State of Minnesota

Minnesota Housing Finance Agency

In the Matter of the Proposed Rules
Relating to the Homeownership
Assistance Fund

Statement of Need
and Reasonableness

Minnesota Rules 4900.1300 through 4900.1390

Minnesota Statutes section 462A.21, subdivision 8, authorizes the Minnesota Housing Finance Agency (MHFA) to establish a Homeownership Assistance Fund (HAF) on terms and conditions it deems advisable to assist persons of low and moderate income in the purchase of affordable residential housing and further provides that MHFA may use the funds to provide additional security for eligible loans or to pay costs associated with or provide additional security for bonds issued by MHFA. Since 1978, HAF has been used to provide downpayment assistance and/or monthly payment assistance to recipients who receive MHFA first mortgage loans through various mortgage revenue bond programs. Over 5,500 recipients have received HAF loans in an aggregate amount of $18.7 million.

The current administrative rules which govern HAF only provide for the use of HAF proceeds in the manner specified above. MHFA has recently undertaken a review of both the administrative rules governing HAF and the uses to which HAF proceeds are put. This review included consideration of various alternatives for the use of HAF proceeds, and included consultation with representatives of institutional lenders, nonprofit housing providers, and local government. As a result of this review, MHFA is hereby proposing a revision to the administrative rules governing HAF which greatly expands the potential uses of HAF proceeds while imposing appropriate limitations on their use.

MHFA is proposing revision of the administrative rules governing HAF for three primary reasons. First, the federal government has recently passed new affordable housing legislation and many additional proposals are being considered and developed. Such legislation typically provides for leveraging of federal resources with other sources of capital either as an absolute requirement for receipt of federal funds or as a priority by which limited federal funds will be allocated. The proposed rule will provide for reasonable flexibility in the application of HAF proceeds so that a variety of proposals under new federal housing legislation may be considered.

Second, MHFA has been developing a number of new program initiatives in which it may be appropriate to apply HAF in new and innovative fashions. Furthermore, various nonprofit and for-profit providers of affordable housing are proposing initiatives in which multiple sources of capital are being combined to provide affordable homeownership opportunities. Again, the proposed rules revision would provide for reasonably flexible application of HAF funds in such initiatives.

Finally, the use of HAF in its current form has declined over the past three years. HAF was originally devised to work most effectively in conjunction with insured conventional mortgage loans and majority of MHFA loans were originated in this fashion as late as 1986. Since 1986, insured conventional loans have rapidly declined as a percentage of Agency business, and FHA/VA loans currently comprise over 80% of mortgage originations. FHA/VA loans originated in conjunction with HAF were not underwritten as favorably as insured conventional loans, and HAF use subsequently declined. Although FHA has recently taken steps to provide for more aggressive underwriting treatment of HAF loans, it is not known whether HAF use will increase to the levels that it had been previously.

Minnesota Rules 4900.1300 and 4900.1315 provides the scope and definition of the Homeownership Assistance Fund rules. Nothing is contained in the definitions which is deemed controversial.

Minnesota Rules 4900.1331 provides general information regarding HAF. Under subpart 2 of this section. it is noted that HAF monies may only be used in conjunction with first mortgage loans made or purchased by MHFA, but that monies may be combined with outside sources within this limitation. This is to enable MHFA to leverage funds in collaborative efforts with other entities within the specific uses of HAF noted in Minnesota Rules 4900.1375. This enables MHFA to respond appropriately and flexibly to various proposals pertaining to housing affordability that may be generated from a variety of sources.

Minnesota Rules 4900.1331, subpart 3, specifies that individual applications of HAF monies must provide for a reasonable likelihood of recapturing said monies for later use. The subpart further provides that a lien with an appropriate repayment schedule must be taken by MHFA for certain uses described under Minnesota Rules 4900.1375 to provide for adequate security. HAF has been structured to provide for fund recapture since its inception so that scarce public resources may be reused to further affordability for homeownership.

Minnesota Rules 4900.1331, subpart 3, also provide that repayment provisions for certain uses of HAF allowed under part 4900.1375 must take into consideration potential income growth of recipients and percentage of income that recipients may reasonably dedicate toward mortgage payments under mortgage industry accepted underwriting standards. This provision was also provided in previous rules governing HAF. It is designed to both be sensitive to the fact that individuals may only reasonably dedicate a certain portion of their income toward HAF repayment, which is a portion of total housing debt service. However, it is also appropriate to establish a reasonable, progressive repayment schedule that provides for accelerated repayment as a HAF recipient's income grows. This enables funds to be recaptured and recycled more efficiently and effectively.

Minnesota Rules 4900.1331, subpart 4 covers HAF default. It is taken virtually in its entirety from current administrative rules governing HAF. The only modification of this rule is that the default provisions only apply to appropriate uses of HAF in Minnesota Rules 4900.1375.

Minnesota Rules 4900.1345 specifies requirements pertaining to HAF recipients. Subpart 1 describes the "three year requirement," which, for the most part, limits HAF assistance to first time homebuyers. In this subpart, the three year requirement is in effect for certain specified uses of HAF under Minnesota Rules 4900.1375 in all cases in which HAF is used with mortgage revenue bond funds. In fact, the three year requirement is identical to the three year requirement described in federal law pertaining to the use of mortgage revenue bond funds. In cases in which HAF is to be used with funds other than mortgage revenue bond funds, the three year requirement also applies, except exceptions are provided for certain circumstances in which imposition of the three year requirement would be particularly burdensome. It is deemed that the three year requirement with the exceptions specified is appropriate as assistance is most appropriately provided to individuals that housing policy studies have shown find it most difficult to acquire affordable housing.

Minnesota Rules 4900.1345, subpart 2, provides income limits for HAF recipients. The proposed rule greatly simplifies the manner by which HAF income limits may be determined by replacing a cumbersome income limit matrix with an independent index promulgated by the United States Department of Housing and Urban Development. The percentages of income specified in the proposed rule provide that HAF funds are reserved for individuals that are under the income threshold that HUD specifies as "low income." The legislative history of HAF indicates that it was intended to be used by modest income individuals, and the proposed rule continues to meet that requirement.

Minnesota Rules 4900.1359 covers property that is eligible to be purchased with HAF assistance. An addition is provided to the previous rule that specifies that, at the time the property is purchased, the property must be totally completed, in good repair, and meet mortgage industry accepted underwriting standards or provisions must be made to assure that these standards will be met. It is appropriate that modest income borrowers only purchase safe, sound and sanitary housing, and the addition to this rule assures that this will occur.

Minnesota Rules 4900.1375 describes the uses of HAF as well as imposes limitations on these uses. Generally, the uses described in this part retains both a modified monthly assistance and downpayment assistance program, but also adds seven additional potential uses. While some flexibility is maintained as to the application of monies for each particular use, limitations were also provided in all cases to maintain control on funds use. These limitations were often derived to be compatible with other sources of funds with which HAF monies may be leveraged.

Minnesota Rules 4900.1375, subpart 2, covers monthly assistance, and anticipates a monthly assistance program which is compatible with the program described under previous administrative rules. As in the previous administrative rules, monthly assistance must be reduced annually. However, the amount of monthly assistance may be as much as $160 per month, and the specific increment by which monthly assistance must be reduced is not specified. This flexibility is intentional so that customized applications of HAF within said limitations may be developed.

Minnesota Rules 4900.1375, subpart 3, retains what was previously referred to as the HAF "downpayment" assistance program. This program has been extended to include all entry costs, as closing costs beyond downpayment also are a substantial barrier to homeownership. As under previous rule, only 50% of entry costs may be provided under the program. However, the maximum allowable entry cost assistance is now $3500, which is compatible with entry cost provisions provided by cities of Minneapolis and St. Paul. Thus, leverage opportunities are anticipated within this subpart.

Minnesota Rules 4900.1375 allows non-interest participation loans under HAF to reduce the interest rate on a first mortgage loan to affordable levels. The maximum interest rate that MHFA may effect on a first mortgage loan through a participation interest is established at 2% to limit the total contribution that MHFA may make in any such circumstance to reasonable levels.

Minnesota Rules 4900.1375, subparts 5 and 7 cover equity participation loans and equity contribution loans. Both of these devices have been successfully used in various housing programs both within Minnesota and nationally. The limitations on these programs were established to be compatible with programs that are currently operated by the cities of Minneapolis and St. Paul. Again, this provides leverage opportunities to stretch the use of HAF proceeds.

Minnesota Rules 4900.1375, subpart 6, covers buy down loans. The buy down limitations are established to be compatible with limitations on such programs imposed by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, which are the organizations which, for the most part, establish underwriting standards for the mortgage industry.

Minnesota Rules 4900.1375, subpart 8, provides for the development of an emergency mortgage assistance component for eligible recipients that are unable to make mortgage payments due to circumstances which are generally beyond their control. MHFA reviewed similar programs that have been developed for such purposes throughout the country, and has established limitations on such use that are common in such programs.

Minnesota Rules 4900.1375, subpart 9, allows HAF money to be used on construction for rehabilitation loans to nonprofit entities that are constructing or rehabilitating housing designed for HAF recipients. This component is designed primarily to aid in specific neighborhood revitalization efforts or to aid in disposition of government real estate assets by entities such as the Federal Housing Administration, the Resolution Trust Corporation, or MHFA. Again, appropriate limitations have been provided as to loan amount using an independent index and as to interest rate.

Minnesota Rules 4900.1375, subpart 10, allows HAF to be used for coinsurance or mortgage insurance risk sharing agreements. In recent years, private mortgage insurers have been unwilling to provide mortgage insurance on equivalent terms and conditions in all areas of Minnesota, which hinders affordability in many Minnesota counties. Various models have been developed by which private mortgage insurers are willing to share risk with public agencies that are attempting to provide affordable housing in such areas. The limitations within this subpart are established based upon an agreement that MHFA has already entered into with a private mortgage insurer but which used funds other than HAF.

Minnesota Rules 4900.1390 places limits on the application of HAF monies. This section is included so that the use of HAF money provided under Minnesota Rules 4900.1375 do not extend beyond that which is necessary to make housing affordable. With limited resources, it is inappropriate for individuals to receive subsidies which are not needed. Factors that may be considered in limiting the amount of assistance available are also provided under this section.

MHFA is mindful of the provisions of section 14.115 of Minnesota Statutes, entitled "Small Business Considerations in Rulemaking." Since the recipients of HAF loans under the proposed regulation either are natural persons and families of low and moderate income who purchase a home with a first mortgage from MHFA or are nonprofit housing providers, the regulation does not effect small businesses directly, and the said law, by its terms, is inapplicable to this proposed regulation. Further, to the extent that HAF uses which are subject to this regulation may have an indirect effect on small businesses, the effect of this 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.