

NCSHA Annual Awards for Program Excellence
Legislative Campaign Category
Executive Summary

Name of entry:	Purchase of Partnership Loan Fund from the State
Category name and number:	Legislative Campaign Category
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HFA:	Virginia Housing Development Authority

Like many other states, in FY03, the Commonwealth of Virginia was facing a substantial revenue shortfall and state officials were searching for ways to plug the resulting large budget gap. VHDA was well aware of actions in other states to “raid” HFA fund balances, and was therefore concerned that one of the potential "solutions" to the Virginia budget crisis would be for VHDA to be directed to transfer some of its reserves to the state. In order to avoid that potentiality, VHDA looked for alternative means through which the authority could help generate needed revenues for the state. One idea was for VHDA to purchase some of the loans from the state’s Housing Partnership Fund revolving loan pool in order to generate needed cash for the state. The Fund’s outstanding loan balance of \$91 million made it a significant potential source of revenue.

When VHDA joined these discussions in the fall of 2002, the authority was initially asked to consider purchasing a small number of mortgage loans from the state. VHDA already serviced these loans for the state and was familiar with them. However, the authority was concerned that the request could balloon into a much larger one and was therefore careful that any options discussed could be undertaken in a manner financially neutral to VHDA. Most of the loans in the portfolio had unusual characteristics, carried predominantly below-market interest rates, and were of lesser credit quality. VHDA was clear from the outset that the loans would have to be purchased at a discount to offset these factors. The request from the state did in fact balloon into a request for VHDA to purchase the entire \$91 million portfolio of loans in question. If the transaction were wrongly priced or mishandled, the financial and political consequences could have been severe.

Two additional issues also significantly affected the handling of this issue. First, the Fund was an important source of highly discounted and flexible financing for “difficult-to-do” developments. Most non-profit groups and many other stakeholders were strongly opposed to the sale. They assumed that it would substantially reduce or eliminate the availability of future funding. To the extent that any future funding was possible, they wanted it to be provided under the Fund’s interest rates, terms, and underwriting standards, which were more liberal than VHDA's. Second, the Fund was administered by the state Department of Housing and Community Development (DHCD), and was a central part of its housing programs. Therefore, in order for the idea of a sale to be successful, VHDA had to find a way to: 1) ensure that a sale did not harm to the authority’s balance sheet; 2) address the substantial concerns of stakeholders—including legislators—regarding the future availability of highly targeted loan funds; and 3) retain DHCD involvement in any replacement funding structure. The key to resolving these concerns while addressing VHDA’s financial needs was the creation of a working group of key affected parties in which VHDA could broker an acceptable solution. The state needed a fixed revenue figure to use in budget planning. This opened the door to establishing an amount to be returned to the state that was

politically reasonable, while obtaining agreement that any final sales proceeds in excess of that amount would be retained for housing purposes.

Before the state budget was finalized in December 2002 in advance of the 2003 legislative session that began in January 2003, VHDA staff did an initial valuation of the loans and estimated the fair market price at \$56 million. In February, the state budget was passed that included language directing VHDA to purchase the loans at fair market value by June 30, 2003, with the first \$41 million of the purchase proceeds to be deposited into the state's general fund, and any remaining balance to be held by VHDA but managed jointly by VHDA and the state Department of Housing and Community Development. These funds were to be used for new loans. An outside loan valuation firm was hired to set the final fair market price for the loans. By June 2003, market interest rates had declined since the initial staff valuation and in June the price was set at \$60 million for the portfolio's \$91 million par balance, \$4 million more than the preliminary VHDA estimate. A bond issue was sold by competitive bid to finance the purchase and all of the purchased loans were pledged to the issue. The bonds closed on June 26, and on June 30, VHDA gave \$41 million to the state.

VHDA had to work to overcome a number of obstacles in the process. There was initial pressure to make the preliminary valuation as high as possible to provide the greatest amount possible for the state, and for a new replacement loan fund. A great deal of education was necessary to help key legislators and their staffs understand the sale transaction and the critical importance of a fair valuation of the portfolio. VHDA also had to work closely with nonprofit housing groups over a period of several months to help them understand the transaction, to build trust about the potential for a favorable outcome, and to craft a new loan program going forward that would meet or exceed their needs. In order to help instill trust in the long-term intent to preserve highly targeted funding for affordable housing, VHDA pledged to provide \$1 million in agency reserves annually to further capitalize a new replacement loan fund. VHDA was successful in overcoming both sets of obstacles, with the outcome being a win-win solution for the authority, the state, and the non-profits, who came away with actually more funding than before the sale, at even more flexible terms.

In the end, the state received \$41 million for its budget deficit, the state Department of Housing and Community Development received \$19 million for new loans, key stakeholders came out ahead, and VHDA did not suffer any adverse financial or political consequences. In fact, VHDA was able to bring significant financial and programmatic expertise to bear in crafting an overall solution that led to VHDA being viewed as a very open, willing, and creative partner.