STATE OF MINNESOTA

MINNESOTA HOUSING FINANCE AGENCY

In the Matter of the Proposed Rules
Relating to Income Limits for Tax Reform
Transition Demonstration Program

Statement of Need
and Reasonableness

4900.0381

Minnesota Statutes, Section 462A.03, Subdivision 10, requires that the Minnesota Housing Finance Agency (Agency) establish in its rules income limits for the purpose of defining persons and families of low and moderate income. For most of the Agency's home mortgage programs, the sources for definition of low and moderate income persons and families are two Agency Rules; Minn. Rules pt. 4900.0010, Subp. 23 establishes maximum limits for adjusted income for Agency programs therein specified, and adjusted income is, in turn, determined pursuant to a formula set forth in the definition of Minn. Rules pt. 4900.0010, Subp. 3. The formula for adjusted income provides that certain deductions be taken from actual gross income to arrive at an adjusted gross income.

On October 22, 1986, President Reagan signed the Tax Reform Act of 1986 (the Act) into law. This law provided very stringent income targeting provisions to which MHFA will be required to rigorously adhere in its home mortgage programs. The Act provides that the Agency may only provide mortgage financing to mortgagors whose family income is 115% or less of "applicable median family income" as determined by the Secretary of the Treasury; and, in so doing, must provide for income targeting based on actual gross income as opposed to adjusted income or any similar formula. The Act also provides for severe penalties for non-compliance.

At this time, no U.S. Treasury Department regulations implementing the Act have been promulgated pertaining to the Agency's programs. However, the Agency wishes by the proposed rule to establish income limits which may be used for its home mortgage programs which comply with the provisions of the Act to the best of its present understanding. This will enable the Agency to continue its home mortgage programs in the interim between passage of the Act and the issuance of U.S. Treasury Department regulations implementing its applicable provisions. The Agency anticipates establishing new rules for income limits at the time final Treasury regulations are issued.

Paragraphs A and B of the proposed rule differ from the rules described in the first paragraph above in that; first, no income limit established exceeds 115% of median income for the various areas of the state set forth as prescribed by the Department of Housing and Urban Development (HUD) and; second, the income limits set forth are based on gross, as opposed to adjusted gross income. HUD limits are used since they were referenced in the Act to be used for such purposes. Actual gross income is used since it is essential under the Act to track such income, and adjusted income formulas provide a statistical bias for which it will be administratively impossible to compensate.

The proposed rule employs a set of income limits based upon the cost of obtaining money, rather than one income limit. This is both reasonable and necessary because uncertain bond market conditions make it difficult to implement a program based upon one income limit, in that income limits are a function of what interest rates must be charged to the mortgagor to meet the Agency's cost of money as determined in each bond sale.

Minnesota Statutes Section 462A.03, Subdivision 10, specifies four criteria for determination of persons and families of low and moderate income. They are (1) the amount of total income of such persons and families available for housing needs, (2) the size of the family, (3) the cost and condition of housing facilities available (4) the eligibility of such persons and families to compete successfully in the normal housing market and to pay the amounts at which private enterprise is providing sanitary, decent, and safe housing.

In reference to the first of the criteria set forth above, i.e., "the amount of total income of such persons and families for housing needs," the general underwriting standard in the mortgage loan industry is that the estimated monthly mortgage payment (principal, interest, taxes, and insurance) should not exceed 28% of gross monthly income. This standard was applied in arriving at the maximum adjusted income limits specified in the proposed rule. The standard assumes that families able to pay less than 28% of their income are not low and moderate income, and should not be eligible to purchase houses from the funds made available for the various Agency Programs under this rule.

The second criterion specified in the statutory definitions of persons and families of low and moderate income is the size of the family. For reasons cited above, adjustments for family size as previously provided in the adjusted income formula may no longer be reasonably used under federal law, but have been taken into account in the statute by reference to federal income limits.

The third criterion specified in the statute as set forth above is the cost and condition of housing facilities available. While the cost of both new and existing homes has remained stable in all other counties of Minnesota, costs in Metropolitan Statistical Areas and counties of high population density have continued to increase in recent years, and should continue to rise in the immediate future. The proposed set of income limits in Paragraphs A and B of the proposed rule will allow a household to purchase a new home at $85,000 in the ten county Minneapolis/St. Paul Metropolitan Statistical Area, $67,000 in Benton, Blue Earth, Clay, Nicollet, Olmsted, St. Louis, Sherburne and Stearns counties, or $63,000 in all other counties; or an existing home at

$75,000 in the ten county Minneapolis/St. Paul Metropolitan Statistical Area, $57,000 in Benton, Blue Earth, Clay, Nicollet, Olmsted, St. Louis, Sherburne and Stearns counties, or $50,000 in all other counties. In light of current median house prices for new and existing homes, these home prices are reasonable.

The fourth criterion specified in the statute is the ability of such persons and families to compete in the normal housing market. The range of income limits provided allows income limits to be established for a variety of market conditions. For example, the current Agency home mortgage program interest rate is 7.85% versus a 9 1/2% conventional rate and, thus, less income is needed to qualify for its loan. As market and Agency interest rates increase, the relationship becomes more pronounced, as in 1985 when the Agency rate was 9.95% and conventional rates were 12 1/2%. Under the proposed rule, no limits are established for rates under 9% as lower income limits would preclude homeowners in many markets from access to favorable Agency terms.

In summary, the Agency, through these proposed rules, offers a family of lower income the ability to purchase housing of comparable cost by virtue of the Agency's capacity to provide below market interest rate financing.

The Agency is mindful of the provisions of Section 14.115 of Minnesota Statutes, entitled Small Business Considerations in Rulemaking, but since the recipients of home mortgage loans under the proposed regulation must be natural persons and families of low and moderate income who purchase a home with a first mortgage from the Agency, the regulation does not affect small businesses directly, and the said law, by its terms, is inapplicable to this proposed regulation. Further, to the extent that the Agency loans which are the subject of this regulation may have an indirect effect on small businesses, the effect of the proposed rule is to make such loans more capable of feasible underwriting, and, consequently, more obtainable; and, as a result, the proposed rule has no negative effect on small businesses.