

Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 184 (Chairman, Education, Health, and Environmental Affairs Committee)
(By Request – Departmental – Housing and Community Development)

Education, Health, and Environmental Affairs

Environmental Matters

**Department of Housing and Community Development - Revenue Bonds Issued
by the Community Development Administration - Interest Rate Exchange
Agreements**

This departmental bill authorizes the Community Development Administration (CDA) to enter into interest rate exchange agreements or contracts providing for payments based on changes in interest rates.

The bill takes effect July 1, 2005.

Fiscal Summary

State Effect: None. The change is technical in nature and would not directly affect governmental finances.

Local Effect: None.

Small Business Effect: The Department of Housing and Community Development (DHCD) has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

Current Law: The State Treasurer is authorized to enter into interest rate exchange agreements for managing debt service and to contract with the necessary agents. In

addition, Baltimore City and county governments are authorized to enter into interest rate exchange agreements.

CDA, a division of DHCD, may borrow money and issue bonds or notes and may use the proceeds to provide funds for: (1) issuing or participating in issuing mortgages or other loans; (2) purchasing securities backed by a mortgage or other loans; (3) purchasing local obligations; (4) meeting any development cost; or (5) achieving any other of its purposes.

Background: Interest rate exchange agreements (swaps) are a device in public financing that can lead to reduced total interest costs during the life of a bond issuance. To illustrate how a swap works, there are three parties involved – the holder of the bond, the issuer of the bond (in this case CDA), and a third party. The third party agrees to take a fixed rate of interest on the bond from CDA, and pays the variable rate of interest to CDA, who pays the bond holder. This allows CDA to issue variable rate bonds, which can be more attractive to bond holders. The swap is a hedge against an increase in the interest rate. If the variable rate rises above the fixed rate that CDA is paying to the third party, the third party is still obligated to provide to CDA the amount necessary to pay the bond holder the variable rate of interest.

DHCD advises that currently the interest rates on variable rate bonds are low (*e.g.*, approximately 2.1%) while the interest rates on fixed rate products such as mortgages are high (*e.g.*, approximately 4.75% for fixed rate bonds). By altering between fixed and variable interest rates, CDA can effectively manage the interest costs even after the point of issuance. This will allow CDA to offer a more attractive mortgage rate to its customers.

CDA provides mortgages mostly for individuals purchasing single-family homes for the first time, but also to multi-family properties. In calendar 2004, CDA issued 1,600 mortgages.

State Fiscal Effect: None. Management of this type of debt finance instrument will be handled in the same manner as current debt financing instruments. Allowing CDA to enter into interest rate swaps will enable them to offer a lower mortgage rate to its clients. DHCD estimates that as of February 7, 2005, this authority could lower the interest rate for single-family mortgages by .4%. This is based solely on market conditions and could change at any time.

DHCD anticipates that interest rate swaps would affect the number of mortgages CDA can issue. However, DHCD funds CDA mortgages through tax-exempt revenue bonds, not through budgeted funds, therefore, there will be no impact on State revenues. DHCD advises that based on financial conditions as of February 7, 2005, the number of

mortgages that CDA would issue in fiscal 2006 could decrease to 800 if CDA is not able to enter into interest rate swaps. Alternatively, DHCD would like to issue 2,600 mortgages in fiscal 2006, and anticipates that interest rate swaps could assist in obtaining that goal.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Housing and Community Development, Treasurer's Office, Department of Legislative Services

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ncs/rhh

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