unused Funds

VHDA's decision not to comply with the HUD directive resulted in the loss of a large amount of Section 8 assistance and the opportunity to house a significant number of additional families in Virginia. In fiscal years 1996 through 1998, VHDA did not

spend on average 19 percent of its available budget authority annually. During the three-year period, a total of \$30 million of available funds was not used to provide housing assistance. Table 5 shows the amount of unused annual budget authority for fiscal years 1996 through 1999.

The failure to spend these funds resulted in the lost opportunity to house a substantial number of additional very low income families. A Section 8 expert retained by VHDA in 1998 conducted an analysis of the difference between the number of units funded by VHDA in FY 1998 and the number of units that could have been funded had VHDA managed its Section 8 program on the basis of available budget authority. According to that analysis, VHDA could have funded 2,445 additional housing units based on the available budget authority for that year. The report stated that "VHDA clearly could have provided more assistance to needy families" in FY 1998.

Other Housing Authorities Complied with HUD Directive and More Fully Utilized Section 8 Funds

Most of the local housing authorities in the State that administer Section 8 funds directly through annual contribution contracts with HUD began complying with the HUD policy directive well before VHDA. Moreover, most of these other housing authorities have more fully utilized their annual budget authority over the last several years.

Responses to JLARC's survey of housing authorities that administer Section 8 funds in the State directly through ACCs with HUD revealed that all respondents began managing Section 8 funds by budget authority instead of by units prior to 1999,

Table 5

Unused Annual Budget Authority, FYs 96-99 (In Millions)

Fiscal Year	Annual Budget Authority	Amount Used	Amount Unused	Percent Unused
1996	\$50.8	\$39.2	\$11.6	23%
1997	\$46.9*	\$41.4	\$5.5	12%
1998	\$58.1	\$45.6	\$12.5	22%
1999	\$61.5	\$54.3	\$7.2	12%

Notes: This includes funds allocated for the certificate and voucher programs through contracts with the HUD Virginia State Office and HUD's Washington D.C. field office.

* In FY 1997, HUD authorized VHDA to use approximately \$30 million in VHDA project reserves as annual budget authority that was in addition to the \$46.9 million shown.

Source: Data provided by VHDA Section 8 finance officer.

when VHDA first did so. More than half of the respondents began managing by budget authority instead of units prior to 1997.

VHDA's high percentage of unused annual budget authority appears to be substantially more than that of authorities that administer Section 8 programs of comparable size in other states. The Section 8 consultant retained by VHDA in 1998 reported that other states with comparable programs had a substantially lower percentage of funds not utilized than VHDA. The consultant's survey of other states found that the average amount of unused annual budget authority for Section 8 certificate programs was approximately six percent, and was even less for voucher programs. In contrast, VHDA's unused budget authority averaged approximately 19 percent between fiscal years 1996 and 1998.

Most of those local housing authorities responding to the JLARC staff survey indicated that they have had a lower percentage of unused budget authority over the last four fiscal years than VHDA. This appears to result, at least in part, from the fact that these housing authorities began to comply earlier than VHDA with the HUD directive.

VHDA's Failure to Manage by Budget Authority Has Adversely Impacted Funding

VHDA's decision to ignore the HUD policy directive regarding managing by budget authority has also adversely impacted the current Section 8 program. In December 1998, HUD issued a policy notice which stated that future funding allocations for the tenant-based Section 8 program would be based on the number of units leased as of October 1, 1997. This action by HUD, combined with VHDA's decision not to comply with the 1995 policy directive until FY 1999, has exacerbated the present shortage of available Section 8 housing.

Due to the funding shortage and in accordance with HUD's instructions, VHDA imposed a moratorium on the admission of new families to the program for FY 2000. This moratorium was imposed because HUD directed VHDA to overlease in FY 1999, which resulted in a funding shortage for FY 2000. As a result, no new families have been admitted to the program during this fiscal year. According to VHDA's Section 8 finance officer, this moratorium is causing extreme hardships in numerous localities around the State as demand grows for Section 8 assistance.

If VHDA had begun managing by budget authority by FY 1997, the authority likely would have been able to lease substantially more units in that fiscal year than it had as of October 1, 1997, thereby significantly increasing the funding allocated by HUD to VHDA for FY 2000. As a result, the VHDA Section 8 program would not have faced a significant budget deficit at the outset of the fiscal year and would not have needed to be so restrictive regarding the admission of new families to the program. Although HUD recently approved an additional \$8.8 million to cover most of VHDA's projected deficit for FY 2000, VHDA is having to draw upon project reserves to fund all

of the families currently receiving assistance through VHDA. Therefore, the authority continues to maintain its moratorium on the acceptance of new families into the program.

VHDA Needs to Maximize Use of Section 8 Funds

With the high demand for Section 8 housing and the importance of these funds in assisting very low income persons in obtaining affordable housing, it is essential that VHDA make every effort to fully utilize every dollar of Section 8 funding provided by the federal government. VHDA has cited several obstacles (including the 90-day delay rule in re-issuance of certificates or vouchers, a shortage of landlords and affordable housing units, and reduced fair market rents) to fully utilizing its available Section 8 funding as a partial explanation for the percentage of annual budget authority that has gone unused. However, in 1999, when the decision was made to manage by budget authority and not by units, VHDA was able to provide funding for 1,800 additional units. This clearly indicates that with a different management approach, VHDA could have housed substantially more families in the years prior to FY 1999, and Virginia would have lost substantially less funds. Moreover, VHDA presently would not be encountering such financial constraints in its Section 8 program resulting from the HUD decision to base FY 2000 funding on the number of units leased as of October 1, 1997.

In the future, VHDA needs to ensure that it maximizes the use of federal Section 8 funds provided to help house very low income Virginians. While working with HUD appears to present many challenges, VHDA's approach to minimize these challenges was not in the best interest of the State and resulted in a substantial number of very low income households which could have been assisted with available Section 8 funds not receiving housing assistance.

Recommendation (6). The Virginia Housing Development Authority should implement management policies to ensure that all federal Section 8 funds allocated to the authority are utilized to the maximum extent reasonably practicable.

VHDA NEEDS TO IMPROVE ADMINISTRATION OF THE SECTION 8 PROGRAM

Along with the failure to fully utilize Section 8 funds allocated to the State, this review found other weaknesses in VHDA's administration of the Section 8 program. VHDA does not allocate administrative fees equitably to local agents. In addition, VHDA has not automated aspects of the program, and the present payment disbursement system that VHDA uses does not adequately perform this function. These deficiencies in automation have increased VHDA's costs of administering the program and have reduced the amount of administrative fees that can be allocated to local agents.

Administrative Fees Are Not Allocated Equitably

VHDA receives administrative fees from HUD to pay for the administration of the Section 8 program based on the total number of units leased under Section 8 across the State. HUD established a formula for the per-unit allocation of administrative fees based on the established fair market rent in a given locality and the number of units established under the Annual Contributions Contract (ACC). The HUD allocation formula establishes three per-unit rates for each locality and pays fees to the State based on the number of units under contract in that area. HUD pays the full rate, called Column A, for each unit up to 600, and a lower rate, called Column B, for each unit over the initial 600. A third rate, called Column C, is established to pay administrative fees for units located in properties owned by public housing authorities. Of the overall amount of administrative fees that VHDA receives from HUD, VHDA retains approximately one-third to cover its costs and forwards the remainder to the local agents.

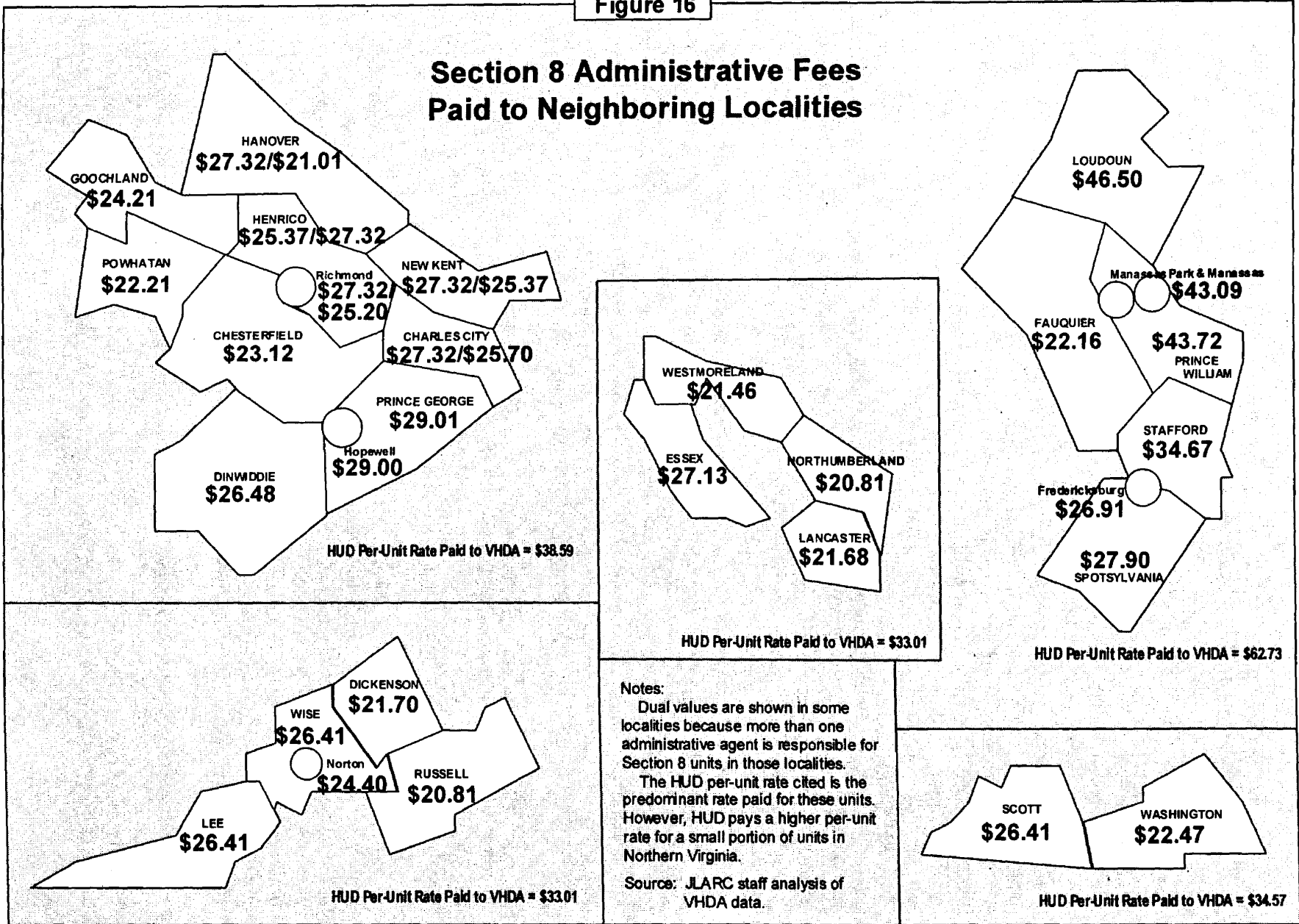
No Formal Process for Determining Agent Fees. Per-unit administrative fees paid to VHDA by HUD vary across jurisdictions because the fees are based on the fair market rent in each jurisdiction. The per-unit fee allocated by HUD ranges from \$33 to \$68 per month depending on the location of the unit and the established column rate for the unit under contract. VHDA retains a percentage of the fee provided for each unit and allocates the remainder to the local agent responsible for the unit. VHDA has complete discretion as to the percentage of the administrative fee that is allocated to each local agent. VHDA has developed an individual agreement with each local agent as to the percentage of the administrative fee to be received by the agent.

Currently, VHDA has no formal policy in place for determining the percentage of administrative fees paid to each locality. Senior VHDA Section 8 personnel indicated that in the initial years of the program, localities were required to submit annual funding requests to the authority. VHDA conducted annual reviews of the operational expenses and administrative budgets of its administrative agents and negotiated the administrative fee rate with local agents based on recognized program needs. However, as the program grew in size, VHDA ceased this requirement and moved instead to an administrative fee arrangement based primarily on individual negotiation between each local agent and VHDA. According to the director of the VHDA multifamily special programs division, which is responsible for the Section 8 program, fee increases in recent years have gone to the local agents that have been most vocal in lobbying for them.

Administrative Fees Paid Are Inconsistent Across Localities. This informal process of fee negotiation has resulted in inequitable allocation of fees to some local agents. Analysis of administrative fees paid by VHDA to local agents across the state for FY 1999 reveals numerous inequities in fee rates paid by VHDA. As Figure 16 indicates, there is often a wide range in the fee rate received by local agents within the same geographic area, although HUD pays the same per-unit fee to VHDA for units in each of the jurisdictions within that area.

Figure 16

Section 8 Administrative Fees Paid to Neighboring Localities



Notes:
 Dual values are shown in some localities because more than one administrative agent is responsible for Section 8 units in those localities.
 The HUD per-unit rate cited is the predominant rate paid for these units. However, HUD pays a higher per-unit rate for a small portion of units in Northern Virginia.
 Source: JLARC staff analysis of VHDA data.

Northern Virginia appears to have the widest discrepancies between local agents in terms of the per-unit fee allocated by VHDA. Within the Washington metropolitan statistical area (MSA), Loudoun and Prince William counties earn the highest administrative fee rate per unit from VHDA. They receive \$46.50 and \$43.72 respectively from VHDA per unit on a monthly basis. In contrast, the local agent in Fauquier County, which is also in the Washington MSA, receives only \$22.16 per unit. Similarly, the local agent serving Fredericksburg receives only \$26.91 per unit. VHDA receives the same per-unit rate from HUD for units in all four of these jurisdictions.

Another area of the State in which there are inequitable fee allocations to local agents is in the Richmond MSA. Within the Richmond MSA there is a wide variance in fees paid not only among adjacent counties, but between administrative agents operating within the same county as well. For example, in Hanover County VHDA currently pays two separate local agents two substantially different administrative fees per unit. One agent receives \$27.32 per unit while the other agent receives only \$21.01 per unit, a difference of more than six dollars per unit per month. Across jurisdictions in the Richmond MSA, per-unit administrative fees range from \$21.01 in Hanover County to \$29.01 in Prince George County, a difference of \$8 per unit per month. The HUD-approved administrative fee rate per unit received by VHDA is the same for all localities in the Richmond MSA.

In the southwestern part of the State, the administrative fees paid by VHDA to program administrators vary from \$20.81 per unit in Russell County to \$26.41 in neighboring Lee and Wise counties, a difference of \$5.60 per unit per month. Yet the HUD-approved per-unit administrative fee rate paid to VHDA is the same for all of these localities. Similarly, the administrative fee provided to Scott County is \$26.41, while the fee paid to the local agent in Washington County is only \$22.47. However, VHDA is paid the same per unit rate for the units in both counties.

Similar discrepancies in fees paid by VHDA also exist between neighboring local agents in the Northern Neck region of the State. Essex County earns a per unit rate from VHDA of \$27.13, while nearby Northumberland County earns only \$20.81 per unit, a difference of more than six dollars per unit per month.

Small differences in administrative fees earned per unit can have a significant impact on the overall amount of fees earned by a locality. For example, a difference of \$5 per unit per month for an agent administering a program with 200 units represents a potential \$12,000 per year in funds not being earned by an agent. Given the size of the budgets of most of the local agents and the deficits being incurred by most local agents (discussed in more detail later in this chapter), a \$12,000 annual difference could have a significant impact on a local agent's ability to fund its operations.

VHDA Should Formalize Fee Allocation System. In recent years, it appears that fee rate adjustments have resulted primarily from informal negotiations between local agents and VHDA. This has resulted in an inequitable fee structure that appears to reward local agents with effective negotiation skills and leaves out local

agents that have not effectively negotiated fee rate increases. This verbal negotiation process of determining administrative fees is inequitable, and a formalized process for setting fee rates needs to be established.

Recommendation (7). VHDA should discontinue its current process of verbal negotiation in determining the allocation of Section 8 administrative fees to local administrative agents and should implement a formal policy that will ensure a fair and equitable distribution of these fees.

VHDA Has Not Effectively Automated Data Transmittal

One of the primary functions performed by VHDA in administering the Section 8 program is the transmission of tenant occupancy data to HUD. HUD requires the submission of basic tenant characteristic information necessary to monitor compliance with tenant occupancy requirements and maintains a database that contains information on all tenants receiving Section 8 assistance. Local agents are responsible for completion of the HUD 50058 form that contains the basic tenant characteristic information, and are required to send hard copies of these forms to VHDA. VHDA then compiles the data and submits it electronically to HUD. VHDA has five employees who key this data from the submitted hard copies for transmission to HUD.

Despite several attempts to contract with private vendors to develop an automated system, VHDA continues to use an antiquated, inefficient system. VHDA has apparently recognized the need to automate the data transmittal system for at least ten years and has issued a series of requests for proposals over the last several years for the development of an automated system. However, VHDA has been unsuccessful in developing a satisfactory system through this process. As a result, VHDA continues to require the submission of hard copy data that must be keyed at VHDA before it can be forwarded to HUD.

Frustration with the lack of automation of the data transmittal process has been expressed both by VHDA staff as well as local agents. The director of the multi-family special programs division acknowledged in an interview with JLARC staff that the current system is inefficient and needs to be automated. According to a VHDA Section 8 program manager:

There is no question that the program should have been automated before now. We have tried, but for a variety of reasons [VHDA] has not gotten there. We need software to take care of the 50058, and the Executive Director understands this. We now appear to have a consensus within the agency, but initially [this issue] did not get the attention it needed.

Many of the local agents would like to be able to transmit tenant occupancy data electronically. One local agent stated:

We have been asking for improved automation for 15 years. VHDA supposedly has studied this and reviewed various programs for years, but we still have no means of electronically submitting this information. I am confident that thousands of dollars have been spent and we are no closer to automating the program. Frankly, this is inexcusable, especially given the volume of paperwork that is required to administer the program.

With current technology, VHDA should already have an automated data transmittal system. The current system is inefficient both for local agents and for VHDA. The state of New York, which follows a model similar to VHDA in the administration of a large portion of its tenant-based Section 8 funds, has had an automated data transmittal system for ten years. All of its local agents are able to submit the required forms to the state electronically. In order to make the tenant data transmittal process more efficient, VHDA needs to make the development of an automated data transmittal system a high priority.

Recommendation (8). The Virginia Housing Development Authority should make the development of a Section 8 automated data transmittal system a high priority and commit the resources necessary to develop it.

Lack of Automation Has Resulted in Problems with Payment Disbursals

As part of its administration of the Section 8 program, VHDA disburses rent payments to landlords participating in the program and utility allowance checks to tenants. The current system by which VHDA writes checks to landlords and tenants is inadequate and has resulted in substantial problems with payments.

Until the fall of 1999, VHDA had contracted with a third party vendor to perform the check-writing service on behalf of VHDA. Efforts had been made during this time to contract with a vendor to develop an in-house check-writing system, but those efforts were unsuccessful. However, when VHDA determined in 1998 that its third party check-writing vendor was not year 2000 compliant, VHDA decided to bring the check-writing function in-house, using an existing data platform. In October 1999, VHDA made this conversion.

The conversion to the in-house system was to a data platform that was incapable of handling the disbursement function effectively. As a result, this transfer of the check-writing system in-house has led to a number of problems with payment disbursals. The major problem has been the inaccuracy of many of the checks that have been issued. Inaccuracies have resulted primarily in overpayments but also in some underpayments of landlords. In many cases landlords have received overpayments for as much as one full month's rent. In addition, checks have been sent late, to incorrect addresses, and to the wrong persons.

During the month of October 1999, VHDA received 1,308 inquiries, most of which related to problems with rent or utility payments. Between November 1999 and February 2000, VHDA received an average of 515 calls per month regarding problems with rent or utility payments. VHDA has set up a telephone hotline to receive payment inquiries and has had to hire five temporary employees to help address the payment problems.

Local agent frustration with the payment problems is reflected in responses to the JLARC survey of local agents. Forty-two percent of survey respondents rated the timeliness of checks received by landlords and tenants as "poor" or "very poor." Similarly, 41 percent of survey respondents rated the accuracy of landlord and tenant payments as "poor" or "very poor."

VHDA retained the accounting firm of KPMG in March of 2000 to conduct an actuarial analysis of the losses that may have resulted from these inaccurate payments. KPMG recently concluded from an analysis of 1,360 cases (19 percent of approximately 6,600 total problem cases) that 800 (58 percent) of them involved overpayments. Therefore, it is possible that there may be as many as 4,000 total cases in which there have been overpayments since the internal check-writing system was established. VHDA is currently developing procedures to use in recapturing overpayments.

The problems with the payment disbursement system have increased substantially the cost of administration of the Section 8 program. VHDA has incurred additional telephone and postage expenses, labor costs, and expenses associated with recovery of the overpayments. These expenses have come out of the administrative fees that the State receives from HUD, thereby limiting the amount of fees available for local agents. At the same time, this problem has imposed a substantial burden on the local agents, as well as on VHDA's staff. In addition, these problems have likely discouraged some landlords from continuing to participate in the Section 8 program.

VHDA has been working to address the problem and has had some success in reducing the number of mistakes. In March and April, VHDA received fewer than 300 calls regarding payment inquiries. However, a substantial number of erroneous payments continue to be made, and VHDA has not developed a long-term solution to address the problem. There is consensus that the check-writing system needs to be moved off the current data platform, but there appears to be some disagreement as to whether VHDA should build a new system in-house or buy an entirely new system. While VHDA appears to have taken short-term steps to reduce these incorrect payments, the authority needs to develop a long-term solution to avoid a recurrence in the future.

A simple solution to the problem may be to contract with a commercial bank to perform the function. The state of New York, which is also responsible for making rental assistance and utility payments on behalf of local agents, contracts with a commercial bank to handle landlord and tenant payments. According to the director of the New York program, this has been an effective means to disburse the payments. VHDA

needs to explore this option as well as other alternatives to determine which is the most effective and least costly solution.

Recommendation (9). The Virginia Housing Development Authority should make the development of an effective Section 8 payment disbursement system a high priority and commit the resources necessary to develop it.

Training and Technical Assistance Provided Has Been Insufficient

Another primary function of VHDA in the administration of Section 8 is to provide training and technical support to local administrative agents. While VHDA provides some training to new local agents, ongoing training is sporadic and inadequate. Local agents expressed frustration with the training provided in their responses to the JLARC staff survey. Fifty percent of those local agents responding to the JLARC staff survey rated their training as “poor” or “very poor.” One survey respondent wrote:

We have always felt VHDA did too little to make sure all agents had a good working knowledge of program requirements and their implementation, especially since agents often come to their positions without any prior housing experience.

With constant changes in program procedures and requirements, some level of ongoing training is needed for local agents. VHDA needs to provide the training necessary for local agents to effectively administer their programs. In addition, VHDA needs to solicit input from local agents on the types of training needed, and provide training on a regular basis. New York, which has 52 local agents, holds a training conference annually for all of its local agents. According to the director of the New York program, this conference provides an invaluable opportunity for local agents to exchange information and ideas, and it serves to “raise the bar on the quality of the Section 8 program.” The new executive director of VHDA has established an advisory council of local agents for the purpose of providing agents with a forum in which to raise concerns and express their needs.

Recommendation (10). The Virginia Housing Development Authority should solicit input from local administrative agents on training needs and develop a regular training program that meets the training needs of the agents.

VHDA Needs to Improve Efficiency and Allocate More Fees to Local Agents

One of the biggest concerns raised by local agents in their responses to the JLARC staff survey was that they were receiving insufficient administrative fees to administer their programs. Seventy-five percent of survey respondents who administer Section 8 units solely through VHDA indicated they felt that they receive insufficient administrative fees. A majority of the local agent respondents reported operating deficits for fiscal year 1999, ranging from \$1,000 to as much as \$50,000. The aggregate

deficit for local agents appears to be increasing over time. The total reported deficit of local agents in FY 1997 was \$472,131. However, by FY 1999 the aggregate deficit reported had increased to \$719,140.

Given the deficit being run by local agents, VHDA needs to take measures to improve efficiency and reduce excess expenditures in order to reduce the portion of administrative fees that need to be retained by VHDA. As mentioned previously, VHDA currently retains approximately 34 percent of the total administrative fees and allocates the remainder to localities.

Automation Would Reduce Costs. One of the major ways that VHDA could reduce costs would be through improved automation. As described previously, the lack of effective automation has created inefficiencies and costs that could be reduced substantially. With an automated data transmittal system, VHDA would not need personnel to handle the extensive paper records and key data received. In addition, an effective payment disbursement system would have reduced administrative costs substantially over the past eight months. As a result of the problems with the existing system, the Section 8 program has incurred substantial personnel and communication costs that should have been avoided.

Unnecessary Rent Expenditures. Along with improved automation, VHDA needs to eliminate excessive expenditures. One expense that could be reduced is the rental fee paid to VHDA by the Section 8 program for office space in the VHDA building. The rent paid to VHDA for the Section 8 program in FY 2000 (\$229,400) includes charges for VHDA's subsidized cafeteria and fitness center. Administrative fees clearly should not be paying for such employee benefits while local agents are incurring operating deficits.

VHDA should consider not charging the Section 8 program rent at all. VHDA staff has expressed pride in their ability to creatively finance the VHDA building at a low interest rate. VHDA should consider passing some of the savings along to the Section 8 program.

Reducing the Number of Local Agents. Another way to improve efficiency and reduce costs would be to reduce the number of local agents. Seventy-five agents appears to be a large number of agents to be administering 11,900 units. Some of the local agents administer less than 100 Section 8 units. A smaller number of local agents would enable the program to be administered more efficiently both at the State and local levels. VHDA would have fewer administrative agents to deal with, and the local agents would benefit from greater economies of scale.

New York Program Should Be Studied for Guidance on Efficient Section 8 Administration. Based on discussions with HUD and Section 8 program managers in other states, it appears that the only state that uses an administrative model comparable to VHDA is New York state. As mentioned previously, in New York the state administers Section 8 assistance for 23,000 units through 52 local agents throughout the state. Like Virginia, the local agents perform the day-to-day administration of

the program, and the state staff are responsible for making disbursements to the landlords, submitting tenant occupancy information to HUD, providing technical support, and providing oversight of the program.

New York appears to administer its program more efficiently than VHDA. In contrast to VHDA, which allocates only 66 percent of its administrative fee to local agents, the state program in New York allocates 90 percent of the administrative fees to the local agents. New York is apparently able to minimize its costs through several means. It has developed an automated system that allows local agents to transfer tenant occupancy information electronically. In addition, it contracts with a commercial bank to handle payment disbursements for no additional charge. Also, New York state is able to administer the program with a state staff of sixteen full-time equivalent positions. In contrast, VHDA has 25 full-time positions, plus temporary personnel, and administers substantially fewer units.

While New York receives more administrative fees because of the greater number of units administered and fewer local agents, it appears that the program is run more efficiently than the program administered by VHDA. VHDA needs to study New York's program to see whether some of the program's practices and procedures could be applied to the VHDA program to increase its efficiency.

***Recommendation (11).* The Virginia Housing Development Authority should take measures to improve efficiency and reduce excessive expenditures of the Section 8 program in order to allocate more fees to local administrative agents. VHDA should direct the consultant currently evaluating the Section 8 program to assess staffing, organization, and other potential cost saving measures.**

Recent HUD Audit Raised Additional Management Concerns

In February 2000, the HUD Office of the Inspector General (OIG) conducted a review of the VHDA tenant-based Section 8 program, which focused on compliance with HUD program requirements. The OIG concluded that VHDA effectively manages its Section 8 program with regard to federal requirements, but identified a number of areas of needed improvement.

The OIG found that VHDA had not performed the requisite number of re-inspections of Section 8 units initially inspected by local agents. According to the director of multifamily special programs, VHDA has since modified its inspection procedures to comply with HUD requirements.

In addition, the OIG found that VHDA had not followed HUD policies and procedures in establishing tenant utility allowances, and some tenants have received allowances that were too low and thus were below the amount they spent on utilities. As a result, some Section 8 tenants in Virginia have incurred housing payments that are in excess of program requirements. According to VHDA, the authority is currently in the process of updating its utility allowances.

The report also identified some program irregularities at the local level. They included lack of compliance with housing quality standards, improper administration of waiting lists, improper accounting, failure to properly determine rent reasonableness, and a failure to adequately verify tenant income. VHDA agreed with these findings and indicates that it is implementing additional administrative procedures and training to improve local agent compliance with HUD requirements.

VHDA NEEDS TO REVIEW TURNING OVER UNITS TO LOCAL AGENTS WITH SUFFICIENT ADMINISTRATIVE CAPACITY

An issue that has arisen in recent years is the desire of some local administrative agents who currently administer Section 8 units to administer those units directly through HUD. These local agents do not feel that they need the support provided by VHDA and can more efficiently administer the program without VHDA involvement. However, VHDA is concerned that the loss of these units will reduce the administrative fees it receives by such a large amount that VHDA will be unable to pay for the administration of the program.

Some Local Agents Have Capacity to Administer Section 8 Program

Some of the local agents that currently administer units through VHDA have developed the capacity to administer the Section 8 program directly with HUD and without the assistance of VHDA. Most of these local agents have obtained this capacity because they presently administer some portion of their units directly through HUD. Initially, these local agents administered Section 8 units entirely through VHDA but over the years acquired additional units directly from HUD. These local agents no longer need the VHDA support structure and have the proven capacity to administer units directly. In addition, a few of the larger local agents which currently administer all of their units through VHDA have also expressed a desire to administer their Section 8 units directly through HUD. Local agents have been pursuing this issue with the authority for some time. According to a VHDA Section 8 program manager:

Local agents with direct HUD contracts should be able to do all of their units through HUD. There is overlap and duplication between the programs. Local agents have the skills and should be given local control. It's time for VHDA to let them fly.

Based on the JLARC staff survey of local agents, 20 of the local agents which responded to the survey would like to administer all of their units directly through HUD. This represents approximately 5,000 of the 11,900 units currently under the VHDA contract with HUD. A majority of the local agents that have expressed an interest in administering their units through HUD are presently administering both HUD and VHDA units. However, nine of the agents indicating that they would like to receive their units directly from HUD currently administer all of their units through VHDA.

Local Agents Would Benefit from Administering Units Directly with HUD

Local agents with the capacity to administer the program without VHDA assistance clearly would benefit financially from administering their units directly through HUD. They would receive 100 percent of the administrative fee for each unit instead of two-thirds of the fee, which is the average amount of the administrative fee allocated to local agents by VHDA. In addition, because HUD provides a higher per unit administrative fee for the first 600 units in a contract with a housing authority, they would receive a higher per unit rate for the first 600 units leased than they currently do.

The other major advantage for these local agents would be that this would remove a layer of bureaucracy and give them greater control over the administration of their programs. They would have control over the disbursement of payments to landlords and tenants and could communicate directly with HUD.

VHDA Needs to Assess Transferring Units

Some of these local agents have sought direct administration of their units for several years. In the past, VHDA has rejected all such requests. Its primary rationale has been that certain economies of scale would be lost, and the lost administrative fees would make it difficult to pay for the administration of the program. However, the current executive director appears to be more receptive to requests to transfer these units.

With the current inefficiencies in VHDA's administration of the program, it is difficult to assess whether VHDA could afford to lose the administrative fees associated with the units that would be lost and still cover the cost of the administration of the program. Certainly, some of the lost revenue from turning over the units to local agents could be made up by improved program efficiency. Moreover, there clearly would be some costs savings for VHDA resulting from the reduction in units and the number of administrative agents for which it would be responsible.

Given the benefits that would accrue to local agents if the units were turned over, VHDA needs to make every effort to reduce program costs. This would permit VHDA to accurately assess whether it could administer the program without the administrative fees from those agents' units, while ensuring that an adequate portion of the fee is allocated to the remaining local agents. VHDA then needs to develop a plan for turning over at least a portion of units to the local agents that desire to administer the program on their own.

Recommendation (12). The Virginia Housing Development Authority should perform a comprehensive evaluation of the financial impact of transferring Section 8 units to local agents that desire to administer all of their units directly through the United States Department of Housing and Urban Development, based on an accurate assessment of the funds needed by VHDA to administer the Section 8 program efficiently. VHDA should then develop a plan for the transfer of at least a portion of these units to the local agents.

V. VHDA's Mission

As mentioned previously in this report, the Virginia Housing Development Authority has a strong financial reputation and receives impressive ratings from the bond rating agencies. In addition, VHDA has a professional and competent staff, and VHDA's financing programs are generally well-managed.

While VHDA appears to be well-managed and enjoys a strong financial position, this review indicates that the authority could do more to meet its mission to help households obtain safe and sanitary housing that otherwise would be unaffordable. Instead, VHDA's highest priority appears to be maintaining a strong financial position and impressive bond ratings. This emphasis on financial strength is evidenced in the review of the VHDA programs discussed in the previous chapters. In both the single family and the multifamily programs, VHDA's primary emphasis appears to be on loan production instead of helping those most in need of assistance. This does not mean that individual VHDA staff are not committed to meeting the housing needs of low and moderate income Virginians; rather, the authority's focus on volume of loan activity and financial strength appears to result in programs which do not adequately address the housing needs of low income Virginians.

This focus on financial strength is most directly reflected by the authority's high fund balance. VHDA's fund balance exceeds what is required to maintain its financial strength. The authority could use more of this financial strength to further its mission to assist those otherwise unable to obtain affordable housing. In addition, executive salaries are appreciably higher when compared to other respected state housing finance agencies across the country.

The primary focus of VHDA's administration and programs needs to be on the authority's mission to help low and moderate income households obtain safe, sanitary, and affordable housing. To better accomplish this mission, the authority needs to conduct an examination of its current philosophy and programs and assess what changes need to be made to more effectively fulfill its mission. In addition, VHDA needs to be made more accountable to the General Assembly to ensure that the authority is adequately focused on fulfilling its mission.

VHDA HAS FINANCIAL STRENGTH THAT SHOULD BE BETTER UTILIZED

Based on a review of VHDA's financial position, it is apparent that VHDA has financial strength that could be better utilized to fulfill its statutory mission. VHDA has used less than its full financial strength to provide assistance to low and very low income households which could most benefit from the authority's assistance. This use of less than its full financial strength is evidenced by VHDA's conservative analysis of how much of its fund balance could be contributed to the Virginia Housing Fund, and

its contribution to the VHF is effectively less than recommended by the authority's own consultant. It appears that VHDA should examine whether it could annually contribute additional funds to the Virginia Housing Fund without jeopardizing its financial strength and bond ratings.

VHDA Consultant Recommends How Much Money Can Be Contributed Annually to the Virginia Housing Fund

In 1986, VHDA created the Virginia Housing Fund, which was the first and is the largest such fund of any state housing finance authority in the nation. This fund was created to provide housing for lower income families in creative and innovative ways. Over \$172 million has been capitalized in the VHF since its initial funding in 1987.

The VHF targets households at the lower income levels which currently are not being served by VHDA's traditional programs. A portion of the excess funds raised from the profits of VHDA's traditional single family and multifamily programs are transferred to the authority's general fund and then to the VHF to provide lower interest rate loans for mortgages and projects that otherwise would not be funded. VHDA financial and management staff have told JLARC staff that one of the major reasons for VHDA's emphasis on profit-making in its traditional single family and multifamily programs is to create more funds for VHF programs. However, only a portion of VHDA's profits from its traditional programs are reflected in the amount of funds that VHDA contributes to the VHF each year.

Over the 13 years that the VHF has been in existence, approximately \$235 million has been loaned. Of this amount, \$143 million has been used for single family loans, \$74 million for multifamily loans, and the remaining \$18 million has been used for Virginia Housing Partnership Fund loans and loans for special needs housing. (Approximately \$105 million of the \$143 million in single family loans has been made using bond resolution funds supported by \$37 million in VHF funds that have served as reserves.) These loan amounts (funded from VHDA's fund balances) are small relative to the funds loaned through VHDA's traditional loan programs (funded principally from bond proceeds). In FY 1999, VHDA loaned \$578 million in traditional single family mortgages. The total amount of VHF money loaned in single family mortgages during the past 13 years is less than one-fourth of this one year amount. Likewise, the total amount of VHF money used for multifamily loans during the past 13 years is equal to less than one-third of the \$257 million used in FY 1999 for traditional multifamily loans.

VHDA annually contributes \$20 million to the Virginia Housing Fund. VHDA derives the amount of its annual contribution from the periodic retention of a financial consultant to evaluate how much the authority can contribute to the VHF without adversely impacting its financial strength. CFX Incorporated (CFX) conducted the most recent analysis on behalf of VHDA in 1996. CFX concluded that VHDA could contribute between \$18 million and \$20 million in new money to the Virginia Housing

Fund annually for five years without having "an undue adverse impact" on the authority's financial strength.

Based on questions regarding the conclusions and the completeness of the CFX study, JLARC staff retained a financial consultant to review the CFX report as well as assess how much VHDA could contribute annually to the Virginia Housing Fund. The accounting firm that performed this analysis on behalf of JLARC was Reznick, Fedder & Silverman (Reznick).

VHDA Fund Balances Appear to Exceed Levels Necessary to Maintain Financial Strength

Assessments by CFX and Reznick both concluded that VHDA fund balances are in excess of the levels needed to maintain "top tier" financial status. Top tier status is one of several measures of financial strength used by rating agencies to evaluate housing finance agencies. This designation is given by Standard & Poor's to housing finance agencies that meet certain financial thresholds and have superior managerial and financial expertise. Eleven other state housing finance agencies have top tier status. VHDA has developed sizeable fund balances because it annually generates substantially greater income from mortgages and investments than it has expenditures.

Based on its analysis of VHDA's top tier status, CFX projected that by June 2000 VHDA would have nearly \$600 million of accumulated fund balances in excess of what would be required to meet rating agency guidelines for a highly rated housing finance agency. The analysis conducted by Reznick concluded that the CFX projection was "very conservative" and found instead that the authority's fund balance as of December 31, 1999, exceeded the minimum threshold for Standard & Poor's top tier rating by \$737 million.

Further evidence of VHDA's financial strength is its current issuer rating. Its AA+ rating from Standard and Poor's is the highest financial rating presently given to housing finance agencies. This rating is partially attributable to the sizeable fund balance that VHDA has accumulated. Most other housing finance agencies with top tier status have general obligation bond ratings of AA or AA-. The only other state housing finance agency with a AA+ rating is the West Virginia Housing Development Fund.

VHDA Needs to Assess How Financial Strength Can Be Better Utilized to Fulfill Its Public Mission

Clearly, VHDA has a great deal of financial strength. However, it could be used more effectively to fulfill its statutory mission. The authority's decisions, while perhaps in VHDA's best financial interests, raise questions about whether VHDA's decisions are the optimum way of accomplishing its mission.

VHDA has relied upon the CFX analysis to determine how much money VHDA could contribute to the VHF annually. However, this analysis was incomplete, and includes some questionable assumptions. In assessing how much money VHDA could contribute to the VHF, CFX conducted two types of analysis. The first analysis, referred to as the top tier analysis, assessed how much of VHDA's fund balance exceeded the level of fund balance needed to maintain its top tier status. Based on this analysis, CFX projected that VHDA would have an "excess top tier fund balance" of \$600 million by June 2000.

However, CFX conducted no further analysis of the extent to which this excess fund balance could be allocated to the VHF or other similar programs. CFX did not conduct any further analysis of this fund balance because it found that as a result of management policy choices, "much" of the substantial balance identified by the top tier analysis "consists of mortgage loans which are relatively illiquid and therefore not a steady source of cash for contribution to the Virginia Housing Fund." CFX's rationale for failing to pursue further the top tier analysis does not appear to have been supported by the consultant's own findings. CFX projected through its top tier analysis that as of June 2000 there would be \$230 million of excess liquidity (which the Reznick analysis has concluded actually would be \$245 million if a purely mathematical error made by CFX were corrected). Therefore, despite CFX's statement that "much" of VHDA's fund balance was illiquid, more than 40 percent of the June 2000 excess fund balance was projected by CFX to be liquid, according to top tier guidelines. Moreover, by simply modifying its policies or using an available line of credit, VHDA could have created additional fund liquidity. Rather than pursuing an analysis based on the funds it found to be liquid or those which could have been made liquid based on different management policies, CFX decided not to complete its top tier analysis and did not try to determine how much of this substantial excess fund balance could be contributed to the Virginia Housing Fund.

Instead, CFX performed a more restrictive capital valuation analysis to evaluate how much VHDA could contribute to the VHF. This analysis projected the cash flow from the liquidation of VHDA's existing assets and liabilities over the life of the existing bonds. The purpose of this analysis was to determine how much money could be withdrawn indefinitely each year in the form of cash from VHDA bond resolutions and the authority's general fund while maintaining a constant present value of expected future cash flows (the total valuation).

The Reznick analysis concluded that the CFX capital valuation analysis was "too mechanical" because it focused exclusively on numbers and did not consider all of the factors that should be considered in a decision about how much to allocate to the VHF. No qualitative factors were discussed in the CFX written report. Moreover, the Reznick analysis found several of the assumptions on which CFX based its analysis to be overly conservative or unrealistic.

One of the primary factors that the capital valuation analysis omits is VHDA's plans for current and future operations. The capital valuation analysis assumes no new housing finance or other profitable business activity by VHDA. VHDA clearly has

continued to produce new housing finance activity since the CFX report. Reznick notes that the CFX study also omits certain nonfinancial factors in determining how much money to allocate to the VHF. Specifically, VHDA needs to consider not only financial factors, but also such factors as Virginia's housing needs, programs established and capital needs in the VHF, bond availability, economic outlook and conditions, and the long-term goals and objectives of VHDA, none of which were incorporated into the capital valuation analysis.

Several of the assumptions used by CFX in the capital valuation analysis appear to have been overly conservative. For example, the total valuation of VHDA assets that CFX calculated appears to be substantially less than VHDA's actual fund balance. In addition, the assumption that operating expenses would grow into perpetuity was overly conservative. CFX assumed that these expenses would be incurred in the first five years at the level projected in VHDA's existing business plan and thereafter, increase by one percent annually from year six into perpetuity, even though CFX also assumed that VHDA would have no new housing finance or other profitable new business activity during this period.

Reznick further concluded that the assumption used by CFX that operating expenses would continue to grow after 30 years was unrealistic. In its analysis, CFX assumed a growth rate of one percent in operating expenses which continued into perpetuity (approximately 65 years), which is 35 years beyond the point at which all existing assets and liabilities would be liquidated. After 30 years all bonds would be repaid, all of VHDA's assets would be converted to cash, and operating expenses could be stopped. Reznick determined that a more realistic conclusion would be reached by assuming that operating expenses stop after year 30. Modifying only this assumption significantly impacts the results of the analysis conducted by CFX.

Finally, the assumption that contributions to the VHF, which presumably would be used for loans, would not be recoverable also appears to be unrealistic. In performing its analysis, CFX assumed that funds contributed would be removed from the assets of VHDA indefinitely. In reality, VHDA is recovering a high rate of the principal loaned through the VHF, as well as approximately \$8 million annually in interest from VHF investments and mortgages.

VHDA Could Allocate Substantially More than It Currently Allocates to the Virginia Housing Fund

In 1996, CFX recommended that VHDA could allocate \$18 to \$20 million in new money each year to the VHF. (CFX's capital valuation analysis actually indicated that VHDA could contribute \$26.7 million annually but reduced the amount recommended to \$18 to \$20 million without providing any rationale or explanation.) Reznick's review of the CFX report concluded that VHDA could allocate a substantially higher annual amount to the VHF. If the assumption regarding operating expenses after 30 years were more realistic, the amount that could be contributed using the capital valuation analysis would increase substantially. In addition, VHDA has not returned inter-

est generated by the VHF to the Fund, despite a CFX assumption to the contrary, effectively reducing VHDA's annual contribution to the VHF.

With Realistic Assumption, Amount that Can Be Contributed Increases Substantially. As mentioned in the previous section, the assumption that operating expenses will continue to have a one percent perpetual growth rate for 65 years when assets are converted to cash after 30 years appears to be unrealistic. If this assumption was modified and operating expenses were stopped after 30 years, the CFX analysis would produce a significantly different result. Applying the CFX analysis methodology with this more realistic assumption shows that VHDA would have \$34.4 million per year in excess revenue that could have been allocated to the Virginia Housing Fund, rather than the \$18 to \$20 million recommended in the CFX report.

Interest on VHF Assets Was Not Included in CFX Annual Allocation Amount. One of CFX's clearly stated assumptions in its report was that any interest generated from existing Virginia Housing Fund assets would remain in the VHF. Based on this assumption, it is clear that CFX's recommendation of an \$18 to \$20 million contribution to the VHF was separate from any calculation of interest income. VHF assets that existed at the time of the CFX study generate approximately \$4 million in interest annually. In determining that VHDA could contribute \$18 to \$20 million in new money to the VHF each year, CFX appears to have anticipated that this amount would be in addition to any amount earned in interest on existing VHF assets. However, VHDA states that this interest amount is included in its \$20 million annual allocation. As a result, VHDA is effectively reducing its annual contribution of new funds from \$20 million to \$16 million.

VHDA Effectively Contributes Less than \$20 Million Annually. In performing its analysis, CFX also assumed that no interest would be generated from subsequent contributions made to the VHF. However, inconsistent with the CFX assumptions, the contributions made by VHDA to the VHF since the time of the CFX study have generated earnings. In 1999, the interest earned from VHF investments and mortgages from contributions since the study was approximately \$4 million (resulting in a total of \$8 million in interest from VHF assets earned by VHDA in 1999).

VHDA currently returns this interest generated by VHF investments and mortgages to the authority's general fund, rather than to the VHF. As Part II of the regulations governing the Virginia Housing Fund states, however:

The fund is a revolving loan fund. It is the authority's intent that repaid principal plus interest, less any loss of interest or principal in the event of default sustained by the fund, will be recycled and loaned to additional projects up to the full amount of the fund as approved by the board.

This general principle makes clear that interest generated from VHF investments and mortgages was intended to remain in the Virginia Housing Fund.

Based on its assumption that no interest would be generated from future contributions to the VHF, CFX's recommended annual contribution to the VHF of \$18 to \$20 million clearly did not incorporate any interest calculation. By not returning the total \$8 million in interest earned both from existing assets and subsequent contributions to the Fund, in addition to the \$20 million VHDA contributes annually, VHDA is effectively reducing its annual contribution of new funds to the VHF from \$20 million to \$12 million. Therefore, VHDA's current contribution of new funds is almost one-third the \$34.4 million in new funds that it could be contributing to the VHF using its own consultant's methodology.

Recommendation (13). The Virginia Housing Development Authority should contribute the maximum amount feasible annually to the Virginia Housing Fund without having an undue adverse impact on VHDA's financial strength.

Recommendation (14). The Virginia Housing Development Authority should leave all interest generated from Virginia Housing Fund investments and mortgages in the Virginia Housing Fund.

VHDA Needs to More Effectively Analyze How Its Financial Strength Can Be Used

There appears to be strong demand for low-cost financing of both multifamily and single family housing. In terms of multifamily loans, the demand for traditional loans currently exceeds the supply: by the fall of 1999, the entire 2000 tax-exempt bond cap for housing had already been allocated; and in the year 2000 federal low income tax credit competition, \$2.18 has been requested for every \$1.00 available. The low-interest loans offered by VHDA for the VHF programs are attractive to multifamily developers of low-income housing. One barrier to the use of these VHF funds by multifamily developers is a self-imposed cap by VHDA on these loans of \$750,000. While this cap promotes the development of smaller projects, it also appears to anticipate a high demand for these funds, and therefore attempts to spread these funds among as many developers as possible.

There also exists strong demand for VHF funds to provide low interest single family loans. Several regional administrators of the VHF regional loan fund have told JLARC staff that they are able to use their currently allocated funds and that current demand exceeds the amount allocated. Clearly a demand exists for VHF loan monies, and both the CFX and Reznick reports show that VHDA has excess financial strength that could be used to meet this demand.

VHDA needs to fully reevaluate the approach it currently uses to assess how much it can contribute to the Virginia Housing Fund without adversely impacting its financial strength. If VHDA continues to generate profits in its traditional single family and multifamily programs, then these profits, which play a major part in VHDA's

financial strength, need to be reflected in the amount of funds that VHDA contributes to the VHF each year. With economic conditions constantly changing, VHDA needs to assess its financial strength more frequently so that the authority can more accurately determine how to effectively allocate its resources. In addition, VHDA should avoid a purely mechanical test such as the capital valuation analysis.

In determining the amount of funds that can be allocated to the VHF, VHDA needs to consider all pertinent factors such as plans for current and future business operations, tax-exempt bond availability, economic outlook and conditions, housing needs, long-term goals and objectives, the actual risk associated with contributions to the VHF, and bond rating agency requirements. In any future evaluation of the funds that can be allocated to the VHF, VHDA also needs to factor in its statutory mission to help households find safe and sanitary housing that otherwise might be unaffordable to them.

Recommendation (15). The Virginia Housing Development Authority should modify its current process for determining the amount of funds that can be allocated to the Virginia Housing Fund to include all relevant factors that will help VHDA to more accurately determine how much can be contributed annually. Each time VHDA conducts an assessment of how much it can contribute to the Virginia Housing Fund, the authority should report the results to the Virginia Housing Study Commission.

EXECUTIVE SALARIES ARE COMPARATIVELY HIGH

VHDA bases its executive salary structure on private market comparisons. While VHDA staff salaries overall appear in line with salaries for comparable positions in other agencies, VHDA executive base salaries are high in comparison to other independent agencies in the State as well as to housing finance authorities in other states.

Executive Salary Structure Is Based Almost Exclusively on Private Market Comparisons

VHDA executive salaries are based almost exclusively on a comparison to private financial market salaries. As a result, executive salaries are generally set above those of other governmental agencies in Virginia. There are currently no restrictions or limits on VHDA salaries as long as they are approved by the Board of Commissioners. The salary grade system established by VHDA allows the agency substantial discretion in setting individual salaries.

Lack of Limitations or Restrictions. VHDA has a 12 grade compensation system. However, this grade structure provides the authority considerable discretion

in setting executive salaries because the pay ranges for the top two grades are wide. Moreover, two executive level staff currently receive salaries that exceed the salary range for their pay grade. For the current fiscal year, the pay scale for grade 11 positions ranges from \$56,828 to \$145,860, a difference of \$89,032. For pay grade 12, the range is from \$71,036 to \$182,325, a difference of \$111,289. The executive and deputy executive directors are not subject to this pay grade structure. The executive director's salary is set by the Board of Commissioners and the deputy executive director's salary by the executive director.

Salaries Are Based on Private Market Comparisons. VHDA exclusively uses private market comparisons to establish executive salaries. Salary scales are based on periodic surveys conducted by consultants. The board believes that VHDA competes with private sector organizations, such as lending institutions, for competent and experienced employees. The authority's goal over the last several years has been to raise executive salaries to at least 97 percent of comparable private market base salaries. Based on the analysis of a management consultant recently retained by VHDA to evaluate salaries in comparison with comparable private market salaries, it appears that VHDA has been successful in achieving this goal. According to the consultant's analysis, five of the seven executive committee staff have salaries exceeding 97 percent of the comparable private market median base salary (Table 6).

Table 6

VHDA Competitive Market Analysis of Executive Staff Base Salaries

Position	VHDA FY 2000 Base Salary	Market Median Base Salary	VHDA % Market Median
Executive Director	\$176,868	\$221,700	80%
Deputy Executive Director	\$171,876	\$173,400	99%
Director of Finance	\$185,273	\$161,100	115%
General Counsel	\$159,366	\$140,600	113%
Director of Admin. Services	\$118,209	\$129,000	92%
Director of Multifamily	\$147,812	\$131,800	112%
Director of Single Family	\$138,340	\$131,800	105%

Note: VHDA salaries provided are base salaries and do not include bonuses awarded to executive staff. In FY 1995 through FY 1998 executive staff bonuses ranged between 2 and 7 percent of salary. No bonuses were paid to executive staff in FY 1999. Salaries listed for directors of Finance and Multifamily include lump sum payments because they are at the maximum of their pay range.

Source: VHDA / William Mercer Inc. data.

VHDA Salaries Are Generally Higher than Comparable Public Salaries

As part of JLARC's review of VHDA executive salaries, JLARC staff analyzed salary data from other state housing finance agencies as well as from the other Virginia independent authorities. From this review it is evident that VHDA executive salaries exceed salaries paid for comparable positions at other state housing finance agencies. In addition, VHDA executive salaries generally exceed salaries for comparable positions at other independent agencies in Virginia government. VHDA also provides employee benefits modeled on public sector benefit programs as well as an in-house fitness center staffed by a professional trainer and a subsidized cafeteria.

Salaries Higher than Other Housing Finance Agencies. Table 7 provides a comparison between VHDA salaries and the salaries paid for comparable positions at other state housing financing agencies that have been designated by Standard & Poor's as having top tier status. This table demonstrates the substantial difference in salaries paid between VHDA and housing finance agencies in other states.

Table 7

Executive Salaries at Top Tier State HFA's

Position	VHDA	California	Conn.	Mass.	Michigan	Minn.	Missouri	Penn.	Rhode Island	West Virginia
Executive Director	\$188,330	\$114,996	\$118,426	\$127,544	\$102,416	\$ 97,300	\$101,628	\$113,400	\$120,094	\$135,000
Deputy Executive Director	\$167,684	\$101,616	----	\$125,320	\$ 97,405	\$ 95,462	\$ 82,068	\$105,000	----	\$110,028
Director of Finance	\$181,640	\$ 96,012	\$105,170	\$106,442	\$ 97,405	\$ 78,948	\$ 91,548	----	\$107,352	\$ 69,960
General Counsel	\$156,241	\$ 91,440	\$107,293	\$123,573	\$ 64,978	\$ 80,150	\$ 62,844	\$ 92,400	\$ 70,000	\$ 69,096
Director of Admin.	\$115,891	\$ 75,504	\$ 98,069	\$102,115	\$ 85,086	----	----	----	----	----
Director of Multifamily	\$144,914	\$ 79,512	\$ 99,270	\$103,289	\$ 90,159	\$ 80,760	\$ 60,816	\$ 88,600	\$ 93,600	----
Director of Single Family	\$134,966	\$ 79,512	\$ 92,015	\$100,244	\$ 83,436	\$ 80,760	\$ 49,740	\$ 88,600	\$ 89,480	\$ 80,136

Note: All salaries shown are as of March 1999. VHDA base salaries, for some positions, include lump sum longevity bonuses. Current base salaries for VHDA executives are listed in Table 6. Salaries listed for directors of Finance and Multifamily include lump sum payments because they are at the maximum of their salary range.

Source: VHDA data.

VHDA Salaries Higher than Most Positions at Other Virginia Independent Agencies. As part of its review of VHDA executive salaries, JLARC staff conducted a review of executive salaries at other independent agencies across the State (Table 8). The number of positions for which JLARC staff could conduct comparisons was limited because, for several positions, there were no comparable positions at other State agencies. VHDA executive staff earn more than most executive staff in comparable positions at the other independent State agencies.

VHDA Models Benefits on Public Sector. While VHDA compares itself to the private market for purposes of setting salaries, the authority tries to model other benefits provided on the public sector. VHDA employees receive comparable health and disability insurance benefits to those offered to public sector employees with a lesser cost to individual employees. In addition, employees receive comparable retirement benefits and holiday and annual leave. VHDA also offers greater job security and stability than the private sector.

Executive Staff Turnover Is Extremely Low. VHDA believes that higher executive salaries are needed to retain staff that might otherwise be lost to jobs in the private sector. Over the past 10 years, however, only three executives have left VHDA. Two of those individuals retired, and the other employee's position was eliminated.

Table 8

Average Executive Base Salaries at Virginia's Independent State Agencies

Position	VHDA	Virginia Retirement System	State Corporation Commission	State Lottery	Virginia Economic Development Partnership	Workers Compensation Commission	Virginia Port Authority
Executive Director	\$176,868	\$120,986	\$121,936	\$118,324	\$170,000	\$ 125,610	\$ 155,505
Deputy Executive Director	\$171,876	\$115,600		\$105,362		\$ 93,500	\$ 119,600
General Counsel	\$159,366		\$115,800	\$ 74,182			
Director of Communications	\$112,732		\$ 72,699	\$ 89,602	\$ 43,617		\$ 63,600

Notes: All figures are based on FY 2000 data. Except for Executive Director salaries, other agencies' salaries are the current midpoint for the grade. The VHDA Director of Communications was removed from the Executive Committee in 1997. For VHDA and some other agency positions, employees are eligible to receive annual incentive bonuses. The director of the Port Authority is eligible for a 35 percent annual bonus.

Source: JLARC survey data.

VHDA Has Ongoing Concerns About Salary Competitiveness

VHDA staff continue to have concerns that salaries are not sufficiently competitive to recruit and retain staff. As a result, the authority hired a consultant to evaluate the salary structure and make recommendations. The consultant concluded that although executive level staff had base salaries close to comparable private market positions, the market comparisons did not take into account substantial bonuses received by comparable employees in the private sector. Therefore, the consultant concluded that executive staff were not receiving comparable total compensation.

VHDA's consultant recommended that salary ranges be adjusted upward to more closely match the total compensation received in similar private sector positions and that executive staff be given annual performance bonuses targeted at 10 percent of salary. Based on the consultant's recommendations, VHDA has recently implemented new higher salary ranges for executive level positions for FY 2001 (Table 9). These new salary ranges for the executive and deputy directors are substantially higher than the current ranges and do not include recommended performance bonuses.

Table 9

Proposed VHDA Executive Salary Ranges for FY 2000-01

Position	Minimum	Midpoint	Maximum
Executive Director	\$165,000	\$220,000	\$275,000
Deputy Executive Director	\$127,500	\$170,000	\$212,500
Director of Finance	\$120,000	\$160,000	\$200,000
General Counsel	\$105,000	\$140,000	\$175,000
Director of Admin. Services	\$97,500	\$130,000	\$162,000
Director of Multifamily	\$97,500	\$130,000	\$162,000
Director of Single Family	\$97,500	\$130,000	\$162,000

Note: These proposed salary ranges are for base salaries and do not include recommended annual performance bonuses.

Source: VHDA / William Mercer Inc. data.

CONCLUSION: VHDA COULD BETTER FULFILL ITS MISSION

VHDA could better fulfill its public mission. While VHDA enjoys a strong financial position and high bond ratings, it could use more of this financial strength to further its mission to provide housing to individuals otherwise unable to afford it. VHDA needs to conduct a reexamination of its philosophy and programs and make necessary modifications to better meet its mission. VHDA also needs to be made more directly accountable to the General Assembly to better ensure that it is meeting its mission.

Public Mission Is Not Adequately Prioritized

Based on this review of VHDA programs, it is apparent that generating revenue and maintaining impressive financial strength is a high priority for the authority. This emphasis on financial strength is most clearly evidenced by the amount of profit generated by VHDA annually and its large fund balance. However, VHDA is not using this strength sufficiently to meet its mission. VHDA contributes less to the VHF than appears possible based on its financial strength.

This focus on financial strength is also clearly evidenced from JLARC's review of the single family loan program. As was discussed in Chapter II, the single family loan program is designed to maximize the number of loans closed with less consideration given to the quality of the assistance provided by the products. The loan products do not offer significantly lower interest rates than those offered by the private market, and more than one-third of those served could qualify for private market loans.

The review of the multifamily program further reflects the authority's need to focus more on its mission. As discussed in Chapter III, VHDA has helped to finance a substantial number of multifamily projects, but the authority has not made an effort to conduct an analysis of housing needs in Virginia. Similarly, VHDA has not made much effort to encourage affordable rents for the multifamily projects financed by the authority.

Finally, the problems with VHDA's administration of the Section 8 program further reflect the authority's need to focus more on providing housing assistance. VHDA chose not to fully utilize Section 8 funds to give itself an additional financial cushion that does not appear to have been necessary.

Assessment of VHDA Programs Needs to Be Undertaken

This review reveals that VHDA needs to examine its current philosophy and programs to assess how it can better utilize its impressive resources to more effectively fulfill its statutory mission to help provide safe and sanitary housing to those other-

wise unable to afford it. This may require VHDA to change its overall priorities and to make some specific program modifications.

While maintaining financial strength is essential to its future success, the authority needs to balance its emphasis on financial strength with the quality of the assistance provided by its loan products. This will be essential for it to more effectively meet its public mission.

As discussed in Chapter II, at a minimum VHDA needs to develop new single family loan products specifically designed to provide meaningful assistance to low income households in the purchase of their first home. To the extent that VHDA continues to generate revenue through single family loan products that are not substantially different than private market products, the authority needs to transfer more of the cash flow generated from such loans to provide meaningful assistance through the Virginia Housing Fund to the extent feasible.

As discussed previously in this chapter, VHDA needs to prioritize its commitment to the Virginia Housing Fund. The authority needs to better balance its goal of increasing its fund balance and financial strength with the need to provide more financial assistance to the VHF. In considering this issue, VHDA needs to more accurately and reasonably assess how much it can afford to contribute to the VHF without having an undue adverse impact on its financial strength.

VHDA should work to more effectively meet its mission in the multifamily area as well. As discussed in Chapter III, VHDA needs to regularly conduct an analysis of housing needs in the State and proactively take action to encourage the development of projects that meet those needs. Moreover, the program needs to give more attention to the rents charged so that the tenants will not have an unreasonable housing cost burden.

Finally, as discussed in Chapter IV, VHDA needs to make every effort to use all Section 8 funds provided to the State by HUD. In addition, executive staff need to ensure that the program receives the management necessary to ensure that the funds are effectively disbursed and the local agents are adequately supported and equitably treated in their day-to-day administration of the program.

Additional Oversight Needed

While it is important that VHDA maintain its independence, this review indicates the need for VHDA to have increased accountability to the General Assembly. VHDA was created by the General Assembly, and the authority's ability to operate as a self-supporting agency is directly the result of its ability to issue tax-exempt bonds created by the federal government and allocated to the State of Virginia. Therefore, it is directly accountable to the General Assembly.

Establishing some additional oversight and accountability will help to ensure that VHDA is adequately focused on fulfilling its mission. The primary areas in which the General Assembly may wish to exercise periodic oversight are the financial position of the authority and utilization of Section 8 funds.

One of the most important aspects of this oversight would be to review periodically the financial position of VHDA to assess whether the authority has excess financial strength that could be utilized to provide greater assistance in furtherance of the authority's mission. The General Assembly may want to direct the Housing Study Commission to play an oversight role in VHDA's financial analysis and in administration of the Section 8 program.

Recommendation (16). The General Assembly may wish to consider whether the Virginia Housing Study Commission should play a more active role in oversight of the Virginia Housing Development Authority in its financing of housing programs. The Virginia Housing Study Commission may also wish to conduct oversight of the Section 8 program in its oversight of VHDA.

Appendixes

	<i>Page</i>
Appendix A: Study Mandate.....	A-1
Appendix B: Incidence of Housing Problems by Income Category	B-1
Appendix C: Agency Responses	C-1

Appendix A

House Joint Resolution No. 731 1999 Session

Directing the Joint Legislative Audit and Review Commission (JLARC), with the assistance of the Virginia Housing Study Commission, to study the various programs administered by the Virginia Housing Development Authority (VHDA).

WHEREAS, the Virginia Housing Development Authority was created in 1972 to assist in addressing the serious shortage of sanitary and safe residential housing which existed in Virginia; and

WHEREAS, a major objective of VHDA was to provide residential housing at prices or rentals which persons and families of low and moderate income could afford; and

WHEREAS, over the past twenty-seven years, VHDA has succeeded in providing housing for many Virginians who could not have otherwise afforded sanitary and safe housing; and

WHEREAS, one of the many housing programs administered by VHDA is the Section 8 Rental Certificate and Voucher program, funded by the federal government, with overview by the U. S. Department of Housing and Urban Development (HUD); and

WHEREAS, HUD, as a part of a \$ 5.2 billion congressionally mandated recision, recovered approximately \$ 31 million from the Virginia Section 8 Certificate and Voucher program administered by VHDA; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Joint Legislative Audit and Review Commission (JLARC), with the assistance of the Virginia Housing Study Commission, be directed to study the various programs administered by the Virginia Housing Development Authority, particularly the Section 8 Program, and determine whether the programs are operating in accordance with the declaration of intent set forth in §36-55.25 of the Code of Virginia and that the housing needs of low and moderate income Virginians are being addressed by VHDA. The Commission shall also review the performance, operation, management, and organization of the Virginia Housing Development Authority.

All agencies of the Commonwealth shall provide assistance to the Commission, upon request.

The Joint Legislative Audit and Review Commission shall complete its work in time to submit its findings and recommendations to the Governor and the 2001 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Appendix B

Incidence (Percent) of Housing Problems within Income Levels, by Planning District

Planning District	Income Levels (Percent of Area Median Income)				
	Poverty (0-30%)	Very Low (31-50%)	Low (51-80%)	Moderate (81-95%)	Upper (96% +)
1. Lenowisco	67.7%	38.8%	20.2%	11.0%	4.8%
2. Cumberland Plateau	67.8	36.3	18.9	8.4	4.4
3. Mount Rogers	62.0	37.5	19.0	10.9	4.6
4. New River Valley	76.9	57.4	29.8	13	4.6
5. Fifth	68.9	49.9	23.0	11.0	3.8
6. Central Shenandoah	68.4	50.6	24.7	14.0	6.4
7. Lord Fairfax	70.7	50.3	31.1	21.0	8.9
8. Northern Virginia	78.3	78.6	69.6	55.4	20.1
9. Rappahanock-Rapidan	67.4	49.3	37.4	27.9	13.7
10. Thomas Jefferson	74.1	56.4	38.1	18.7	7.4
11. Central Virginia	67.0	44.4	22.1	11.7	4.6
12. West Piedmont	66.4	41.9	21.2	11.8	4.7
13. Southside	70.2	46.0	25.2	19.1	7.3
14. Piedmont	71.3	44.3	25.5	17.4	7.3
15. Richmond Regional	72.5	64.0	37.4	20.5	6.1
16. RADCO	69.3	59.3	47.3	32.9	11.3
17. Northern Neck	73.9	46.1	32.5	23.5	10.1
18. Middle Peninsula	73.8	50.1	37.1	21.2	9.2
19. Crater	70.3	50.4	25.9	13.0	5.7
22. Accomack-Northampton	76.5	54.7	29.1	16.6	8.4
23. Hampton Roads	74.7	70.7	51.7	32.8	13.2

Source: JLARC analysis of Virginia Center for Housing Research data.

Note: The incidence of housing problems within each income level includes both owner and renter households.

Appendix C

Agency Responses

As part of an extensive data validation process, each State agency involved in a JLARC review 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 this version of the report.

This appendix contains the responses of the Secretary of Commerce and Trade and the Virginia Housing Development Authority.



JUN 6 2000

COMMONWEALTH of VIRGINIA

Office of the Governor

June 1, 2000

James S. Gilmore, III
Governor

Barry E. DuVal
Secretary of Commerce and Trade

Mr. Philip A. Leone
Director
Joint Legislative Audit and Review Commission
Suite 1100
General Assembly Building
Richmond, Virginia 23219

Dear Mr. Leone:

Thank you for providing me with a copy of the exposure draft of your report: Review of the Virginia Housing Development Authority. Your staff has obviously taken a great deal of time to provide a thorough review of a complicated subject.

VHDA has a long history of providing low and moderate income housing while maintaining top ratings for financial performance. My office is carefully examining the issues that have been raised in the Review. Moreover, I have asked the Executive Director of VHDA for a full response to the recommendations offered by JLARC.

I look forward to working with VHDA, JLARC and the General Assembly to address the issues raised by the Review.

Sincerely yours,

A handwritten signature in cursive script that reads "Barry E. DuVal".

Barry E. DuVal

BED:jcd



June 8, 2000

Mr. Philip Leone, Director
Joint Legislative Audit and Review Commission
Suite 1100, General Assembly Building
Capitol Square
Richmond, VA 23219

Dear Mr. Leone:

VHDA has reviewed JLARC's report on the Authority's activities and operations. We appreciate the professional manner in which the study was conducted. Such periodic reviews are healthy, and we intend to use the report in our ongoing efforts to consider ways in which we can continue to improve our service to the citizens of the Commonwealth.

Following is VHDA's written response to the issues JLARC has raised. Our detailed comments regarding particular facts put forth in the report and the assumptions underlying the specific findings drawn from those facts were shared with you at length in our meeting on June 5. This written response is intended to provide an overall summary of VHDA's position regarding the issues raised and the steps that VHDA intends to take to follow up on the recommendations made. VHDA's written comments on each of the report's specific recommendations are contained in Enclosure A.

Many of the issues raised by JLARC have been under review by VHDA during the past year. VHDA and JLARC are in general agreement on the future direction the Authority should take in fulfilling its mission and purpose. In many cases, steps are already being taken to enable VHDA to better pursue that direction. Furthermore, it is VHDA's belief that although JLARC has drawn some incorrect assumptions from the facts reviewed and has, at times, made assertions not warranted by the facts, the questions raised and the challenges posed in its recommendations are generally valid and appropriate. VHDA is committed to continuing to address the public purpose challenges posed by JLARC and accepts the Authority's responsibility to openly and forthrightly account to the Administration and General Assembly on a regular basis for its sound stewardship of the Commonwealth's resources.

Virginia Housing Development Authority
601 South Belvidere Street • Richmond, Virginia 23220-6500
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Website: www.vhda.com

VHDA's mission/purpose. VHDA and JLARC are in agreement regarding the Authority's primary mission/purpose and the nature of the housing needs which VHDA was created to address. In 1972, the General Assembly found there to be "a serious shortage of sanitary and safe residential housing at prices or rentals which persons and families of low and moderate income can afford" and, therefore, created the Virginia 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..." At that time, Virginia still had a considerable amount of poor quality housing needing to be upgraded or replaced. In 1970, nearly 200,000 housing units—over 13% of Virginia's entire housing stock—lacked complete indoor plumbing. In addition, the Commonwealth was experiencing unprecedented demand for new affordable housing generated by the entry of the baby boom generation into the housing market. Both of those needs were exacerbated by inflation and rising interest rates which pushed the cost of new and rehabilitated housing beyond the means of a significant share of Virginians.

Since 1972, considerable change has occurred in housing conditions and needs in the Commonwealth. For example, seriously substandard housing now comprises a relatively small share of total housing units; interest rates and inflation have declined; and many baby boomers are now "trading up" to their second home. Nevertheless, as JLARC has documented, considerable housing needs remain to be addressed. Affordability is now the primary housing problem for most households with unmet housing needs. In addition there is an ongoing need to preserve the Commonwealth's aging stock of affordable housing, a need to provide appropriate housing linked with supportive services for the frail elderly and people with physical and mental disabilities, and a need to expand housing opportunities for the Commonwealth's minority and growing immigrant populations.

VHDA's fundamental business philosophies. From its inception, VHDA has embraced a number of fundamental business philosophies that have shaped the Authority's response to its public purpose mandate. The Authority believes that these business philosophies, and the policies arising from them, have aided the accomplishment of the Authority's mission and purpose. We remain open to reviewing these philosophies as circumstances warrant, but do not view them as inherently inconsistent with the expansion of our efforts to best serve Virginia's highest priority housing needs.

- **Maximization of the number of persons served.** In light of the substantial excess of housing needs relative to resources, VHDA has sought to develop programs, products and services that enable the Authority to serve the largest number of low- and moderate-income persons possible. VHDA believes that this philosophy is consistent with its legislative mandate to address the broad and extensive housing needs of low- and moderate-income Virginians and that it has been carried out in a manner that has not resulted in a disproportionate focus on or benefit to moderate income households. This philosophy, except when in direct conflict with other important mission-related goals (e.g., addressing particular priority housing needs that require greater amounts of subsidy), has been generally adhered to over time.

- **Management of resources on a conservative/long-term basis.** VHDA believes that housing problems cannot be resolved through one-time, short-term actions. Rather, they involve long-term needs that must continue to be addressed as the existing housing stock ages and new affordable housing must be created to serve a growing number of households. Quality affordable housing is a long-term investment that must be adequately managed and recapitalized over time. Therefore, VHDA manages its resources and assets on a conservative/long-term basis to ensure the ongoing availability of adequate capital to address future housing needs.
- **Maintenance of organizational adaptability.** The difference between the cost of quality housing and the amount that low- and moderate-income households can afford to pay is very large. Subsidies are required in order to bridge this affordability gap. Such subsidies, including the tax-exemption on VHDA bonds, are provided or authorized by public entities external to VHDA (primarily the IRS and HUD) and, therefore, remain largely outside the Authority's control. At the same time, VHDA raises its mortgage funds in the private capital markets and relies on partnerships with private mortgage lenders and the private housing industry to deliver its products and services. Therefore, VHDA has adopted an organizational and management structure that enables adaptability to changes in the availability of external public resources and the private business environment in which the Authority must operate.

Policy choices arising from VHDA's business philosophies. The following key policy choices cited by JLARC have arisen from VHDA's fundamental business philosophies.

- **Building and maintenance of fund balances/financial strength.** During the early years of the Authority's history when deep federal subsidies were available to support the development of rental housing affordable to very low-income households, VHDA, along with many other state housing finance agencies, aggressively built substantial fund balances in order to create a strong financial base with which to support long-term program activities. Those financial management policies proved fortuitous during the middle and late 1980's when the federal government took a succession of actions that sharply curtailed the subsidy resources relied on by VHDA and other state housing finance agencies to enable their programs to reach lower income households. Those federal actions included: (1) the elimination of direct deep federal subsidies for the development of rental housing affordable to very low-income households; (2) a sharp curtailment of federal tax incentives for private investment in rental housing; and (3) the imposition of significant restrictions on state and local authority to issue tax-exempt bonds. VHDA continued its policy of building and maintaining fund balances as it became clear that in the future the Authority would have to rely heavily on the issuance of taxable bonds and the use of internally generated subsidy funds (i.e., the Virginia Housing Fund) in order to continue addressing the significant unmet housing needs of the Commonwealth (Enclosure B).

- **Maximization of resources.** VHDA cannot carry out its philosophy of maximizing the number of people served without adopting a policy of maximizing the use of all available resources. This policy has been carried out in several ways. For example, VHDA has generally tried to maximize the benefit derived from available home purchase resources by avoiding over-subsidization of individual homebuyers—i.e., providing only as much assistance as is necessary to enable individual homebuyers to meet loan qualification requirements in order to serve a larger number of low-income homebuyers. VHDA has also chosen to structure programs in a manner that maximizes the total amount of resources available to address housing needs. For example, VHDA's multifamily tax-exempt bond program blends tax-exempt and taxable bond funds in each loan in order to stretch the use of limited tax-exempt bond resources and maximize the amount of 4% federal Low Income Housing Tax Credits available to developers of affordable rental housing (4% tax credits are automatically made available to projects in which the majority of loan funds are tax-exempt bonds). In VHDA's single family loan programs, the blending of tax-exempt and taxable bond funds has enabled the Authority to serve far more households in need of home purchase assistance—**more low income households** as well as more moderate income households—than would otherwise be possible using tax-exempt bond funds alone (Enclosure C).
- **Operation on a private business model.** VHDA has chosen to operate on a private business model in order to successfully manage a large and complex mortgage business that must link strong long-term private partnerships with external public subsidies in order to address difficult housing needs. VHDA's private partners demand efficiency and sound business practices, while the Authority's public stakeholders demand creative and effective responses to unmet housing needs. VHDA has striven to recruit and retain dedicated, skilled and creative staff in order to continue meeting these challenges. This need will grow as the Authority is challenged to restructure its programs and operations to keep pace with the radical transformation that is occurring in mortgage lending through industry consolidation and technological change.

Validation of businesses philosophies and policies. VHDA believes that the validation of its business philosophies and policies lies in the results they have achieved.

- **Use of financial strength to increase resources for affordable housing.** VHDA uses its financial strength in a number of significant ways to benefit households that need housing assistance. The Authority's high bond ratings have enabled VHDA to offer lower interest rates on its loans than would otherwise be possible. In addition, VHDA's high bond ratings have enabled the Authority to issue very substantial amounts of taxable bonds under favorable terms and conditions to offset the shrinking amount of tax-exempt bonds that VHDA can issue under current IRS restrictions (Enclosure B). In calendar years 1997 through 1999, fully 74 percent of the total loan capital raised by VHDA was from the sale of taxable bonds. High bond ratings have

also enabled VHDA to be a leader among state housing finance agencies in the development of creative higher risk loan products that address the many credit barriers, in addition to interest rate, that prevent low- and moderate-income households from being able to purchase a home. Finally, and most importantly, VHDA's high level of net revenues has enabled the Authority to create \$172 million in internally generated low-interest capital to support the programs of the Virginia Housing Fund. This is far and away the largest amount of internally-generated subsidized loan capital produced by any state housing finance agency.

- **Service to low-income Virginians.** The Virginia Housing Fund has enabled VHDA to serve the needs of a substantial number of low- and very low-income households that would otherwise not be possible. Whereas many other state housing finance agencies rely on federal HOME funds or state housing trust fund resources that they administer to support their lending programs serving the needs of low- and very low-income households, VHDA has had to rely on internally generated resources to meet those needs. In addition, through creative program design—in part made possible by VHDA's financial strength—the Authority's bond programs and activities have provided benefit to a greater number of low-income households than those of most other state housing finance agencies including those specifically cited by JLARC (Enclosure C).
- **Creativity and innovation in the use of resources.** VHDA has become widely recognized as a leader among state housing finance agencies in the development of innovative products and services to address the Commonwealth's unmet housing needs. This is the direct result of VHDA's operation on a private business model and the Authority's ongoing efforts to attract and retain creative, skilled and dedicated staff.

VHDA's accountability to the Commonwealth. VHDA accepts its accountability to the Commonwealth in the fulfillment of its mission and the considerable public responsibilities that entails. While VHDA receives no direct state appropriation of funds, the Authority nevertheless operates with indirect subsidies provided to it by the Commonwealth (i.e., VHDA's nonprofit status and its authority to issue tax-exempt bonds) and allocates/ administers considerable housing subsidies on the Commonwealth's behalf (i.e., federal Section 8 subsidies and Low Income Housing Tax Credits). As JLARC fairly notes, these subsidies require responsible stewardship. The Authority's size and financial strength require it to demonstrate substantial leadership in addressing the housing needs of the Commonwealth. While VHDA's results have been considerable and exceed those of virtually all other state housing finance agencies, it is appropriate for the Commonwealth to question, as JLARC has done, whether the Authority has fully and adequately used the resources entrusted to it to the fullest. VHDA agrees with JLARC that as a steward of the Commonwealth's resources, VHDA must answer not only for the contributions it has made, but also for any resources left on the table.

VHDA's acceptance of the challenges posed by JLARC. VHDA fully accepts and intends to address the following challenges posed directly or indirectly in JLARC's report.

- **New fund balances study.** VHDA's current five-year business plan calls for the fund balances study to be updated in FY 2002. In light of the questions raised by JLARC in regard to certain of the assumptions made by VHDA's consultant (cfX), VHDA intends to accelerate the timing of a new report in order for its findings to be implemented in FY 2001. The Authority recognizes the need to work with the Administration and the General Assembly in regard to the manner in which an updated study is conducted. Therefore, VHDA proposes to involve the Department of Housing and Community Development and the Virginia Housing Study Commission in the selection of a consultant and the determination of the appropriate assumptions on which a new report should be based.
- **Improved management of Section 8.** While the HUD Inspector General and JLARC both found VHDA's overall management of the Section 8 program to be sound, VHDA accepts that its conservative management of program funds resulted in lesser use of subsidy resources than was possible under certain directives received from HUD and, thereby, contributed to the recapture of program funds. VHDA fully understands the impact of that recapture and subsequent leasing moratorium on very low-income citizens of the Commonwealth, and is fully committed to ensuring that program funds are utilized to the maximum extent possible in the future. Over the past year, VHDA has begun to take the necessary steps to correct the deficiencies cited by JLARC including the elevation of the Section 8 program to a high level of management priority. VHDA has contracted with Abt Associates, a national expert in the management and administration of the Section 8 program, to comprehensively review and recommend the administrative changes required to fully address the findings and recommendations made by the HUD Inspector General and JLARC. That report is to be delivered to VHDA in August and the Authority fully intends to act on its recommendations in an expeditious manner.
- **Greater openness/outreach to all stakeholders.** VHDA recognizes that it would benefit by the increased involvement of all stakeholders in the planning, allocation and management of its resources. Steps have been taken over the past year to create sufficient opportunities for meaningful two-way communication between stakeholders and VHDA. In December, VHDA reported to the General Assembly in House Document No. 31 on its plan for improving its communication with local governments and members of the housing industry regarding the administration of the Authority's multifamily housing programs. VHDA intends to build upon that plan in order to improve communications and relations with all stakeholder groups. The VHDA Board of Commissioners has been involved in these outreach efforts in order to be part of an active dialogue with the public concerning housing needs.

- **Proactive leadership in identifying and addressing critical unmet housing needs.** The JLARC report challenges VHDA to be less reactive and more proactive in addressing the critical unmet housing needs of the Commonwealth. Specifically, the report recommends that the Authority take the lead in carrying out housing needs assessments with which to better ensure that VHDA's resources are allocated in a manner that best addresses the priority housing problems in each area of Virginia. VHDA accepts this recommendation while recognizing its need to carry out this responsibility in close coordination with the Department of Housing and Community Development, the Housing Study Commission, local governments, local housing authorities and planning district commissions. In the past year, the General Assembly has specifically challenged VHDA to exercise greater leadership in addressing the housing needs of the frail elderly, people with physical and mental disabilities, and minority and immigrant homebuyers. VHDA is currently assisting the Department of Housing and Community Development in organizing and managing an inter-agency assisted living advisory group to identify and implement working models for developing affordable assisted living opportunities in the Commonwealth. VHDA intends to actively work with the Department of Housing and Community Development, the Department of Mental Health, Mental Retardation and Substance Abuse Services, the Disability Commission, the Housing Study Commission and other partner organizations to implement the recommendations of Senate Document No. 12 and to carry out the legislative study mandated under by the 2000 General Assembly in HJR 254 as incorporated in HJR 253.
- **Improved coordination of state-controlled subsidy resources.** The state housing finance agencies cited by JLARC as offering programs more clearly targeted to the needs of low-income households, are able to utilize a wider array of external federal and state housing subsidies than are available to VHDA. Many of their targeted lending programs rely on the use of federal HOME funds, state housing trust fund monies or other federal or state subsidies that they directly administer on their state's behalf. In order for Virginia to match such initiatives, greater efforts must be made to better coordinate the planning, allocation and use of all housing resources controlled by state-level entities so that, in total, all state-controlled resources are put to optimal use. VHDA is prepared to be proactive in seeking ways for better coordination to occur.
- **Building collaborative partnerships to address key priorities.** The most critical housing needs in the Commonwealth cannot be addressed without layering multiple resources and subsidies that are frequently administered/managed by different organizations. VHDA accepts its need to become a more active collaborative partner with other entities (e.g., local governments, public housing authorities, nonprofit organizations, HUD, and social service agencies) in order to better address the Commonwealth's key housing priorities, and fully commits to doing so.

In closing, I would like to reiterate VHDA's belief that while the Authority disagrees with many of the specific assumptions and assertions made by JLARC regarding VHDA's programs, activities and use of resources, we nevertheless fully accept the appropriateness of the questions raised and challenges posed by JLARC, and recognize our responsibility to address those questions and issues openly on an ongoing basis with the Administration, the General Assembly and VHDA's other stakeholders.

Thank you for the opportunity to respond to your report.

Sincerely,

A handwritten signature in black ink that reads "Susan F. Dewey". The signature is written in a cursive style with a large, looped "S" and "D".

Susan F. Dewey
Executive Director

SFD:BSM:bm
Enclosures: [3]

Enclosure A—VHDA Responses to JLARC Recommendations

Single Family Loan Programs

JLARC Recommendations	VHDA Response
<p>1. VHDA should conduct a review of the single family loan program to assess how the program can be improved to better meet VHDA's mission. VHDA should present its findings to the Board of Commissioners with recommended modifications.</p>	<p>VHDA agrees fully with the value of regularly evaluating how well current products, programs and services are addressing the needs of low- and moderate-income homebuyers, and considering opportunities to better target assistance to those most in need. VHDA regularly reviews its single family loan programs through analysis of unmet housing needs; analysis of current market trends and conditions; information provided by stakeholders; and evaluation of existing and potential products and programs by VHDA's inter-divisional single family new products team. VHDA will continue these activities with specific consideration to the issues and potential opportunities identified by JLARC. Recommendations will continue to be made to VHDA's Board of Commissioners on means to address specific low- and moderate-income housing needs currently not being met by the private sector.</p> <p>VHDA is currently considering several new programs that would, in addition to addressing the needs of low and moderate income homebuyers, also provide funds to rehabilitate aging housing stock and provide relief to current homeowners that are temporarily experiencing financial problems due to unemployment. VHDA will also be assisting the Housing Study Commission in reviewing how the Authority's single family programs can better serve the needs of minority and immigrant populations.</p>
<p>2. VHDA should develop one or more loan products targeted to low-income households that provide substantially more assistance than financing provided by the private lending market.</p>	<p>VHDA is in full agreement with the need to expand loan programs such as the Regional Loan Fund that are specifically targeted to low-income borrowers. VHDA is committed to continuing its support for the Regional Loan Fund program and other initiatives, such as VHDA funding for local Habitat for Humanity programs, which target low- and very low-income households. VHDA will continue to seek opportunities to develop additional programs targeted to low-income households and will continue to set annual lending objectives for loans made to households with income of 60% or less of HUD area median income as adjusted for household size.</p>

Enclosure A—VHDA Responses to JLARC Recommendations

Multifamily Loan Programs

JLARC Recommendations	VHDA Response
<p>3. VHDA should conduct a fundamental review of the processes by which rents are set for the projects it finances. In addition, VHDA should evaluate how it could provide incentives to developers to provide more affordable rents. Options that should be considered include further lowering interest rates on VHDA financing and providing additional equity to developers through second mortgages.</p>	<p>VHDA has policies to encourage lower rents. For example, the Low Income Housing Tax Credit allocation plan provides an incentive for developers to set rents that are affordable to tenants with incomes of 50% or less of area median income. Nevertheless, the affordability gap for many Virginians is sufficiently large that VHDA must continue to seek additional ways to achieve greater rent affordability in the developments it finances.</p> <p>This will continue to be a major challenge in the absence of deep subsidy funds. Absent such subsidies, the provision of affordable rents must be balanced with the need to maintain the ongoing physical quality and financial viability of rental projects. In the 1970's, HUD relied on rent restrictions to ensure the ongoing affordability of projects financed for low-income occupancy under the Section 236 loan program. When inflation pushed up operating costs in those projects, Congress had to authorize the Flexible Subsidy program and Loan Management Set-Asides of Section 8 subsidies in order to prevent large-scale defaults. VHDA lacks appropriated public subsidies with which to provide such deep levels of project assistance.</p> <p>In addition, restrictions that prevent tenants from paying in excess of 30% of income for rent can, in practice, deny access to quality housing to very low-income households. This problem is recognized even in the Section 8 program where the subsidy for voucher recipients is set based on a rental payment equal to 30% of income, but where voucher holders are allowed to incur higher out-of-pocket expenses if they so choose in order to obtain better housing.</p>
<p>4. VHDA should conduct a comprehensive analysis of the housing needs in all regions of the State periodically. VHDA should use the results of this analysis to design and administer financing programs that will match the housing needs of low- and moderate-income persons in each region of the State.</p>	<p>VHDA agrees with the importance of collecting fuller information on unmet housing needs in order to better design programs and allocate limited subsidy resources in a manner that best addresses the differing needs among demographic groups and urban and rural housing market areas. This must be done in a manner that adequately reflects the highly dynamic nature of housing demand. This is particularly true in light of the extreme differences in rates of population growth/decline among geographic regions and population groups within the Commonwealth.</p>

Enclosure A—VHDA Responses to JLARC Recommendations

VHDA Governance and Oversight

JLARC Recommendations	VHDA Response
<p>5. The General Assembly may wish to consider amending §36-55.28 of the <i>Code of Virginia</i> to require that the Governor appoint no more than two persons from any one area of the State to the VHDA Board of Commissioners.</p>	<p>The appointment of Board members is at the discretion of the Governor. The Code requires that Board members have varied professional and industry backgrounds. That has proven to be desirable. Throughout VHDA's history, Governors have attempted to maintain reasonable geographic representation on VHDA's Board. In practice, it can be difficult to achieve both professional/industry representation and a predetermined geographic representation. Therefore, current statutory requirements appear to be adequate.</p>
<p>16. The General Assembly may wish to consider whether the Virginia Housing Study Commission should play a more active role in oversight of VHDA in its financing of housing programs. The Virginia Housing Study Commission may also wish to conduct oversight of the Section 8 program in its oversight of VHDA.</p>	<p>VHDA recognizes and accepts its responsibility to account to the Administration and General Assembly on a regular basis for its sound stewardship of the Commonwealth's resources and the resources that it administers on the Commonwealth's behalf.</p>

Section 8 Program

JLARC Recommendations	VHDA Response
<p>6. VHDA should implement management policies to ensure that all federal Section 8 funds allocated to the authority are utilized to the maximum extent reasonably practicable.</p> <p>7. VHDA should discontinue its current process of verbal negotiation in determining the allocation of Section 8 administrative fees to local administrative agents and should implement a formal policy that will ensure a fair and equitable distribution of these fees.</p>	<p>VHDA agrees with recommendations 6 through 12 concerning the Authority's administration of the federal Section 8 tenant-based rental assistance program. VHDA has made the Section 8 program a top management priority, and has contracted with Abt Associates, a national expert on the management of the Section 8 program, to comprehensively review and recommend the administrative changes required to fully address the findings and recommendations made by the HUD Inspector General and JLARC. That report is to be delivered to VHDA in August and the Authority fully intends to act on its recommendations in an expeditious manner.</p>

Enclosure A—VHDA Responses to JLARC Recommendations

Section 8 Program (continued)

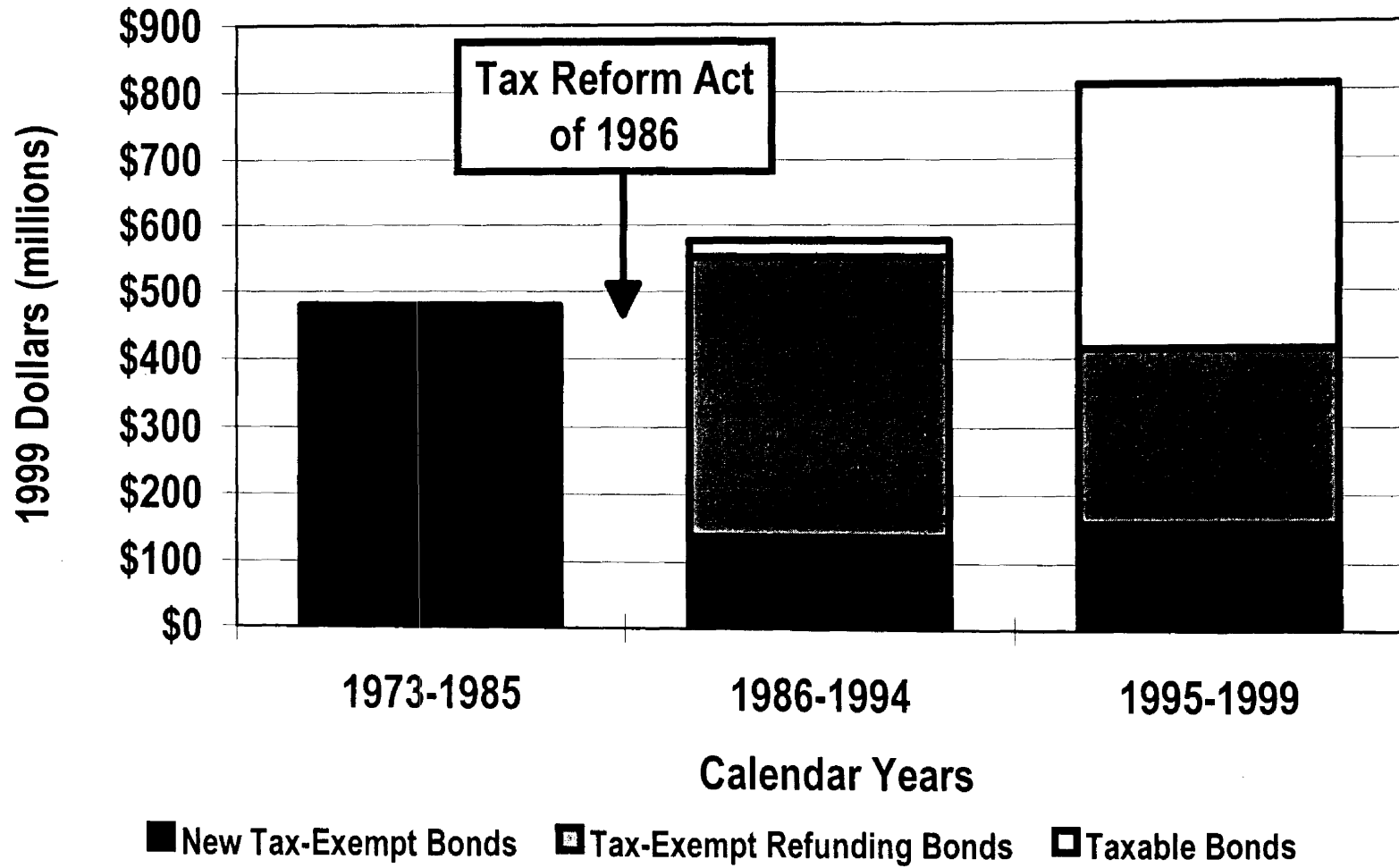
JLARC Recommendations	VHDA Response
<p>8. VHDA should make the development of a Section 8 automated data transmittal system a high priority and commit the resources necessary to develop it.</p>	<p>(see above)</p>
<p>9. VHDA should make the development of an effective Section 8 payment disbursement system a high priority and commit the resources necessary to develop it.</p>	
<p>10. VHDA should solicit input from local administrative agents on training needs and develop a regular training program that meets the training needs of the agents.</p>	
<p>11. VHDA should take measures to improve efficiency and reduce excessive expenditures of the Section 8 program in order to allocate more fees to local administrative agents. VHDA should direct the consultant currently evaluating the Section 8 program to assess staffing, organization and other potential cost saving measures.</p>	
<p>12. VHDA should perform a comprehensive evaluation of the financial impact of transferring Section 8 units to local agents that desire to administer all of their units directly through HUD, based on an accurate assessment of the funds needed by VHDA to administer the Section 8 program efficiently. VHDA should then develop a plan for the transfer of at least a portion of these units to the local agents.</p>	

Enclosure A—VHDA Responses to JLARC Recommendations

Virginia Housing Fund

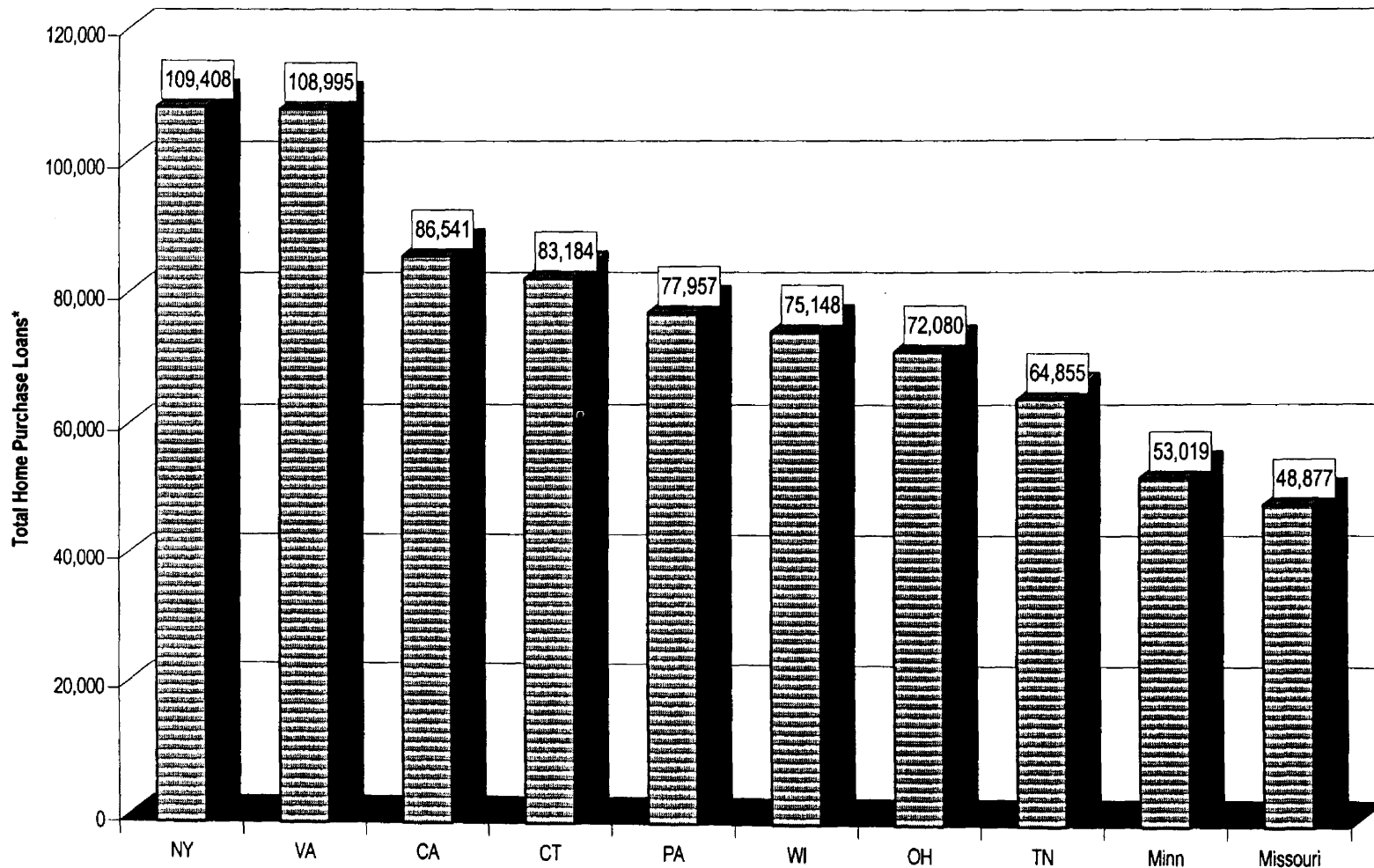
JLARC Recommendations	VHDA Response
<p>13. VHDA should contribute the maximum amount feasible annually to the Virginia Housing Fund without having an undue adverse impact on VHDA's financial strength.</p>	<p>VHDA fully agrees with this recommendation. On two occasions the Authority has hired external consultants to make recommendations to the VHDA Board of Commissioners regarding such amounts.</p>
<p>14. VHDA should leave all interest generated from Virginia Housing Fund investments and mortgages in the Virginia Housing Fund.</p>	<p>VHDA has always contributed to the Virginia Housing Fund (VHF) an amount well in excess of the interest on investments and mortgages in the VHF, thereby in effect retaining an amount equal to such interest in the VHF. VHDA believes that the cash flows in the cfX study reflect this practice and that accordingly the recommended \$18-\$20 million per year contribution to the VHF includes the return of interest generated by VHF assets.</p> <p>VHDA will require that future fund balance studies clearly address the treatment and disposition of interest in the VHF.</p>
<p>15. VHDA should modify its current process for determining the amount of funds that can be allocated to the Virginia Housing Fund to include all relevant factors that will help VHDA to more accurately determine how much can be contributed annually. Each time VHDA conducts an assessment of how much it can contribute to the Virginia Housing Fund, the authority should report the results to the Virginia Housing Study Commission.</p>	<p>VHDA's current five-year business plan calls for the fund balances study to be updated in FY 2002. In light of the questions raised by JLARC in regard to certain of the assumptions made by cfX, VHDA intends to accelerate the timing of a new report in order for its findings to be implemented in FY 2001. The Authority recognizes the need for agreement with the Administration and the General Assembly in regard to the manner in which an updated study is conducted. Therefore, VHDA proposes to involve the Department of Housing and Community Development and the Virginia Housing Study Commission in the selection of a consultant and the determination of the appropriate assumptions on which a new report should be based. VHDA agrees with JLARC that the findings of a new study should be annually reexamined in light of changing circumstances and future projections.</p>

Average Annual Bond Issuance for New Loan Production



Enclosure B

VHDA Is Second among State Housing Finance Agencies in The Number of First-Time Home Buyers Served

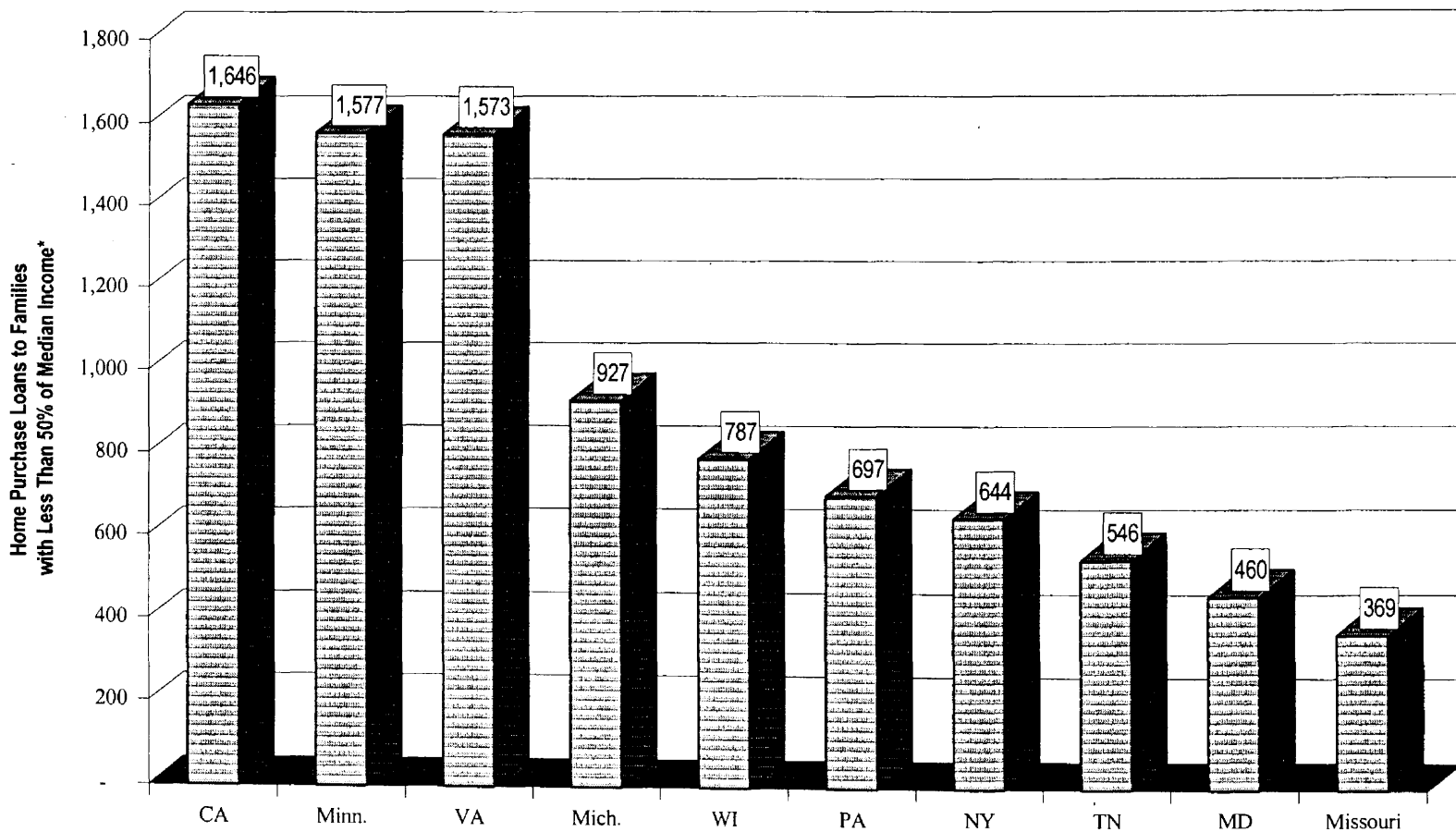


Top Ten State Housing Finance Agencies

*Single-family tax-exempt bond home purchase loans closed since housing finance agency inception

Source: State HFA Factbook: 1998 NCSHA Annual Survey Results

VHDA Is Third among State Housing Finance Agencies in The Number of Low-Income Home Buyers Served in 1998



Top Ten State Housing Finance Agencies

*1998 Single-family tax-exempt bond home purchase loans closed to households with income less than 50% of the greater of state or area median income in accordance with IRS guidelines for mortgage revenue bond programs

Source: State HFA Factbook: 1998 NCSHA Annual Survey Results

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