



DEPARTMENT OF COMMUNITY DEVELOPMENT SERVICES

Grants Management Division

m e m o r a n d u m

TO: Bruce Walden, Chief Administration Officer

FROM: Elizabeth Tyler, AICP, City Planner/Director

DATE: April 7, 2005

SUBJECT: **2005 Private Activity Bond Cap Allocation**

Description

Included on the April 11, 2005 agenda of the Urbana City Council Committee of the Whole is the 2005 Private Activity Bond Cap. For 2005, the City of Urbana may issue up to \$3,098,000 in private activity revenue bonds. This staff memorandum provides a recommendation to reserve the 2005 private activity bond cap to support first-time homebuyers.

Issues

The issue is to determine the best use of the City of Urbana's 2005 private activity bond cap. The options include reserving the bond cap for a specific project such as the Lakeside Terrace Redevelopment Project or participate in the homebuyer assistance programs offered by Stern Brothers & Co. and the Illinois Housing Development Authority (IHDA). Any unused bond cap not ceded for any combination of these programs will be ceded back to the State of Illinois for use by another municipality.

Background

Pursuant to the Internal Revenue Service code, each municipality is allowed to issue private activity revenue bonds up to \$80.00 per capita per year. Based upon on the most recent U.S. Census population estimate of 38,725, the City of Urbana may issue up to \$3,098,000 in private activity revenue bonds this year. (Last year the amount was \$3,059,280 and the population was 38,241.) The City may utilize its private activity bond authority for one of three activities:

- 1) Below-market-rate financing for affordable housing
- 2) Mortgage credit certificates in support of homeownership, or
- 3) Below-market-rate financing for limited types of industrial developments

The State of Illinois each year recaptures any bond allocation unused by the City as of May 1. The City may elect to use its allocation, allow its allocation to be recaptured by the State, or voluntarily cede its allocation to the State or to any community.

Program 1 - Reserve the 2005 private activity bond cap for the purpose of furthering

neighborhood initiatives.

Under federal law, state and local governments can issue a certain amount of tax-free bonds for projects that the federal government does not consider traditional governmental purposes. These bonds are called private activity bonds. Since they are historically used for private business development they are also known as industrial development bonds. Private organizations prefer these bonds over other borrowing mechanisms because the interest on the bonds is free from federal taxes, which allows the issuer to sell the bonds at a lower interest rate than taxable bonds. The City may choose to use its bonding authority (also called “bond cap”) for a local purpose or cede the amount to the state or another entity for their use.

While private activity bond authority allows the City to issue tax-exempt debt for certain projects, it does not create a source of funds for annual principal and interest payments (“debt service”). Funds for debt service expense must be identified as part of the project financing plan.

Last year the City of Urbana reserved its 2004 bond cap to develop a financing resource for the Lakeside Terrace Redevelopment Project.

At this time, staff is not recommending that any portion of the 2005 bond cap be reserved for neighborhood improvement activities, including the redevelopment of Lakeside Terrace. Since the final project financing is not yet complete, staff submits that another year of bond cap should not be allocated to this project. It is likely that the project financing for Lakeside Terrace will be completed in the spring of 2006. By that time, next year’s bond allocation could be ceded toward this redevelopment project.

Programs 2 through 5 (Homebuyer Assistance Programs)

In recent years, Urbana has used its private activity bond allocation for homebuyer assistance programs.

In order to qualify for the *AssistUrbana* and Illinois Housing Development Authority (IHDA) homebuyer assistance programs, participating households will need to meet income and purchase price limits. While the program would be available citywide, the Internal Revenue Service has designated program target areas (which can be located using IHDA’s website at <http://www.ihda.org/census.htm>). Income and purchase price limits vary depending on whether the property purchased is located in or out of the target area. Households purchasing within the target areas need not be first-time homebuyers. Income and purchase price limits applicable to the 2005 program are as follows.

<u>Maximum Household Income Limits</u>		
Non-targeted areas	1-2 person household	\$63,300
	3 or more persons	\$72,795
Targeted area	1-2 person household	\$75,960
	3 or more persons	\$88,620

<u>Maximum Purchase Price Limits (single-family home)</u>		
Non-targeted areas	Existing properties	\$204,430
	New construction	\$204,430
Targeted area	Existing properties	\$249,860
	New construction	\$249,860

A significant change to the IHDA programs is that communities can cede a portion of their bond cap to IHDA be able to utilize both the First-Time Homebuyer Program (*MRB*) and the Home Equity Loan Program (*HELP*). This allows the lenders to be more flexible in meeting the specific needs of first-time homebuyers. Lenders could help buyers with downpayment assistance or with obtaining a lower interest rate. Also noteworthy is that IHDA has implemented web-based tools to help lenders with processing loans. These enhancements could lead to increased utilization of the IHDA programs.

Program 2 - *AssistUrbana*

The *AssistUrbana* Program was first started under the name of *AccessUrbana* in 1995 and has subsequently assisted nearly 200 families with purchasing a home in Urbana.

AssistUrbana currently provides 30-year fixed rate FHA/VA mortgage loans or conventional loans at 5.95 percent interest through Busey Bank, BankIllinois, BankOne, National City Bank, and Union Planters Bank. The program also provides non-repayable, non-taxable grants for downpayment and closing costs up to 4.25 percent of the home mortgage amount. The City and local lenders market the program through direct mailers, seminars, and media advertising.

The new program would be structured similarly to previous years' programs in that both downpayment grants and mortgage financing would be offered. The program would provide downpayment grants up to 4.25 percent of the home mortgage amounts. *AssistUrbana* supports both FHA and VA lending programs.

The interest rate would reflect changes in market conditions since the program bonds are sold in intervals throughout the year. Also similar to past years is the list of communities participating in the *Assist* program; including Urbana, Champaign, Rantoul, Peoria, Springfield, Decatur, Charleston, Danville, and Mattoon.

Last year the City did not cede any portion of their bond cap to the *AssistUrbana* Program. However, in consideration of the City's previous participation in the program, in 2004 the program assisted 18 homebuyers, leveraging \$1,521,563 in mortgage loans, with an average mortgage amount of \$84,531.

Historically, the *AssistUrbana* program has been the most utilized of the homebuyer programs.

To participate in the *AssistUrbana* for 2005, the City would need to transfer all or a portion of its bond allocation to the Sterns Brothers & Co. If the City decides to participate in this program, loans would be available beginning around June 1.

David Rasch, with Stern Brothers & Co., has indicated since the City of Urbana did not participate in 2004, it is not likely that they will be able to meet our local bank's demand for downpayment assistance, without ceding bond cap for 2005.

Staff recommends ceding \$2,323,500 (75%) to the *AssistUrbana* Program.

Program 3 - Illinois Housing Development Authority Homebuyer Assistance Programs

First-Time Homebuyer Program (*MRB*)

The program provides 30-year fixed-rate mortgages at below market interest rates.

Current rates are as follows:

5.80% - 0 Points

5.65% - 1 Point

5.50% - 2 Points

5.35% - 3 Points

The City did not cede any of its bond cap to the *MRB* program for 2004. Considering the limited utilization of the program in previous years, staff recommends ceding a portion of the bond cap to this program for 2005.

Program 4 - Home Equity Loan Program (*HELP*)

The Home Equity Loan Program (*HELP*) program provides 4.25% of the mortgage as a grant for downpayment assistance and a fixed rate mortgage. *HELP* is very similar to the *AssistUrbana* Program. The differences seem to be the underwriting criteria for the programs. IHDA has indicated that their *HELP* underwriting requirements are a bit more involved than those for *AssistUrbana*.

Last year the City did not cede any bond cap to the IHDA *HELP* program.

The following is a list of IHDA approved lenders that can participate in these programs:

Bank of Rantoul, Bank One Mortgage Corporation, Bank Champaign, N.A., Main Street Bank, Busey Bank, First-Federal Savings Bank of C-U, First Mid-Illinois Bank and Trust, First Midwest Mortgage Corporation, National City Bank, Rantoul First Bank, SB, RBC Mortgage Company, Union Planters Bank, N.A., United Financial Mortgage Corp., Wells Fargo Home Mortgage.

To participate in the IHDA homebuyer programs for 2005, the City would need to transfer all or a portion of its bond allocation to the IHDA. If the city decides to participate in this program,

loans would be available beginning around June 1.

Considering the limited utilization of the program in previous years, staff recommends ceding \$774,500 (25%) of its bond cap to IHDA's combination of the First Time Homebuyer Program (MRB) and Home Equity Loan Program (HELP).

Program 5 - Mortgage Credit Certificate (MCC)

This program offers a tax credit that can assist homebuyers in qualifying for a mortgage by reducing one's federal income taxes.

The following is an example of tax savings associated with this project:

Assume a family earns \$40,000 annually with no other standard tax deductions. They buy their first home and borrow \$95,000 at an interest rate of 7.5 % while qualifying for a Mortgage Credit Certificate. The tax savings in the example are \$1,508. The homeowner may take this credit as long as they maintain the original mortgage and live in the house as their principal residence.

	<u>Taxes Without MCC</u>	<u>Taxes With MCC</u>
Income	\$40,000	\$40,000
Mortgage Deduction	7,095	5,321
Taxable Income	30,258	32,306
Taxes Due at 15%	4,936	5,202
MCC Credit	—	1,774
Taxes Due	\$4,936	3,428

The City has not had any experience with ceding bond cap to this program.

Staff submits that the Mortgage Credit Certificate, while providing the most financial benefit to homebuyers, requires a great deal more administration for first-time homebuyers. For instance, homebuyers must be sure to file the appropriate forms on their federal tax returns in order to realize benefits.

A related consideration is that most first time homebuyers have a greater need to receive downpayment assistance or a lower interest rate in order to purchase a home.

Considering the limited utilization of the program in previous years, staff does not recommend ceding bond cap to this program for 2005.

Options

The options available to the City of Urbana are numerous. The City can cede as much or as little of their private activity bond cap to one or all of the following programs:

- Reserve private activity bond cap for the purpose of furthering neighborhood initiatives
- *AssistUrbana*
- First-Time Homebuyer Program (MRB)
- Mortgage Credit Certificate (MCC)
- Home Equity Loan Program (HELP)

Fiscal Impacts

For the homebuyer assistance programs, other than Community Development staff time to organize and market the programs, there would be no City financial outlay connected to the programs.

The City would realize increase in property taxes from new Urbana homebuyers. Program administrative fees incurred by the bond counsels and by the City's bond consultants would be paid with bond proceeds.

For homebuyer programs, the City would have no liability for bond repayment since the City would not be the bond issuer and all mortgage repayments would be government-insured.

Recommendations

Grants Management Division staff and the Community Development Commission recommend ceding the 2005 private activity bond cap to homebuyer assistance programs. Specifically, \$2,323,500 (75%) to the *AssistUrbana* Program and \$774,500 (25%) to the combined IHDA First Time Homebuyer Program (MRB) and Home Equity Loan Program (HELP).

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