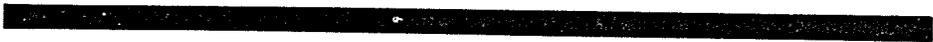


B230



STAFF EVALUATION



Texas Housing Agency



**A Staff Report
to the
Sunset Advisory Commission**



TEXAS HOUSING AGENCY

November 1990

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SUMMARY

Summary

The Texas Housing Agency is subject to the Sunset Act and will be automatically abolished unless statutorily continued by the 72nd Legislature in 1991. The review of the agency included an assessment of: the need for the functions of the agency; benefits that could be gained through transfer of all or part of the agency's functions to another existing agency; and changes needed if the agency is continued using its current organizational structure. The results are summarized below.

Assessment of Need for Agency Functions

The review concluded that the functions of the Texas Housing Agency should be continued for a 12 year period. The primary functions of the agency which are to encourage private capital investment in low income residential housing and to provide for the acquisition, construction and rehabilitation of low income housing through public financing and construction and mortgage loans continue to be needed. There continues to be a need for the provision of affordable housing in the state and having a state agency available to issue mortgage revenue bonds and provide other housing programs to low and moderate income families helps to ensure that these needs are met across the state.

Assessment of Organizational Alternatives

If the decision is made to continue the functions of the agency, the review concluded that the Texas Housing Agency should be continued as a separate agency. The duties and responsibilities of the agency are distinct from those of other bond issuing agencies and a separate board and agency is needed to set housing policy and carry out housing programs for the state.

Recommendations if Agency is Continued

- The composition of the board should be changed to include three members of the general public.
- The administration of the agency should be changed by:
 - subjecting the agency to oversight similar to that in place for state agencies; and
- The operation of the agency's programs should be improved by:
 - establishing a trust fund for provision of downpayment assistance and closing costs, property acquisition and housing rehabilitation to make affordable housing available to low income Texas residents;
 - requiring the agency to obtain approval from the attorney general for use of outside counsel;

- authorizing the agency to acquire a limited amount of property for the purposes of providing affordable housing to low income individuals and households;
- requiring a quality control plan in statute to ensure proper compliance of lenders, servicers, REO contractors and other contractors with prescribed requirements;
- establishing specific internal auditor requirements in statute to ensure the timely and accurate performance of agency functions;
- requiring the agency to increase the number of low income individuals and families served by its mortgage revenue bond programs through special targeting strategies;
- requiring the agency to consider lenders' past performance in providing services to low income individuals as a condition for participation in agency bond programs; and
- amending the Private Allocation Act to secure the agency's reservation for a portion of the federal bond allocation.

Fiscal Impact

While the recommendations listed above are expected to improve the effectiveness and efficiency of the agency, the recommendations should not have a significant fiscal impact.

BACKGROUND

Creation and Powers

The 66th Legislature created the Texas Housing Agency (THA) and its nine member board in 1979. The agency's primary responsibilities are to encourage private capital investment in low income residential housing and to provide for the acquisition, construction and rehabilitation of low income housing through public financing and construction and mortgage loans.

To meet its responsibility of providing affordable housing to low and moderate income individuals, the agency has operated four programs since 1979. These programs include the Single Family Mortgage Revenue Bond Program, the Single Family Mortgage Credit Certificate Program, the Multi-Family Bond Program and the Multi-Family Low Income Tax Credit Program. Since its creation, the agency has provided more than \$1.8 billion in assistance to 58,000 low and moderate income families in Texas.

In response to a downturn in the Texas economy during the middle and late 1980's, THA developed new programs to meet the housing needs of low and moderate income Texans. The failure of many savings and loan institutions resulted in the federal government taking over a great deal of foreclosed property, much of which is in Texas. This event provided THA with the opportunity to develop programs to reach individuals who were previously unable to purchase homes. Recently THA entered into an agreement with the federal government's Resolution Trust Corporation (RTC) to finance the sale of these government properties. These RTC properties combined with properties held by other federal agencies create a large pool of affordable housing and provide THA with an opportunity to provide homes to low and moderate income Texans.

Policy-making Body

The board is composed of nine members appointed by the governor with the advice and consent of the senate for staggered six-year terms. The statute requires the governor to fill the nine positions on the board with individuals who have experience in particular fields related to housing. These areas of expertise include housing development administration, commercial banking, real estate operations, home building, apartment construction or ownership, mortgage banking, savings and loan operations, municipal or county government, and low and moderate income housing. To be eligible to serve on the board an individual must be a qualified voter of the state of Texas and not hold public office. The governor designates one member to serve as chairman.

The duties of the board include approving all bonds issued by the agency, approving all managers and co-managers for the agency bond issues, selecting the executive administrator, approving the agency budget, and overseeing the agency's administration and programs. The current board is assisted by three sub-committees: personnel and programs, finance and planning, and audit. These sub-committees were created to ensure board oversight of major agency functions and make board member expertise available to agency management in a structured way. The part-time board is required to meet once every quarter or at times specified by

resolution of the board and may hold special meetings when called by the chairman, the administrator, or three of the board members.

Funding and Organization

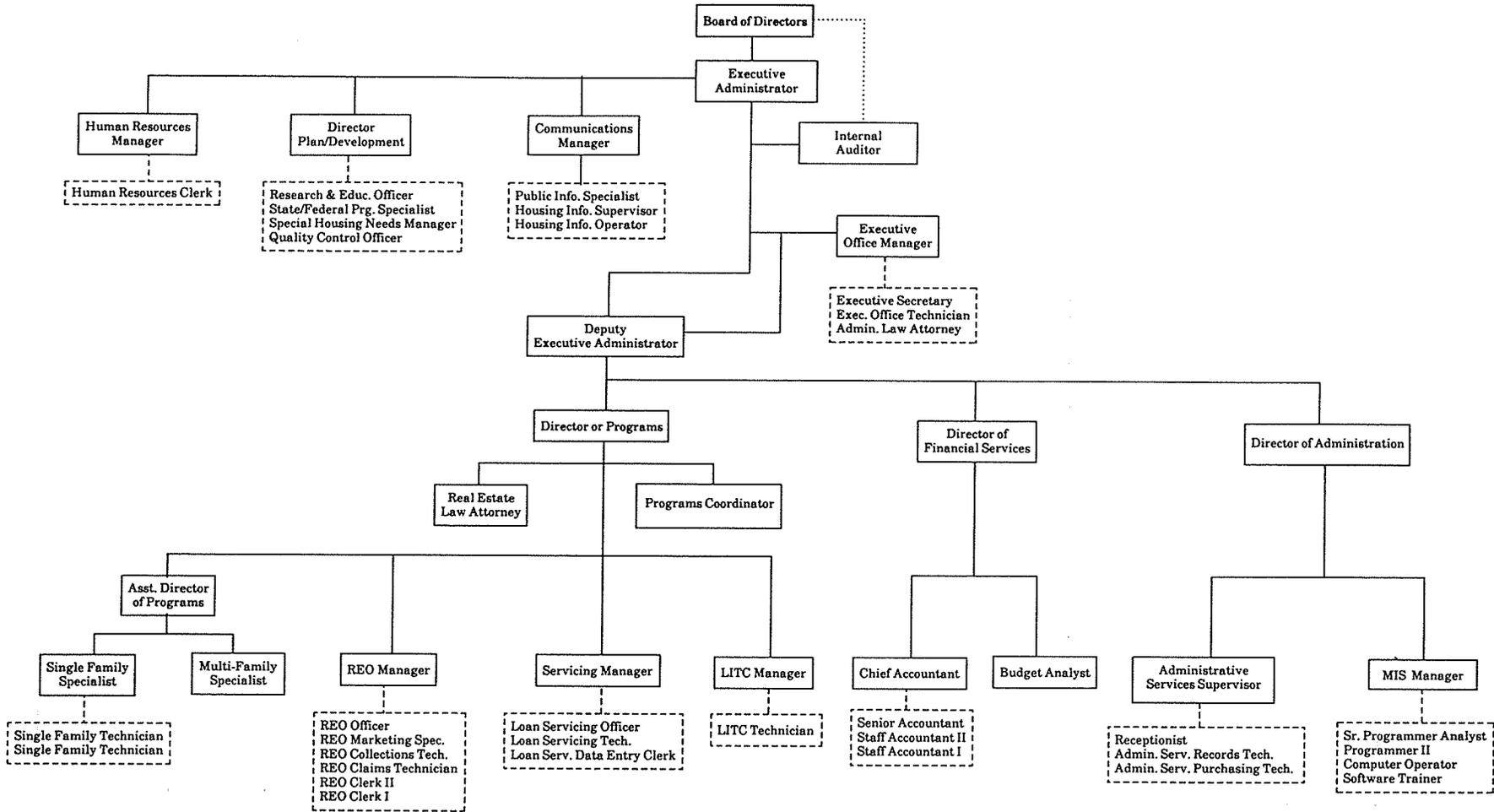
The agency was authorized 55 full-time employees (FTE's) for fiscal year 1990 to facilitate the issuance of mortgage revenue bonds and manage and monitor the single family and multi-family bond and tax credit programs. The agency maintains no field or regional offices as all programs and functions are conducted at the state office in Austin. The two exhibits that follow describe this work force and indicate its organization. The first of these exhibits, Exhibit A below, depicts how the agency's work force has changed over a five year period in categories of employment and compares it with goals set in the Appropriations Act. While the agency is not subject to the Appropriations Act, the minority goals set out in the Act are applicable to most state agencies and therefore serve as a useful reference point. The second exhibit, Exhibit B, shows the organizational pattern for the 55 employees.

Exhibit A

Percentage of Minorities in Agency's Workforce

Job Category	1986 Total Workforce 26		1990 Total Workforce 47		1990-1991 Appropriations Act Statewide Goal for Minority Workforce Representation
	Total Positions	% Minority	Total Positions	% Minority	
Administrators	5	20%	4	50%	14%
Professionals	9	22%	21	38%	18%
Technicians	4	50%	8	50%	23%
Para-Professional	0	--	5	40%	23%
Administrative Support	8	62.5%	9	22%	25%

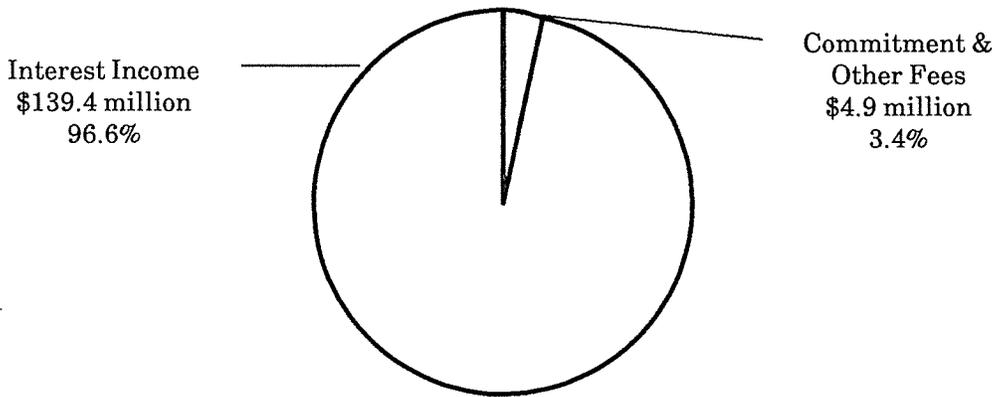
**Exhibit B
TEXAS HOUSING AGENCY
Organizational Chart
Fiscal Year 1991**



The agency receives no state or federal funds and is financed through revenues generated as interest on wholly owned loans and mortgage backed certificates, interest on investment of funds collected from loans and mortgage backed certificates, interest on investment of unexpended proceeds from the sale of mortgage revenue bonds, and fees earned from lenders and developers. In fiscal year 1989, agency revenues totalled \$144.3 million and are divided into two categories: interest income of \$139.4 million and commitment and other fees of \$4.9 million. Agency expenditures totalled \$136.4 million and are broken into three broad categories as follows: bond interest expense at \$124.1 million, administration at \$3.1 million, and service and insurance fees at \$9.2 million. Exhibit C shows the agency's revenues and expenditures for fiscal year 1989.

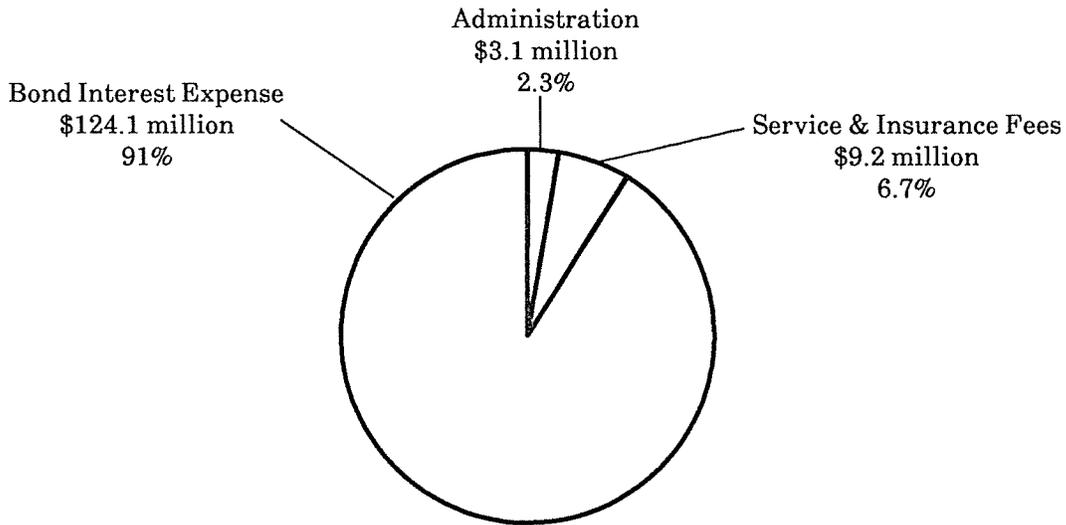
Exhibit C

**Texas Housing Agency Revenues
Fiscal Year 1989**



Total Revenues in FY 1989: \$144.3 million

**Texas Housing Agency Expenditures
Fiscal Year 1989**



Total Expenditures in FY 1989: \$136.4 million

In fiscal year 1989, THA had assets totalling over \$1.5 billion. The majority of assets are made up of loans receivable and mortgage backed certificates, while the majority of liabilities are made up of bonds payable. Exhibit D shows the agency's assets and liabilities.

Exhibit D
Texas Housing Agency Assets
Fiscal Year 1989

ASSETS

Investments	\$ 558,848,000
Loans Receivable (net)	914,527,000
Accrued Interest Receivable	14,683,000
Property Acquired	10,639,000
Deferred Issuance Cost & Other Assets	<u>27,011,000</u>
TOTAL ASSETS	<u>\$ 1,525,708,000</u>

Texas Housing Agency Liabilities
Fiscal Year 1989

LIABILITIES and FUND BALANCES

Bonds Payable	\$ 1,432,517,000
Accrued Interest Payable	47,619,000
Lender Entitlements	2,558,000
Trustee Fees Payable & Other Accrued Expenses	<u>1,525,000</u>
TOTAL LIABILITIES	\$ 1,484,219,000
Restricted Fund Balances	<u>41,489,000</u>
TOTAL LIABILITIES and FUND BALANCES	<u>\$ 1,525,708,000</u>

Programs and Functions

The Texas Housing Agency is responsible for encouraging private capital investment in low and moderate income housing and for stimulating the acquisition, construction, and rehabilitation of low and moderate income housing through public financing and mortgage loans. The Texas Housing Agency conducts four programs that provide an opportunity for low and moderate income families to own their own homes or stimulate the construction and rehabilitation of low income rental properties. Two programs, the Single Family Mortgage Revenue Bond Program (SFMRB) and the Multi-Family Mortgage Revenue Bond Program (MFMRB), are financed through the issuance of bonds. The remaining two programs, the Single Family Mortgage Credit Certificate Program (MCC) and the Low Income Tax Credit Program (LITC), provide tax credits to homebuyers or to for-profit and non-profit developers of affordable, suitable rental units. The Texas Housing Agency is also responsible for managing and marketing properties that were financed through the agency's previous bond programs and have been foreclosed upon. Recently THA entered into an agreement to market and provide loans for homes which were taken over by the federal Resolution Trust Corporation (RTC) from failed savings and loan institutions. The agency issued \$140 million in tax-exempt bonds to help approximately 3,000 Texas families buy RTC properties valued at up to \$67,500. The Texas Housing Agency will provide the loans at rates well below the average market rate and RTC will pay up to \$6 million in upfront fees. These fees will be used to reduce the interest rate on loans used to purchase RTC properties.

Bond Programs

The Texas Housing Agency issues bonds to provide funds to aid low and moderate income individuals and families in purchasing a home and to provide an incentive for non-profit and for-profit developers to build, acquire, or rehabilitate rental housing for low and moderate income individuals. Agency bond issues are structured by the staff of THA with the aid of financial and legal advisors. These bond offerings are backed by a reserve fund held by THA and are not obligations of the state of Texas. The terms of the bond specify the exact use of the bond proceeds. The bond issue is sold to an underwriter who buys the entire issuance and in turn sells it to investors. The timing of the issuance, the special provisions of the bond issue itself and the price that these investors are willing to pay determines the interest rate at which these funds will be offered to borrowers.

When issuing bonds, THA may pay fees to a bond counsel(s), a financial advisor(s), an underwriter(s), and a bond rating service such as Moody's or Standard and Poor's. The bond counsel provides an opinion concerning the bond issue based upon a review of all applicable securities laws, required procedural steps, and federal tax laws. The financial advisor provides a wide variety of services including analysis of the financing needs of the state, construction of the issue, choosing the underwriter, and dealings with the rating agency. To increase bond marketability, THA's bonds are rated by a national bond rating agency which considers the state's economic problems and possibilities, the agency's current debt ratio and financial position, the stability and experience of the agency's administration, the specific terms and obligations of the original issue and the state's needs. To maintain a favorable bond rating, the agency must hold at least two percent of its outstanding bonds in the reserve fund discussed earlier.

The federal government imposes a cap on the amount of private activity bonds issued in Texas and the state's Private Allocation Act establishes a formula for distributing the bond authority within that federal cap. The Act currently provides that one-third of the federally allowed authority be designated for mortgage revenue bonds. Under the Act, the Texas Housing Agency received one-third of the mortgage revenue bond allocation and the local housing authorities receive the remaining two-thirds. The remaining authority is designated for bonds that fund such activities as industrial development or roads and bridges. In fiscal year 1990, THA used all of its authorized allocation and refunding capabilities for an amount totalling \$140 million.

A provision in the Private Allocation Act provides that if the federal government does not authorize states to issue tax-exempt mortgage revenue bonds, the reserved allocation for these bonds becomes null and void. The authorization for these bonds sunsetted effective September 30, 1990, but was reinstated in October 1990. As a result of the Act, the agency as well as local housing authorities are no longer entitled to a reserved allocation under the Act, even though the bonds were reauthorized in October of 1990.

Once bonds have been issued, THA selects lenders to participate in the program. These lenders are responsible for channeling bond proceeds to borrowers who qualify for loans under THA program guidelines. General program guidelines and regulations are set by the Department of Housing and Urban Development, the Federal Housing Administration and the Internal Revenue Service and include household income and property selling price limits, restrictions on previous home ownership, and areas in which loans should be targeted. State housing agencies can add additional restrictions based on the individual needs of the state. After a loan is made, it is either serviced by the originating lender or sold to a servicer(s) who handles all the servicing requirements such as loan tracking, billing and payments. These servicers remit principal and interest payments to THA on a bi-monthly schedule and these funds are used to retire bonds issued by the agency. Since fiscal year 1980, THA has offered 38 bond issues valued at more than \$2.3 billion.

Because of the structure of the mortgage revenue bond (MRB) programs throughout the country, there is a tendency for loans to go to moderate income persons rather than low income persons. The MRB programs require prospective home buyers to meet a wide range of criteria before they qualify for a loan. This criteria is based on the standard loan requirements of the banks as well as requirements set by FHA and GNMA. Prospective buyers typically must have three to five percent of the purchase price of a home available and must demonstrate that they have income sufficient to meet the required monthly payment. The property purchased must also be within a prospective buyer's price range and meet FHA standards concerning structural integrity. Houses priced at a level which low income buyers can afford may not always be able to meet all required FHA standards. These federal restrictions and the pressures on mortgage lenders to make loans only to persons with a demonstrated credit history and who have the highest potential to repay the loans tend to result in mostly moderate income persons being served by the MRB program.

Single Family Mortgage Revenue Bond Program

The purpose of the Single Family Mortgage Revenue Bond (MRB) Program is to provide "sanitary, decent and safe homes" for low and moderate income Texans who are first time home buyers or have not owned a house in the last three years. The

goal of the program is to reduce high down payment and closing costs and, through lower than market interest rates, make house payments more affordable.

The program is funded through the use of tax-exempt mortgage revenue bonds which are limited obligations of THA. The state of Texas does not have any obligation to support or repay these loans. The bond proceeds are allocated to mortgage lenders across the state who channel this money to low and moderate income Texans who qualify for the program. Since 1979 the Single Family MRB Program has provided approximately \$1 billion in mortgage loans to over 19,000 families across Texas. In fiscal year 1990, the program made funds available for 2,265 loans valued at \$107.8 million. The Texas Housing Agency assigned four employees to this activity in fiscal year 1990.

Multi-Family Mortgage Revenue Bond Program

The Multi-Family Mortgage Revenue Bond Program was established to provide decent, safe and affordable rental housing to low and moderate income Texans. The intent of the program is to provide an incentive for non-profit and for-profit developers to construct or rehabilitate affordable rental units.

The program is funded by the agency's issuance of a type of tax exempt "private activity bond" called exempt facility bonds. The proceeds of these bonds are provided to developers, both non-profit and for-profit, to construct, rehabilitate or acquire rental housing having a designated number of units set aside for low and moderate income individuals. These units must remain designated for low and moderate income tenants for a specified amount of time. The agency monitors these properties on a monthly basis to ensure that they meet federal and state guidelines including the level of the rent and the percentage of low and moderate income people living in the development. Agency monitoring consists of reviewing occupancy rates and income levels of tenants living in these developments as reported by the managers of these units.

The program was originated in fiscal year 1986 and to date has provided more than \$309 million to 36 multi-family developments containing 8,430 units. Over the last 36 months, the program has been inactive due to the real estate and rental property markets in Texas. During the last three years, there has been an oversupply of rental units on the market in Texas and THA has discontinued making these loans. The program department, however, monitors the occupancy rates of rental units in Texas and may offer another multi-family bond program when the need arises. The agency also monitors the 36 multi-family developments financed between 1986 and 1988. This program was staffed by one employee in fiscal year 1990.

Tax Credit Programs

The Texas Housing Agency offers two tax credit programs: one targeting individual families and one targeting the developers of multifamily rental units. Annual income tax credits of up to \$2,000 are granted to individual borrowers for the life of the mortgage loan and provides these individuals with a higher after-tax income allowing them to qualify for mortgage loans. Tax credits are also granted to non-profit and for-profit developers for up to ten years if they agree to designate a certain percentage of units within a complex as low income.

Single Family Mortgage Credit Certificate Program

Like the Single Family Mortgage Revenue Program, this program is designed to provide "sanitary, decent and safe housing" to low and moderate income Texans who are purchasing their first home or have not owned a home in three years. However, instead of using mortgage revenue bonds, the program provides qualified applicants with a \$2,000 income tax credit for each year of the mortgage loan. This credit provides a family with more after-tax income increasing their ability to qualify for a home mortgage loan.

The agency funds this program by converting a portion of its tax-exempt bond authority to mortgage credit certificate authority. The issuance of bonds is not required and the tax credits are made available to qualified borrowers by lenders throughout the state.

This program was initiated in fiscal year 1986 and since that time has provided approximately \$487 million in credits to 7,887 families. In fiscal year 1989, the program provided \$95.9 million in tax credits to 1,514 families. In fiscal year 1990, this program was deactivated. The THA assigned two employees to this activity during fiscal year 1990.

Low Income Tax Credit Program

The Low Income Tax Credit Program is designed to provide a corporate income tax credit to the developers for building or rehabilitating rental properties. The tax credit can be claimed annually for a period of ten years. The amount of the tax credit is based on the percentage of units serving low income tenants and the cost of construction, rehabilitation, or acquisition. This program was authorized by Congress for three years beginning in 1987. The program is scheduled to run through December 1991.

Each year the federal government, through the Internal Revenue Service (IRS), allocates tax credits to state housing agencies. The allocation is based upon per capita income and need for affordable housing in the state. In fiscal year 1990, the federal government allocated \$21 million in tax credits to the agency.

However, because of declining federal support, THA received only \$15.1 million in fiscal year 1991. To receive a tax credit developers send applications to THA where they are evaluated by the program division based upon guidelines provided by the IRS. Those projects which qualify are reviewed by the THA board and the projects approved by the board receive tax credits. THA received applications from 746 developers and approved 546 of the applications in fiscal years 1987 through 1990.

This program began on January 1, 1987 and since then has provided \$33.1 million to developments serving 22,499 families. THA assigned two employees to this activity in fiscal year 1990.

Other Programs

The agency also handles single family properties that were financed through the agency's earlier bond programs and have been foreclosed upon through the real estate owned (REO) department. The agency has issued bonds to make funds available for the disposal of property acquired through the Resolution Trust Corporation (RTC) Affordable Housing Program. Both of these programs attempt to provide low and

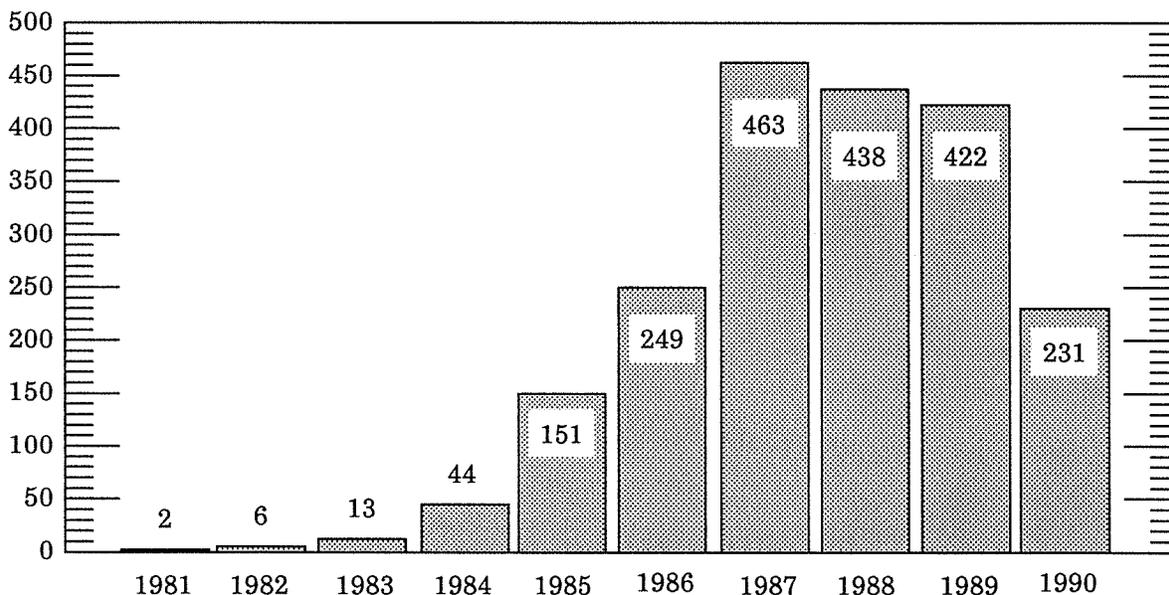
moderate income families an opportunity to purchase homes that have been foreclosed upon and are on either the agency's REO list or RTC's property list.

Real Estate Owned Department

The REO department's primary objective is to quickly and efficiently resell foreclosed properties. This involves management, marketing, and the accurate filing of pool insurance. The management and marketing functions are intended to rapidly sell a property which has been foreclosed upon to ensure that THA obtains a fair price at sale. The REO department hires property management contractors who are responsible for the preservation and maintenance of REO properties while they are being marketed. This includes making necessary internal and external repairs that are required to qualify for insurance. The properties are marketed by these contractors through real estate brokers.

The REO department is also responsible for the tracking of property from foreclosure to sale. At the time the property is sold, a primary and pool insurance claim is filed for any unpaid principal and interest as well as any other outstanding expenses. The prompt and accurate filing of these claims reduces the risk of loss to the pool insurance accounts. Currently the REO department manages approximately 278 properties. On average, THA receives 29 new properties each month and it takes about one year to sell each property. Exhibit E shows the number of REO properties processed by THA since fiscal year 1981. The agency assigned seven employees to the REO department in fiscal year 1990.

Exhibit E
Real Estate Owned by THA
1981-1990



Working closely with the REO Department is the loan services section of the program department which monitors loans and ensures that borrowers are making

timely payments and that servicers are performing their assigned duties. If the servicers do not perform their assigned duties such as monitoring mortgage accounts or notifying individuals of late payments, THA may not be able to collect the entire proceeds of insurance policies.

The Resolution Trust Corporation (RTC) is a federal agency which was created by Congress to dispose of foreclosed homes taken over from failed savings and loan institutions. Working in partnership with THA, RTC will make 6,000 properties valued at less than \$67,500 each available in Texas. Section 501 of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989, requires that a ninety day marketing period be established in which RTC owned eligible properties will be marketed in a manner which preserves their availability and affordability for low and moderate income individuals and families which are defined as not earning more than 115 percent of area median family income for purchasing homes. Sales of rental property will only be made to developers who restrict residents to those with 80 percent of area median family income or less. After that period, the properties will be available to the all interested parties regardless of income.

The Texas Housing Agency has recently issued approximately \$140 million in single family mortgage revenue bonds to provide funding for qualified individuals and families who would like to purchase these homes. The money will be disbursed through selected lenders and only houses on the RTC list will be eligible.

Central Administration

The executive administrator is responsible for the overall administration of the agency and its programs, including overseeing public relations, strategic planning, internal audit and human resources/EEO functions, while the deputy executive administrator is responsible for the day-to-day operation of the agency including the programs mentioned above and administrative and financial functions. The administrative department is responsible for the production and updating of all procedure manuals, purchasing, records and management information services. The financial services department is responsible for accounting, investment management, budgeting, interaction with the state and independent auditors, and all other financial and bond related matters. In fiscal year 1990, the agency had 17 employees assigned to the administrative and financial departments.

RESULTS OF REVIEW

Overall Approach to the Review

Overall Approach to the Review

The Sunset Act requires an assessment of several factors as part of an agency's review. These factors include: a determination of the continued need for the functions performed by the agency; a determination of whether those functions could be better performed by another agency; whether functions performed by another agency could be better performed by the agency under review; and, finally, a determination of the need for any changes in the agency's statute.

Approach to Current Review

In accordance with the Sunset Act, the review of the Texas Housing Agency included an assessment of the need to continue the functions performed by the agency; whether benefits would be gained by combining the functions of the department with those of another organization; and finally, if the functions are continued in their present form, whether changes are needed to improve the efficiency and effectiveness of the agency.

The need for agency functions focused on whether continued state involvement in the provision of affordable housing for low and moderate income persons in Texas was needed. The remainder of the report details changes that should be made if the agency is continued in its present form.

To make determinations in each of the review areas the staff performed a number of activities. These included:

- review of agency documents, legislative reports, other states' reports, other states' statutes, previous evaluations of agency activities and literature containing background resource material;
- interviews with key agency staff and the board chairman;
- attendance at the agency's housing conference, lender meeting, rating agency presentation and board meetings;
- phone and personal interviews with bond rating agencies, underwriters associated with the agency, lenders participating in the agency's programs, other states' housing finance agencies, the federal Resolution Trust Corporation and Housing and Urban Development and the National Council of State Housing Agencies;
- interviews with groups affected by or interested in the activities and policies of the agency, including consumer and housing advocates and local housing authorities;
- tours of some of the agency's real estate owned (REO) properties and an interview with an REO contractor; and
- interviews with employees of state agencies affected by the activities of the agency.

The principal findings and conclusions resulting from the review are set out in three sections of the report: 1) Assessment of Need for Agency Functions; 2) Assessment of Organizational Alternatives; and 3) Recommendations if the Agency is Continued.

Assessment of Need for Agency Functions

ISSUE 1: The functions of the Texas Housing Agency should be continued.

BACKGROUND

The Texas Housing Agency has been responsible for providing affordable housing to low and moderate income individuals through four programs since 1979. These include the Single Family Mortgage Revenue Bond Program, the Single Family Mortgage Credit Certificate Program, the Multi-Family Mortgage Revenue Bond Program and the Multi-Family Low Income Tax Credit Program. Since 1979, the agency has provided more than \$1.8 billion in assistance to 58,000 low and moderate income families in Texas.

To justify the continuation of an agency and its functions, there must be a current and continuing need for the state to provide the agency's functions. In addition, the agency must have carried out these functions in a generally efficient and effective manner. Finally, the functions should not duplicate those of any other state agency.

The current evaluation of the need to continue the functions of the agency determined that:

- ▶ **The primary agency functions of providing affordable housing to low and moderate income individuals continue to be needed. Many Texas residents cannot qualify for conventional loans at market interest rates with standard downpayments and closing costs but may have incomes which would enable them to afford lower monthly mortgage payments. The provision of alternative means to these residents for purchasing a home continues to be an appropriate state goal.**
- ▶ **Although local housing authorities perform many of the same functions which the agency conducts, a statewide policy focus is needed to fill gaps in affordable housing, particularly where no local housing authorities exist. Data produced by the Texas Department of Commerce with regard to applications for mortgage revenue bond allocations in the state indicate that despite the involvement of both local and state bond issuers, there continues to be a need and demand for below-market housing loans beyond what the state and local governments can currently meet.**
- ▶ **While organizational structures may vary, 48 states have an agency at the state level to administer statewide housing policy and issue bonds for providing affordable housing to state residents.**

- ▶ **The ability of the agency to serve over 58,000 low and moderate income families since the agency's creation indicates that there has been significant use of agency services.**

Based on these factors, the review concluded that there is a continuing need for the functions of the agency.

RECOMMENDATION

- **The functions of the Texas Housing Agency should be continued.**

Continuing the functions of the agency would keep a framework in place for the provision of affordable housing based on statewide needs and policies. Continuation of the agency would enable the state to help meet the continuing demand for housing that can be afforded by those with low and moderate incomes.

FISCAL IMPACT

The agency has been self-supporting through proceeds from the bonds it issues and fees it charges lenders and others who participate in the agency programs. No general revenue funds would be required if the agency is continued, unless the legislature chooses to make an appropriation to the housing trust fund discussed in Issue 6.

Assessment of Organizational Alternatives

ISSUE 2: The Texas Housing Agency should be continued as a separate agency with its current functions.

BACKGROUND

During each review, the potential benefits of transferring all or part of an agency's duties and functions to other state agencies are examined. Combining the activities of different agencies can have several benefits, such as eliminating the duplication of agency activities, reducing state expenditures, and increasing the amount and quality of services provided to the public.

The Texas Housing Agency is a free-standing agency whose primary responsibilities are to provide affordable housing to low and moderate income individuals through four programs since 1979. Two of the programs are bond issuing programs and the other two involve issuing tax credits to individuals or multi-family housing developers. Because the agency is a self-supporting bond issuing agency, it differs significantly from most state agencies which are subject to the Legislative Appropriations Act. The functions performed by the agency are not similar to the regulatory or direct service functions of many state agencies.

An assessment of existing agencies to determine the potential for transfer of the department's functions did not reveal any alternatives that would achieve significant cost savings or efficiencies. The review did determine that other states conduct the function of issuing mortgage revenue bonds through agencies with broader bond issuing functions. Two states issue these bonds through their Departments of Commerce; one state housing agency operates as part of a community development authority and one state operates as part of a broad investment finance authority.

A review of the functions of other state housing agencies and agencies within the state that perform similar functions of the agency indicated the following:

- ▶ **The Texas Department of Community Affairs (TDCA) serves a similar population as that served by the housing agency but combining these functions with THA would not result in significant cost savings.**
 - The TDCA's primary function is to allocate federal funds for programs serving the homeless or near-homeless and programs which allocate "Section 8" housing funds for rental assistance to local jurisdictions.
 - Transferring these functions to the THA would not reduce the number of employees needed as THA does not perform a similar function currently.
- ▶ **The Texas Public Finance Authority (TPFA) conducts bond issuing functions which are similar to those of the Texas Housing**

Agency (THA), but the policy needs of the two agencies require different types of expertise and no significant cost savings could be realized by combining the functions of the two agencies.

- The types of bonds issued by the two agencies vary considerably. The TPFA could not achieve any significant economies of scale through larger bond issues as separate mortgage revenue bond issues would still be needed at the same or comparable costs as those which THA is currently incurring.
- ▶ **The Texas Department of Commerce (TDOC) allocates federal Community Development Block Grants (CDBG) to certain cities and counties. Although a portion of these funds can be used for housing development, no significant cost savings would be achieved by combining this allocation function with current THA functions.**
 - The federal government distributes some CDBG funds (about \$119 million in fiscal year 1990) directly to metropolitan cities and urban counties.
 - The TDOC distributed an additional \$48 million in 1990 to smaller or rural cities or counties, known as "non-entitlement" recipients.
 - No significant efficiencies or savings could be accomplished by consolidating authority for TDOC's allocation of the "non-entitlement" CDBG funds with the THA. Due to the differences in the effort needed to carry out the functions, no reduction in staffing appears feasible.

RECOMMENDATION

- **The Texas Housing Agency should be continued as a separate agency with its current functions.**

The programs and functions assigned to the Texas Housing Agency are appropriately placed in the agency. No significant benefits would be achieved by transferring any duties or activities to another agency.

FISCAL IMPACT

No change in agency expenditures would be required as a result of this recommendation.

Recommendations if Agency is Continued

ISSUE 3: Public members should be included in the composition of the Texas Housing Agency's board of directors.**BACKGROUND**

The Texas Housing Agency's board is a nine-member policy-making body created in 1979. The members of the board are appointed by the governor with the advice and the consent of the senate. These members serve staggered six-year terms and represent the following constituencies: housing development administration, commercial banking, real estate, home building, apartment construction, mortgage banking, savings and loan operations, municipal or county government, and housing advocacy interests. The governor designates one member as the chairman. There are currently no positions on the board for public members.

The duties and responsibilities of the board include authorizing bonds, making rules governing the administration of the agency and agency programs, adopting procedures concerning loans, adopting standards for underwriting loans, adopting minimum property standards for property financed by the agency, establishing interest rates and amortization schedules for loans made or purchased by the agency, setting fees related to programs, establishing eligibility criteria for individuals or families wishing to participate in the agency's programs, compiling a list of mortgage lenders, and approving the annual report and budget. These many duties are carried out without the direct assistance and perspective that can be provided by public members.

The review analyzed the need for balanced representation of industry concerns versus those of the general public in the decision and policy-making process of the THA. The analysis also examined the effect of adding public members on the ability of the agency to continue its bond issuance activities and the structure of housing agency boards in other states. The analysis indicated that:

- ▶ **In the past decade, the legislature has added public members to many regulatory and service agency policy-making boards and commissions. On average, at least one-third of the membership of the boards and commissions has been required to be public.**
- ▶ **While industry representatives and the THA board are concerned with the housing needs of low and moderate income families, they are expected to take into consideration and represent the positions of their industries in policy-making discussions. Public members would not be tied to an industry group and would be able to directly address the broad-scale needs and concerns of low and moderate income individuals.**
- ▶ **Currently there is a duplication of representation on the THA board: three members representing banks or related institutions**

and two members representing home and apartment construction.

- The following states have avoided duplication of representation in the banking and construction areas by appointing only one representative from each of the industries: Maine, Massachusetts, Oklahoma, California, and Colorado.
- During the review of THA, consumer and non-profit housing groups suggested designating positions on the THA board for only one representative of banking institutions and one representative of construction and suggest that these three positions be filled with persons representing the public and low income housing advocacy interests.
- ▶ **The majority of other bond issuing agencies in the state, which issue bonds similar to those of the Texas Housing Agency, have public members or unrestricted membership on their boards.**
 - The following Texas agencies issue bonds that are similar to those issued by the THA, in that they are revenue bonds or self-supporting general obligation bonds: Veteran's Land Board, Water Development Board, Texas Parks and Wildlife Department, the Texas Higher Education Coordinating Board, the Texas Department of Agriculture, the Texas Department of Commerce, the Texas Public Finance Authority and the Texas Turnpike Authority.
 - Of these, the Texas Turnpike Authority, Texas Water Development Board, Texas Parks and Wildlife Department, Texas Higher Education Coordinating Board, Texas Department of Commerce, and Texas Public Finance Authority designate positions on their boards for public members or have unrestricted membership. The Texas Department of Agriculture does not have a board or commission.
- ▶ **Having public members on the board would not adversely affect the agency's ability to issue bonds or maintain a high bond rating. The most important factor in providing a high quality bond offering at low interest rates is not the composition of the board, but the type of professional assistance the agency receives from underwriters, bond counsel and attorneys.**
 - The THA board decides when a new bond program is needed and hires professionals such as underwriters, bond counselors, and attorneys to structure the offering, find an investor if it is a private placement, and put the bond offering on the market. The board itself does not perform the technical work to get the bond issues to market.
 - According to Standard and Poor's, a national bond rating agency, the composition of the board alone should not affect a bond's rating. The most important factor in maintaining good bond ratings is the maintenance of the reserve fund, the state of the economy in the area, and the general ability of the issuing agency to perform its functions in accordance with sound financial practice.

- ▶ **Other state housing agencies and bond issuing agencies have public members and have had no problems with bond ratings.**
 - Of the 48 state housing agencies, 20 have at least one public member on the board.
 - New Mexico, Colorado, Florida, Louisiana, Oklahoma, Wisconsin, Utah, Virginia and California were surveyed to determine if public members in any way restricted the ability of the board to make good housing decisions or affected the agency's bond rating. Of the nine state housing agencies surveyed, all indicated that they have had no problems in getting good bond ratings or making competent policy decisions.

PROBLEM

Currently there are no positions on the THA board for public members. All positions on the board represent an interest group or industry and a majority of members represent either lending institutions or builders. While these individuals are all qualified to set housing policy for the state, the general public is not adequately represented by this composition.

RECOMMENDATION

- **The statute should be amended to include positions on the board for three representatives of the general public. The current size of nine members should be maintained and the composition of the board should include the following representatives:**
 - 1 banking professional**
 - 1 licensed real estate broker**
 - 1 builder (single and/or multifamily dwellings)**
 - 1 state or local government representative**
 - 1 person with housing development administration experience**
 - 1 person experienced in the housing needs of low and moderate income families**
 - 3 public members**

The composition of the board recommended above would provide for one-third public membership and eliminate current duplication of representation for the banking and construction industries. The public members would not be connected to any of the industries associated with the housing agency including banking, real estate or building and would provide a perspective reflecting the needs of the general population. Six positions would be filled with industry representatives who would be able to provide expertise in their respective areas.

The change in the composition of the board would be accomplished by replacing the duplicated outgoing industry members with public members. These industry members represent savings and loan operations (term expires January 31, 1993),

home building (term expires January 31, 1993) and commercial banking (term expires January 31, 1995).

FISCAL IMPACT

Agency costs should not be affected by this recommendation.

ISSUE 4: The Texas Housing Agency should be subject to oversight procedures similar to those in place for state agencies.

BACKGROUND

The Texas Housing Agency has an administrative budget of nearly \$3.8 million for fiscal year 1990 and oversees annual expenditures of over \$139 million for operating its bond programs. The agency finances its operations solely through the revenues generated from its bond sales and investments and is not subject to the Appropriations Act.

Although the agency oversees funds in excess of \$1.5 billion, it maintains a considerable amount of flexibility with regard to its operations. The agency is authorized by statute to place its funds in a depository submitting a bid with the most favorable interest rate. As of August 31, 1990, funds of about \$279 million are in local depositories and \$453 million are in a reserve fund in the state treasurer's Safekeeping Trust Company.

The statute requires the agency to have an annual audit either by the state auditor or a certified public accountant. The audit is submitted to the governor and the legislature. The agency also must file an annual report of its activities with the governor and legislature. The agency's budget is prepared by the staff and approved by the agency board. In contrast, most state agencies must undergo a review of their budget requests by the governor and legislature and a check of their expenditures through the Office of the State Comptroller. Most state agencies are also subject to other statutory requirements designed to standardize state practice, ensure consistent personnel policies affecting state employees and limit expenditures to reasonable levels. For example, state law subjects most agencies to provisions affecting classification of employees, purchasing procedures, travel restrictions and standards of conduct that employees and board members must meet.

A review of the current state controls over the agency's operations and a comparison of these controls to those that exist for other state agencies indicated the following:

- ▶ **Weaknesses or deviations from standard state practice indicate that additional controls are needed over the agency's practices.**
 - Reserved bond funds of \$21 million were inappropriately transferred to an uninsured bank outside of the country in 1987. Since that time, the agency has elected to place the funds it holds in reserve in the Texas Treasury Safekeeping Trust Company. \$279 million remains in outside depositories in accordance with the provisions in some of the agency's bond covenants and the agency cannot require the transfer of these funds. All of the funds are the fiduciary responsibility of the bank designated as bond trustee in the bond indentures.

- Private depositories in Texas have generally faced economic pressures and have been forced to develop stricter policies and procedures to ensure solvency and profitability. The state treasurer is somewhat insulated from these pressures. Unlike private depositories, the state treasurer does not need to make a profit and charges only for the cost of managing the funds. The treasurer's trust company indicates that costs in the private sector could be twice as high as those of the treasurer. The state treasurer must maintain a detailed system of checks and balances related to the transfer of money from its system in order to maintain the bond rating of the state of Texas.
- Unlike most other state agencies, the agency has the potential to acquire surplus bond funds, which are funds in excess of those needed to offset the agency's debt. These funds have amounted to \$5.5 million, \$13.8 million, \$14.3 million, \$6 million and \$8.2 million for 1985 through 1989 respectively. The agency has considerable discretion regarding the use of these funds. The funds may currently be used for agency operations, special housing programs or, when held in reserve, as a cushion against future rating agency requirements or to enhance the agency's financial standing. Although members of the general public can attend agency board meetings and comment on the agency's operating budget, no system currently exists for the agency to specifically plan for its use of surplus funds and hold hearings on the plan.
- The legislature has input into the policies and planning processes of most state agencies through the appropriations process. The legislature is made aware of the agencies' plans by the Legislative Appropriations Requests they submit. The legislature may appropriate significant funding to areas of high priority and restrict funding in lower priority areas. Through the use of riders in the appropriations bill, the legislature can also ensure that specific intentions with regard to an agency's operations are carried out. The periodic review of state agency programs by the Legislative Budget Board (LBB) also provides an opportunity for input into the agencies' planning and policy-setting processes. The THA is not subject to the appropriations process, nor is it subject to program evaluations by the LBB.
- Unlike most state agencies, the THA is not subject to, and until recently has not complied with, the state's Position Classification Act or the provisions in the Appropriations Act which pertain to classified employment. These requirements help to ensure conformity in salary and position classification practices across state agencies and include oversight by the state auditor's office to ensure that such conformity exists.
- The office of the Secretary of State reports that the agency's board is not subject to the financial disclosure requirements set out in Art. 6252-9b, V.T.C.S. for appointed state officers of major state agencies.

- ▶ **Market conditions and financial environments which affect the housing agency's activities could change significantly in a two year legislative appropriations cycle. For example, the agency has acquired a number of properties through foreclosure which it is required to repair, maintain and market. A change in the market could result in an unexpected large inventory of properties accruing to the agency which then require maintenance and repair. The agency needs the flexibility to direct funds where they are most needed in response to changing environments. Placing agency funds under appropriations could increase the state's liability with regard to the agency's \$1.5 billion in bonded indebtedness and other areas.**

- ▶ **For the management of state agency funds not required for agency operation, the state treasurer operates a Safekeeping Trust Company for managing public funds held outside the treasury which can provide safety, liquidity and an interest yield comparable to other private depositories.**
 - The trust company currently manages funds of the Texas Public Finance Authority, Texas Department of Banking, Texas Real Estate Commission, Texas Parks and Wildlife Department, Teacher Retirement System, Texas Department of Commerce and other state agencies.

 - The weighted average yield on the aggregate funds held by the agency's trustees outside of the treasury trust company was 8.223 percent compared to 8.847 percent for the funds in the treasurer's trust company. The investment functions performed by both the outside depository and the treasurer are done at the instruction of the agency or its bond trustee designated in the bond indentures, so the success of the fund cannot be directly attributed to the holder of the funds. Nevertheless, the treasurer is equipped to operate in accordance with the trust indentures at the direction of the agency or its bond trustees in the same manner as regular depositories and the yield has been comparable for the two types of funds.

- ▶ **Other state housing finance agencies have been identified that are subject to more oversight or accountability than THA is.**
 - The housing finance agency in Wisconsin is governed by a board which includes four legislators. In addition, the agency is subject to fiscal and program audits by the state's legislative audit bureau upon request of the legislature. The agency must annually submit to the governor and the legislature the actual and projected amounts of surplus funds available and a plan for spending the funds. During legislative review, changes are made to the plan and expenditures can only be made in accordance with the plan.

 - In Minnesota, the legislature sets a ceiling on the agency's operating expenses. While the agency cannot spend beyond the ceiling, they do have the flexibility to determine how funds within the allowed limit are spent.

PROBLEM

The agency's activities and funds are not subject to the same requirements or oversight procedures as those of other state agencies. These standard requirements or procedures safeguard against inequitable employment practices, inefficient expenditures or practices in conflict with the public interest and allow for increased input regarding the agency's operating budget and plans for use of surplus revenues.

RECOMMENDATION

The following requirements should be set out in statute to increase the oversight of the agency and its accountability:

- The agency should be required to improve its planning and budget process by:
 - developing a proposed annual budget that sets out the agency's plan for operating expenditures and use of surplus bond revenues;
 - holding public hearings in various regions of the state to receive comments on the proposed budget;
 - adjusting the proposed budget based on public input and approving the budget during its August board meeting;
- The agency should be subject to the Position Classification Act and the provisions in the Appropriations Act that pertain to classified employment;
- The agency's board should be subject to the financial disclosure requirements for officers of major state agencies set out in Article 6252-9b, V.T.C.S.; and
- The statute should require that, except for the agency's operating funds, THA's funds should be placed with the Texas Treasury Safekeeping Trust Company for investment and management at the direction of the agency.

Placing the above requirements on the Texas Housing Agency will bring the agency operations more in line with standard practices in other state agencies. Requiring the agency to develop a plan for spending its surplus bond revenues and to hold public hearings on the plan and its proposed budget each year, should provide the agency with useful information with which to structure its programs and allow for additional public input regarding agency functions. The agency could use the information provided in the hearing to adjust its plans and budget when appropriate and possible. By making the agency subject to the provisions in the appropriations act relating to classified employees, the agency will be required to comply with standard hiring, promotion and demotion requirements and personnel and payroll reporting procedures. The agency has already begun to

initiate some of the practices discussed above, however, requiring compliance with the statutes will ensure that state employees and board members across the state are treated equitably and subject to the same policies. Under the financial disclosure requirements, board members will be required to file annual financial disclosure statements with the Secretary of State as are other appointed officers of major state agencies. Requiring the placement of agency funds in the treasury's trust company, as is the agency's current practice, could help to prevent the type of misinvestment which has occurred in the past.

FISCAL IMPACT

The state treasurer's trust company has indicated that it can invest and manage the agency's funds at a cost less than that available in the private sector, however, the review did not attempt to estimate the potential savings. Some cost will be associated with hearings but the expense should be minimal.

ISSUE 5: The agency should be required to obtain approval from the attorney general's office before hiring outside legal counsel.

BACKGROUND

The Texas Housing Agency currently has two attorneys on staff to perform its legal responsibilities. In addition, the agency frequently uses outside legal counsel to perform specialized services such as the preparation of bond indentures, interpretations of the effect on the agency of any federal legislation, the handling of tax lawsuits and foreclosure matters in court and consultation regarding litigation involving employees, among other activities. The agency's attorneys perform a variety of routine legal services, including answering all legal questions from the board, the staff and the public, preparing contracts and drafting resolutions for board meetings. Agency attorneys also prepare and handle litigation involving the agency.

It is much more common for the attorney general's office to handle an agency's legal duties than for an agency to turn to outside legal counsel. The Texas Housing Agency, however, has traditionally used outside counsel for these services. For example, the agency recently sought interpretation from a private attorney relating to a provision in the Texas Private Allocation Act and requested information regarding general venue law and ways in which the agency's venue for certain cases could be changed.

The review analyzed the agency's policy for obtaining legal services and general state policy and practices regarding the use of legal counsel. The analysis also compared the practice of the Texas Housing Agency with other state agencies. The analysis indicated the following:

- ▶ **One of the functions of the attorney general is to provide legal services for state agencies.**
 - Article IV, Section 22 of the Texas Constitution creates and defines the role of the attorney general. Among other responsibilities, the attorney general and district and county attorneys are mandated to represent the state before trial and appellate courts.
 - Over the years, the attorney general has interpreted the constitutional construction to mandate the attorney general and his staff to handle all the legal duties of state agencies with statewide jurisdiction, where the attorney general has available resources. This viewpoint has been affirmed by the courts, particularly in Maud v. Terrell (200 S.W.2nd 375).
- ▶ **Agencies must get prior authorization from the attorney general before hiring outside counsel.**

- The Supreme Court declared in Maud v. Terrell that it is the constitutional right of the attorney general to decline the use of outside services at his discretion. The court further stated that when outside services are used by agencies, it must be in subordination to the authority of the attorney general.
- The legislature has supported this policy by including a provision in the appropriations act which prohibits state agencies from expending funds for outside legal counsel to defend the agency in court without the express authorization of the attorney general's office. Article V, Section 41, of the current Appropriations Act specifically requires agencies to get the consent of the attorney general's office before an outside firm is retained. The agency is not subject to the Appropriations Act.
- ▶ **Because the Texas Housing Agency is outside the appropriations process, it is not subject to the requirement in the Appropriations Act to obtain the attorney general's consent before using outside counsel. It appears, however, that the state constitution and case law would require the attorney general's approval of the agency's outside counsel.**
- Until recently, the agency, by board policy, has sought permission from the attorney general (AG) for its use of outside counsel. The AG authorized the agency to expend approximately \$516,000 for outside legal counsel in fiscal year 1990. The AG recently denied the agency authority to use outside counsel because the services the agency wished to obtain were available through the office of the AG. The AG has approved outside counsel for cases in which the AG could not immediately provide the services.
- The agency's board adopted a formal resolution at its September 26, 1990 meeting which declares that the agency may use its own funds to engage outside counsel of its choosing (at least with respect to all non-litigation matters) without the necessity for prior attorney general consent and approval.

PROBLEM

The state constitution, general case law and the state Appropriations Act generally indicate that state agencies with statewide jurisdiction must get the approval of the attorney general's office before they can hire outside legal counsel. The agency has taken steps to remove itself from this process, even though other state agencies in similar circumstances have had to follow this general state policy.

RECOMMENDATION

- **The statute should be amended to require the agency to request the permission of the Office of the Attorney General to hire outside legal counsel.**

This recommendation would require the agency to follow the policies and procedures of the attorney general's office in requesting authority to hire outside legal counsel. It does not, in any way, prohibit the agency from continuing to hire outside counsel or from hiring in-house counsel in the future. However, by this recommendation, the attorney general's office might deny authorization and require the agency to utilize the services of the attorney general's staff or its own legal staff for a part or all of its legal responsibilities.

FISCAL IMPACT

A fiscal impact may result from this recommendation but it cannot be estimated at this time.

ISSUE 6: The statute should establish a housing trust fund for the provision of downpayment and closing cost assistance and acquisition and rehabilitation of property for low income Texas residents.

BACKGROUND

Changes in the economy and housing market in Texas have pushed affordable housing beyond the reach of many low income families and individuals. Persons who can afford modest monthly payments are often excluded from home ownership because of the large downpayment requirements of conventional loans. Although the traditional programs operated by housing agencies have lowered the downpayment requirements, the three to five percent cannot always be met by persons who would otherwise qualify.

Other states have expanded their programs when they realized that there were significant numbers of people excluded. Examples of programs operated by other states include making funds available for preserving existing homes that have deteriorated due to age, preventing foreclosures, providing rental assistance and providing downpayment assistance for the purchase of a home.

Since additional revenues are usually needed and the bond program generally cannot be used to further subsidize this activity, states have sought other sources of revenue.

Some states have used appropriated funds; others have used surplus bond revenues, or a combination of these sources. Surplus bond revenues are defined as funds in excess of those which must be held in reserve to offset the outstanding obligations of the agency. Agencies maintain interest bearing reserve funds to protect against cash shortfalls which might result from delinquent payments or insurance claims delays and such funds do accumulate balances beyond what is needed to offset the agency's debt. The Texas Housing Agency reports that it must maintain a reserve fund balance of two percent or greater of the total amount of bonds outstanding to maintain an AA/A+ rating from the major bond rating agencies. The amount of funds held in reserve is used as one benchmark of the agency's financial health. The audited reserve fund balance as of August 31, 1989 was nearly \$36.9 million, or 2.6 percent of bonds outstanding after accounting adjustments. The amount held in the fund beyond the required two percent is considered surplus revenue. (The bond covenants related to each bond issue generally set out how the bond proceeds are to be used and could affect the agency's ability to use surplus revenue.)

The agency's goal since 1987 has been to increase the amount held in reserve to four percent of bonds outstanding, an amount necessary for the agency to achieve "top tier" status. Achieving such status could reduce the risk on the bonds, lower the agency's interest payments and enable the agency to extend lower interest rates to borrowers. In 1989, the agency would have needed in excess of an additional \$20 million to reach top tier status.

The housing agency has used surplus revenues in 1988 and 1989 to help finance a mortgage program offering rates below those the agency would have been able to use in a regular program. Funds have also been used for general and administrative agency expenses.

The review examined the data available on housing needs in Texas, possible sources of funding within the agency to meet those needs and the programs of other local and state housing finance agencies and determined the following:

▶ **The current programs offered by the agency do not fully address the housing needs of low income Texas residents.**

- In the agency's current mortgage revenue bond programs, "low income" is defined as 80 percent or below the median family income in the area. Generally, this definition currently covers households with annual incomes less than \$27,700. The revenue bond programs require the payment of closing costs and a downpayment of three to five percent of the purchase price of the home. These costs average \$3,600 and are beyond the reach of many potential low income homebuyers.
- The single family mortgage revenue bond program only serves qualified homebuyers and does not address the needs of those who live in substandard housing or cannot reasonably afford to purchase a home.
- The multifamily bond program, which has financed 36 multifamily rental housing developments since 1979, is limited in scope and effect. The program only requires that 20 percent of the rental units be occupied by tenants with very low incomes (50 percent or less of the area median income) and 40 percent be occupied by those with low incomes of 60 percent or less of the median. The program has been inactive for the past three years due to changes in the 1986 Tax Reform Act which made the program less profitable for the development of this type of housing.

▶ **Trust funds are used by many states to expand homeownership opportunities for low and moderate income families.**

- States having housing trust funds include Arizona, California, Delaware, Georgia, Kentucky, Maine, Maryland, Minnesota, New Jersey, North Carolina, Tennessee, Vermont, Virginia, New York, Illinois and Washington. The funds range from \$10 million to \$25 million per state.
- Connecticut, Florida and Maine operate downpayment assistance programs that offer low income buyers a downpayment second mortgage if they can demonstrate sufficient income to support monthly mortgage payments, homeowners insurance and real estate taxes and meet certain tests that demonstrate the economic stability of the potential buyer.

- California, Delaware, Maine and New Jersey use trust funds to provide for the rehabilitation of substandard residential apartments or homes for the elderly, disabled or other groups or to convert nonresidential space to residential purposes.
- Maine uses a trust fund to "buy down" interest rates on all or a portion of loans made under a bond issue, thereby facilitating loans to lower income individuals.
- Washington partially uses trust funds to finance technical assistance or administrative costs for non-profit community or neighborhood-based organizations.
- ▶ **Most housing trust funds limit the use of all or some of their funds to households with low incomes.**
 - Of 34 state and local housing trust funds in existence in mid-1988, 25 contained restrictions limiting funds to incomes at or below 80 percent of the median income for the area. Seventeen of these, including California, required that all of the funds benefit these households.
 - Eight state and local housing trust funds require that all or some of their funds benefit even lower income households, at or below 50 percent of the median income for the area. Washington and New Jersey require that all of their funds benefit only these households.
- ▶ **Texas could establish a trust fund using surplus revenue beyond that needed to maintain agency bond ratings.**
 - The agency reports that it has had surpluses in the amounts of \$5.5 million, \$13.8 million, \$14.3 million, \$6 million and \$8.2 million for 1985 through 1989 respectively.
 - Based on audited fiscal year 1989 figures, placement of one-half of the agency's surplus revenue beyond that needed to maintain agency bond ratings in a housing trust fund would have provided start-up funds of \$4.1 million and would leave the agency with reserve funds of 2.3 percent of outstanding bonded indebtedness, more than what is required for its current AA/A+ bond rating. Audited figures for fiscal year 1990 are not available, but the agency indicates it will not have surpluses for 1990. The agency used available surplus funds to enhance the financing of a recent bond issue.
- ▶ **Other states have used surplus funds to start and maintain housing trust funds.**
 - The Kentucky Housing Corporation established a Housing Trust Fund with an initial capitalization of \$8.9 million from its surplus fund. The corporation specified in its largest indenture that all future excess annual income after debt service was applied to the housing trust fund. In 1986, the fund received \$4.5 million from

excess money in the reserve fund and in 1987 the fund received \$5 million.

- The Tennessee Housing Development Agency committed interest earned on the agency reserves to its housing program fund, along with several other revenue sources. Funds of \$1.4 million and \$1.8 million were dedicated to a housing trust fund in 1988 and 1989 respectively.
- Virginia used \$45 million in excess interest on debt service reserves to capitalize its housing fund.

PROBLEM

The state's current mortgage revenue bond programs are not sufficiently adequate to meet the varied needs of low income persons for affordable housing. Persons with limited or fixed incomes often cannot meet downpayment or closing cost requirements. Homes that could be made available to low income persons often need rehabilitation work to make them meet minimum loan inspection requirements. In addition, homes owned by elderly, disabled or other individuals with low incomes may be in need of rehabilitation to bring them up to standard condition. The state does not currently have programs in place or funds designated to address these special needs.

RECOMMENDATION

- **The statute should establish a housing trust fund placed with the Texas Treasury Safekeeping Trust Company to be administered by THA for providing assistance to persons at or below 80 percent of the median family income for the area. The statute would provide that:**
 - **the fund consist of surplus bond revenue funds, appropriations authorized by the legislature and other public or private contributions;**

The sources of revenue mentioned above are typical of those used by similar agencies in other states. The recommendation does not mandate a legislative appropriation, but the legislature could appropriate funds to the trust fund if it so chooses.

- **surplus revenue funds would be transferred into the reserve fund under the following conditions:**

No later than January 10 of each year, one-half of all interest earned and surplus revenues in excess of two percent of the agency's outstanding bonded indebtedness (or an amount required by a national bond rating agency to maintain current bond ratings of AA/A+) would be placed in the housing trust fund;

Once the agency's reserve fund reaches "top tier" status (four percent of the agency's outstanding bonded indebtedness), all additional surplus revenue would revert to the trust fund;

If, at any time, the national bond rating agency determines that the agency needs to increase the percentage of funds held in reserve, the agency would be authorized to cease the transfer of funds into the trust fund until such rating agency requirements are met.

The agency has an independent audit conducted annually which verifies the amount of funds actually available beyond that needed to meet reserve fund requirements. The statute requires that this audit report be submitted by January 1 each year. The statute would specify that the amount of money transferred to the fund would be based on the audit report and the transfer would take place no later than ten days after the agency's receipt of the audit report. If the national bond rating agency determines that an amount in excess of the two percent is needed to maintain the agency's current rating of AA/A+, the agency would be authorized to set aside the amount required by the rating agency before transferring any funds to the trust fund.

This provision takes into consideration the agency's goal of achieving top tier status. As discussed above, the agency would set aside in its reserve fund one-half of its surplus funds in excess of the two percent needed to maintain its current bond rating each year until the reserve fund amounts are adequate to achieve top tier status (currently four percent of the agency's outstanding bonded indebtedness). Any amounts in excess of that needed for maintaining top tier status would revert to the trust fund.

- **the agency would adopt rules for determining eligibility for the fund, promoting the fund, and considering applications for grants or loans;**

A trust fund created in Texas from surplus funds in excess of those needed to maintain the agency's bond rating would initially have a limited fund balance. A system would therefore be needed for using the funds in the most effective manner possible, making the public aware of the fund, evaluating the need for funds and prioritizing the use of the fund. Techniques used by other trust funds include returning payments and interest on loans made from the fund back to the fund, establishing a maximum grant amount and prioritizing grants or loans to individuals or groups that match trust funds with funds from other sources among others. Under this recommendation, the agency would have the discretion to set limitations and priorities for the fund.

- **uses of the fund would be limited to the provision of downpayment assistance or closing costs, or costs associated with the acquisition or rehabilitation of property by the agency to provide housing to low income persons.**

Because the balances in the fund will be relatively limited, it is important to set restrictions on the uses of the fund. Based on the fiscal

year 1989 audit and the conditions of this recommendation, about \$4.1 million would have been placed in the trust fund in January of 1990. Given an average of \$3,600 for downpayment and closing costs in the agency's programs, the trust fund could assist over 1,000 households to obtain loans, if funds were used exclusively for this purpose. Within the limitations discussed above, the agency would have the discretion to further target the elderly, disabled persons or other populations with the definition of low income.

Establishing a housing trust fund in statute would result in an increased number of low income persons being served by the agency. This recommendation enables the agency to work towards a top tier bond rating while providing services that otherwise would not be available through the agency. The housing trust fund would not have an adverse effect on the agency's bond rating or reserve fund status as funds would only revert to the fund after all rating agency and reserve fund requirements had been satisfactorily met. The agency would be authorized to cease the transfer of funds into the trust fund until the reserve fund reaches rating agency requirements. In addition, the agency would be authorized to transfer funds from the trust fund to the reserve fund if this becomes necessary to meet rating agency requirements.

The use of surplus funds in excess of the minimum required to be held in reserve would not represent a new practice for the agency. The agency reports, for example, that in 1990, surplus funds were used to finance their recent bond issue to provide loans for the purchase of Resolution Trust Corporation (RTC) properties. The result of the use of these funds is that the agency has only the minimum amount in reserves that is required to maintain its bond rating.

The formula discussed in the recommendation would allow only one-half of the surplus funds to revert to a trust fund. The other half could be used by the agency to finance bond issues, acquire property (if given the authority to do so as proposed in Issue 7) or to increase the amount in the reserve fund as a cushion to meet anticipated rating agency requirements.

Bond covenants of past bond issues may specifically direct the bond trustee as to the uses of the bond proceeds. This recommendation would not interfere with the development of bond covenants necessary to ensure proper placement of the issue, however, the statute would clearly specify that future bond covenants may not prevent the use of surplus revenues which exceed an amount required to be held in reserve for housing programs approved by the agency and its board.

FISCAL IMPACT

The establishment of a trust fund would not affect the agency's operating budget. The agency could continue to operate as it currently does using the fees it collects from lenders and other sources. There would be no effect on the state's General Revenue Fund unless the legislature chooses to make a state appropriation to the fund.

ISSUE 7: The agency should have limited statutory authority to buy housing units for resale or rental to low income individuals and households.

BACKGROUND

The primary purpose of the agency is to ensure that there is a "sufficient supply of safe and sanitary residential housing properties at reasonable and affordable rates for low and moderate income families". The agency currently attempts to meet these objectives through bond and tax credit programs. The agency issues bonds and uses the proceeds to provide funding for low interest loans. These loans are offered to low income families and individuals for the purchase of single family dwellings and to non-profit and for-profit housing groups for the acquisition or construction of multi-family developments. In addition, the agency also has the authority to issue annual tax credits to individuals and families. These tax credits, in effect, increase the individual's or family's income allowing them to qualify for a home mortgage loan. The agency also provides tax credits to developers as an incentive to build, acquire, and/or rehabilitate multi-family complexes. A certain percentage of units in these complexes is set aside for low and moderate income individuals or families.

Another method which could be used to meet the objectives mentioned above is based on the authority to acquire and own property. These properties could be acquired, rehabilitated and resold or rented to low and moderate income individuals and families. Currently the agency is prohibited by Section 8(a)(5)(A) of the Texas Housing Agency statute from constructing or acquiring property unless through foreclosure of mortgages or sales under deeds of trust.

Recently enacted federal legislation, the Financial Institutions Reform Recovery and Enforcement Act (FIRREA) of 1989, includes provisions which allow public agencies to acquire properties on a preferred basis to be used to serve low and moderate income individuals. The Texas Housing Agency, along with regional, county and municipal housing agencies could participate in opportunities afforded under this Act if authorized to do so by state law.

The review examined programs related to the acquisition and resale or rental of properties in other states and the opportunities associated with these programs. In addition, the review analyzed the availability of property, the ability to fund the acquisition of property, and the advantages and disadvantages of property ownership. The analysis indicated that:

- ▶ **Federal agencies such as the Department of Housing and Urban Development (HUD), the Resolution Trust Corporation (RTC), the Federal National Mortgage Authority (FNMA), and the Federal Home Loan Mortgage Corporation have recently offered to make properties available to state housing agencies to be used to serve the needs of low income individuals.**

- ▶ **There is a significant amount of property in Texas owned by federal agencies which could be bought by the agency at a discount and offered to low income Texans or non-profit organizations.**
 - The Resolution Trust Corporation has control of over 15,000 foreclosed properties in Texas valued at \$5.1 billion, including 14,328 single family residences and 971 multi-family developments. The Resolution Trust Corporation has offered both single and multi-family properties to THA at a discount.
 - Federal agencies including the Federal Housing Administration, the Veterans Administration, and the Federal Deposit Insurance Corporation have over 20,500 single family residences and 26 multi-family developments in Texas. Recently HUD offered to sell THA some or all of 1,700 properties at \$1 per property.
 - Savings and loan institutions in the southwest have at least two to three billion dollars worth of foreclosed eligible residential property in Texas.
- ▶ **The agency could develop and implement new programs which could be used to provide assistance to more individuals and families if it had the authority to own property.**
 - The agency could purchase properties, in bulk, at discounts from already depressed prices with or without tax-exempt financing and lease to low and very low income Texans.
 - The agency could purchase multi-family properties at a discount, and rehabilitate them for rental to low and very low income Texans. In developments of sufficient size, apartment units could be made available to a carpenter who would have the responsibility of performing general maintenance and repairs and to one or more security personnel who would be responsible for maintaining security in the complex in exchange for rent.
 - The agency could purchase both single and multi-family residences for rental to low and very low income Texans who, after five (5) years of payment of all ad valorem taxes and adequate maintenance, would receive the option of acquiring the deed to the property and paying the remainder of the mortgage on the property over the remaining term of the loan.
 - The agency could purchase multi-family properties at a discount and sell these properties to non-profit organizations who would be unable to afford them using conventional loans. THA could offer these non-profit organizations loans at lower interest rates.
- ▶ **The authority to acquire property would provide several advantages to the agency.**

- Property ownership would increase the agency's options in providing safe and sanitary housing to low income Texans.
- Properties now controlled by the federal government could be used by the state to provide high quality housing.
- Acquiring properties would prevent their further deterioration and reduce the glut of housing on the market.
- ▶ **Eleven states were surveyed to determine if they have the statutory authority to own property and what types of programs are offered because of this authority. These states are characterized as being located in the southwest United States or as being similar to Texas in size or demographics.**
 - Of 11 states surveyed, the following eight have the authority to own property: Washington, Louisiana, Utah, Virginia, Wisconsin, Pennsylvania, Colorado and New Mexico.
 - The Virginia Housing Agency buys, rehabilitates and manages multi-family complexes. The acquisition of these complexes is financed by the issuance of both taxable and central function tax-exempt bonds. The only restrictions on the program involve the income of applicants.
 - The Pennsylvania Housing and Finance Agency also buys, rehabilitates and manages multi-family complexes. The agency does not buy single-family dwellings. Property acquisition and rehabilitation is financed through legislative appropriations.
 - The Colorado Housing and Finance Authority buys and rehabilitates apartment complexes, retains ownership, and manages these properties through a contractor. Property acquisition and ownership is financed through the issuance of general obligation bonds.
 - California, Florida and Oklahoma do not have the authority to own property and have not asked their legislatures for the authority.
- ▶ **While there are advantages to acquiring housing properties, the program should be limited to avoid possible pitfalls. The agency's bonding authority should not be used for this purpose.**
 - Due to the nature of the bond market, the smallest amount for a viable bond issue is \$10 million.
 - This amount of purchasing power coupled with large numbers of available housing units could result in pressures to overbuy. Multiple defaults would have a negative impact on the agency's credit rating and would involve additional costs.
 - Authority to purchase through bond issues could create unneeded competition with local housing authorities and non-profit groups.

PROBLEM

The agency does not have the statutory authority to own property and is unable to take advantage of current market opportunities to help low and very low income households.

RECOMMENDATION

- **The agency should have limited statutory authority to acquire and own property for resale or rental with the following restrictions:**
 - **all properties acquired by the agency must be able to meet FHA standards and qualify for home mortgage insurance after rehabilitation;**
 - **all properties acquired would only be available to individuals or households that are defined as low income (less than or equal to 80 percent of median family income);**
 - **all funding for property acquisition should come from surplus revenues in excess of those required for the reserve fund; and**
 - **an annual independent audit should be conducted to analyze the property ownership program's financial stability, cost effectiveness and ability to serve low income individuals and households.**

Because of the risks associated with property ownership, the restrictions above are intended to ensure that the program is viable and that risks are reduced. The intent of the restrictions is to ensure that properties acquired are saleable, that properties are targeted to low income individuals and households, that the number of properties is limited to a manageable amount, that the agency does not issue additional bonds to finance property acquisition, and that an independent auditor, as part of the annual audit, analyzes the property ownership program. Another recommendation in the report (Issue 6) deals with the creation of a trust fund consisting of surplus bond revenues, appropriations authorized by the legislature, and other public or private contributions. An appropriation for the fund is not mandated, but the legislature could make an appropriation if it so chooses. This fund, if created, would be used by the agency to finance property acquisition and ownership. Regardless of whether or not a trust fund is established, the agency could use surplus bond proceeds to acquire and rehabilitate property.

FISCAL IMPACT

The agency would have to develop a source of funding independent from the current mortgage revenue and securitized bond programs. Another recommendation in this report (Issue 6) would provide for the establishment of a housing trust fund. This fund, if established, could be used by the agency to

finance this program. Regardless of whether or not a trust fund is established, the agency could use surplus bond proceeds to acquire and rehabilitate property.

There will be increased costs associated with purchasing, rehabilitating and selling property, and a new department and employees would probably have to be added. Based on the acquisition of 2,000 to 3,000 properties, the agency estimates that it would have to add an additional four staff members at a cost of \$125,000. If the agency did not purchase this many properties, fewer additional staff members would be required. The actual cost would depend upon the number of properties acquired. The costs for appraisal of each property purchased would be approximately \$125.

The agency has estimated that it could earn as much as \$15,000 per property through resale of the property. This money could be placed in a trust fund to finance additional acquisitions of property or other programs.

ISSUE 8: The agency should be required by statute to develop a quality control plan to ensure that servicers, lenders, REO contractors and other contractors comply with prescribed requirements.

BACKGROUND

The agency works with lenders, servicers, and REO contractors to make bond proceeds available to borrowers, collect principal and interest payments, monitor the delinquency and foreclosure of loans, and manage and market foreclosed properties. Agency procedures to review the performance of these lenders, servicers, and REO contractors vary.

Lenders originate agency loans and are required to meet the requirements of the agency, the Federal Housing Administration (FHA), the Veterans Administration (VA) and the Internal Revenue Service (IRS). These lenders are monitored by FHA and the Government National Mortgage Association (GNMA) to ensure that they are originating loans that meet federal standards. An institution may be both a lender and a servicer if it originates and then services the loan. The agency does lender monitoring through the servicing and REO departments. For example, if these departments notice that a lender has originated a high number of delinquent or foreclosed loans, then the agency may undertake an audit of the lender in question.

The agency follows a more formal process in evaluating the compliance of servicers with agency and insurance company requirements. Servicers are required to perform duties and responsibilities as described in the sales and servicing agreement with the agency. These duties include collecting principal and interest payments from borrowers, remitting these payments to THA, notifying the primary mortgage and pool insurers of delinquent and foreclosed loans and filing insurance claims on foreclosed properties. The agency, through the servicing and REO departments, constantly monitors the performance of servicers. The agency receives reports concerning the remittance of principal and interest payments, the notification of delinquency and foreclosures, and the filing of insurance claims. If a servicer fails to perform as required or fails to submit a report or file a claim in a timely manner, then the agency may conduct an audit of the servicer. Whether an audit takes place depends upon the severity of the violation and the past performance of the lender.

In the past, the servicer(s) has been responsible for managing and marketing foreclosed properties under THA programs. The failure of the servicer(s) to sell these properties in a timely manner, however, prompted the agency to take control of the properties. The agency established a real estate owned (REO) department and hired contractors to manage and market the foreclosed properties. Real estate owned contractors are monitored and reviewed by the REO department. Real estate owned contractors are required by the REO contract with the agency to make necessary emergency repairs to a property after it has been foreclosed upon to protect it from further deterioration, make internal and external repairs to the property as deemed necessary by the insurer and the

agency, maintain the property and keep it free of litter, and market the property. The REO department inspects properties on a quarterly basis to ensure that the contractor is meeting the terms of the REO contract. If a problem is found, THA notifies the contractor and requires that contractor to provide the necessary services.

Under the RTC bond program developed in 1990, the risk to the agency from substandard loan origination procedures or failure of the servicer to comply with contract requirements is reduced. Under the agency's old bond programs, the foreclosed properties were the responsibility of the agency. The agency's new bond programs are backed by GNMA securities and require that the servicer be responsible for the foreclosed properties. The agency will not be responsible for managing and marketing foreclosed properties under these new programs.

The review analyzed the agency's current monitoring plans for lenders, servicers and REO contractors and assessed the need for strengthening these processes to ensure that lenders, servicers and REO contractors participating in agency programs are receiving consistent and timely evaluation of their performance in meeting all federal and contract requirements. As part of the review the risks and possible losses involved in lender, servicer, and REO contractor performance were examined. The analysis indicated that:

- ▶ **Despite the reduced risk to the agency under the new bond issues, a monitoring plan for lenders, servicers and REO contractors continues to be desirable. The agency is still responsible for and continues to monitor the servicing of some 13,000 loans originated under the non-securitized programs. These loans will continue to experience foreclosures and the agency estimates that it will continue to manage REO's for the next eight to ten years.**
- ▶ **The agency does not have a plan to monitor the performance of lenders. Currently failure of a lender to originate good loans would only be detected if staff in the servicing or REO department noticed that a lender had an abnormal number of delinquent or foreclosed loans.**
- ▶ **Failure to monitor the loan origination procedures of lenders increases the risk of financial loss to the agency by allowing lenders to originate loans that do not meet federal or insurer requirements.**
 - When a lender originates a loan which does not meet federal or insurer requirements and the property is foreclosed upon, the agency must recover expenses and losses directly from the lender. This is a costly and time consuming process.
 - Since the creation of THA, lenders have made approximately 91 loans that were foreclosed upon and were attributed to lender error or fraud. These 91 loans were not covered by mortgage insurance because of some mistake that the lender made in originating the loan. THA has set aside approximately \$1,210,000 to cover possible losses attributable to these loans.

- ▶ **Although THA does monitor the performance of servicers and, if deemed necessary, will perform an audit of selected servicers, the agency does not have a formalized, written plan describing the steps and criteria to be used in such monitoring and auditing.**
- ▶ **Failure to monitor servicers can result in lost insurance proceeds and interest earnings.**
 - If a servicer fails to meet the requirements of the sales and servicing agreement and the loan is foreclosed upon, the insurer may deny any claims on the loan presented by the agency. To recover these denied claims, the agency must document the amount of the loss and bill the servicer. The servicer may dispute this amount or refuse to pay the amount in full. As time passes, servicers may go into bankruptcy, receivership or conservatorship, reducing the chances of recovering these funds.
 - The agency has identified a potential loss of \$3.8 million on 550 loans which have been sold and on which pool insurance and supplemental claims have been paid. Currently, the agency is attempting to determine the amount that it will be able to collect from servicers. Some of these loans have been in default since 1985. This \$3.8 million is representative of all the revenues collected less the unpaid principal balance at the time of default, claimable expenses and accrued interest. Historically the loans in this area are attributable to servicing errors such as late notices on delinquency and late foreclosure starts. The longer that these claims go uncollected, the greater the probability of financial loss to the agency.
 - During fiscal year 1990, the insurers denied claims totalling approximately \$1.055 million due to the failure of servicers to meet requirements of the sales and servicing agreement. The agency collected \$521,316 from these servicers resulting in a shortfall of \$533,881 which is being pursued by REO and agency legal staff. As time passes, the probability of collecting these funds decreases.
- ▶ **The REO department does monitor REO contractors, but does not have a written monitoring or audit plan to ensure that REO contractors are meeting terms of the REO contract.**
- ▶ **Failure to monitor the performance of REO contractors can result in the loss of insurance proceeds.**
 - If the REO contractor does not perform the duties described in the REO contract in a timely manner, the primary mortgage insurer or pool insurer may withhold interest payments in a final claim settlement and refuse to reimburse the agency for expenses caused by REO contractor non-compliance.
 - If the REO contractor does not maintain the property and make the necessary repairs, the house may not be able to be resold. If this occurs, the primary mortgage and pool insurers may withhold all

- payments for further maintenance and marketing, forcing THA to pick up these expenses.
- Failure of the REO contractor to make needed repairs quickly can result in the deterioration of the property. The insurers would not pay for damage caused by REO contractor neglect. The agency would be forced to pay for these repairs.
 - Since April 1990, THA and the pool insurer have sent 22 letters to REO contractors notifying them of failure to perform services.
 - The REO department is currently reviewing files and has determined that the failure of the REO contractors to perform their duties in an adequate and timely manner will cost THA approximately \$35,000 in lost interest during fiscal year 1990.
- ▶ **Requiring in statute that the agency develop and use a quality control plan would ensure that the plan would be continued regardless of the makeup of the administration or staff.**
- Instability in the administration of the agency and high turnover rates in the staff have caused programs to be created and then abolished and has allowed critical functions to be understaffed or understaffed. For example, the agency was without an internal audit function between May and October 1990.
- ▶ **California has developed an extensive, written monitoring and audit plan for lenders and servicers, and for the monitoring of REO's. A five percent sample of loans is analyzed and if a problem is found, an in-depth audit of the lender is performed. Servicers are monitored on an annual basis to ensure that all functions are performed in a timely manner and that insurance claims are made in compliance with servicing agreements. Property owned by the California Housing Finance Agency is managed by real estate brokers who handle repairs and maintain and market the property. The brokers are monitored by inspectors to ensure that the property is maintained and marketed properly.**

PROBLEM

The agency has not developed a written quality control review plan to guide the agency in its evaluation of lender, servicer and REO contractor performance.

RECOMMENDATION

- **The following three statutory recommendations would require the agency to strengthen its monitoring efforts concerning the performance of lenders, servicers, REO contractors and other contractors:**

1. The agency should be required to develop a written plan to monitor and audit the performance of lenders. This plan would include requirements for:
 - a review of the lender's loan origination policies to ensure that they have a quality control plan and that this plan is up to date with all current federal requirements;
 - the auditing of selected loans and paperwork associated with the loan originated by lenders to see if quality control guidelines were followed;
 - the auditing of lender financial statements;
 - monitoring levels of delinquency and foreclosure rates of the various lenders to determine if there are any problem areas;
 - in-depth auditing of lenders with excessively high delinquency or foreclosure rates; and
 - a reporting procedure to agency administration.
2. The agency should be required to develop a written plan based on the requirements enumerated in the sales and servicing agreement to monitor and audit the performance of servicers. This plan would include requirements for:
 - the development of criteria for evaluation of servicer performance;
 - routine monitoring of servicer performance based on prescribed criteria;
 - the auditing of servicer financial statements;
 - a process for in-depth auditing of servicers when there has been a substantial violation of servicer duties and responsibilities;
 - the designation of an audit team consisting of staff from relevant areas; and
 - a reporting procedure to agency administration.
3. The agency should be required to develop a written plan to monitor and audit the performance of REO contractors and other agency contractors. This plan would include requirements for:
 - the periodic inspections of REO property;
 - monitoring contractor performance based upon contract requirements; and

-- a periodic review of contractor billing procedures.

The purpose of these recommendations is to ensure that the agency develops a written plan for monitoring lenders, servicers, REO contractors and other agency contractors. Although the agency currently monitors these functions, a written plan will ensure that regardless of staffing or administration the performance of these crucial activities will be consistent and will receive adequate agency oversight.

The agency has the ability to perform these monitoring and auditing recommendations. In the case of the REO and servicing departments, these recommendations are in support of the programs that are already in place and require that the plans be formalized and written. For lenders, the agency has a quality control officer who can be responsible for coordinating the activities of the agency concerning the monitoring of lenders.

FISCAL IMPACT

The Texas Housing Agency is currently developing a quality control plan which will include the review and audit of lenders, servicers and REO contractors. The REO department currently conducts reviews and audits of REO contractors. The requirement for these functions to be statutory should not create additional costs. Once the plans are in place and operational, the agency will be in a better position to avoid losses associated with lost interest from denied insurance claims.

ISSUE 9: The agency should improve its internal audit efforts.**BACKGROUND**

State agencies obtain information to manage and evaluate their operations in a variety of ways. One of these is a strong internal audit function. The Internal Audit Act, effective September 1, 1989, sets out internal audit requirements for state agencies subject to the Act. The Act includes provisions for the appointment and duties of the internal auditor. The Act requires, among other things, that the internal audit function be kept separate from other staff functions and that the internal auditor should not be involved in developing agency operating systems since the internal auditor will need to evaluate each system at some future date. Agencies which have an operating budget exceeding \$10 million, or a staff of more than 300 employees, or receive and process cash items in excess of \$10 million annually are subject to the Act. The governor's office, the legislature and the state auditor have all recognized the importance of this function through executive orders, legislation, audit findings and other mechanisms.

An effective internal audit function is essential because it provides accurate and consistent information to managers for use in evaluating how well programs are operating. The information generated through internal audits also allows managers and administrators to identify potential problem areas and to take the necessary steps to correct problems before they result in declining performance or the actual loss of agency funds.

Before 1987, the Texas Housing Agency did not have an established internal audit function. The function was established in 1987 by the agency's board as an independent appraisal activity to conduct reviews of operations and procedures and to report findings and recommendations to THA's management and board. Some of the responsibilities of the internal auditor set by the board include appraising the effectiveness and application of administrative and financial controls and the reliability of data developed within THA, evaluating compliance of THA policies and procedures with state and federal laws, assessing the adequacy of controls for safeguarding THA assets, and conducting reviews of agency programs to ensure that they are efficient and effective and are consistent with agency objectives. The agency has not consistently had an effective internal audit function since the position was created in 1988. For example, since 1988, the agency has filled the internal auditor position for a total of 14 months and has record of only four internal audits being conducted. Subjects of these reviews include the cash disbursement cycle, the single family loan purchase cycle, multi-family bond indenture letters of credit and real estate owned (REO) files. Because THA receives and processes cash items in excess of \$10 million annually, it is subject to the Internal Audit Act.

The review examined the agency's internal audit function and compared it with internal audit functions in other state agencies. In addition, state and independent auditor reports, and applicable state laws and their requirements were examined. The analysis indicated that:

- ▶ **Other state agencies subject to the Internal Audit Act, such as the State Department of Highways and Public Transportation, the Texas Department of Health, and the Texas Department of Human Services, have developed comprehensive internal audit functions which result in the agencies having useful information with which to manage their operations, solve problems and avoid unnecessary risk. Some important components of the internal audit functions in these agencies include:**
 - the development of an annual audit plan based on risk analysis techniques which consider the amount of money at risk, results of recent reviews, elapsed time since the last review, changes in management or changes in policies or directives;
 - communication between the internal auditor and the board or commission concerning the focus of the internal audit plan, approval of the plan, and review and implementation of internal auditor recommendations;
 - separation of the internal auditor from duties which include the development of agency functions or the development of agency policy;
 - full and free access of the internal auditor to department activities and records unless otherwise restricted or privileged by law; and
 - freedom of the internal auditor to bring additional functions within the department to the attention of the board or commission if the need for audit arises.

- ▶ **Because the agency performs many internal functions that could result in the loss of funds if not performed in an accurate and timely manner, it is important to have a strong internal audit function in the agency.**
 - The agency has many assets and liabilities which should be protected with adequate financial controls. In fiscal year 1989, the agency had assets and liabilities totalling \$1.5 billion.
 - The agency must monitor the performance of servicers to determine if they have followed the requirements of the insurance carriers and the sales and servicing agreement. If the agency does not detect the failure of servicers to meet these requirements, then the insurance company is not required to pay for losses on foreclosed loans. The agency is forced to try to collect from the servicer. This is a time consuming and labor intensive process which may or may not yield complete recovery of funds. The agency has identified a potential loss of \$3.8 million on 550 loans which have been sold and on which pool insurance and supplemental claims have been paid. These funds may still be collected, however, the more time that elapses, the greater the chance that the claim will be denied or that some of the servicer institutions will go into bankruptcy, receivership or

conservatorship, diminishing the opportunity to recover these denied claims.

- THA must monitor its real estate owned (REO) contractors to ensure that they meet insurance requirements concerning the management and marketing of foreclosed properties. The agency estimates that it has lost approximately \$35,000 in lost interest payments during fiscal year 1990 due to failure of REO contractors to perform services in compliance with REO contracts.
- ▶ **Since the agency's creation in 1979, there has not been a consistent agency focus on internal auditing. Although some problems have been identified by the internal auditor, many more problems were first identified by an external auditing process, such as those performed by the agency's independent auditor or the state auditor. Problems identified by an external review include:**
 - lack of communication between the real estate owned, loan servicing, and accounting departments which has led to discrepancies in the amount of principal and interest payments remitted by servicers. These departments often make adjustments to account balances in their systems without notifying the other departments;
 - the need for THA to increase its monitoring of servicers in order to determine the amount of funds owed by the servicers, eliminate the high number of errors in servicers reports, and ensure that servicers follow the requirements specified in the sales and servicing agreement;
 - monitoring of servicer compliance with requirements and the tracking of funds outstanding on foreclosed properties is done manually and should be automated to ensure that these transactions are made accurately and efficiently;
 - monitoring of REO contractors was not done in a timely manner and that contracts for these contractors were not consistent; and
 - the agency needs to remove REO's from their portfolio when the account is closed in order to accurately calculate the gain or loss on property and determine the appropriate level of REO reserves.
- ▶ **The agency now meets many of the requirements in the Internal Audit Act. However, attention continues to be needed in the following areas:**
 - the fiscal year 1990 internal audit plan was based on the findings of the state auditor and the independent auditor rather than on criteria set out in a risk analysis evaluation;
 - neither the board nor the internal audit committee reviewed or approved the agency's internal audit plan for fiscal year 1990; and

- in the past, the internal auditor has been required to provide input on management decisions and develop agency operating systems. Under the requirements of the Internal Audit Act, the internal audit function should be kept separate from other staff functions and the internal auditor should not be involved in developing agency operating systems since the internal auditor will need to evaluate each system at some future date.

PROBLEM

A good internal audit function can help the agency identify weaknesses in its operations, make needed changes and safeguard its assets. Although THA has developed an internal audit function, the agency's statute does not set out a framework to guide its activities in this area and the agency has not consistently met all the requirements of the Internal Audit Act.

RECOMMENDATION

- **The statute should establish specific internal audit requirements to ensure that agency functions are performed in an effective and efficient manner and are in compliance with all applicable state and federal laws. These requirements should specify that:**
 - **the internal auditor should prepare an annual audit plan based on accepted risk assessment techniques, which prioritizes high risk functions in the agency and have the plan approved by the board;**
 - **the internal auditor should be afforded unrestricted access to department activities and records unless otherwise restricted or privileged by law;**
 - **the internal auditor should have the authority to bring before the board issues outside the annual audit plan that require immediate attention;**
 - **the internal auditor should submit reports directly to the board of directors and the executive administrator; and**
 - **the internal auditor should be free of all operational or management responsibilities that would impair the ability to make independent reviews of all agency operations.**

Placing the provisions listed above in the agency's statute will help ensure that the agency has an internal audit function free from unnecessary restrictions which is likely to produce meaningful information for the agency to use in conducting its operations. The provisions incorporate some of the policies and procedures that have been adopted by other state agencies identified as having successful internal audit programs. The agency would continue to be subject to all

of the provisions of the Internal Audit Act. The requirements provide for the auditor to focus the audit plan on high risk areas within the agency, while leaving flexibility for the internal auditor to identify other critical areas outside the plan. Having the internal auditor report directly to the board and specifying that the auditor should not perform operational functions for the agency sufficiently separates the auditor from the agency administration so that audits can be conducted in an independent manner without bias.

FISCAL IMPACT

Requiring the agency to meet the requirements set out above should not create additional auditing costs. However, the agency should save money by ensuring that assets are protected with adequate control procedures and critical functions are being performed in an efficient and effective manner.

ISSUE 10: The THA should be required to increase the number of low income participants served by its mortgage revenue bond programs.

BACKGROUND

The Texas Housing Agency is authorized by the federal government to issue tax-exempt mortgage revenue bonds to provide loans to low and moderate income first time homebuyers. When Congress reauthorized the use of these bonds in 1984, it approved a statement of intent directing state governments to use their authority to provide assistance to the lowest income families who can use the program before assisting higher income families. The federal government has established that first time homebuyers with incomes of no more than 115 percent of their area average median income may be eligible for this program. The average median family income for the program in Texas is \$34,600. States have the discretion to set lower, more restrictive, limits for their bond programs but may not exceed the federal income ceilings. The agency's statute, however, does not set eligibility requirements more restrictive than federal levels.

As a targeting strategy, federal regulations also require that 20 percent of the mortgage revenue bond funds (\$46 million in 1989) be set aside for one year to be used only in particular locations where the U.S. Department of Housing and Urban Development (HUD) has determined that property is in an area of chronic economic distress and special targeting is needed to revitalize the area. If, at the end of the year, the funds are not used they become available for loans under the standard requirements.

It is important that THA use its funds where the need is greatest and to serve persons who can not be helped through conventional mortgage programs. This careful use of funds is particularly important for THA since the federal limit on the dollar amount of private activity bonds which the state may issue has been consistently declining in recent years. The amount of these bonds which Texas is authorized to issue has decreased by almost 63 percent since 1984.

Because of the structure of the mortgage revenue bond (MRB) programs throughout the country, there is a tendency for loans to go to moderate income persons rather than low income persons. The MRB programs require prospective home buyers to meet a wide range of criteria before they qualify for a loan. This criteria is based on the standard loan requirements of the banks as well as requirements set by FHA and GNMA. Prospective buyers typically must have three to five percent of the purchase price of a home available and must demonstrate that they have income sufficient to make the required monthly payment. The property purchased must also be within a prospective buyer's price range and meet FHA standards concerning structural integrity. Houses priced at a level which low income buyers can afford may not always be able to meet all required FHA standards. These federal restrictions and the pressures on mortgage lenders to make loans only to persons with a demonstrated credit

history who have the highest potential to repay the loans tend to result in mostly moderate income persons being served by the MRB program.

An examination of existing law and agency practice to determine if the mortgage revenue bond programs are appropriately serving low income homebuyers indicated the following:

- ▶ **Between 1980 and 1987, less than 45 percent of the 17,150 loans made under the agency's bond programs involved persons with annual incomes below \$24,000, an amount which falls within HUD's definition of "low income". Nearly twenty percent of the loans were made to households with annual incomes greater than \$60,000.**
- ▶ **The federal targeting approach is focused on geographic areas rather than low income populations and has been of little use in Texas.**
 - The agency indicates that the areas targeted by HUD often do not include a significant number of marketable properties which can be sold under the bond program. For example, the federally targeted areas include golf courses, university property and an air force base.
 - The agency has made numerous attempts to expand the number or size of eligible census tracts, but HUD has never approved any of the agency's proposed changes. The National Council of State Housing Agencies reports that it is very difficult for a tract to meet the 11 criteria set by HUD for changing or adding census tracts and that HUD has not approved changes for any state in recent years.
 - Of the \$46,139,000 in funds which the agency and its lenders set aside for the targeted areas in 1989, only \$109,714, or less than one percent, was used for loans in these areas before the one year period expired. The remaining \$46,029,286 became available for use under standard requirements.
- ▶ **The targeting strategies used by the agency have not resulted in a significant number of loans being made to low income groups.**
 - Generally, loans are made to qualifying applicants across the state on a first-come, first-serve basis by applying the standard federal income and purchase price requirements. Since its creation, the agency has not lowered the income eligibility ceiling for any portion of any of its bond issues.
 - The agency has set certain purchase price ceilings on recent bond issues. In 1986, the agency placed a purchase price ceiling of \$80,000 on eligible homes for the first 30 days of the bond programs.
 - In 1987, 1988 and 1989, a ceiling of \$40,000 was set for the first five months under two different bond programs. Under one \$7 million bond issue in 1988, the purchase price ceiling on all properties was set at \$40,000. The total amount of bonds issued since 1987 which

had a \$40,000 purchase price ceiling placed on them was \$68,584,000 compared to a total amount of \$248,920,000 in bonds issued for the same time period. This indicates that the agency set a significant target for 27.6 percent of the bonds issued since 1987.

▶ **The agency has demonstrated that it has the ability to successfully target funds to low income groups using mortgage revenue bonds, though the funds dedicated to such targeted efforts have been limited.**

-- Because of the comparatively low incomes of persons living in south and west Texas and the need for affordable housing in the area, the agency in 1989 set aside \$7 million at an interest rate of 6.69 percent to provide loans to persons living in a targeted 16 county area. By setting the maximum purchase price of the residence at \$40,000, the agency helped to ensure that funds would be used by lower income participants. In addition, the low interest rate reduced the amount of annual income required to qualify for the loan. Under this program, the agency has made 81 loans and 21 additional loans are in process. The average income of persons served under this program was \$14,640 per year.

▶ **Other states have adopted laws and many state housing finance authorities have adopted regulations which set mortgage revenue bond eligibility limits significantly lower than the federal standards.**

-- Tennessee's Housing Development Agency, by board rule, uses state income limits and purchase price limits which have been determined to be more restrictive than the federal requirements. The agency's board has determined by policy that the requirements used for the state will be lower than federal requirements. The state agency reports that the purchase price limitations, for example, were about 92.6 percent of those allowable by the federal government.

-- Wisconsin, by agency policy, has recently set its income eligibility ceilings for all bond issues at 90 percent of the county median.

-- Colorado has been offering different bond issue programs each quarter which involve special set-asides of funds for certain periods of time. In the last few issues, the agency lowered the required income ceiling for 30 days to 80 percent of the median income. In addition, upon learning of the large number of loans that were being made to single borrowers with the maximum allowable income, the Colorado housing agency lowered the ceiling for this category of borrower.

-- Minnesota reports that its eligibility requirements for all mortgage revenue bond programs are set at a level comparable to 80 percent of the median. In addition, the state sets aside 50 percent of bond funds for specially targeted populations such as those with low incomes, the elderly or disabled.

- Kentucky's housing agency statute sets \$25,000, or an amount determined by the legislature, as the income eligibility level for mortgage revenue bond programs. In addition, Kentucky sets purchase price limitations by board rule which are more restrictive than federal requirements.

PROBLEM

Although some states have specifically targeted mortgage revenue funds to low income individuals, the mortgage revenue bond program in Texas is not structured to serve those most in need before serving other eligible participants. The federal targeting approach is not focused on increasing the number of low income persons served in Texas and the agency does not consistently target bond revenue funds to specific income groups or other populations.

RECOMMENDATION

The statute should require the agency to set eligibility requirements and develop policies and programs that result in increasing the number of low income participants, defined as households earning 80 percent or less of the area median family income, served by its bond programs.

- The statute should require that for each bond issue, the agency adopt a targeting strategy for focusing its program toward low income participants which may include, but would not be limited to the following:
 - creating a set-aside period for mortgage revenue bond proceeds to be made available only to persons or families at 80 percent of median family income;
 - setting a maximum income and/or maximum selling price; or
 - establishing a tiered interest rate structure making the lower interest rate available to a targeted group of low income participants.

Requiring the agency to adopt a targeting strategy for each of its bond issues should increase the number of low income persons served by the agency's programs, without reducing the flexibility the agency needs to respond to changing market conditions. The statute would require that, for each bond issue, the agency establish a strategy for targeting low income borrowers and marketing their programs to this population.

FISCAL IMPACT

There should be no fiscal impact on the agency as a result of this recommendation.

ISSUE 11: The process for selecting lenders to participate in the agency's programs should include an evaluation of the lender's past performance in meeting agency objectives.

BACKGROUND

The agency is responsible for providing loans to low and moderate income individuals and families. To meet this responsibility, the agency issues bonds and uses the proceeds to offer low interest loans to qualified borrowers. To facilitate these programs, the agency must allocate funds to lenders distributed across the state. The allocation process is based on the requests of lenders to participate in the programs and the evaluation of these lenders by the agency.

Neither the criteria used to select lenders nor the selection process is specified in rule or statute, however, the agency has developed a formal process to select lenders and allocate funds to these lenders. The first step in the lender selection process is the "invitation to participate" which the agency sends to all lenders in the state. The invitation describes the requirements of the bond program and specifies the documentation that must be provided to the agency by the candidate lender. Lenders who desire to participate submit a participation fee and other documentation such as financial statements, a board resolution giving the lending institution authority to act as a lender in the program, and the opinion of the lender's general counsel attesting to the ability of the lender to originate mortgage loans.

After the candidate lender submits the required documents, they are reviewed by an approval process team composed of THA staff. Financial statements are reviewed by the accounting department and internal auditor; the board resolution and counsel opinion are reviewed by THA administration and general counsel; and compliance by the lender with the reporting requirements and loan origination procedures of past programs is evaluated by the program department, servicing department and REO department. Each lender is assigned a relative score based upon the following criteria: legal acceptability of all documents; performance of the lender in agency programs measured by the quality of previous applications to participate; and the financial condition of the lender. After agency departments have completed a preliminary review of a candidate lender's file and approved the candidate lender, all documents are forwarded to the executive administrator and the chairman of the board for approval or rejection which is based upon the lender's relative score. The approval process is completed when the lender is notified of acceptance or rejection.

The review analyzed the agency's current process of lender selection and fund allocation and whether this process is similar to other state housing agency efforts in this area. The analysis also examined the availability of additional criteria to be used in evaluating lenders and the agency's effort to evaluate past lender performance in meeting agency goals. The analysis indicated that:

- ▶ **Traditionally, the mortgage revenue bond programs have not focused on serving those with low incomes. The median family income for the state of Texas is approximately \$34,600. Families defined as being low income make between 50 percent and 80 percent of median income or between \$17,300 and \$27,680.**
 - Between 1980 and 1987, less than 45 percent of the 17,150 loans made under the agency's bond programs involved persons classified as low income or with incomes between \$17,300 and \$27,680.
 - During fiscal years 1989 and 1990, approximately 45 percent of loans made under bond programs "33" and "34" of the single family mortgage revenue bond program went to households classified as being low income. As with all of the agency's bond programs, programs 33 and 34 provide low interest loans to low and moderate income individuals.

- ▶ **The lender's Community Reinvestment Act (CRA) rating can be used as criteria when selecting or allocating funds to lenders.**
 - The Community Reinvestment Act (CRA) requires financial institutions to determine the credit needs of low and moderate income groups and market services to these individuals. The Federal Reserve Bank, Office of the Comptroller of the Currency, and the Office of Thrift Supervision do an evaluation of banks and thrift institutions and their lending patterns and rate them based on their service to these lower income groups. Institutions may receive a rating of from one (1) to four (4) with one being "outstanding" and four being "substantial noncompliance". Each lender's ability to expand, acquire other institutions or open branch offices is based upon the CRA rating.
 - Community Reinvestment Act ratings could be used as a measure of a lending institution's commitment to serving the needs of the community and of low income groups, and in meeting the objectives of the agency.
 - The agency can receive these ratings from lending institutions or the Office of Thrift Supervision, the Federal Reserve Bank or the Office of the Comptroller of the Currency.

- ▶ **The agency does not consider the lender's past performance in serving low income applicants or geographic regions when selecting or allocating funds to lenders.**
 - Characteristics of loan portfolios that are important to agency objectives are the income level and location of persons receiving loans from the lenders. The performance of lenders as measured by these two criteria could be evaluated by the agency and used as part of the selection process.
 - The agency collects data on the income level and region of those receiving loans and is able to determine which lenders are making

particular loans. Currently the agency does not analyze this data to determine which lenders had high rates of success at making loans to low income individuals or in targeted areas.

- ▶ **Other state housing agencies such as California, New Mexico, Virginia and Washington use CRA ratings, monitor the past performance of lenders in serving low income applicants, or consider the lenders' geographic distribution of loans when selecting lenders for participation in bond programs.**
- ▶ **During the review of THA, persons representing low income housing and non-profit housing groups indicated that closer monitoring of the lenders' performance in serving low income groups and meeting CRA requirements would allow the agency to make better decisions when selecting and allocating funds to lenders.**
- ▶ **Participating lenders have indicated that additional information requirements relating to the selection process would not discourage them from participating in future THA programs.**

PROBLEM

Although lender ability to meet THA objectives is crucial to the agency's success, the current selection process used by THA to select lenders does not take into account readily available information such as CRA ratings or key lender performance data related to the income levels of applicants or regions traditionally served by the lenders requesting to participate in the agency's bond programs.

RECOMMENDATION

- **The statute should require the agency to develop a lender selection process which includes but is not limited to consideration of the following criteria:**
 - **the lender's distribution of loans by income and geographic region in past THA programs; and**
 - **the lender's Community Reinvestment Act rating.**

While adding new criteria to the lender selection process will not guarantee that more low income Texans will be served by the agency's bond programs, it will provide the agency with better information on which to base its lender selection and fund allocation decisions. The agency will know which lenders have traditionally made loans to lower income individuals, which lenders have achieved good CRA ratings and the success of lenders in past THA programs. The THA board would have the flexibility to determine how much weight would be given to the lender's performance in making selection and allocation decisions.

FISCAL IMPACT

This recommendation should create no additional costs for the agency.

ISSUE 12: The Private Allocation Act should be amended to secure the agency's reservation for a portion of the federal bond allocation.

BACKGROUND

The Private Allocation Act, administered by the Texas Department of Commerce, is a state law which divides the federally allowed bond allocation among eligible bond issuers in the state. The Act provides that one-third of the federal allocation be designated for mortgage revenue bonds while the remaining allocation be available for other types of bonds, such as industrial development bonds. The Texas Housing Agency receives one-third of the mortgage revenue bond allocation in accordance with the Act while local housing authorities receive the remaining two-thirds. The Act generally provides that, as of September 1 of each year, any unused allocation amount reverts to a general pool so that all eligible bond issuers can compete for the remaining allocation.

The Act specifies that if federal authority for the issuance of tax-exempt mortgage revenue bonds terminates, the issuers of these bonds would lose the portion of the allocation that the Act reserved for them. This provision has particular current significance because the state's authority to issue mortgage revenue bonds and industrial development bonds terminated as a result of a federal sunset provision on September 30, 1990 and was reinstated in late October 1990. Due to these circumstances, the Texas Housing Agency, local housing authorities and certain industrial development bond issuers now no longer have a portion of the allocation reserved for their use.

A review of the Private Allocation Act and its effect indicated the following:

- ▶ **When the federal authorization to issue mortgage revenue bonds was not continued, the agency's reservation for a specified allocation amount became null and void.**
 - The Private Allocation Act states that "if qualified mortgage bonds... no longer qualify for treatment as tax-exempt obligations..." the agency's reservation of a portion of the state's allocation becomes null and void.
 - In fiscal year 1991, the amount of bond authority reserved for the THA was \$93,250,000.
 - Although the authorization to issue mortgage revenue bonds has been reinstated at the federal level, the effect of the Private Allocation Act is that the agency must wait until September 1 of each year to compete in the general pool with all other bond issuers for a portion of the unused or unreserved portion of the state's allocation. This could result in the agency obtaining an allocation

significantly less than the one-third of the state's mortgage revenue allocation previously reserved for them.

- ▶ **The demand for the issuance of mortgage revenue bonds and the home loans made through such bonds has exceeded the supply of such bonds in the past. This demand, combined with the need in Texas for affordable housing opportunities, indicates that a portion of the state bond allocation should be reserved for mortgage revenue bonds.**
 - In 1990, local housing authorities used their full allocation and requested additional allocations in excess of \$251 million.
 - The Texas Housing Agency used its full allocation of over \$93 million and, based on a survey of its participating lenders, determined that a demand exists for at least \$267,000 more in state issued mortgage revenue bonds.
- ▶ **Federal authorization for mortgage revenue bonds has been done on a year to year basis in recent years. This annual authorization approach will continue to cause problems due to the current structure of the state's Private Allocation Act.**
 - Federal authorization was discontinued in 1983, but reinstated after six months in 1984.
 - Federal authorization was discontinued in September 1990 and reinstated in October 1990, resulting in a one month lapse.
 - The current authorization is set to expire September 30, 1991. Unless Texas' Private Allocation Act is changed, inaction by Congress at that time will leave the state's housing agency without its bond allocation reservation for as long as the Act is in effect.
 - If the Act continues to require the agency to wait until September 1 of the allocation year to compete for an allocation, the agency will lose the flexibility it needs to issue bonds in the most favorable financial markets at a time when the board determines a new bond issue is needed.

PROBLEM

Although the federal government has reauthorized the issuance of tax-exempt mortgage revenue bonds, the agency cannot currently access its previously reserved portion of the state's allocation. Under the Private Allocation Act, the only way that the agency can currently issue such bonds is to wait until after September 1st of each year and compete in the general pool for any unused or unallocated portion of the state's allocation still remaining at that time. This does not provide the agency with the flexibility it needs to issue bonds in the most favorable financial markets when the board determines more bonds should be issued. Reservations should not automatically become void when federal authorization is discontinued because the federal government has discontinued

and then reauthorized bond authority within short time periods in the past and could do so again in the future.

RECOMMENDATION

- **The Texas Private Allocation Act should be changed to protect the housing agency's allocation of bond authority.**

Amending the Act as discussed above would increase the opportunity of the agency to access up to the full amount of the allocation reserved for them, if the federal authority to issue bonds is discontinued and then reinstated. Under this recommendation, if the federal government should again discontinue and then reinstate authority to issue tax-exempt mortgage revenue bonds, the agency would not have to wait until September 1 to compete in a general pool for any remaining bond allocation. Instead, the agency would be guaranteed a specific allocation that it could use at any time up until the time the funds revert into a general pool.

FISCAL IMPACT

There should be no fiscal impact from this recommendation.

ACROSS-THE-BOARD RECOMMENDATIONS

From its inception, the Sunset Commission identified common agency problems. These problems have been addressed through standard statutory provisions incorporated into the legislation developed for agencies undergoing sunset review. Since these provisions are routinely applied to all agencies under review, the specific language is not repeated throughout the reports. The application to particular agencies is denoted in abbreviated chart form.

Texas Housing Agency

Applied	Modified	Not Applied	Across-the-Board Recommendations
			A. GENERAL
See Issue #3			1. Require public membership on boards and commissions.
X			2. Require specific provisions relating to conflicts of interest.
X			3. Provide that a person registered as a lobbyist under Article 6252-9c, V.A.C.S., may not act as general counsel to the board or serve as a member of the board.
X			4. Require that appointment to the board shall be made without regard to race, color, handicap, sex, religion, age, or national origin of the appointee.
X			5. Specify grounds for removal of a board member.
X			6. Require the board to make annual written reports to the governor, the auditor, and the legislature accounting for all receipts and disbursements made under its statute.
X			7. Require the board to establish skill-oriented career ladders.
X			8. Require a system of merit pay based on documented employee performance.
X			9. Provide for notification and information to the public concerning board activities.
		X	10. Place agency funds in the treasury to ensure legislative review of agency expenditures through the appropriation process.
X			11. Require files to be maintained on complaints.
X			12. Require that all parties to formal complaints be periodically informed in writing as to the status of the complaint.
X			13. Require development of an E.E.O. policy.
X			14. Require the agency to provide information on standards of conduct to board members and employees.
X			15. Provide for public testimony at agency meetings.
X			16. Require that the policy body of an agency develop and implement policies which clearly separate board and staff functions.
X			17. Require development of accessibility plan.

*Already in law -- no statutory change needed.

**Already in law -- requires updating to reflect standard ATB language.

Texas Housing Agency
(cont.)

Applied	Modified	Not Applied	Across-the-Board Recommendations
			B. LICENSING
		X	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
		X	2. Provide for notice to a person taking an examination of the results of the exam within a reasonable time of the testing date.
		X	3. Provide an analysis, on request, to individuals failing the examination.
		X	4. Require licensing disqualifications to be: 1) easily determined, and 2) based on currently existing conditions.
		X X	5. (a) Provide for licensing by endorsement rather than reciprocity. (b) Provide for licensing by reciprocity rather than endorsement.
		X	6. Authorize the staggered renewal of licenses.
		X	7. Authorize agencies to use a full range of penalties.
		X	8. Specify board hearing requirements.
		X	9. Revise restrictive rules or statutes to allow advertising and competitive bidding practices which are not deceptive or misleading.
		X	10. Authorize the board to adopt a system of voluntary continuing education.

*Already in law -- no statutory change needed.

**Already in law -- requires updating to reflect standard ATB language.

MINOR STATUTORY MODIFICATIONS

Discussions with agency personnel concerning the agency and its statute indicated a need to make minor statutory changes. The changes are non-substantive in nature and are made to comply with federal requirements or to remove out-dated references. The following material provides a description of the needed changes and the rationale for each.

Minor Modifications to the Texas Housing Agency

Change	Reason	Location in Statute
1. Change "administrator" to "director."	To bring job titles in line with those in other state agencies.	Art. 12691-6, V.T.C.S., Sections 6(b), 6(g), 7(a), 18(a), and 42.
2. Change "director(s)" to "member(s)".	To make reference to board members consistent with titles used in other agency statutes.	Art. 12691-6, V.T.C.S., Sections 2, 5, 6, 21 and 42.

Texas Housing Agency

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