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SENATE

REPORT
No. 96–727

TRANSITIONAL RULES FOR TAX-EXEMPT MORTGAGE BONDS

MAY 15 (legislative day, JANUARY 3), 1980.—Ordered to be printed

Mr. LONG, from the Committee on Finance, submitted the following

REPORT

[To accompany S. Res. 435]

The Committee on Finance reported the following original resolution (S. Res. 435) relating to transitional rules governing the use of tax-exempt State and municipal bonds known as mortgage bonds and recommends that the resolution do pass.

Present Law

Interest on bonds issued by State and local governments is generally exempt from Federal income tax. However, there are certain circumstances when interest on such bonds is not tax-exempt. For example, interest on such bonds which are classified as industrial development bonds or which are "arbitrage bonds" (i.e., reinvestment of bond proceeds expected to produce a materially higher yield than paid on the underlying bonds) would not be exempt from Federal income tax.

In 1968, Congress substantially restricted the uses for which tax-exempt industrial bonds could be issued. In doing so, Congress provided a specific exception for industrial development bonds used to provide residential real property. The explanation of this exception in the legislative history on the Revenue and Expenditure Control Act of 1968 makes no distinction between multifamily rental housing and single-family, owner-occupied residents. However, at that time, tax-exempt bonds generally were not being issued for single-family residences.

Beginning in the early 1970's several State governments instituted tax-exempt bond programs (nonindustrial development bonds) to finance the purchase of owner-occupied residences. More recently, many local governments have instituted similar programs. Under these

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programs, the State or local government typically will issue bonds and lend the bond proceeds through one or more private lending institutions to private individuals for the purchase or rehabilitation of homes.

On April 25, 1979, legislation was introduced in the House of Representatives which would generally restrict the use of tax-exempt State and local bonds issued to provide mortgages for housing.

Summary of H.R. 5741

On March 26, 1980, the House approved H.R. 5741, "The Mortgage Subsidy Tax Act of 1979." This measure generally restricts the issuance of tax-exempt bonds for housing unless a series of requirements are met. Tax-exempt bonds for single-family, owner-occupied residences would only be authorized where:

a. The mortgages are for the principal residence of the borrower.

b. The borrower must not have been a homeowner within the last three years, except in the case of rehabilitation loans, "targeted areas," etc.

c. The borrower cannot have income in excess of 115 percent of the median family income in the Standard Metropolitan Statistical Area (SMSA) or county (if not an SMSA) where the mortgage is placed. A higher limit is authorized where the residence is located in a "targeted area" (i.e., low-income area or an area of chronic economic distress).

d. The purchase price of each residence cannot be more than 80 percent of the average purchase price for the past year in the SMSA (or county) where the residence is located. In a "targeted area" the price could be up to 110 percent of the average purchase price.

e. At least 75 percent of the funds to be loaned out must be to purchasers generally making no more than 5 percent down payments.

f. The effective interest rate on mortgages to home owners would be limited to 1.0 percentage point above the yield to maturity to the purchasers of the bonds, calculated on the date of issuance. Arbitrage earnings other than the 1.0 percentage point on home mortgages would be required to be returned to the borrowers.

g. The total amount of housing bonds that can be issued in a State year would be limited to the greater of $50,000,000 or 5 percent of the average for all mortgages originated in the State during the preceding three years.

h. A series of transitional rules are also provided to permit the issuance of various bond issues which were in the process of being approved by the appropriate governing bodies prior to April 25, 1979. A special exemption for State housing finance agencies would permit the issuance of up to $150 million of tax-exempt bonds by such agencies even where no action was taken prior to April 25, 1979.

In addition, in the case of multifamily rental housing, the present exception for tax-exempt bonds would be limited to multifamily housing projects in which at least 20 percent of the units are to be occupied by low- and moderate-income individuals. Special transitional rules are also provided.

Reason for Resolution

The tight money policy that has been adopted by the Federal Reserve and the Carter administration has resulted in a substantial decrease in the number of housing starts in this country. This slow down in the housing industry has resulted in large numbers of workers in the housing industry being put out of work. Moreover, the high interest rates have placed home ownership beyond the means of most needy families.

While some restrictions must be placed on the use of tax-exempt mortage bonds, it will take some time for the committee and the Senate to consider this bill. In the meantime, State and local governments cannot issues bonds under the permanent restrictions of the House passed bill because these rules may be substantially revised by the time the bill becomes law. In addition many local governments are not covered by the transitional rules and can't use this avenue to provide needed housing and employment to their citizens.

Explanation of Resolution

The committee's resolution provides that any legislation to be passed by the Senate restricting the use of mortgage bonds will not apply to bonds issued before January 1, 1981, provided that bond proceeds (exclusive of issuance costs and a reasonably required reserve) are committed to mortgages within one year after the date of issuance. In order to satisfy this commitment requirement, a firm commitment letter must commit to an individual a stated amount of money for the purchase or improvement of a particular residence for a stated period of time at a stated interest rate. A particular bond issue will not become taxable solely by reason of the fact that all of the proceeds of the issue were not committed to mortgages within within one year from the date of issuance as long as the uncommitted portion of the proceeds are used to redeem obligations within 18 months of the date of the issuance of the bonds.

This resolution will provide a more responsible transitional rule that permits State and local Governments to continue their housing programs until final restrictions on the use of mortgage bonds can be agreed to.

Vote of the Committee in Reporting the Resolution

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the vote by the committee to report the resolution. The resolution was ordered reported by the following roll call vote:

YEAS (15)	NAYS (1)
Long	Durenberger
Talmadge	
Byrd of Va.	
Nelson	
Gravel	
Bentsen	
Matsunaga	
Baucus	
Boren	
Dole	
Packwood	
Roth	
Danforth	
Chafee	
Wallop	

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