S. HRG. 98-207

HOUSING FINANCE OPPORTUNITY ACT AND DENIAL OF TAX EXEMPTION TO CERTAIN BONDS GUARANTEED BY FEDERAL AGENCIES

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 137 and S. 1061

MAY 13, 1983

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HOUSING FINANCE OPPORTUNITY ACT AND DENIAL OF TAX EXEMPTION TO CERTAIN BONDS GUARANTEED BY FEDERAL AGENCIES

FRIDAY, MAY 13, 1983

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Present: Senators Packwood, Roth, and Mitchell.

[The committee press release announcing this hearing; the text of bills S. 137 and S. 1061; the description of S. 137 and S. 1061 by the Joint Committee on Taxation; and the opening statements of Senators Roth and Pryor follow:]

[Press release No. 83-131, Apr. 19, 1983]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SETS HEARING ON THE HOUSING FINANCE OPPORTUNITY ACT OF 1983 AND THE DENIAL OF TAX EXEMPTION TO CERTAIN BONDS, GUARANTEED BY FEDERAL AGENCIES

Senator Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, announced today that the Subcommittee will hold a hearing on Friday, May 13, 1983, on S. 137 and S. 1061.

The hearing will begin at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The following legislative proposals will be considered at the hearing:

S. 137.—Introduced by Senator Roth for himself and others. S. 137 would make the tax exemption for single family mortgage revenue bonds permanent.

S. 1061.—Introduced by Senator Dole by request. S. 1061 would generally deny tax exempt treatment to certain bonds that are, in effect, guaranteed by certain Federal agencies.

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(2) Written statements must be typed on letter-sized paper (not legal size) and at least 100 copies must be delivered not later than noon on Thursday, May 12, 1983.

(3) All witnesses must include with their written statements a summary of the principal points included in the statement.

(4) Oral presentations should be limited to a short discussion of principal points included in the one-page summary. Witnesses must not read their written statements. The entire prepared statement will be included in the record of the hearing.

(5) Not more than 5 minutes will be allowed for the oral summary.

Written statements.—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Roderick A. DeArment, Chief Counsel, Committee on finance, Room SD-221, Dirksen Senate Office

Building, Washington, D.C. 20510, not later than Friday, May 27, 1983. On the first page of your written statement, please indicate the date and subject of the hearing.

II

98TH CONGRESS
1ST SESSION

S. 137

To amend the Internal Revenue Code of 1954 to continue to allow mortgage bonds to be issued.

IN THE SENATE OF THE UNITED STATES

JANUARY 26 (legislative day, JANUARY 25), 1983

Mr. ROTH (for himself, Mr. MITCHELL, Mr. SASSER, Mr. DURENBERGER, Mr. DANFORTH, Mr. HEFLIN, Mr. DODD, Mr. TSONGAS, Mr. MELCHER, Mr. ABDNOR, Mr. PACKWOOD, Mr. D'AMATO, Mr. STAFFORD, Mr. COCHRAN, Mr. LEVIN, Mr. TRIBLE, Mr. RIEGLE, Mr. WALLOP, Mr. CRANSTON, Mr. MURKOWSKI, Mr. PELL, and Mr. HUDDLESTON) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 to continue to allow mortgage bonds to be issued.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Housing Finance Opportunity Act of 1983".

SEC. 2. REQUIREMENTS FOR MORTGAGE SUBSIDY BONDS.

(a) IN GENERAL.—Section 103A(c)(1) of the Internal Revenue Code of 1954 (relating to the definition of a qualified mortgage bond) is amended to read as follows:

"(1) QUALIFIED MORTGAGE BOND DEFINED.—

"IN GENERAL.—For purposes of this title, the term 'qualified mortgage bond' means an obligation which is issued as part of a qualified mortgage issue."

(b) The amendment made by this section applies to obligations issued after December 31, 1983.

II

98TH CONGRESS
1ST SESSION

S. 1061

To amend the Internal Revenue Code of 1954 with respect to the tax treatment of bonds that are guaranteed by certain Federal agencies.

IN THE SENATE OF THE UNITED STATES

APRIL 15 (legislative day, APRIL 12), 1983

Mr. DOLE introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 with respect to the tax treatment of bonds that are guaranteed by certain Federal agencies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. TAX EXEMPTION DENIED WHERE PROCEEDS INVESTED IN FEDERALLY INSURED DEPOSITS.

The Internal Revenue Code of 1954 is amended by adding after section 103A the following new section:

"SEC. 103B. FEDERALLY GUARANTEED BONDS.

"(a) IN GENERAL.—Except as otherwise provided in this section, subsections (a)(1) and (a)(2) of section 103 shall not apply to any obligation issued as part of an issue if a significant portion of the principal or interest required to be paid on the issue is to be insured (directly or indirectly) by a Federal depository insurance agency as a result of the investment of the proceeds of the issue in deposits or accounts in a federally insured financial institution.

"(b) EXCEPTIONS.—For purposes of subsection (a), the investment of proceeds of the issue will not be taken into account to the extent that proceeds of the issue are invested—

"(1) for a temporary period (as defined in section 103(c)(4)(A)),

"(2) in a bona fide debt service fund, or

"(3) in a reserve which meets the requirements of section 103(c)(4)(B).

"(c) FEDERALLY INSURED FINANCIAL INSTITUTION.—For purposes of this section, the term 'federally insured financial institution' means—

"(1) a bank (as defined in section 581),

"(2) a mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution, or

"(3) a credit union,

the deposits or accounts of which are insured under Federal law.

"(d) FEDERAL DEPOSITORY INSURANCE AGENCY.—For purposes of this section, the term 'Federal depository insurance agency' means a Federal agency that insures deposits in federally insured financial institutions.".

SEC. 2. EFFECTIVE DATE.

The amendment made by section 1 shall apply to obligations issued after April 15, 1983, except that such amendment shall not apply to any obligation issued after April 15, 1983, pursuant to a written commitment that was binding on March 4, 1983, and at all times thereafter.

DESCRIPTION OF TAX BILLS (S. 137 AND S. 1061)

RELATING TO

MORTGAGE SUBSIDY BONDS AND FEDERAL GUARANTEES OF TAX-EXEMPT BOND INVESTMENTS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON MAY 13, 1983

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on May 13, 1983, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are two bills scheduled for the hearing: S. 137 ("Housing Finance Opportunity Act of 1983", relating to tax exemption for qualified mortgage bonds) and S. 1061 (relating to denial of tax exemption on obligations where bond proceeds are invested in federally insured deposits).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, explanation of provisions, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 137—Senators Roth, Mitchell, Durenberger, Danforth, Packwood, Wallop, and Others

"The Housing Finance Opportunity Act of 1983"

The Mortgage Subsidy Bond Tax Act of 1980 (the "1980 Act") imposed restrictions on the ability of State and local governments to issue tax-exempt bonds to finance owner-occupied residences. The 1980 Act provides that interest on mortgage subsidy bonds is exempt from taxation only if the bonds are "qualified mortgage bonds" or "qualified veterans' mortgage bonds". Qualified mortgage bonds must satisfy a number of requirements including a requirement that the bonds be issued before January 1, 1984.

The bill would make permanent the tax exemption presently provided for qualified mortgage bonds.

2. S. 1061—Senator Dole

Denial of Tax Exemption Where Bond Proceeds Are Invested in Federally Insured Deposits

Present law generally permits State and local governments to invest the proceeds of tax-exempt bond issues in certificates of deposit of federally insured financial institutions. The amounts deposited with the financial institutions then may be loaned for projects which qualify for tax-exempt financing. The certificates are pledged as security for repayment of the tax-exempt bonds. Because the certificates are insured by Federal depository insurance agencies in amounts up to $100,000 per bondholder, the repayment of the tax-exempt bonds effectively is guaranteed by those agencies.

The bill would eliminate the tax exemption for any obligation which was part of an issue a significant portion of the principal or interest on which is to be insured (directly or indirectly) by a Federal depository insurance agency as a result of the investment of the proceeds of the issue in deposits or accounts in a federally insured financial institution. However, exceptions are provided for (1) temporary period investments, (2) bona fide debt service reserves, and (3) reasonably required reserves.

II. DESCRIPTION OF BILLS

1. S. 137—Senators Roth, Mitchell, Durenberger, Danforth, Packwood, Wallop, and Others

"The Housing Finance Opportunity Act of 1983"

Present Law

Overview

The Mortgage Subsidy Bond Tax Act of 1980 (the "1980 Act") [1] imposed restrictions on the ability of State or local governments to issue bonds, the interest on which is tax-exempt, for the purpose of making mortgage loans on single family residences.[2] The 1980 Act provides that interest on mortgage subsidy bonds is exempt from taxation only if the bonds are "qualified mortgage bonds" or "qualified veterans' mortgage bonds".

Qualified veterans' mortgage bonds

Qualified veterans' mortgage bonds are general obligation bonds, the proceeds of which are used to finance mortgage loans to veterans. The tax-exemption for veterans' bonds is permanent.

Qualified mortgage bonds

Qualified mortgage bonds must be issued before January 1, 1984, and must satisfy numerous requirements, discussed below.

Volume limitations

The 1980 Act restricts the aggregate annual volume of qualified mortgage bonds that a State, and local governments within the State, can issue. The State ceiling is equal to the greater of (1) 9 percent of the average annual aggregate principal amount of mortgages executed during the 3 preceding years for single-family owner-occupied residences located within the State or (2) $200 million.

Limitation to single-family, owner-occupied residences

All proceeds (except issuance costs and reasonably required reserves) of qualified mortgage bonds must be used to finance the purchase of single-family residences [3] located within the jurisdiction of the issuing authority. Additionally, it must be reasonably

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[1] Title XI of the Omnibus Reconciliation Act of 1980 (Pub. L. 96-499). The provisions of this Act (i.e., Code sec. 103A) were subsequently amended by section 220 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248) ("TEFRA").

[2] Tax-exempt industrial development bonds also may be issued to finance projects for certain multi-family residential rental housing. Tax exemption for such bonds is permanent.

[3] Generally, the term single-family residence includes 2-, 3-, and 4-family residences if (1) the units in the residence were first occupied at least 5 years before the mortgage is executed and (2) one unit in the residence is occupied by the owner of the units.

expected that each residence will become the principal residence of the mortgagor within a reasonable time after the financing is provided.

General limitation to new mortgages

With certain exceptions, all proceeds of qualified mortgage bonds must be used for acquisition of new mortgages rather than existing mortgages. The exceptions permit replacement of construction period loans and other temporary initial financing, and certain rehabilitation loans. Rehabilitation loans must be made for work begun at least 20 years after the residence is first used and the expenditures must equal 25 percent or more of the mortgagor's adjusted basis in the building. Additionally, at least 75 percent of the existing external walls of the building must be retained as such after the rehabilitation.

Certain mortgage assumptions permitted

Loans financed by qualified mortgage bond proceeds may be assumed if the residence satisfies the location and principal residence requirements, discussed above, and the assuming mortgagor satisfies the three-year and purchase price requirements, discussed below.

Limitation on advance refunding

Qualified mortgage bonds may not be advance refunded.

Targeting requirement

At least 20 percent of the proceeds of each issue must be made available for owner-financing in "targeted areas" for a period of at least one year. The term targeted area means a census tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median family income, or an area designated as an area of chronic economic distress.

Three-year requirement

In order for an issue to be a qualified mortgage issue, at least 90 percent of the mortgages financed from the bond proceeds are required to be provided to mortgagors, each of whom did not have a present ownership interest in a principal residence at any time during the three-year period ending on the date the mortgage is granted.[4] The three-year requirement does not apply with respect to mortgagors of residences in three situations: (1) mortgagors of residences that are located in targeted areas; (2) mortgagors who receive qualified home improvement loans;[5] and (3) mortgagors who receive qualified rehabilitation loans.

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[4] Section 220(c) of TEFRA reduced the percentage of bond proceeds that must be used in a manner satisfying the three-year requirement from 100 percent to 90 percent, effective for bonds issued after September 3, 1982.

[5] Qualified home improvement loans are loans, not exceeding $15,000, that finance the alteration or repair of a residence in a manner that substantially protects "the basic livability or energy efficiency of the property" (sec. 103A(l)(6)).

Purchase price requirement

In order for an issue to be a qualified mortgage issue, all of the mortgages (or other financing) provided from the bond proceeds, except qualified home improvement loans, are required to be for the purchase of residences where the acquisition cost of each residence does not exceed 110 percent (120 percent in targeted areas) of the average area purchase price applicable to that residence.[6]

Arbitrage requirements

In order for an issue to be a qualified mortgage issue, the issue is required to meet certain limitations regarding arbitrage as to both mortgage loans and nonmortgage investments.

Mortgage investments.—The effective rate of interest on mortgages provided under an issue of qualified mortgage bonds may not exceed the yield on the issue by more than 1.125 percentage points.[7] This determination is made on a composite basis for all mortgages under the issue. Consequently, the effective interest rate on some mortgages may be greater than 1.125 percentage points above the yield of the issue if other mortgages have a lower effective interest rate.

Nonmortgage investments.—The 1980 Act also imposed restrictions on the arbitrage permitted to be earned on nonmortgage investments. The amount of qualified mortgage bond proceeds that can be invested at unrestricted yield in nonmortgage investments is limited to 150 percent of the debt service on the issue for the year. An exception to the 150-percent debt service rule is provided, however, for proceeds invested for an initial temporary period until such proceeds are needed for mortgages. Arbitrage earned by the issuer on nonmortgage investments must be paid or credited to the mortgagors or paid to the Federal Government.

Qualified mortgage bonds usually have established a reserve to secure payment of the debt service on the bonds. This reserve must be reduced as debt service is reduced. However, if the sale of any investment would result in a loss exceeding the amount otherwise required to be paid or credited to mortgagors, the investment may be retained until it can be sold without resulting in such a loss.[8]

Background

State housing agencies began issuing mortgage subsidy bonds in the early 1970's. However, prior to 1978, most state housing finance agency bonds were issued to provide multi-family rental housing. The volume of bonds issued to provide for single-family housing increased from $36 million in 1971 to $959 million in 1977. During 1978, the last full year before any provisions of the 1980 Act were effective, State and local governments issued $3.3 billion of bonds for owner-occupied residential real property.

[6] Section 220(d) of TEFRA increased the maximum purchase price requirement from 90 percent (110 percent in targeted areas) to its present level, effective for bonds issued after September 3, 1982.

[7] Section 220(a) of TEFRA increased the maximum permitted arbitrage from 1 percentage point to 1.125 percentage points, effective for bonds issued after September 3, 1982.

[8] The rule permitting retention of an investment where its disposition would result in a loss was added by section 220(b) of TEFRA, effective for bonds issued after September 3, 1982.

The volume of qualified mortgage bonds issued since 1978, and the percentage of total tax-exempt State and local borrowing comprised of such bonds, are shown in Table 1.

TABLE 1.—VOLUME OF QUALIFIED MORTGAGE BONDS, 1979-83

[Dollars in billions]

Year	State qualified mortgage bonds	Local qualified mortgage bonds	Percent of total State and local bonds
1979	$3.3	$4.5	16.2
1980	5.0	5.5	19.2
1981	1.7	1.2	5.0
1982	5.5	3.5	10.4

As shown in Tables 1 and 2, qualified mortgage bonds represented 10.4 percent of total State and local government borrowing during 1982.

Table 2 shows the relative percentages of borrowing by State and local governments by purpose during 1982.

TABLE 2.—COMPOSITION OF STATE AND LOCAL GOVERNMENT BORROWING IN 1982

Purpose	Percent
Owner-occupied housing	10.4
Veterans' housing	0.6
Education	9.7
Water and sewer	5.3
Highways, bridges, and tunnels	1.3
Gas and electric	11.0
Industrial aid	14.7
Pollution control	7.6
Hospital	11.2
Multi-family rental housing	5.9
Other purposes	22.3
Total	100

Issues

The bill raises several issues in providing for a continuation of the exemption of interest on qualified mortgage bonds:

First, what should be the appropriate level of the total Federal subsidy to owner-occupied housing in light of the demands on the available pool of credit for other purposes, the effect that such subsidies have on the cost of housing, and the cost of the subsidy to the Federal Government?

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Second, what should be the role of tax-exempt bonds as a part of this total subsidy in light of the relative efficiencies of tax-exempt bonds and other forms of subsidy?

Third, what is the impact of permitting tax exemption for interest on mortgage bonds on the cost to State and local governments of borrowing for other purposes?

Fourth, if the exemption of interest on qualified mortgage bonds is to be continued, should the length of the exemption be limited by a period of time (i.e., an extension for a specified period of time)?

Fifth, assuming that exemption of interest on qualified mortgage bonds is to be continued, do the existing limitations target the subsidy to those individuals who are most in need of assistance?

Explanation of the Bill

The bill would make permanent the tax exemption presently provided for qualified mortgage bonds.

Effective Date

The bill would be effective on the date of enactment.

Revenue Effect

It is estimated that this bill would reduce fiscal year receipts by $0.1 billion in 1984, $0.2 billion in 1985, $0.5 billion in 1986, $0.8 billion in 1987, and $1.2 billion in 1988.

2. S. 1061—Senator Dole

Denial of Tax Exemption Where Bond Proceeds Are Invested in Federally Insured Deposits

Present Law

Federal income tax rules

State and local obligations

In general.—Interest on State and local government obligations generally is exempt from Federal income tax. Under this rule, State and local governments generally may issue tax-exempt bonds to finance public projects or services, including schools, roads, water, sewer, and general improvement projects and the financing of public debt. Additionally, State and local governments may provide tax-exempt financing for student loans and for use by tax-exempt religious, charitable, scientific, or educational organizations.

Industrial development bonds.—Under present law, industrial development bonds (IDBs) are taxable except when issued for certain specified purposes. Industrial development bonds are obligations issued as part of an issue all or a major portion of the proceeds of which are to be used in any trade or business carried on by a nonexempt person and the payment of principal or interest on which is derived from, or secured by, money or property used in a trade or business.

One of the exceptions under which interest on IDBs is tax-exempt is where the proceeds of the IDBs are used for certain exempt functions. Under this rule, interest on IDBs is tax-exempt if the bond proceeds are used to finance the following activities: (1) projects for multi-family residential rental housing; (2) sports facilities; (3) convention or trade show facilities; (4) airports, docks, wharves, mass commuting facilities, or parking facilities; (5) sewage and solid waste disposal facilities, or facilities for the local furnishing of electricity or gas; (6) air or water pollution control facilities; (7) certain facilities for the furnishing of water; (8) qualified hydroelectric generating facilities; (9) qualified mass commuting vehicles; or (10) local district heating or cooling facilities. In addition, interest on IDBs used to acquire or develop land as the site for an industrial park is exempt from tax.

Present law also provides tax exemption for certain "small issue" IDBs the proceeds of which are used for the acquisition, construction, or improvement of land or depreciable property. This exception applies to issues of $1 million or less without regard to related capital expenditures. Alternatively, the exception applies if the amount of the issue, together with certain related capital expenditures over a 6-year period, does not exceed $10,000,000.

Treasury Regulations provide that whether the proceeds of an obligation are used for exempt facilities is to be determined by the ultimate use of the proceeds (Treas. Reg. § 1.103-8(a)(4)). Those regulations illustrate this principle by indicating that bond proceeds are used for an exempt purpose where the proceeds of the bonds are lent to banks or other financial institutions who then relend those proceeds for exempt functions (referred to as a "loan to lenders" program).

Scholarship funding bonds

In addition to State and local obligations, qualified scholarship funding bonds are exempt from Federal income tax. Qualified scholarship funding bonds are obligations issued by a not-for-profit corporation established and operated exclusively for the purpose of acquiring student loan notes. To qualify for tax exemption, the corporation must be required to use any income (after payment of expenses and debt service) to purchase additional student loan notes, or to pay over any income to the State or a political subdivision.

Federal deposit insurance rules

The Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) insure deposits in banks and thrift institutions to a maximum of $100,000 per depositor.[1] Where assets of a trust are deposited in Federally insured institutions, the trust funds are insured up to $100,000 for each beneficial owner of the funds.[2] Additionally, where a public official deposits funds required to be paid to holders of bonds issued by a public unit, the interest of each bondholder is insured up to $100,000.[3]

The FDIC and FSLIC concluded in letter rulings issued in 1982 that, where the proceeds of a tax-exempt bond issue are used to purchase certificates of deposit of insured financial institutions, which may occur in loans to lenders programs, each bondholder's proportionate interest in the deposits would be separately recognized. Thus, if one or more depository banks failed, the interest of each bondholder would be insured up to $100,000 for each depository bank.[4]

Background

Typical structure of FDIC- and FSLIC-insured bonds

In certain recent issues of tax-exempt bonds, the issuing authority has deposited the bond proceeds in bank or savings and loan accounts insured by the FDIC or FSLIC, to be loaned to the user by the depository institution. In the typical arrangement, the issuer transfers the proceeds to a trustee for the bondholders, and the trustee deposits the funds in FDIC- or FSLIC-insured certificates of

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[1] The FDIC provides insurance for deposits in commercial banks and State mutual savings banks. The FSLIC insures deposits in savings and loan associations, Federal mutual savings banks, and certain other thrift institutions.

[2] 12 U.S.C. sec. 1817(i) and 12 C.F.R. sec. 331.1(b) (FDIC); 12 U.S.C. sec. 1724(b) and 12 C.F.R. sec. 564.2(c) (FSLIC).

[3] 12 C.F.R. sec. 330.8(b) (FDIC); 12 C.F.R. sec. 564.8(b) (FSLIC).

[4] This insurance would be separate from insurance on any deposits which the bondholder individually maintained in the bank.

deposit. The depository institution agrees to provide the deposited funds to private users for stated tax-exempt purposes. Interest and principal on the bonds are repaid from payments on the certificates of deposit. The repayment of the bonds is secured by the certificates. Because the proceeds of the bonds are used ultimately for exempt purposes, the bonds qualify as tax-exempt obligations under present law. Because the trustee for the bondholders holds a certificate of deposit in an insured institution, the amount of each bondholder's holdings is insured to the extent of $100,000 for each depository institution.

Volume and uses of FDIC- and FSLIC-insured tax-exempt bonds

The first FDIC- and FSLIC-insured tax-exempt bonds appear to have been issued in October 1982. Since then, approximately $2 billion of these bonds have been issued. Most of this amount consists of IDBs used to provide projects for multi-family residential rental property.

Precedents for Federal guarantees of tax-exempt bonds

The Public Debt Act of 1941 [5] prohibits the Federal Government from issuing tax-exempt obligations. Since that time, the Federal Government has generally refrained from guaranteeing tax-exempt State or municipal bonds. However, in certain limited cases, Federal agencies may provide additional security for tax-exempt bonds through (1) guarantee of obligations which are used to secure tax-exempt bonds or (2) subordination of debts owed to the Federal Government to the tax-exempt bonds. In other cases, the law specifically prohibits the guarantee of tax-exempt obligations.

New York City loan guarantees

The New York City Financial Assistance Act of 1978 (Pub. L. 95-339) authorized the Treasury Department to guarantee payment of interest and principal on New York City indebtedness issued to certain public employee pension funds. The Act provided specifically that any guaranteed obligation would be treated as a taxable obligation with respect to interest accrued during the guarantee period. The Conference Report accompanying the Act [6] states that the conferees sought to avoid establishing a precedent for tax-exempt federally guaranteed obligations since obligations which combined a Federal guarantee and tax-exempt interest would be more desirable to investors than United States Treasury obligations (which are taxable) or other obligations issued by State or local governments (which are tax-exempt but not federally guaranteed).

Small Business Administration guarantees

The Small Business Administration (SBA) is authorized to guarantee 100 percent of the payments due from eligible small businesses under contracts for the planning, design, or installation of governmentally mandated pollution control facilities.[7] The current

[5] 55 Stat. 7 (1941).
[6] H. Rep. No. 95-1369, accompanying H.R. 12426, 95th Cong., 2d Sess. (July 18, 1978).
[7] Small Business Investment Act of 1958, 15 U.S.C. sec. 694-1.

policy of the SBA is to avoid participation in pollution control projects financed with tax-exempt obligations. However, the Senate Committee on Small Business has reported favorably [8] a bill (S. 499) which would prohibit the SBA from declining to participate in projects because of the presence of tax-exempt financing. In addition, the bill states that it is the declared policy of Congress that the guarantee of payments for pollution control facilities would not cause the interest on tax-exempt obligations used to finance the facilities to be taxable.

Department of Agriculture programs (Farmers Home Administration)

The Farmers Home Administration (FmHA) guarantees loans for various purposes, including emergency loans, farm operating loans, farm ownership loans, soil and water loans, business and industrial loans, economic emergency loans, and guaranteed rural housing loans. The FmHA amended its regulations in 1982 to provide that the FmHA will not guarantee loans made with the proceeds of tax-exempt obligations.[9] Additionally, no FmHA loan may serve as collateral for a tax-exempt issue.

Housing and Urban Development

Low income housing.—Section 11(b) of the Housing Act of 1937 [10] provides a special tax exemption for obligations issued by State and local housing agencies in connection with low-income housing projects. The Act [11] prohibits the Department of Housing and Urban Development (HUD) from guaranteeing any tax-exempt obligation issued by a State or local agency. However, under certain circumstances, an issuer may pledge HUD loans or contributions (which are backed by the full faith and credit of the United States) as security for tax-exempt obligations.

Mortgage insurance.—The Federal Housing Authority (FHA) is authorized to insure mortgages on various properties, including certain owner-occupied housing, rental and cooperative housing, housing for moderate income and displaced families, housing for elderly persons, and hospitals and nursing homes.[12] These may include mortgages on properties constructed with tax-exempt financing. In these situations, FHA-insured mortgages may be pledged as security for tax-exempt bonds.

Energy program guarantees

Under certain energy production or conservation programs, the Federal government may guarantee the payment of principal or interest on IDBs used to finance qualified hydroelectric generating facilities or qualified steam-generating or alcohol-producing facilities. The Internal Revenue Code[13] eliminates the tax exemption for bonds guaranteed under these programs. Additionally, the tax ex-

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[8] S. Rep. No. 98-22, 98th Cong., 1st Sess. (March 11, 1983). The House Committee on Small Business has reported similar legislation.
[9] 7 C.F.R. sec. 1980.23.
[10] 42 U.S.C. sec. 1437i(b).
[11] 42 U.S.C. sec. 1437c(g).
[12] National Housing Act of 1934, 12 U.S.C. sec. 1707 *et seq.*
[13] Code sec. 103(h).

emption is eliminated when principal or interest on the bonds is to be paid with funds provided by the Federal government (or by State or local governments) under an energy production or conservation program.

Issues

The guarantee of tax-exempt obligations by Federal deposit insurance agencies raises several policy issues:

First, do such guarantees have a detrimental effect on the market for Federal securities?

Second, do such guarantees increase the volume of tax-exempt bonds and, therefore, have a detrimental effect on the issuance of tax-exempt bonds for traditional public purposes?

Third, does the double benefit from both Federal guarantees and tax exemption distort the proper allocation of capital in the marketplace?

Fourth, is the denial of tax-exemption or denial of Federal guarantee the proper method for dealing with the problem?

Fifth, how can guarantees derived through Federal deposit insurance be distinguished from other Federal guarantees?

Explanation of the Bill

The bill would eliminate the tax exemption for any obligation if a significant portion of the principal or interest required to be paid on the issue of which the obligation is a part is to be insured (directly or indirectly) by a Federal depository insurance agency as a result of the investment of the proceeds of the issue in deposits or accounts in a federally insured financial institution. A federally insured financial institution is defined as a bank, savings institution (including a mutual savings bank, cooperative bank, and domestic building and loan association), or credit union, the deposits or accounts of which are insured under Federal law. The term Federal depository insurance agency means a Federal agency (including the FDIC and FSLIC) that insures deposits in federally insured financial institutions.

Tax exemption would not be denied, under the bill, to the extent that proceeds are invested (1) for a temporary period, until such proceeds are needed for the purpose for which the issue was issued; (2) in a bona fide debt service fund; or (3) in a reasonably required reserve or replacement fund (not exceeding 15 percent of the proceeds of the issue, unless the issuer established that a higher amount is necessary).

The bill would not effect any Federal guarantee (direct or indirect) of tax-exempt bonds other than that resulting from Federal depository insurance.

Effective Date

The bill would apply to obligations issued after April 15, 1983. However, the bill would not apply to any obligation issued after April 15, 1983, pursuant to a written commitment that was binding on March 4, 1983, and at all times thereafter.

Revenue Effect

The exact size of the revenue effect for this bill is indeterminate. However, because there are many potential bond programs that could effectively utilize FSLIC and FDIC guarantees, the revenue gain in future years is likely to be substantial.

OPENING STATEMENT OF SENATOR WILLIAM V. ROTH, JR., MORTGAGE REVENUE BOND HEARING, MAY 13, 1983

Mr. Chairman, I am pleased that we have an opportunity today to review the operation and effectiveness of the Mortgage Revenue Bond Program. As my colleagues are aware, without enactment of the legislation I have introduced, S. 137, the Housing Finance Opportunity Act of 1983, the authority for state and local governments to issue mortgage revenue bonds will expire on December 31. I might add that there is an impressive array of support for continuation of the program. I have been joined by 73 of my colleagues in the Senate in sponsoring legislative for repeal of the sunset provision, a number which is broadly bipartisan and constitutes a majority of the Members of both the Finance Committee and the Banking, Housing, and Urban Affairs Committee.

Why is there such strong support for the mortgage revenue bond program? I think it is because it is a people program which attempts to address the problem of housing affordability and enables people to purchase their own homes—a longtime national goal. The program accomplished this objective by providing capital for mortgages at below-market rates. This differential can provide enough of a savings on a homeowner's monthly payment to make homeownership possible. It is a program which has been targeted. Bond proceeds are limited primarily to first time homebuyers and cannot be applied to homes greater than 110 percent of the average area purchase price. Additionally, the mortgage revenue bond program gives States and localities great flexibility in responding to their own unique housing needs without cumbersome Federal intervention and control.

Why is there a need for this program? The past decade saw a dramatic increase in the price of homeownership. The average cost of a home jumped from $25,000 to nearly $70,000 today. Simultaneously, in the late seventies interest rates began a dramatic climb upward culminating in record heights in the first 6 months of 1982. The monthly mortgage payments required to purchase a home under these circumstances effectively made homeownership an unattainable dream for a great number of American people—especially the first time homebuyer. Interestingly enough, the mortgage revenue bond program evolved as a private market response to bridge the gap in housing affordability, and bond issues of this type became increasingly popular in the late seventies. The proliferation of issues caused some alarm in Congress and thus there was movement to restrict the program—which was done for the first time in the Omnibus Reconciliation Act of 1980 through the Mortgage Subsidy Bond Tax Act. This vehicle restricted the volume of the bonds, the interest rate which could be charged for mortgages made through bond proceeds, established purchase price limitations and targetted bond proceeds to first time homebuyers. It also provided for a sunset of the program on December 31, 1983. Last year it became apparent that these restrictions were overly severe and could not sustain a self-supporting and workable program and so some small modifications were made through the enactment of the Tax Equity and Fiscal Responsibility Act of 1982. Having thus fine tuned the program, we find that it will now be terminated without repeal of the sunset provision. While there has been a significant decline in interest rates from the record rates of a year ago, they are still high by historical standards—with a conventional mortgage rate being in the neighborhood of 13 percent. Significant progress has also been made on the inflation front which affects the costs of housing—however, we can assume that there will continue to be a rise in the price of housing even if it is more moderate than the recent past experience. This occurs during a time period when there are more first time homebuyers entering the marketplace than at any other time in our Nation's history as a result of the maturation of the baby boom generation. It is estimated that the demand generated by this phenomena will result in one and one half million additional first time homebuyers a year in the marketplace. The mortgage revenue bond program can help meet this increased demand for affordable housing opportunities.

Has the program been effective in meeting the stated objective of providing homeownership opportunities? We are fortunate today to have a panel of witnesses who are experienced with the use of the mortgage revenue bond program. I would particularly like to acknowledge the presence of Bob Moyer, the director of housing for the State of Delaware, who has conducted an exemplary mortgage revenue bond program in our State. In the past 3 years the Delaware State Housing Authority has assisted more than 3,500 low and moderate income Delaware families through mortgage revenue bond financing. This accomplishment was made possible in spite of the worst downturn in the history of the housing industry and I, for one, think it is testament to the program's effectiveness. I am sure we will hear more on this subject today.

In closing, I would acknowledge that the program is not without its critics, however, Most recently the General Accounting Office has issued a preliminary report which is highly critical of the program. Again I would defer to the experts before us today on this subject.

With these thoughts in mind, I would like to welcome the witnesses here today representing State and local interests from all over the country who can give us a first hand report on the operation and effectiveness of the mortgage revenue bond program.

OPENING STATEMENT OF SENATOR DAVID PRYOR, SENATE COMMITTEE ON FINANCE, MAY 13, 1983

Mr. Chairman, I am pleased the committee is holding this hearing today to examine mortgage bonds and begin a discussion of the possible extension of the termination date of December 31, 1983, currently in the tax code. I am consponsoring S.137, a bill introduced by Senators Roth and Mitchell, that would repeal the termination date.

Mr. Chairman, mortgage bonds have been extremely important in the State of Arkansas. I've heard from first-time homebuyers, realtors, home builders, and many others about mortgage bonds. I know many people are concerned over the use of these bonds, but I think we all need to consider the many benefits that flow from their use.

Mr. Chairman, I am particularly pleased that today the committee will hear from The Honorable Bill Clinton, Governor of the State of Arkansas. Governor Clinton is very knowledgable on this subject. I welcome him today and I urge my colleagues to seriously consider his views on mortgage bonds.

Senator PACKWOOD. The committee will come to order, please.

Although we have only two bills before us today, we have a lengthy list of witnesses. I am going to ask the witnesses to abbreviate their testimony and have their entire statements placed in the record as if given. I want to emphasize as strongly as possible that witnesses highlight the points they want to make in their oral testimony.

I do ask unanimous consent that a statement from Senator Pryor be placed in the record at this stage.

We will call first on the Honorable John Chapoton, the Assistant Secretary of the Treasury for Tax Policy. We make an exception to our 5-minute rule for Secretary Chapoton because he has to testify on both of the bills.

But, Buck, I would appreciate it if you did not read your entire statement.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. We do have a rather lengthy statement, Mr. Chairman. I will try to summarize it. These are two important bills before you today, and I do want to make several points.

First, as usual, we are very happy to have the opportunity to present the administration's views on these two bills. The first is S. 137, which would eliminate the 1983 sunset on tax exemption for qualified mortgage subsidy bonds. In 1968, in response to a rapidly growing volume of private purpose tax-exempt bonds, Congress amended section 103 of the code to limit the types of private activities that could be financed with tax-exempt bonds. This was of course the legislation dealing with industrial development bonds.

In that legislation, tax-exempt financing was allowed to continue for residential real property for family units. In 1968, at the time this legislation was enacted, virtually all tax-exempt housing bonds were for low income multifamily rental projects. We think it is highly unlikely that Congress intended at that time to permit tax-exempt financing for private owner-occupied housing.

Nevertheless, a few State housing agencies began to issue a small amount of tax exempt mortgage subsidy bonds in the early seventies. In 1978 one large municipality issued a $100 million issue, and from that point almost overnight a multibillion housing subsidy program that was never contemplated by Congress came into existence.

The volume of outstanding mortgage subsidy bonds grew from $1 billion in 1977 to $10.5 billion in 1988. The volume of tax exempt obligations for owner-occupied housing as a percentage of the total tax exempt financing for all purposes skyrocketed from less than 3 percent to a total of 20 percent in this same period.

This tremendous unanticipated increase in the level of Federal assistance to owner-occupied housing caused a great deal of concern within the Treasury and in Congress, and that led to the 1980 Mortgage Subsidy Bond Act, which is the subject of the hearing today.

The Mortgage Subsidy Bond Act was an attempt by Congress to target tax exempt financing for owner-occupied housing to those individuals in greatest need of the subsidy, to curtail the burgeoning federal revenue loss, and to direct more of the subsidy to home buyers. The act provided, of course, that the mortgage subsidy bond legislation would expire at the end of this year.

The Mortgage Subsidy Bond Act was amended in TEFRA in several ways: increasing the amount of bond proceeds that could be used by existing homeowners; by increasing the purchase price limitation from 90 percent of the area's average price, to 110 percent; and by increasing the interest rate that housing agencies could charge a qualifying home buyer that raised the limitation on the issuer's arbitrage profit to 1⅛ percentage points.

The effect of these changes, Mr. Chairman, in TEFRA was to allow more affluent families to participate in the mortgage subsidy bond program, and since there are volume caps on a State-by-State basis, the result may be to displace lower income families from participation in the program.

The Treasury supports the December 31, 1983, sunset of the tax-exempt mortgage subsidy bond program and thus we strongly oppose S. 137. We think continuation of the tax-exempt financing for owner-occupied housing does three things that dictate allowing the sunset to go into effect: It damages the traditional tax-exempt bond market; it is not cost effective; and it will cause future significant revenue losses to the Federal Government.

We also think that mortgage subsidy bonds are unnecessary in view of other Federal assistance for low- and moderate-income home buyers.

Dealing first with the damage to the tax-exempt market, mortgage subsidy bonds issued through the end of 1982, accumulated to some $30 billion housing bonds outstanding. We estimate this additional outstanding amount of tax-exempt bonds will increase total future interest payments on public purpose bonds issued in 1982 by at least $2 billion.

Senator PACKWOOD. Buck, give me a perspective. How much do you estimate the interest otherwise? $2 billion in relation to what?

Mr. CHAPOTON. A conservative estimate is that each billion dollars of additional tax exempts increases the interest rate on all tax exempts by 1 basis point; $30 billion of additional outstanding tax exempt bonds thus raises tax-exempt interest rates by 30 basis points, or 0.3 percent.

Senator PACKWOOD. I heard what you said, but translate that into language that I follow.

Mr. CHAPOTON. One basis point is one-hundredth of 1 percent for each $1 billion outstanding; $30 billion outstanding mortgage subsidy bonds through the end of 1982 would increase the interest cost of all tax exempt bonds outstanding by three-tenths of 1 percent.

Senator PACKWOOD. But again, put it in dollar figures.

Mr. CHAPOTON. OK. $41 billion of public purpose bonds were issued in 1982. $41 billion times 0.003 equals $123 million additional interest per year.

Senator PACKWOOD. And the mortgage subsidy bonds will result in an increase in interest in just 1982 of $2 billion?

Mr. CHAPOTON. No, on bonds issued in 1982. So you multiply the $123 million per year additional cost by the estimated period that those bonds will be outstanding. We have taken 18 years, 18 times $123 million. That is an undiscounted figure. You could discount that back if you wanted to see the present value of it. I think that the $2 billion undiscounted amount is a conservative estimate of the total additional interest cost of the public purpose bonds issued just during that year.

We think that tax exempt bonds are an inherently inefficient means of providing assistance to low- and moderate-income home buyers. The portion of the benefits captured by investors is large due to the large outstanding volume of tax exempt obligations, including mortgage bonds.

Studies show that the benefits captured by the holders of tax exempts are at least one-third of the total of the program; stated differently, only two-thirds of the intended benefits are reaching the intended beneficiaries. The GAO study, which has been submitted to the committee, states that mortgage subsidy bonds may be even less efficient than that.

Senator PACKWOOD Let me understand what you are saying there. Of the bonds issued, a third of the payment goes to the bondholders and two-thirds of it goes for building houses?

Mr. CHAPOTON. A third of the benefit goes to the bondholder and two-thirds of the subsidy ends up in the hands of the ultimate user of the homes.

The tax-exempt financing is also, Mr. Chairman, an inefficient subsidy because the rate of subsidy varies greatly depending on the condition of the tax exempt market. For example, in 1982 the interest rate differential between long-term taxables and tax exempts varied from 11 percent in early 1982 to about 21 percent at the end of the year. Traditionally the differential has been around 30 percent, so it fluctuated greatly in just that 1 year.

That shows that the subsidy involved is unrelated to the amount of assistance that low- and moderate-income families may need to purchase a home. It is a rather arbitrary subsidy.

And finally tax-exempt bonds result in large future losses to the Treasury. Much of the discussion on mortgage subsidy bonds unfortunately is concentrated on what we think is a misleading statistic, that is the annual revenue loss for a single year. While that is important, it is a poor measure of the total cost of the mortgage subsidy bond program because the bonds remain outstanding for a long number of years, as long as 30 years.

The revenue loss accumulates each year as the amount of outstanding bonds increases. We estimate that the additional revenue loss from a permanent extension of the sunset would be only about $0.3 billion in 1985, but $0.9 billion in 1987, $1.8 billion in 1989, and cumulating thereafter, because bonds would be issued every year. This would be in addition to the $1.1 billion revenue loss already occurring from currently outstanding mortgage subsidy bonds.

A simple 1-year extension of the sunset would result in an annual revenue loss of between $250 million to $300 million. Over the term of those bonds outstanding, we estimate that would be in the $4 to $5 billion range, undiscounted.

It has been argued that mortgage subsidy bonds do not involve future revenue loss because they increase total economic activity. This is a point often made when you talk about revenue estimates on specific targeted types of tax benefits, and we think it is a false argument. It is based on the erroneous assumption that funds used to buy these bonds would otherwise have generated no economic activity.

In actuality, of course, the funds invested in tax exempt mortgage bonds would have been used for other economic investments or for other consumption. Either of those uses would generate roughly the same economic activity and taxable income as generated by their use in the housing sector.

Additional income in the housing sector generated by mortgage revenue bonds, in other words, is offset by higher costs of raising capital and reduced income in other sectors of the economy. That is a very key point. The total cost of mortgage subsidy bonds includes more than just the revenue loss.

The high level of existing housing subsidies has caused what many economists consider to be an excessive amount of investment in owner-occupied housing. Additional subsidies for owner-occupied housing would divert capital resources from other sectors of the economy, resulting in less investment in business plant and equipment, as well as less State and local government infrastructure.

Tax-exempt financing of owner-occupied housing is a recent phenomenon, as I have pointed out. The mortgage subsidy bond program was originated in the late seventies without congressional involvement. We think the approaching sunset should be used as an opportunity to examine the mortgage subsidy bond program in relation to total Federal assistance to owner-occupied housing.

We believe that the Federal support for owner-occupied housing for low- and moderate-income families is sufficient without continuation of this program. The tax reduction for home mortgage interest payments, which we strongly support, insures that a family's largest investment in their home is completely exempt from Federal tax. In addition, the FHA provides mortgage insurance for families who may be unable to obtain mortgages without Federal assistance. Many families, particularly first-time home buyers, are able to purchase a home with a low downpayment with FHA insurance.

There are also loan guarantees and direct loan programs to assist veterans, the elderly and the handicapped, and low-income rural families in obtaining mortgages. Tax-exempt mortgage bonds are simply another subsidy program on top of the existing structure of incentives for owner-occupied housing and result in overlapping benefits.

If the mortgage subsidy bond program were to be continued by Congress, we would point out that consideration should be given to limiting the damage to the tax-exempt market and to future Federal revenue losses by simultaneously placing restrictions on other private purpose tax exempt bonds. Congress enacted several restrictions upon bonds used for private businesses last year in TEFRA. Further restrictions on all private purpose bonds could offset some of the effects of allowing additional mortgage subsidy bonds after 1983.

Some State and local governments may prefer to assist owner-occupied housing in lieu of financing other eligible private purpose activities, and in our view the State and local government is the best place to make that decision. They ought to make the decision which federally subsidized activities they believe best serve their particular needs as long as there is some federally determined overall constraint on private purpose tax-exempt bonds.

One way to do that is State volume caps; another is just straight restrictions on the use of private purpose tax-exempt bonds across the board.

If an extension is considered, Mr. Chairman, we also believe that Congress must carefully evaluate the current beneficiaries of the mortgage subsidy bond program. As I pointed out at the outset, the existing eligibility criteria allow relatively affluent families to receive a large part of this Federal subsidy.

Let me turn very briefly to S. 1061. This is a bill which was introduced by Senator Dole at the request of the administration. It is designed to put a stop to what we think was a particularly egregious abuse that combines the tax exempt borrowing privilege granted to State and local governments and the Federal insurance program for deposits in banks and thrift institutions.

The proposed change in the law would provide that interest on bonds that otherwise would qualify for tax-exempt status will be subject to tax if the issuer's obligation to repay a significant portion of the principal or interest on the bonds is insured by the FDIC, FSLIC, or another Federal depository insurance agency, as a result of the investment of the bond proceeds in federally insured deposits.

The proposal would apply generally to all bonds issued after April 15, 1983. We have a strong reason for proposing this change. Placing the credit of the United States behind an obligation that is exempt from Federal taxation creates a security that is superior in the market to the direct obligations issued by the Federal Government. A federally guaranteed tax-exempt obligation also has a distinct competitive advantage over all other tax-exempt obligations issued by State and local governments.

As a result, Federal guarantees of tax-exempt obligations increase the borrowing cost of the Federal, State, and local governments. Because of these considerations there has been a long-time established Federal policy against Federal guarantee of tax-exempt obligations.

This use of the Federal guarantee through deposit of funds in federally guaranteed obligations is a rather recent thing in any volume. It came to our attention early this year. We proposed the legislation on March 4 and proposed that the effective date would be bonds issued after April 15. Our attempt there was to allow the the bonds that were in the pipeline to clear out so that you do not catch people unaware, but at some date in the future to make it clear this could not go forward.

In retrospect, the April 15 effective date may have been a little generous. We now understand that, while we do not have precise figures on bonds issued between March 4 and April 15, one tax news service reported that on March 29 a single bond rating agency had pending requests to provide ratings on some 4 billion of these obligations involving 400 separate issuers and 600 separate bond issues. This I think indicates clearly why the change is needed and why the April 15 date ought to be retained.

That, Mr. Chairman, summarizes very briefly our position on these two pieces of legislation. I would be happy to answer any questions.

[The prepared statement of Hon. John E. Chapoton follows:]

For Release Upon Delivery
Expected at 9:30 a.m., E.D.T.
May 13, 1983

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present the views of the Treasury Department on S. 137, which would eliminate the December 31, 1983 sunset on the tax exemption provided for interest on certain qualified mortgage bonds, and S. 1061, which would deny tax-exempt status to State and local government obligations that are guaranteed by Federal deposit insurance.

S. 137
Elimination of the 1983 Sunset on Tax Exemption for Qualified Mortgage Bonds

Background

In 1968 Congress, in response to a rapidly growing volume of private purpose tax-exempt bonds, amended section 103 of the Internal Revenue Code to limit the types of private activities that could be financed with tax-exempt bonds. While tax-exempt financing was allowed to continue for "residential real property for family units", it is unlikely that Congress intended in the 1968 legislation to permit the use of tax-exempt bonds for owner-occupied housing. At the time the 1968 legislation was enacted, virtually all tax-exempt housing bonds were for low-income multi-family rental projects.

Nevertheless, a few State housing agencies began to issue small amounts of tax-exempt bonds for owner-occupied housing ("mortgage subsidy bonds") in the early and middle 1970's. These early issues were the catalyst for the explosive increase in mortgage subsidy bonds that occurred in 1978 after a large municipality sold a $100 million issue. This issue demonstrated to other localities that they could sponsor mortgage subsidy bond programs to provide below market mortgages to their residents at little or no cost to themselves. Suddenly, almost overnight, a multi-billion dollar housing subsidy program that was never intended by Congress came into being. The volume of outstanding mortgage subsidy bonds grew from $1 billion in 1977 to $10.5 billion in 1980. The volume of tax-exempt obligations for owner-occupied housing as a percentage of the total tax-exempt financing for all purposes sky-rocketed from less than 3 percent of the total to 20 percent during this same period. This tremendous unintended increase in the level of Federal assistance to owner-occupied housing caused a great deal of concern within the Treasury Department and in Congress, leading to a study of the area that culminated in the Mortgage Subsidy Bond Tax Act of 1980 (the "Act").

The Act, which codified the mortgage subsidy bond program under section 103A of the Code, was an attempt by Congress to target the subsidy from the use of tax-exempt bonds for housing to those individuals with the greatest need for the subsidy, to curtail the burgeoning revenue loss from the use of tax-exempt mortgage subsidy bonds, and to direct more of the benefits of the subsidy to the homebuyer. Except for general obligation bonds issued by States to provide housing for veterans, the Act provided that the mortgage subsidy bond program would expire at the end of 1983.

Prior to the Act there was no restriction on who could benefit from the subsidized low-interest rate mortgage loans provided by mortgage subsidy bonds. In targeting the subsidy to low- and moderate-income homebuyers, the Act required that mortgages financed with bond proceeds meet a series of eligibility requirements. In general, a residence financed with a tax-exempt mortgage subsidy bond must be the principal residence of the mortgagor. The mortgagor may not have had a prior ownership interest in a principal residence at any time during the immediately preceding three years ("first-time homebuyer requirement"). In addition, the acquisition cost of an eligible residence under the Act (prior to its amendment in 1982) could not exceed 90 percent of the average area purchase price for single family residences in the area in which the residence is located.

For residences located in certain "targeted areas," the first-time homebuyer requirement is waived, and, prior to the Act's amendment in 1982, the purchase price limitation for homes in targeted areas was set at 110 pecent of the average area purchase price. A targeted area is defined to include a "qualified census tract" or an "area of chronic economic distress." A qualified census tract is a census tract in which at least 70 percent of the families have an income that is 80 percent or less than the statewide median family income. An area of chronic economic distress is an area designated by a State and approved by the Secretaries of Housing and Urban Development and Treasury in accordance with four criteria relating to the condition of the housing stock, the need for subsidized owner-financing, its potential for improving housing conditions, and the existence of a housing assistance plan.

In addition to the tremendous additional revenue loss that would have occurred if the issuance of mortgage subsidy bonds had continued unchecked, an unlimited volume of mortgage subsidy bonds would have further increased the borrowing costs of State and local governments for traditional public projects. To limit this potential impact of mortgage subsidy bonds, the Act imposed a cap on the aggregate amount that could be issued within any State during a calendar year. The amount of this volume cap is equal to the greater of $200 million or 9 percent of the average of mortgages for owner-occupied residences originated in the State during the preceding three years.

Finally, in order to increase the portion of the benefit of the tax-exempt financing to be enjoyed by homebuyers, the Act contained a series of provisions that limited the amount of arbitrage profit that could be earned by an issuer. Under these provisions, the effective interest rate on mortgages made to homebuyers was limited to one percentage point above the yield on the bonds.

A series of changes to the mortgage subsidy bond program were made by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). These amendments permit up to 10 percent of the bond proceeds (in addition to proceeds used in targeted areas) to be used by existing homeowners and increased the purchase price limitations to 110 percent (and to 120 percent in targeted areas) of the average area purchase price. TEFRA also increased the interest rates that bond issuers could charge to qualifying homebuyers by increasing the limitation on the issuer's arbitrage profit to one and one-eighth percentage points.

S. 137

S. 137 would repeal the provision in present Code section 103A that denies the tax exemption for interest on qualified mortgage bonds (which includes all mortgage subsidy bonds other than certain State general obligation bonds that provide mortgages for veterans) issued after December 31, 1983. Thus, the bill would make permanent the tax exemption presently provided for qualified mortgage bonds.

Reasons for Opposing Tax-Exempt Mortgage Subsidy Bonds

The Treasury supports the December 31, 1983 sunset of the tax-exempt mortgage subsidy bond program and, thus, we strongly oppose S. 137. Continuation of tax-exempt financing for owner-occupied housing damages the traditional municipal bond market, is not cost-effective, and will cause large future revenue losses. Moreover, we believe that mortgage subsidy bonds are unnecessary in view of other Federal assistance for low- and moderate-income homebuyers.

Damage to the Tax-Exempt Market. Mortgage subsidy bonds will increase the total future interest payments on public purpose bonds issued in 1982 by at least $2 billion. Private purpose bonds increase the borrowing cost for traditional public projects, such as schools, roads, and sewers, which will cause State and local governments either to reduce local services or increase taxes.

Additional mortgage subsidy bonds will further erode the advantage of tax-exempt financing enjoyed by State and local governments. That advantage occurs because tax-exempt interest rates are less than comparable interest rates on taxable securities. In March 1983, the tax-exempt yield on AAA rated 20-year general obligation bonds was roughly 80 percent of the taxable yield on 20-year Federal securities. Thus, tax exemption provided an effective 20 percent interest rate subsidy to eligible borrowers. The advantage of tax-exempt financing has fluctuated greatly depending on conditions in the tax-exempt bond market, that is, both the supply and demand for tax-exempt securities. When large institutional investors are buying tax-exempts, the percentage spread between tax-exempt and taxable yields tends to widen, thus increasing the advantage. When the supply of tax-exempt bonds increases, a higher tax-exempt rate is necessary to sell the additional supply so the percentage spread tends to narrow and the advantage decreases.

The advantage has declined sharply in recent years due to a drop-off in demand for tax-exempts and a sharp increase in their supply. Part of the reduced demand is cyclical; institutional investors have temporarily left the market. Lower demand has also occurred because of the reduction in marginal tax rates and the increased availability of savings incentives. A third factor is the enormous increase in supply of tax-exempt bonds, particularly the use of tax-exempt financing for private activities, including mortgage subsidy bonds. Table 1 shows the large growth in the volume of private purpose bonds. Private purpose bonds accounted for 20 percent of the long-term tax-exempt market in 1975 and has risen to 50 percent currently.

Table 1
Volume of Long-Term Tax-Exempt Issues by Type of Issue - 1975 Through 1982
(In billions of dollars)

	Calendar Years							
	1975	1976	1977	1978	1979	1980	1981	1982
Total long-term tax-exempt issues	31.3	35.0	46.8	49.0	48.1	54.9	56.7	85.8
Total Private purpose tax exempts	6.2	8.3	13.1	15.8	24.7	29.0	26.7	41.0
Housing bonds	1.5	2.7	4.5	7.1	12.1	14.0	5.6	14.2
Single family MSB's	0.0	0.7	1.0	3.4	7.8	10.5	3.6	8.6
Multi-family IDB's	0.9	1.4	2.9	2.5	2.7	2.2	1.1	5.1
Veteran's GO bonds	0.6	0.6	0.6	1.2	1.6	1.3	0.9	0.5
Private Hospital	1.4	1.9	3.3	2.2	2.4	2.8	3.5	6.1
Student Loans	0.0	0.1	0.1	0.3	0.6	0.5	1.1	1.8
Pollution Control IDB's	2.0	2.1	3.0	2.8	2.5	2.5	3.9	5.1
Small-issue IDB's	1.3	1.5	2.2	3.4	7.1	9.2	12.6	13.8
Refunding bonds	0.9	3.5	9.6	9.3	1.9	1.6	1.2	3.8
Other long-term tax exempts 1/	24.7	23.2	24.1	23.9	21.5	24.3	28.8	41.0
Percent of Long-term Tax Exempts 2/:								
All Private Purposes	20.4	26.3	35.2	39.8	53.5	54.4	48.1	50.0
Mortgage Subsidy Bonds	0.0	2.2	2.7	8.6	16.9	19.7	6.5	10.5

Office of the Secretary of the Treasury
Office of Tax Analysis

May 11, 1983

1/ Includes State and local government financing for public facilities and some private purpose debt that could not be identified or classified.

2/ Excluding refunding bonds which include both private and public purpose bonds.

Source: Office of Financial Management, HUD for housing bonds; Bond Buyer for total pollution control and hospital bonds and total publicly reported tax-exempt bonds; Congressional Budget Office for small-issue IDB's, except 1982 which is an estimate by the Office of Tax Analysis, Treasury.

Thus, State and local government issuers have been hit by a large increase in borrowing costs, due to the general increase in interest rates caused by high inflation and by the reduction in the traditional advantage of tax-exempt financing over taxable financing. Several empirical studies have attempted to isolate the effect of an increased supply of tax-exempt bonds on tax-exempt interest rates. All of the studies conclude that additional tax-exempt bonds exert upward pressure on tax-exempt rates. The above estimate of the additional total interest payments on public purpose bonds issued in 1982 from all outstanding mortgage subsidy bonds uses a very conservative estimate. If higher estimates are correct, the increase in total interest payments could be several times larger.

Cost-Effectiveness. Tax-exempt bonds are an inherently inefficient means of providing assistance to low- and moderate-income homebuyers. The subsidy to homebuyers is possible because high income individuals and financial institutions, who serve as intermediaries, are willing to accept a lower pre-tax interest rate on mortgage subsidy bonds since tax exemption provides a relatively high after-tax rate of return. The portion of the benefits captured by these intermediaries is very large, due to the large outstanding volume of long-term tax-exempt obligations, including mortgage bonds. Studies show that the benefits captured by these persons are at least one-third of the total cost of the program. A program where at most two-thirds of the benefits reach the intended beneficiaries is not cost-effective.

Tax-exempt financing is also a poor means of providing a subsidy since the amount of subsidy varies greatly depending on conditions in the tax-exempt bond market. For instance, in 1982, the interest rate differential between long-term tax-exempt bonds and taxable bonds fluctuated between 11 and 21 percent. Thus, the rate of subsidy is completely unrelated to the amount of assistance that low- and moderate-income families need to purchase a home. In addition, the relatively low rate of subsidy from mortgage subsidy bonds is unlikely to encourage homeownership for people who would not otherwise be purchasing homes.

Revenue Impact. Long-term tax-exempt bonds also result in large future revenue losses. The revenue loss from additional tax-exempt bonds occurs because investors that buy the bonds expect a higher after-tax rate of return due partly to the tax exemption. To the extent that high income investors forego other tax-favored investments to purchase tax-exempt bonds, the revenue loss is lower. But that is not the whole story. When some high income investors forego other tax-favored investments, those investments are purchased by other taxpayers because of their higher after-tax rate of return, again partly because of the tax advantage. Thus, the revenue loss from additional tax-exempt bonds occurs because many different investors have altered their investment portfolios expecting a higher after-tax rate of return from a greater overall supply of tax-favored investments.

Much of the public discussion of mortgage subsidy bonds unfortunately has concentrated on a misleading statistic -- the annual revenue loss for a single year. While the annual revenue loss is important, it is a poor measure of the total cost of mortgage subsidy bonds because these bonds may remain outstanding for as long as 30 years. The revenue loss from tax-exempt mortgage subsidy bonds cumulates each year as the amount of outstanding bonds increases. The additional revenue loss from an extension would be only $0.3 billion in FY 1985, but $0.9 billion in FY 1987 and $1.8 billion in FY 1989. This would be in addition to the $1.1 billion annual revenue loss already occurring from currently outstanding mortgage subsidy bonds. In other words, while a simple one-year extension of the mortgage subsidy bond program results in an annual revenue loss of roughly $250-$300 million, the total future revenue loss from the bonds that would be issued during this one additional year would be $4 billion.* If the program were extended for three years, the total revenue loss would be $15 billion.

It has been argued that mortgage subsidy bonds do not involve any future revenue loss because they increase total economic activity. This argument is false. It is based on the erroneous assumption that the funds used to buy these bonds would otherwise have generated no economic activity. In actuality, however, the funds invested in tax-exempt mortgage bonds would have been used for other economic investments or for consumption. Either use would generate roughly the same economic activity and taxable income as generated by their use in the housing sector. Thus, the additional income in the housing sector generated by mortgage subsidy bonds is offset by higher costs of raising capital and reduced income in other sectors of the economy.

The total cost of mortgage subsidy bonds includes more than just the revenue loss. The high level of existing housing subsidies have caused what many economists consider to be an excessive amount of investment in owner-occupied housing. Additional subsidies for owner-occupied housing would divert capital resources from other sectors of the economy, resulting in less investment in business plant and equipment as well as less State and local government infrastructure.

Other Federal Assistance for Owner-Occupied Housing. Tax-exempt financing of owner-occupied housing is a recent phenomenon. To our knowledge, little or no tax-exempt mortgage

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The total revenue loss estimate is the sum of the annual revenue losses over the expected life of the bonds undiscounted for the time value of money. This calculation is left undiscounted for purposes of comparison with the undiscounted budget authority of direct expenditure programs that involve future costs.

subsidy bonds were issued before 1975 and mortgage subsidy bonds did not appear in any significant volume until 1978. When the original limits on private purpose tax-exempt bonds were enacted in 1968, tax-exempt housing bonds were utilized almost exclusively for low-income multi-family rental housing. The mortgage subsidy bond program was originated by innovative bond counsel, underwriters, and State and local government agencies in the late 1970s without any Congressional involvement. The approaching sunset should be used as an opportunity to examine the mortgage subsidy bond program in relation to total Federal assistance to owner-occupied housing.

We believe that Federal support for owner-occupied housing for low- and moderate-income families is sufficient without mortgage subsidy bonds. The tax deduction of home mortgage interest payments, which we strongly support, insures that a family's largest investment -- its home -- is completely exempt from tax. The deduction enables individuals to change their withholding and have more take-home pay with which to pay their monthly mortgage payments. In addition, the Federal Housing Administration (FHA) provides mortgage insurance for families who may be unable to obtain a mortgage without Federal insurance. Many families, particularly first-time homebuyers, are able to purchase a home with a low downpayment with FHA insurance. In addition, loan guarantees and direct loan programs are available to assist veterans, the elderly and handicapped, and low-income rural families in obtaining mortgages. Tax-exempt mortgage subsidy bonds therefore merely add another subsidy program to the existing structure of incentives for owner-occupied housing, resulting in overlapping Federal benefits.

Other Considerations

In considering the extent to which Federal assistance to low- and moderate-income homebuyers should be provided, the effect of mortgage subsidy bonds on Federal revenues and the tax-exempt market must be considered. Alternatives to tax-exempt financing for assisting these homebuyers also should be explored.

Tax-exempt mortgage subsidy bonds are one of the largest uses of tax-exempt financing for private purposes. As Table 1 shows, a large share of the growth of private purpose tax-exempt financing is a result of the sudden emergence and explosion of mortgage subsidy bonds. If the mortgage subsidy bond program were to continue, consideration should be given to limiting the damage to the tax-exempt bond market and future revenue losses by placing simultaneous restrictions on other private purpose tax-exempt bonds. Congress enacted several restrictions on tax-exempt bonds used to finance private businesses last year in TEFRA. Further restrictions on all private purpose bonds could offset some of the effects of allowing additional mortgage subsidy bonds after 1983.

We recognize that some State and local governments may prefer to assist owner-occupied housing in lieu of financing other eligible private purpose activities. In our view State and local governments should make the decision as to which Federally-subsidized activity they believe best serves their particular needs, as long as there is some Federally determined overall constraint on private purpose tax-exempt bonds. State volume limits patterned after the mortgage subsidy bond State ceilings are one approach that Congress might consider.

In light of the current robust housing recovery and the need to avoid adding to the Federal deficit, the Administration opposes any additional homeownership subsidies. However, if Congress decides to continue additional assistance to low- and moderate-income homebuyers, subject to budgetary constraints, alternative forms of subsidy could avoid interference with the tax-exempt bond market and improve the cost-effectiveness of the program. The GAO study suggested several alternative approaches to assisting low- and moderate-income homebuyers without some of the attendant adverse effects of tax-exempt financing.

Direct assistance programs to homebuyers or housing authorities could be directed to the same target group and use the same administrative system without damaging the tax-exempt bond market. Direct assistance could bypass the inherent inefficiency of using tax-exempt bonds, thus providing more assistance for the same cost or the same amount of assistance at less cost. An additional advantage would be that Congress could set the rate of subsidy it considered appropriate for encouraging low- and moderate-income families to buy homes, rather than accepting the volatile rate of subsidy determined by conditions in the tax-exempt bond market. Further, a direct subsidy could be phased out as the family's income increased or the subsidy could be rebated when the house was sold, thus, in effect, providing a no-interest loan.

Finally, we believe that Congress must carefully evaluate the current beneficiaries of the mortgage subsidy bond program. The existing eligibility criteria allow relatively affluent families to receive this Federal subsidy. As we noted above, other Federal programs already exist to assist low- and moderate-income families purchase a home.

Evaluation of the Present Mortgage Subsidy Bond Program

The mortgage subsidy bond program has been in effect for several years. We believe it is useful to review specific aspects of the program such as the program eligibility criteria, State volume limitation, targeted areas provision, and the arbitrage limitation, in light of the original goal of the 1980 Act of assisting low- and moderate-income first-time homebuyers.

First-time Homebuyer Requirement. Except in certain targeted areas, the 1980 Act restricted the use of tax-exempt mortgage subsidy bond proceeds to first-time homebuyers. The restriction was based on the notion that Federal assistance should be limited to renters. TEFRA liberalized the rules to allow 10 percent of the bond proceeds to be used for existing homeowners in nontargeted areas. Allowing existing homeowners to participate tends to crowd out first-time homebuyers up to the percentage permitted, since existing homebuyers typically are better risks and better able to provide larger downpayments.

Many first-time homebuyers would have purchased a home without the assistance of mortgage subsidy bonds. The GAO report concludes that "a majority of the households assisted with below-market interest rate loans could have and probably would have purchased homes without assistance." Most of the subsidized loans were to individuals or couples between the ages of 20 and 35 whose incomes were among the top 50 percent of the income distribution in their State. These statistics show that the main effect of mortgage subsidy bonds is to allow families to purchase a home earlier or to increase the size of the home purchased. It is unlikely that mortgage subsidy bonds enable renters who do not otherwise have sufficient resources to finance a home at some point in their lives to make such a major purchase. We do not believe that merely changing the timing and size of home purchases merits the large revenue losses from this program.

Purchase Price Limits. In the 1980 legislation Congress recognized that the mortgage interest subsidy should be targeted to lower-income first-time homebuyers. A limitation on the purchase price of the home was chosen because it was viewed as a better measure of a family's "permanent" or lifetime income than annual income that fluctuates greatly and also because it takes into account regional differences in housing costs. The limitations were originally set at 90 percent of the average area purchase price of homes in non-targeted areas and 110 percent in targeted areas. These limits were generally in excess of the purchase price limits for FHA insurance eligibility, thus allowing those who could not qualify for FHA insurance to receive alternative Federal assistance. The purchase price limits were raised in TEFRA. The GAO report shows that even the original purchase price limits allowed relatively affluent families to participate in this program. Again, with a limit on the amount of bonds issued, the participation of affluent families will tend to displace families more deserving of assistance.

State Volume Limitation. In order to limit the revenue loss and impact on the tax-exempt market, the 1980 Act placed limits on the amount of mortgage subsidy bonds that may be issued each year. The State limitation is equal to the greater of $200 million or 9 percent of the preceding three-year average of gross mortgage originations for owner-occupied homes in the State. In 1982, 37 States that were limited to $200 million could have issued bonds in excess of 9 percent of the mortgage market in their States. In 1982, the volume of mortgage subsidy bonds issued exceeded 40 percent of the total gross mortgage originations in several States.

The State volume limits for 1982 totalled $14.4 billion of which $8.6 billion were issued. Due to the three-year average limit, the allowable State volume limits declined to $13.0 billion in 1983. With the recent sharp upturn in the housing market, more States will exceed the $200 million limitation in the future. We estimate that under the current State volume limitation the total allowable volume of mortgage subsidy bonds will reach $23 billion in 1987 and $30 billion in 1990.

The extent to which States have used mortgage subsidy bonds varies greatly. A handful of States issued no mortgage subsidy bonds in 1982. Many others issued close to their State limits. We would expect that State and local governments or their agencies would eventually issue close to their limits if the program were extended permanently. We project that the volume of tax-exempt mortgage subsidy bonds would exceed $20 billion in 1987 and reach $27 billion in 1990 if the program were extended with the current rules.

Targeted Areas. The 1980 Act allowed a higher purchase price limit and the eligibility of existing homeowners in certain targeted areas. States could designate portions of their State as an "area of chronic economic distress." Targeting has been used extensively by some States and not at all by others. Several States have designated more than one-half of their population as living in an area of chronic economic distress. We question whether such extensive use was intended, since existing homebuyers purchasing homes at 120 percent of the average area sales price will displace first-time homebuyers. The absence of objective criteria for the determination of areas of chronic economic distress has resulted in substantial administrative costs at both the State and Federal level.

Arbitrage Limitation. The 1980 Act limited the interest rate that housing authorities could charge mortgagors to no more than one percentage point above the tax-exempt bond yield. This was intended to insure that as much of the tax benefits, as possible, were passed through to the homebuyer. Ironically, the arbitrage limitation does not address the basic inefficiency of tax-exempt bonds. TEFRA increased the limit in response to claims by issuers that the programs could not be self-sufficient without a higher limit.

A higher arbitrage limit increases the interest rate that the homebuyers must pay. The allowable arbitrage is intended to cover certain costs that would normally be borne by the mortgagor such as the mortgage servicing and origination fees and insurance. The allowable arbitrage also includes costs that would not be included or would be significantly less with a conventional mortgage or with direct government assistance.

These additional costs include the costs of underwriting and issuing the bonds as well as the issuer's operating expenses.

S. 1061
Denial of Tax Exemption for Obligations Guaranteed by Federal Deposit Insurance

The second bill before today's hearing is S. 1061, which was introduced by Senator Dole at the request of the Administration. S. 1061 is designed to put a stop to a particularly egregious abuse that combines the tax-exempt borrowing privilege granted to State and local governments and the Federal insurance program for deposits in banks and thrift institutions.

Background

Under current law, State or local government obligations that are classified as industrial development bonds do not qualify for tax-exempt status unless their proceeds are used for certain purposes specified in Internal Revenue Code section 103(b). If the proceeds of an issue of State or local government obligations are simply placed on deposit with a bank, savings and loan association or other financial institution, the obligations generally will be classified as industrial development bonds and the interest on the obligations generally will not be exempt from Federal income tax. However, such obligations may qualify for tax-exempt status if the proceeds are deposited with a financial institution under a "loan to lenders" program and are then reloaned to customers of the financial institution for projects qualifying for tax-exempt financing. The financial institution can serve as an intermediary under these "loan to lenders" programs because the applicable Treasury regulations provide that the ultimate use of the bond proceeds determines whether the bonds are tax exempt. See Treas. Reg. §1.103-8(a)(4).

Consequently, State and local government agencies that issue tax-exempt bonds can invest the proceeds of tax-exempt bond issues in certificates of deposit issued by Federally insured banks and thrift institutions if the banks and thrift institutions reloan the funds for qualifying purposes. These certificates of deposit then can be pledged as security for the repayment of the tax-exempt bonds. Recently, it has been determined that these tax-exempt bond issues can be structured so that the certificates of deposit will be insured by either the Federal Deposit Insurance Corporation (FDIC) or the Federal Savings & Loan Insurance Corporation (FSLIC) in an amount up to $100,000 per holder of the tax-exempt bonds. The FDIC or FSLIC insurance of the pledged certificates of deposit effectively provides a Federal guarantee of these tax-exempt bond issues.

S. 1061

S. 1061 would add a new provision to the Internal Revenue Code to deny tax-exempt status to State and local government obligations that are backed by Federal deposit insurance. Under this new provision, interest on bonds that otherwise would qualify for tax-exempt status will be subject to tax if the issuer's obligation to repay a significant portion of the principal or interest on the bonds is to be insured by FDIC, FSLIC or another Federal depository insurance agency as a result of the investment of the proceeds of the bond issue in Federally insured deposits. The determination whether a deposit is Federally insured will be based upon the laws governing the applicable Federal agency responsible for insuring the deposits made in a particular type of financial institution. The new provision that would be enacted by S. 1061 is similar to the provision proposed in section 2 of H.R. 1635, a bill introduced in the House of Representatives by Congressman Pickle. However, the provision in S. 1061 would apply to interest on all types of bonds that otherwise may be exempt from taxation under section 103(a) of the Code, not just industrial development bonds.

For purposes of the new provision, the investment of proceeds of a bond issue will not be taken into account to the extent that such proceeds are invested: (1) for a temporary period (as defined in Code section 103(c)(4)(A)); (2) as part of a bona fide debt service fund; or (3) in a reasonably required reserve or replacement fund (as defined in Code section 103(c)(4)(B)). A bona fide debt service fund is an investment fund used primarily to achieve a proper matching of revenues and debt service within a bond year.

The proposal generally would apply to all bonds issued after April 15, 1983. However, the proposal would not apply to bonds issued after April 15, 1983, pursuant to a written commitment that was binding on March 4, 1983, and at all times thereafter. The proposed effective date was announced in the March 4 Treasury news release that described the Administration's proposal.

For purposes of the binding commitment exception to the April 15 effective date, a written commitment is binding only if the commitment obligates the issuer to issue the bonds and obligates the underwriter or other bond purchaser to buy the bonds, subject to the conditions customarily contained in bond purchase agreements. The passage of an inducement resolution by an issuer or a commitment by a financial institution to issue certificates of deposit will not prevent the application of the proposal to bonds issued after April 15, 1983.

Discussion

The Administration has very strong reasons for proposing S. 1061. Placing the credit of the United States behind an obligation that is exempt from Federal taxation creates a security that is superior in the market to the direct obligations issued by the Federal government. A Federally guaranteed tax-exempt obligation also has a distinct competitive advantage over all other tax-exempt obligations issued by State and local governments. As a result, Federal guarantees of tax-exempt obligations increase the borrowing costs of Federal, State and local governments.

Because of these and other considerations, there is an established Federal policy against Federal guarantees of tax-exempt obligations. The Public Debt Act of 1941 prohibits the Federal government from issuing tax-exempt obligations directly; and numerous other statutes preclude Federal guarantees of tax exempts in other contexts. The use of FDIC or FSLIC insurance to guarantee tax-exempt bond issues violates this established Federal policy.

The use of FDIC and FSLIC insurance to provide effective Federal guarantees of tax-exempt obligations is particularly alarming because of two factors. First, unlike other Federal loan guarantee programs, loans are guaranteed under the deposit insurance programs whenever an insured institution accepts a qualifying deposit, without requiring any affirmative step to be taken by a Federal agency to grant the guarantee. Second, the deposit insurance programs are essentially open-ended in that they are not subject to any dollar limitations on the amount of loans that may be guaranteed. Thus, if the combined use of the tax-exempt borrowing privilege and Federal deposit insurance is not prohibited, there will be virtually no limit on the ability to obtain effective Federal guarantees of all kinds of tax-exempt obligations.

Before proposing this legislation, the Treasury Department studied a number of other possible alternatives to deal with the problem addressed by S. 1061. We concluded, however, that this type of tax legislation would be the most effective means to cut off the flood of new FDIC and FSLIC-guaranteed bond issues. Our decision to pursue legislation effective for bonds issued after April 15, 1983 was publicly announced in a Treasury news release on March 4. The April 15 effective date was designed to allow bonds already "in the pipeline" to be issued without hardship. In retrospect, the April 15 effective date may well have been too generous. Although we do not have precise figures concerning the volume of FDIC and FSLIC-backed bonds issued between March 4 and April 15, one tax news service reported on March 29 that a single bond rating agency had pending requests to provide ratings on $4 billion of these obligations, involving about 400 separate issuers and 600 separate bond issues. This sort of report makes it clear both why this legislation is needed and why the April 15 effective date must be maintained.

* * *

This concludes my prepared remarks. I would be happy to respond to your questions.

Senator PACKWOOD. I assume from your testimony, Mr. Secretary, that even if Congress did not extend mortgage revenue bond authority, you would not support as an alternative a tax credit for homebuyers which would cover the same groups of people that revenue bonds now cover?

Mr. CHAPOTON. Well, no; I did not cover that in my oral statement. In our written statement we do point out that that should be considered as an alternative if a housing subsidy is continued. That specific approach or other approaches that would provide a greater degree of efficiency should be considered.

Senator PACKWOOD. You have no position on the other alternatives?

Mr. CHAPOTON. No; alternative subsidies would be inconsistent with the administration's basic position that, even without these benefits, the benefit to owner-occupied housing is ample now.

Senator PACKWOOD. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

First of all, if I might just take a minute. I was not here at the beginning. I want to thank you for holding these hearings.

But I have to be very candid with you, Mr. Secretary. I am extremely disappointed. I am disappointed with the administration because it seems to me that we have a program that is working, a program that is effective. I think this country has a commitment, a commitment to the people that we should have the option of owning a home.

And to me the thing that is impressive about this program is that it has worked and it has worked well. There has been a lot of talk about New Federalism, New Federalism, which meant give much more of the decisionmaking back home to the people at the State and local government. Frankly, if you want to talk about federalism, New Federalism, this is an excellent way to go, because what this program has meant is that States and local governments have been able to develop programs that were tailored to the needs of that particular locality.

And it has helped to bring about, to accomplish the goal of homeownership. I just would point out to you that legislation that I introduced has something like 73 people on it, so I think that the administration must recognize that this legislation is going to succeed. And I would hope that you could look at it and we could reauthorize it with your approval or do away with the sunsetting, and look upon this as one major step forward to accomplish two goals of this administration:

One, to permit people to own their own homes; and two, to take the decisionmaking back home.

So I have no questions right now, Mr. Chairman, but I would ask that my statement be included at the beginning.

Senator PACKWOOD. I will put your statement in the record prior to Secretary Chapoton's testimony.

Senator ROTH. Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

I likewise have a statement which I will not read, but will ask to be inserted in the record.

Senator PACKWOOD. We will put it in the record at the same place.

Senator MITCHELL. Mr. Chapoton, I apologize for not having been present during your testimony because of a prior commitment that I had, though I looked through it. And I would like to ask one question regarding what I understand to be one of the principal objections by the Treasury and set forth in the GAO report.

That is the argument regarding cost effectiveness. In your statement on page 5, you say: "Tax exempt bonds are an inherently inefficient means of providing assistance to low and moderate income home buyers."

The implication of such a criticism is that you favor some more efficient means of doing so, and I would like to ask you, what alternative does the administration propose to deal with this problem that would be more efficient?

Mr. CHAPOTON. We are not proposing, Senator Mitchell, an alternative. Let me emphasize, we are not proposing alternatives because we have concluded that the alternative is not needed. There is, if anything, a boom in the housing market now, as you know. There is a lot of Federal assistance to housing in the present law.

In the tax law, we have basically tax exemptions on all owner-occupied housing through the interest deduction and through no treatment of any imputed income, as some countries do. And we strongly support that. But we do not see a need for an additional subsidy at this time.

Senator MITCHELL. But do you not concede that there are millions and millions of Americans, especially younger, newer families, who are unable to purchase homes now? Are you suggesting that there is no problem in that regard? You do not even need a study for that. Commonsense tells you that.

Mr. CHAPOTON. I think as the market improves, though, that those people who have been left out of the market, which is a problem—that that problem is diminishing. I have to say I think the mortgage subsidy bond does not remedy that problem, and I think the GAO report goes to that in great deal.

There is a serious question whether this program lets those people come into the market. Certainly that is always a concern, those people who are locked out of the American dream.

Senator MITCHELL. You could argue, as you have, that this is not the most efficient means. You could argue that it has not been wholly successful. But surely you are not suggesting that this program has not had some effect in making housing available to the people intended to be benefited.

Mr. CHAPOTON. I am not arguing that. Certainly it has had some effect. The question is the efficiency of it and the need for further benefit in that area. We have to recognize that if you lower the cost of capital in one area, you generate more capital in that area, and the capital comes from other segments of our economy. There is not a free lunch here.

Senator MITCHELL. I just think that—I want to say that I share Senator Roth's view regarding disappointment in the administration's position. It just seems to me so gratuitous to say, well, this is not the most efficient way to do it, and then say that we are not going to propose any other way to do it.

Mr. CHAPOTON. No, Senator. In our testimony we do suggest other ways if the Congress wished to do that. I have to say, it is sort of a catch-22, because obviously we are not supporting those other ways either, but they would be more efficient.

Senator MITCHELL. You see, that is the point I want to make. There is no question. There is not a person in this room or a person in this country who would not concede that there is a serious problem in this country today regarding the availability of housing, the opportunity to purchase homes for American families.

I think that is just one of those things that is beyond dispute. Now, here you come and say, here is a program that is trying to do something about it, maybe it is not perfect. And as Senator Roth so rightly said, it is working, at least, to solve the problem. And you say, well, this is not the best way to do it.

Then you say, of course we do not have any other way, either. It seems to me you are avoiding——

Mr. CHAPOTON. I disagree. We do have other ways, but we are not agreeing with your basic premise that further Federal subsidy is needed. The concern you express is a concern, but it is not something that we think the Federal Government should address.

Senator MITCHELL. Mr. Chapoton, the Federal Government has been in the housing field for many, many, many years.

Mr. CHAPOTON. And is still and will remain in the housing field.

Senator MITCHELL. You are not suggesting that it withdraw totally?

Mr. CHAPOTON. No; I am not suggesting that at all.

Senator MITCHELL. So it is not a philosophical question?

Mr. CHAPOTON. No.

Senator MITCHELL. It is there, you support its continuance there?

Mr. CHAPOTON. Correct. But the question is beyond 1983 whether you extend a further subsidy that did not exist in 1977 and earlier years, and if you do so we suggest respectfully that you ought to look at a more efficient way to do so.

Senator MITCHELL. Even though you oppose those other ways?

Mr. CHAPOTON. The other departments probably will oppose.

Senator MITCHELL. What will happen is that if we have a hearing on some other proposal some other guy will come and sit in your chair and say: "Well, this is a lousy way to do it; I am going to point out to you some other ways you might consider, including mortgage revenue bonds."

Mr. CHAPOTON. No; we will make sure he says: "This may be lousy but it is more efficient than mortgage revenue bonds."

Senator MITCHELL. We will be going around in circles, and meanwhile millions of Americans still will not be able to buy homes.

Mr. CHAPOTON. Senator, we also point out in the testimony several issues that should be given thorough consideration if you decide to extend the sunset. As Senator Roth points out, we have not been unaware of some degree of support for an extension on both this side and the House side.

Then you should consider a way to prevent damage to the tax-exempt market and a way to limit the Federal revenue loss. One approach would be to enact rules that require the States to offset other private purpose bonds with these, so that the State or local government can decide whether it wants mortgage subsidy bonds or they wants bonds for businesses. This would limit the damage to the two things that give us the most concern: The damage to the tax exempt market and the Federal revenue loss.

Senator MITCHELL. Well, without agreeing or disagreeing with that specific suggestion, let me say that I think is the kind of testimony that we welcome, which is recognizing the problem, recognizing that we are trying to do something about it, and suggesting ways to do it in a more effective way.

Thank you, Mr. Chapoton.

Thank you, Mr. Chairman.

Senator PACKWOOD. I think basically what the Secretary is saying, George, is this: In terms of helping the poor, you could probably help a few by scattering $100 bills off the top of the Washington Monument, and some of them may fall into the hands of the poor. Perhaps a more efficient way to do it would be to throw the $100 bills off the tops of buildings in areas where the poor live. But the Secretary would probably oppose that system also, even though it would be more efficient than throwing $100 bills off the Washington Monument.

Mr. CHAPOTON. I would agree with that.

Senator MITCHELL. That has to be one of the better analogies I have heard. [Laughter.]

Senator PACKWOOD. I have no further questions. Do you have any more, George?

Senator MITCHELL. No.

Senator PACKWOOD. Thank you for your statement, Mr. Secretary. We appreciate it.

Mr. CHAPOTON. Thank you, Mr. Chairman.

Senator PACKWOOD. Next we will hear from Mr. Baltas Birkle, the Deputy Director for Operations of the Resources, Community and Economic Development Division of the General Accounting Office.

Mr. Birkle, we will put your entire statement in the record and we would appreciate it if you can stay within the time limits we have allotted.

STATEMENT OF HON. BALTAS BIRKLE, DEPUTY DIRECTOR FOR OPERATIONS, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY WILLIAM GAINER, HOUSING AND COMMUNITY DEVELOPMENT ISSUE AREA PLANNING DIRECTOR, GAO, AND LARRY HIRSCHLER, SENIOR EVALUATOR, LOS ANGELES REGIONAL OFFICE, GAO

Mr. BIRKLE. Mr. Chairman and members of the subcommittee, we appreciate being asked to assist your subcommittee in considering some of the policy and technical issues surrounding the use of mortgage subsidy bonds. With me here at the witness table are Mr. William Gainer, who is our Housing and Community Development Issue Area Planning Director, and Mr. Larry Hirschler, Senior Evaluator from our Los Angeles Regional Office.

As you may know, we are in the final stages of completing a comprehensive study of the costs and benefits of mortgage subsidy bonds. Our remarks today will for the most part parallel those provided to the chairman of the Senate Committee on Finance in a report dated April 18, 1983 (exhibit 1). That report was written to answer the Chairman's questions regarding:

The extent to which low- and moderate-income home buyers have been assisted;

The effectiveness of Federal purchase price ceilings and locally imposed income ceilings in targeting program benefits;

And the economic efficiency of mortgage revenue bonds in general.

To answer these questions, we analyzed the loan activity of 40 State and local bond issuers that borrowed in the tax exempt market between December 1981 and July 1982. Our findings are based on more than 20,000 home loans made with these bond proceeds.

In addition, we compared the costs of the bond program to the costs of other subsidy options which could be used to provide the same or similar benefits to home buyers. We met with housing experts in Government, industry and academia to compile a list of such options and selected three of the more feasible options for comparison—a taxable bond option, mortgage grants, and an annual tax credit to home buyers. For the mortgage revenue bond program and each option, we set assumptions and developed an analytical model which we used to calculate the Federal costs associated with the revenue bond program and the other alternatives.

Our analysis differs in some respect from previous published estimates by Treasury, CBO and others, because we estimated the life cycle costs incurred by the Federal Government for a typical housing unit, rather than the yearly cost for a given amount of bonds sold.

Overall, our analysis indicated——

Senator PACKWOOD. Mr. Birkle, let me ask you this. I read your statement last night. I would appreciate it if you would simply summarize it for us.

Mr. BIRKLE. I am going to be leaving out segments as I go along.

Senator PACKWOOD. Thank you.

Mr. BIRKLE. Overall, our analysis indicated that mortgage revenue bonds are very costly when compared to the benefits they provide to assisted home buyers and to the costs of other alternatives which could provide the same level of assistance.

We also found that the public purpose objectives of subsidizing low- and moderate-income households who need assistance to purchase homes is not generally achieved. The major reason for this is that home purchase price limits have been ineffective in targeting benefits.

Estimating the cost of mortgage revenue bonds: namely, the Federal tax loss due to the issuance of tax exempt bonds, is a very controversial subject. The Treasury Department, the Congressional Budget Office, the Joint Committee on Taxation, GAO, and independent experts have all produced a range of estimates over the years.

State and local bond issuers, on the other hand, have often expressed concern that many of these estimates so simplify reality that they cannot be reliably used as a basis for making judgments about the relative worth of tax-exempt financing. With this in mind, we constructed cost estimates using a variety of assumptions.

In all our calculations, the costs of mortgage revenue bonds were estimated to be substantially greater than the benefit to the home buyers, and the major reason for this is that tax exempt housing bonds provide a large tax savings to the bond purchasers.

Based on taxable and tax exempt interest rates existing in 1982, and using what we feel are reasonable assumptions, we calculated that the long-term revenue loss to Treasury resulting from the use of tax exempt bonds could be roughly four times the benefit provided to home buyers in the form of reduced monthly mortgage payments.

Using a direct grant to lenders, Federal costs could be substantially reduced to a level roughly equal to the cash value of the mortgage interest savings to home buyers, and a carefully structured tax credit for home buyers could also have about the same effect.

We have a chart which shows some of our calculations (exhibit 2). It shows that the present value of the lost tax revenue related to bond loans made in 1982 will average at least $13,300 per loan based on an average mortgage amount of $43,000. The cash value of the subsidy to home buyers is about $50 a month.

By contrast, this benefit could be provided as a $3,400 one-time grant to buy down the conventional mortgage interest rates or through yearly tax credits with a present value cost of about $3,500. Thus, the $10 billion raised with revenue bonds for home loans in 1981 and 1982 could result in a tax revenue loss of $2.66 billion in present value.

It should be noted that although borrowers could be said in general to receive benefits proportional to the interest rate reduction, during 1982, as rates began to fall, buyers who chose to wait as little as 6 months to purchase their homes could have gotten lower interest rates than those provided through the mortgage revenue bond subsidy.

We found that most of the subsidized home loans were not made to low- and moderate-income households in need of assistance, but rather to households who probably could have purchased homes without assistance. We found that for the most part these home buyers' incomes and the prices for the homes they purchased were similar to the prices that individuals were paying for FHA unsubsidized mortgage insurance program homes—exhibit 1, pages 8 and 9.

The majority of the mortgage revenue bond home buyers in 1982 were two-person households between 25 and 30 years of age (exhibits 5 and 6) with incomes between $20,000 and $40,000 (exhibit 4). We have a chart that shows the income ranges and the percent of home buyers and the distribution of these people for the mortgage revenue bond spectrum (exhibit 3).

Fifty-three percent of these subsidized buyers were among the more affluent half of the families in their States, and only about 25 percent of the revenue bond funds went to low- and moderate-income households (exhibit 1, pages 18 and 19).

Senator PACKWOOD. As I look at your chart, you show about 45 percent of the revenue bond funds going to people who make $20,000 to $30,000 a year. Is that your definition of affluent?

Mr. BIRKLE. That would still be above 80 percent of median income. I do not know—you would not want to call it affluent, but the programs are aimed at trying to reach low- and moderate-income people and that is one of the measures that Congress and others have used, have set out, that people—the main people who want to be targeted are those that are 80 percent of median income for the area.

So the purpose of the chart is to show that more than half the people who are being reached are well above that 80 percent of median income.

Senator PACKWOOD. Are you also saying that those people making above $20,000, especially $20,000 to $30,000, would have no difficulty buying a home, even if this program did not exist?

Mr. GAINER. Senator, to be able to respond to that question we did some additional research since we put our report out to Chairman Dole. That research consisted of this. We took all the loans made in eight States and we calculated for each $1,000 income bracket, like from $10,000 to $11,000 or $21,000 to $22,000, what the average purchase price of the homes were that these people bought and the average mortgage amount.

When we looked at those and compared that to what type of house they could afford in 1982 without a subsidy, we found that people up to about $25,000 did buy homes more expensive than they could have bought without the program, but the increase in the affordability that the mortgage revenue bond provided seemed to be about $20 per month up to $25,000. Between $25,000 and $28,000 we found that they bought roughly the kind of home they could have afforded without a mortgage revenue bond loan at 15.5 percent interest rates. Above $28,000 people bought homes that were less expensive than they could have purchased without any subsidy.

Senator PACKWOOD. We must run in different circles. I seem to run across many people who are working and making $21,000 or $22,000 or $23,000, and they tell me they simply cannot afford to buy a house.

Maybe they are looking at houses that they should not be living in. Maybe they want to buy a $200,000 or a $150,000 house and they cannot afford to buy it on a $22,000 a year income. I do not know. But they are renting at the moment, because they believe they cannot afford to buy a home.

Your statistics may be valid. They just run contra to my everyday experience.

Mr. GAINER. From another point of view there are graduated payment mortgages available in the market, Senator. Those mortgages would allow people to buy much more expensive homes than they were able to buy with mortgage revenue bonds in 1982 and there would have been no subsidy provided by the Federal Government (see exhibit 14).

The only place I think where there clearly is assistance being provided to those mortgage revenue bond home buyers is for incomes below $25,000--and we believe really that the assistance really only has a substantial effect for those below $20,000.

Mr. BIRKLE. Moving on to the income and purchase price ceilings, effective income and purchase price ceilings could very likely have enhanced the targeting of program benefits under the mortgage revenue bonds. However, in the absence of Federal income guidelines, State and local jurisdictions have generally set their own income ceilings. Some have opted for higher ceilings than others.

Most jurisdictions, however, have set ceilings allowing the participation of relatively affluent households (exhibit 11). For example, in 1982 nearly all jurisdictions with bond programs allowed four-person households with incomes of $30,000 to $40,000 range to participate in some or all subareas within their jurisdiction (exhibit 10).

At the extremes, two State and two local bond-issuing jurisdictions set no income limitations for assisted households, and a few did set income requirements below $20,000 for a portion of the bond funds.

One contention that is made by mortgage revenue bond proponents with regard to income levels of buyers is that the income level of buyers in 1982 were—that the income ceilings for loans were raised out of necessity in 1981 and 1982 because of the unusually high mortage interest rates. According to the Council of State Housing Agencies, interest rates in the bond market during 1981 and 1982 meant that mortgage revenue programs had a difficult time reaching their traditional low- and moderate-income constituencies. Thus they concluded that many housing agencies were forced to extend their programs to higher income families than they were typically accustomed to serving.

Now, to examine this we analyzed information on income ceilings for three different periods: pre-1980, 1981 to 1982 (exhibit 12), and thus far in 1983 (exhibit 15). This information led us to two conclusions:

Although income targeting varied substantially from issuer to issuer, state and local income limits for mortgage revenue bond loans have not been set during any of these periods so as to limit participation to low- and moderate-income households in need of assistance.

Also, income limits set thus far by a dozen bond issuers in 1983 have not on the average declined measurably from 1982, even though the market rate interest for mortgages declined 4 or 5 percentage points. Such a decline in interest rates would allow at least a $6,000 reduction in income limit and still allow some increase in the price of homes being purchased (exhibit 15).

Federally imposed purchase price ceilings also did not effectively limit the participation of the more affluent first time home buyers, because the ceilings were set near the average purchase price of all homes sold in each locality, not those bought by first-time home buyers (exhibit 13).

Another argument used by proponents in support of mortgage revenue bonds is that they increase housing production in general and did so in particular in 1982, and that this in turn resulted in job creation and overall increase in incomes and Federal tax revenues. We performed a study last August which was entitled "Analysis of Options to Aid the Home Building and Forest Products Industries," and we concluded in that study, after analyzing a variety of stimulus proposals, including mortgage revenue bonds, that:

Certain direct subsidies, such as tax credits or mortgage grants, would increase employment and Federal revenues in the short run, but that the costs of such subsidies were greater than the revenue increases.

Regarding the mortgage revenue bonds, however, the study showed that they would have little impact on either housing starts or employment in the short run, because: one, the subsidies were too small to induce additional households to buy in the very high interest rate environment; the bond mechanism was too slow to react quickly when the economy was at its low point; the costs would clearly outweigh the very limited stimulative effect; and four, tying bonds to new construction could result in much of the subsidy being realized by individual builders.

In conclusion, providing subsidies directly to households using a grant or carefully structured tax credit would be less costly than providing mortgage revenue bond financing. Federal purchase price limits and State and local income limits have not effectively targeted loans to those in need of assistance.

Taken together, these conclusions imply that a more direct subsidy mechanism which effectively targeted benefits to households who could not otherwise afford to purchase homes would be much less costly and more effective than the mortgage revenue bond program.

This completes the prepared statement and Mr. Gainer and Mr. Hirchler and I will be glad to answer your questions. Before that, though, I would like to say, in regard to the questions that were posed to the witness from Treasury, we do not want to convey the impression in any way that GAO is not advocating or supporting the idea that there are a lot of people out there that need help in buying homes and that there are programs on the books that can help them.

The purpose of our study and this report was to show, merely to show, that the costs of the mortgage revenue bond program—is not cost effective as compared with other programs. It is not to advocate that we do not think people should be helped.

[The prepared statement of Hon. Baltas Birkle follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M. EDST
FRIDAY, MAY 13, 1983

STATEMENT OF
BALTAS E. BIRKLE, DEPUTY DIRECTOR FOR OPERATIONS
RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

THE COSTS AND BENEFITS OF
SINGLE-FAMILY MORTGAGE
REVENUE BONDS

Mr. Chairman and Members of the Subcommittee:

We appreciate being asked to assist your Subcommittee in considering some of the policy and technical issues surrounding the use of mortgage revenue bonds. As you may know, we are in the final stages of completing a comprehensive study of the costs and benefits of Mortgage Revenue Bonds. Our remarks today, will for the most part parallel those we provided to the Chairman of the Senate Committee on Finance in a report dated April 18, 1983.That report was written to answer the Chairman's questions regarding:

- --the extent to which low and moderate income homebuyers have been assisted,
- --the effectiveness of Federal purchase price ceilings and locally imposed income ceilings in targeting program benefits, and

--the economic efficiency of mortgage revenue bonds in general.

To answer these questions we analyzed the loan activity of 40 State and local bond issuers that borrowed in the tax-exempt market between December 1981 and July 1982. Our findings are based on more than 20,000 home loans made with these bond proceeds.

In addition, we compared the costs of the bond program to the costs of other subsidy options which could be used to provide the same or similar benefits to homebuyers. We met with housing experts in goverment, industry, and academia to compile a list of such options and selected three of the more feasible options for comparison--a taxable bond option, mortgage grants, and an annual tax credit to homebuyers. For the mortgage revenue bond program and each option, we set assumptions and developed an analytical model which we used to calculate the Federal costs associated with the revenue bond program and the other alternatives. Our analysis differs in some respect from previous published estimates by Treasury, CBO and others because we estimated the lifecycle costs incurred by the Federal government for a typical housing unit rather than the yearly costs for a given amount of bonds sold.

Overall, our analysis indicates that mortgage revenue bonds are very costly when compared to the benefits they provide to assisted homebuyers and to the costs of other alternatives which could provide the same level of assistance. We also found that the public purpose objective of subsidizing low- and moderate-income households who need assistance to purchase homes, is not generally achieved. A major reason for this is that purchase price and income limits have been ineffective in targeting benefits.

In our statement today we take no position on whether or not subsidies should be made available to facilitate low- and moderate income homeownership. Rather, we note that if Congress wishes to continue to provide such subsidies, there are more economical ways to do so than with mortgage revenue bonds. Given the fiscal difficulties the country is now facing, we also believe it would make sense to limit such subsidies to first-time homebuyers who clearly could not otherwise buy homes.

BACKGROUND

In the late 1970's, as other forms of mortgage finance were adjusting to changes in the regulatory environment for lenders, the revenue bond method of finance was developing. Under this approach, State or local agencies issue tax-exempt bonds whose proceeds are used to provide below market interest rate mortgages to first time homebuyers. The popularity of mortgage revenue bonds spread rapidly but at the same time their perceived costs to the Federal Government and their possible inequities aroused substantial congressional opposition. Their rapid growth rate was expected to continue because State and local finance agencies could issue these politically popular revenue bonds at little cost to themselves--the major costs are borne by the Federal Government in the form of lost tax revenue. These factors caused the Congress to began considering legislation in 1979 which would limit the volume of bonds issued and attempt to confine their use to low- and moderate-income households. Those deliberations resulted in the Mortgage Subsidy Bond Tax Act of 1980 which placed a variety of restrictions on the use of mortgage bonds. As you know that act also eliminated their use as tax-exempt investments after December 31, 1983.

Implicit in the debate and the events leading up to the 1980 act was the Congress' intent that mortgage revenue bonds benefit those low- and moderate-income households who would have difficulty buying homes at conventional mortgage rates. This is also evidenced by the fact that homebuyer income ceilings were proposed, but later dropped under the assumption that purchase price ceilings and a first-time buyer requirement in combination with income limits imposed by most states and local jurisdictions would effectively target the bond proceeds to those needing assistance.

COST EFFECTIVENESS

With regard to the overall economic efficiency of mortgage revenue bonds, we found them to be rather costly to the Federal Government when compared to the benefits provided buyers and to the possible costs of alternative subsidy mechanisms which could be employed. Estimating these costs--namely Federal tax losses due to the issuance of tax-exempt bonds--is a controversial subject. The Treasury Department, the Congressional Budget Office, the Joint Committee on Taxation, GAO, and independent experts have produced a range of estimates over the years. State and local bond issuers, on the other hand have often expressed concern that many of these estimates so simplify reality that they cannot be reliably used as a basis for making judgments about the relative worth of tax-exempt financing. With this in mind, we constructed cost estimates using a wide variety of assumptions. In all our calculations, the costs of mortgage revenue bonds were estimated to be substantially greater than the benefits to homebuyers. The major reason for this is that tax-exempt housing bonds provide large tax savings to bond purchasers.

Based on taxable and tax-exempt interest rates existing during 1982, and using what we feel are reasonable assumptions, we calculated that the long term revenue loss to the Treasury resulting from the use of tax-exempt bonds could be roughly four times the benefit provided to homebuyers in the form of reduced monthly mortgage payments. Using a direct grant to lenders, Federal costs would be substantially reduced to a level roughly equal to the cash value of the mortgage interest savings to homebuyers. A carefully structured tax-credit for homebuyers could also have about the same effect.

We calculate, for example, that the present value of lost tax revenues related to revenue bond loans made in 1982 will average at least $13,300 per loan based on an average mortgage amount of $43,000. The cash value of the subsidy to homebuyers is about $50 per month. By contrast, this benefit could be provided as a $3,400 one-time grant to buy down the conventional mortgage interest rate, or through yearly tax credits with a present value cost of about $3,500. Thus, the approximately $10 billion raised with revenue bonds for home loans in 1981 and 1982 could result in a tax revenue loss of $2.66 billion in present value. It should be noted that although borrowers could be said to, in general, receive benefits proportional to the interest rate reduction, that during 1982 as rates began to fall, buyers who chose to wait to purchase as little as six months could have gotten lower interest rates than those provided through the mortgage revenue bond subsidy.

A direct subsidy program providing the same number of loans could have been funded for about $680 million-- a savings of approximately $2 billion. Even greater savings could have been achieved if these loans had only been granted to those households that needed assistance to purchase homes. Direct subsidies such as grants or tax credits could reduce overall government costs without reducing benefits to buyers and could enhance the targeting of subsidies. They could also have the added advantage of providing greater flexibility to states and localities to tailor programs to their unique needs. Jurisdictions experiencing severe housing shortgages could limit subsidies to new construction while providing deeper subsidies to fewer households in order to reach lower income households. Jurisdictions with large stocks of older housing available at reasonable prices could provide smaller subsidies to many more buyers. Overall, the level of subsidy could be varied based upon need rather than being the same for all borrowers, which is typical of mortgage revenue bonds unless large local or state contributions are made to further reduce interest rates for needier buyers.

BENEFICIARIES

We found that most subsidized home loans were not made to low- and moderate-income households in need of assistance, but rather to households who probably could have purchased homes without assistance. We also found that for the most part these homebuyers' incomes and the prices of homes they purchased were similar to those of buyers under the Federal Housing Administration's unsubsidized mortgage insurance program.

The majority of mortgage revenue bond homebuyers in 1982 were one or two person households between 20 and 35 years of age with incomes between $20,000 and $40,000. Fifty three percent of these subsidized borrowers were among the more affluent half of the families in their States while only about 25 percent of revenue bond loan funds went to low- or moderate-income households (defined as those with less than 80 percent of median income). Measured a little differently about three-quarters of the buyers we studied had incomes above $20,000 and could very likely have purchased homes anyway. This means that with proper benefit targeting, perhaps as much as three quarters of the loans (and their associated costs) could have been eliminated without really degrading the impact of the program on increasing low- and moderate-income homeownership. This is not inconsistent with our findings in a 1978 report on the 1974/75 Federal Emergency Housing Program, which used a subsidy provided directly to lenders to reduce the interest rate on loans. That study found that sixty-two percent of the recipients would have purchased a home at the same time even if the lower rate loan had not been available. That program used mortgage limits rather than income targeting.

INCOME AND PURCHASE PRICE CEILINGS

Effective income and purchase price ceilings could very likely have enhanced the targeting of program benefits under mortgage revenue bonds. But, the shallow interest subsidy provided by bonds and the desire of issuers' to limit risk to bond holders, and quickly place bond proceeds, would still have limited the ability of mortgage revenue bonds to reach those households who could not otherwise have purchased homes without assistance.

In the absence of Federal income guidelines, State and local jurisdictions have generally set their own income ceilings. Some have opted for higher ceilings than others. Most jurisdictions, however, set ceilings allowing the participation of relatively affluent households. For example, in 1982, nearly all jurisdictions with bond programs allowed four person households with incomes in the $30,000-$40,000 range to participate in some or all sub-areas within their jurisdiction. At the extremes, two States and two local bond-issuing jurisdictions set no income limitations for assisted households, while a few set income requirements below $20,000 for a portion of the bond funds.

One contention made by mortgage revenue bond proponents with regard to income levels of buyers in 1982 is that the income ceilings for loans were raised out of necessity in 1981 and 1982 because of the unusually high mortgage interest rates. According to the Council of State Housing Agencies, interest rates in the bond market during 1981 and 1982 meant that mortgage revenue bonds programs had a difficult time reaching their traditional low-and moderate-income constituencies. Thus they conclude that many housing agencies were forced to extend their programs to higher income families than they were typically accustomed to serving.

To examine this, we analyzed information on income ceilings during three periods--pre-1980, 1981-1982, and thus far in 1983. This information leads us to two conclusions:

--Although income targeting varies substantially from issuer to issuer, State and local income limits for mortgage revenue bond loans have not been set during any of these periods so as to limit participation to low-and moderate-income households in need of assistance.

--Income limits set thus far by a dozen bond issuers in 1983 have not, on average, declined measurably from 1982 even though the market interest for mortgages has declined 4 to 5 percentage points which could allow an average decrease in income limits of at least $6000 and still allow some increases in the price of homes purchsed.

PURCHASE PRICE CEILINGS

Federally imposed purchase price ceilings also did not effectively limit the participation of the more affluent first time homebuyers because the ceilings were set near the average purchase price of all homes sold in each locality--not those bought by first-time buyers only. If we average the more than 100 local price ceilings for new and existing homes established for 1982 and assume a 13.75 percent interest rate for subsidized loans in 1982, we can calculate an average minimum income required to buy these highest priced homes. For new and existing homes, buyers would have needed annual incomes of at least $30,000 and $25,000, respectively. Late in 1982, the basis for establishing ceilings was changed by the Congress to allow substantially higher priced homes to qualify for mortgage bond financing. This will put further upward pressure on purchaser incomes and may also help explain why income limits are not in general being lowered.

COUNTERCYCLICAL STIMULUS TO THE ECONOMY

Another argument used by proponents in support of mortgage revenue bonds is that they increse housing production in general and did so in particular during 1982. This in turn results in job creation and overall increases in incomes and Federal tax revenues. In performing a study which was published last August entitled "Analysis of Options to Aid the Homebuilding and Forest Products Industries", we concluded after analyzing a variety of stimulus proposals including mortgage revenue bonds, that;

--certain direct subsidies such as tax credit or mortgage grants would increase employment and Federal revenues in the short run, but that the costs were greater than the revenue increases;

--greater use of mortgage revenue bonds, however, would have little impact on either housing starts or employment in the short run because, (1) the subsidies were too small to induce additional households to buy in a very high interest rate environment, (2) the bond mechanism was too slow to act quickly when the economy was at its low point, (3) the costs would clearly outweigh the very limited stimulative effect and, (4) tying bonds to new construction could result in much of the subsidy being realized by individual builders.

In conclusion, providing subsidies directly to households using a grant or carefully structured tax credit would be less costly than providing mortgage revenue bond financing. Federal purchase price limits and State and local income limits have not effectively targeted loans to those in need of assistance. Taken together, these conclusions imply that a more direct subsidy mechanism which effectively targeted benefits to households who could not otherwise afford to purchase homes would be much less costly and more effective than the mortgage revenue bond programs now being used by States and localities.

This completes my prepared statement. My colleagues and I will be happy to respond to any questions.

EXHIBIT 1

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman Committee On Finance United States Senate

The Costs And Benefits Of Single-Family Mortgage Revenue Bonds: Preliminary Report

GAO is in the final stages of completing a comprehensive study on the costs and benefits of mortgage revenue bonds. These tax-exempt bonds which are issued by State and local agencies provide subsidized loans to first-time homebuyers. The authority to issue mortgage revenue bonds to finance the purchase of single-family homes will expire on December 31, 1983, unless the Congress extends that authority.

This preliminary report, requested by the Chairman of the Senate Committee on Finance, provides early information on GAO's findings. The Chairman asked GAO to answer questions regarding:

--the extent to which low-and moderate-income homebuyers are assisted,

--the effectiveness of Federal purchase price ceilings and State and locally imposed income limits in targeting program benefits, and

--the efficiency of mortgage revenue bonds in general.

UNITED STATES GENERAL ACCOUNTING OFFICE

GAO/RCED-83-145
APRIL 18, 1983

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

B-211508

The Honorable Robert J. Dole
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

In response to your March 24, 1983, request, we are providing you with preliminary information from our study of tax-exempt mortgage revenue bonds.. Specifically, you asked for information which we gathered regarding (1) the extent to which lower income homebuyers are benefiting from the mortgage revenue bonds, (2) the effectiveness of Federal purchase price ceilings and State and local income limits in targeting loans to the intended households, and (3) the efficiency of mortgage revenue bonds in general. As requested, we coordinated our study with the Congressional Budget Office. We plan to issue a comprehensive final report to the Congress later this spring which will include additional information, but we do not anticipate any changes in our basic conclusions regarding the questions you raised.

In summary, our preliminary analysis indicates that mortgage revenue bonds are costly when compared to the benefits they provide to assisted homebuyers and the costs of other alternatives for providing the same assistance. We also found that the public purpose objective of subsidizing low- and moderate-income households who need assistance to purchase homes is not generally achieved. This is largely because purchase price and income limits have been ineffective in targeting benefits.

This report and its appendixes answer your questions in detail and explain our study objective, scope, and methodology. In brief, we analyzed the loan activity of 40 State and local bond issuers that borrowed in the tax-exempt market between December 1981 and July 1982. Our findings are based on more than 20,000 home loans made with these bond proceeds. Further information on our methodology is shown in appendix I.

BACKGROUND

In the late 1970's, as other forms of mortgage finance were adjusting to changes in the regulatory environment for lenders, the revenue bond method of finance was developing. Under this approach, State or local agencies issue tax-exempt bonds whose proceeds are used to provide below market interest rate mortgages to first time homebuyers. The popularity of mortgage revenue bonds spread rapidly but at the same time their perceived costs to the Federal Government and possible inequities aroused substantial congressional opposition. The rapid growth rate of housing bonds was expected to continue because State and local finance agencies could issue these politically popular revenue bonds at little cost to themselves--the major costs are borne by the Federal Government in the form of lost tax revenue. Thus, the Congress began considering legislation in 1979 which would limit the volume of bonds issued and confine their use to low- and moderate-income households. These deliberations resulted in the Mortgage Subsidy Bond Tax Act of 1980 which placed restrictions on their use. The act also eliminates their use as tax-exempts after December 31, 1983, unless reauthorized by Congress prior to that date.

Implicit in the debate and the events leading up to the 1980 act was the Congress' intent that mortgage revenue bonds benefit those low- and moderate-income households that have difficulty buying homes at conventional mortgage rates. Homebuyer income ceilings were proposed, but later dropped under the assumption that purchase price ceilings and a first-time buyer requirement combined with income limits imposed by most jurisdictions would effectively target the bond proceeds.

COST EFFECTIVENESS

With regard to the overall economic efficiency of mortgage revenue bonds, we found them to be costly to the Federal Government when compared to the benefits provided buyers and to the costs of alternative subsidy mechanisms which could be employed (see appendix II). Estimating the tax-related costs of tax-exempt bonds is a controversial subject. The Treasury Department, the Congressional Budget Office, GAO, and independent experts have produced a range of estimates over the years. State and local bond issuers often express concern that many of these estimates so simplify reality that they cannot be reliably used as a basis for making judgments about the relative worth of tax-exempt financing. With this in mind, we constructed our cost estimates using a variety of assumptions. In all our calculations, the costs of mortgage revenue bonds are estimated to be greater than the benefits to homebuyers. A major reason for this is that tax-exempt housing bonds also provide large tax savings to bond purchasers. In our final report, we expect to refine our cost calculations and show the potential costs over a range of assumptions.

Based on taxable and tax-exempt interest rates existing during 1982, and using what we feel are reasonable assumptions, our calculations indicate that the long term revenue loss to the Treasury could be roughly four times the benefit provided to homebuyers in the form of reduced monthly mortgage payments. Using a direct grant to lenders, Federal costs would be substantially reduced while still providing equivalent mortgage interest savings to homebuyers. A carefully structured tax-credit for homebuyers could also have the same effect.

We calculate, for example, that the present value of lost tax revenues related to revenue bond loans made in 1982 will average at least $13,300 per loan based on an average mortgage amount of $43,000. The cash value of the subsidy to homebuyers is about $50 per month. By contrast, this benefit could be provided as a $3,400 one-time grant to buy down the conventional mortgage interest rate, or through yearly tax credits with a present value cost of about $3,500. Thus, the approximately $10 billion raised with revenue bonds for home loans in 1981 and 1982 could result in a tax revenue loss of $2.66 billion in present value. A direct subsidy program providing the same number of loans could have been funded for about $680 million--a savings of about $2 billion. Even greater savings could have been achieved if these loans were limited to only those households that needed assistance to purchase homes.

Mortgage revenue bond proponents argue that the positive economic effects of additional home purchases outweigh the cost. They contend that subsidies create additional homebuyers and stimulate homebuilding and related industries, and thus increase tax revenues and bond cost-effectiveness. But past research has estimated that a high percentage of tax-exempt subsidized homebuyers would have bought without subsidy and our research supports this finding.

BENEFICIARIES

We found that most subsidized home loans were not made to low- and moderate-income households in need of assistance, but rather to those who probably could have purchased homes without assistance. We also found that for the most part these homebuyers' incomes and the prices of homes they purchased were similar to those of buyers under the Federal Housing Administration's unsubsidized mortgage insurance program.

The typical mortgage revenue bond homebuyer in 1982 was an individual or two persons between 20 and 35 years of age with an income between $20,000 and $40,000. We also found that 53 percent of the subsidized borrowers were among the more affluent half of the families in their States. About 25 percent of revenue bond loan funds did go to low- or moderate-income households (those with less than 80 percent of median income). But three-quarters of the buyers had incomes above $20,000 and could likely have purchased homes anyway. Using a less stringent standard (115 percent of median income considered by the Congress in 1980), 36 percent of the borrowers were households with incomes above the cut off (see appendix III).

INCOME AND PURCHASE PRICE CEILINGS

The effectiveness of income and purchase price ceilings may be the key to targeting assistance to the intended beneficiaries.

In the absence of Federal income guidelines, State and local jurisdictions usually set their own income ceilings. Some opted for higher ceilings than others. Most jurisdictions set ceilings allowing the participation of relatively affluent households. For example, nearly all would allow four person households with incomes in the $30,000-$40,000 range to participate in some or all local areas within their jurisdiction. At the extremes, two States and two local bond-issuing jurisdictions set no income requirements for assisted households, while a few set income requirements below $20,000 for a portion of the bond funds.

Federally imposed purchase price ceilings also did not effectively limit the participation of the more affluent first time homebuyers because the ceilings were set near the average purchase price of homes in each locality. Taking the average of the more than 100 local price ceilings established for 1982 and assuming subsidized borrowing rates similar to those available in 1982, we calculated average minimum incomes required to buy these highest priced homes. Buyers would have needed annual incomes of at least $30,000 and $25,000, respectively, to purchase new and existing homes at these ceilings. The basis for establishing ceilings was changed by the Congress in 1982 to allow substantially higher priced homes to qualify for financing (see appendix IV).

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Providing subsidies directly to households using a grant or carefully structured tax credit would be less costly than mortgage revenue bond financing. Federal purchase price limits and State and local income limits have not effectively targeted loans to those in need of assistance. Taken together, these conclusions imply that a more direct subsidy mechanism which effectively targeted benefits to households who could not otherwise afford to purchase homes would be much less costly and more effective than the mortgage revenue bond programs now being used by States and localities.

We did not obtain official agency comments on this preliminary report. However, we discussed our results informally with HUD and Treasury officials as well as several recognized private sector authorities and made changes where appropriate. Our final report will include additional information on bond program beneficiaries and a more comprehensive cost analysis, including sensitivity analysis. The final report will also include an analysis of any policy options and recommendations which we believe are appropriate. The Secretaries of Housing and Urban Development and Treasury will be given an opportunity to comment on our final report.

As arranged with your staff, unless you publicly announce its contents earlier, we plan no further distribution of this interim report until 30 days from its issue date. At that time, we will send copies to the Secretary of Housing and Urban Development; the Secretary of the Treasury; and the Director, Office of Management and Budget. We will also make copies available to other interested parties at that time.

Sincerely yours,

J. Dexter Peach
Director

OBJECTIVE, SCOPE AND METHODOLOGY

Our objective in this study was to respond to the Senate Finance Committee's request to identify the beneficiaries of mortgage revenue bonds (MRB), determine the effectiveness of program targeting controls, and analyze the general efficiency of MRBs as a mechanism to subsidize homeownership. Our study was performed in accordance with generally accepted government auditing standards.

WORK PERFORMED ON MRB BENEFICIARIES AND PROGRAM TARGETING MECHANISMS

To respond to the Committee's questions, we used information on MRB loan activity we had already obtained from 40 State and local jurisdictions. We had previously requested this information from all 52 jurisdictions that issued single-family bonds under the permanent rules of the Mortgage Subsidy Bond Tax Act of 1980 through mid-July 1982 for States and April 15, 1982 for localities. Of the 52 jurisdictions, we were able to analyze the data from only 40 jurisdictions because 6 did not provide any information, 3 had no loan activity, and 3 provided homebuyers' income in a form which we could not adapt to our summary. From the 40 jurisdictions, we were able to collect information on all MRB activity during the time period examined (20,471 loans in 27 States and 13 localities). The total amount of bonds sold by the 40 jurisdictions was $2.9 billion.

For completed (closed) loans, we obtained information on loan activity in target and nontarget areas; for new and existing houses; incomes of borrowers in $1,000 intervals; and the range, mean, and median for home purchase prices. We also obtained bond issue dates, bond amounts available for mortgages in target and nontarget areas, borrower income limits, types of mortgages (allowed and used) under the program, and purchase price limits. We excluded later bond issues from our study because of limited loan activity at the time of our data collection effort in September and October of 1982. We also excluded from our analysis MRB activity involving purchases of buildings with more than one unit and MRBs for rehabilitation and home improvement.

While the above information allowed us to compare local and State bond activity to State median income, we also compared homebuyer incomes, to the median income of the local area where program participants purchased their homes. To do this, we obtained and analyzed computerized homebuyer data bases from 6 of the 27 States we studied (Alaska, Connecticut, Idaho, Kentucky, New York, and Virginia).

We selected the 6 States based on whether they had made 100 or more loans at the time of our field work and whether they could provide us the detailed information in a timely manner. Although we selected the six States to provide geographic distribution, we make no claim that our analyses in the six States represent the entire MRB program. Rather, they provide an alternative perspective and corroborate our analysis comparing subsidized borrower income to State median income. This information also allowed us to make additional analyses not possible with the 40 jurisdiction data, such as a distribution of loans and mortgage money by income intervals.

We compared MRB homebuyer data with (1) State and county/area median family incomes used by the Department of Housing and Urban Development (HUD) in determining housing assistance eligibility, (2) nationwide Section 203(b) Federal Housing Administration (FHA) homebuyer income and purchase price data, and (3) income ceilings considered before the 1980 act was passed.

We reviewed MRB legislative history, regulations, and studies made by public and private organizations. We studied reports made by HUD and Treasury's Inspector Generals and interviewed officials of HUD's Office of Financial Management, Treasury's Office of Tax Analysis, the Office of Management and Budget's (OMB's) Housing Division, and representatives of State and local bond issuers.

WORK PERFORMED ON MRB COST EFFECTIVENESS

We analyzed the cost of the MRB program with the cost of other housing options. We met with housing experts in government, industry, and academia to compile a list of housing options whose costs could be compared with MRB program costs. In this comparison, we selected three of the more feasible options--the taxable bond option, mortgage grants, and homebuyers' annual tax credits. For the MRB program and each option, we set assumptions and developed an analytical model which we used to calculate the cost of the bond program and each option. Our analysis differs somewhat from previous published estimates by Treasury and others because we calculated the lifecycle costs associated with an individual housing unit rather than the yearly costs for a given amount of bonds sold. Details of our cost methodology are shown in appendix II.

HIGH COST--MARGINAL EFFECTIVENESS

The loss in Federal tax revenues--the largest single cost of mortgage revenue bonds--is inevitably much greater than either the reduction in borrowing costs to State and local governments or the reduction in interest rates to homebuyers. We reached this conclusion in 1980 regarding multifamily housing bonds and are now finding a similar outcome for single-family bonds.

The cost to the Treasury results in a very high rate of return for bondholders in the highest marginal tax brackets, while those with the lowest tax rates receive a return roughly comparable to that on taxable investments. In essence, the average buyer of tax-exempt mortgage revenue bonds, who is typically a high income individual or financial institution, receives tax savings much greater than the interest savings provided to the average assisted homebuyer.

The cost effectiveness of the mortgage revenue bond approach is further degraded because the majority of the households that are assisted with below market interest rate loans could have and probably would have purchased homes without assistance. Both our analysis and past studies of mortgage revenue bonds support this conclusion. For most buyers the interest reduction probably allows the purchase of more expensive homes than they could have purchased without the subsidy. Thus, the cost of assisting those households that could have bought without assistance, is incurred as an unintended side effect of reaching those homebuyers who were really priced out of the home purchase market. For example, if as we estimate in appendix III, only 1 in 4 loan recipients is among those in need of assistance, then the actual cost per targeted household would be 4 times the cost we estimate in this report.

In addition to the tax related costs to the Treasury, the issuance of mortgage revenue bonds has been found to have a negative impact on interest rates for other State and municipal borrowing. This effect can be substantial when new State and local debt grows rapidly and may add hundreds of millions of dollars to the cost of all tax-exempt borrowing. This impact is probably illustrated by the marked decrease in the difference in interest costs between tax-exempt and comparable taxable bonds which occurred when there was a high volume of tax-exempt issues in the late 1970's.

COST OF ALTERNATIVES

Mortgage revenue bond financing is calculated to be more expensive than other more direct subsidy options which we analyzed and between two and six times as costly as the benefits provided to the loan recipients. Mortgage revenue bonds provided homebuyers with an average interest rate reduction of about 2 percentage points during the last two years. The alternatives which we analyzed could have provided this same subsidy but at lower cost.

--Taxable bond option. Taxable bonds could be issued by the same government agencies which have been borrowing with tax-exempts. The Federal Government would then pay a direct interest reduction subsidy to the issuing agency so that its borrowing costs were equivalent to those incurred with tax-exempt securities.

--Mortgage grant. Loan discounts paid by the Federal Government directly to mortgage lenders which would reduce qualified homebuyers' mortgage interest rates by the same amount as that provided when tax-exempt bonds are used. The lender receives a return on investment identical to that on a market interest rate loan. The subsidy is provided as a one time lump sum payment.

--Homebuyers annual tax-credits. Qualified homebuyers would receive a certificate which would allow them a tax credit equivalent to a given percentage point reduction in interest rate each year for 12 years. Recipients could increase their tax withholding exemptions, thereby helping them make monthly mortgage payments. The certificate could become void if buyer income increased substantially although our cost estimates do not assume this. This option results in yearly tax revenue losses as do mortgage revenue bonds.

To estimate the costs of these alternatives, we relied on (1) a traditional tax expenditure methodology similar to those used by the Congressional Budget Office (CBO) and Treasury in developing tax expenditure estimates, with certain variations which were introduced based on our recent research and (2) standard financial analysis techniques for calculating loan discounts, rates of return, and present values of subsidy amounts.

Our final report will show a variety of estimates and sensitivity analyses which establish a range of uncertainty about the point estimates shown in this preliminary report. That analysis will show a range of costs for mortgage revenue bonds from two to six times the cost of the least expensive alternatives. In comparing these alternatives we have, for this report, minimized some of the cost differences between alternatives to provide what we believe are conservative estimates of the savings which could be realized if more direct subsidy alternatives were used.

Based on the average applicable interest rates during 1982, we calculate that MRB financed home loans cost the Treasury at least $13,300 per loan in lost tax revenue, compared to about $50 in monthly interest savings to homeowners. By contrast this benefit could be provided for as little as $3,400 as a one-time grant to buy down the conventional mortgage interest rate. Thus for a $10 billion program (which is an estimate of the amount raised during 1981 and 1982 for home loans) the difference between costs and benefits amounts to about $2 billion. Table 1 shows the cost of subsidizing 200,000 units, the equivalent of a $10 billion MRB program. Although these costs may change slightly in our final report, we believe the relative positions of the alternatives and the cost differences we show here realistically portray the costs of these alternatives.

Table 1

Comparison of Treasury Costs to Subsidize a Mortgage in 1982

Alternative	Subsidy cost per mortgage	Subsidy Cost for 200,000 mortgages (billions)
Mortgage revenue bonds	$13,300	$2.66
Taxable bonds	10,400	2.08
Tax-credits	3,500	.70
Mortgage grants	3,400	.68

These estimates were made using a number of assumptions structured to hold the benefit to the homebuyer (for mortgage amount, interest rate, and term of mortgage) constant for all program options, while carefully defining the underlying parameters which determine subsidy cost differences:

1. All program options provide the same benefit to the homebuyer:

   a) the homebuyer borrows $43,300,

   b) the mortgage interest rate is 13.75 percent,

   c) the mortgage is a standard fixed payment loan with a 30-year term,

   d) mortgages will on average be prepaid 12 years after origination.

2. Tax-exempt and taxable bond options are required to set-a-side 13 percent of the funds raised to cover a variety of costs including reserves, discounts, cost of issuance, capitalized interest, and late payments. Thus, only 87 percent of funds raised will be available to lend for home mortgages. Roughly $50,000 must therefore be raised for each mortgage financed.

3. The cost streams are discounted using a rate equal to the average interest rate on 10-year Government securities and 20-year government securities of constant maturities. This rate was 13 percent in calendar year 1982.

4. The mortgage interest rate resulting from the sale of taxable bonds is equal to the average yield to investors (14.68 in 1982) on Government National Mortgage Association (GNMA) guaranteed, mortgage-backed securities plus 1.5 percentage points. Prepayments of 30-year mortgage loans are assumed to occur in 12 years. The 1.5 percentage points are added to account for the increased risk of mortgage revenue bonds as compared to pass-through securities and a charge for loan servicing. The resulting rate was calculated as 16.18 percent in calendar year 1982. The GNMA rate plus 100 basis points tracks Aa utilities which is another possible index which could be used for this calculation.

5. The tax-exempt bond borrowing rate is equal to the simple average of the Bond Buyer Index of 25 revenue bonds maturing in 30 years. This index averaged 12.49 percent in calendar year 1982. This index tracks closely with the Smith-Barney index of Aa single-family mortgage revenue bonds which also could have been used in making these calculations.

6. The mortgage rate for mortgages under the tax-exempt option is equal to the rate determined in item 5 plus 1.25 percentage points. We view this interest rate as an effective interest rate which includes discount points charged the homebuyer, the costs of issuance and the exceptional call premium required for mortgage revenue bonds. This lending rate is calculated as 13.75 percent in calendar year 1982.

7. All cost calculations are done on an annual basis. Costs are calculated to the end of the year and discounted to the first of the year.

8. The mortgage rates for mortgages under the Mortgage Grant and Tax-Credit options are equal to the GNMA yield rate defined in item 4 plus .5 percentage points for a loan servicing charge. This results in a rate of 15.18 percent in calendar year 1982.

Based on these assumptions, the following specific estimating equations were used to arrive at our cost estimates.

Tax-Exempt Bond Option

Cost = Bond principal (times) the taxable bond interest rate (times) the effective marginal tax bracket of bond buyers for each of the 12 years which mortgages are outstanding.

Taxable Bond Option

Cost = Bond principal (times) the difference between the taxable interest rate and the tax-exempt rate for each of the 12 years which mortgages are outstanding.

Tax-Credit Option

Cost = Mortgage amount (times) the difference between the GNMA rate plus .5 percentage points and the tax-exempt rate on housing bonds for each of the 12 years which mortgages are outstanding.

Mortgage Grant Option

Cost = The present value of the interest rate reduction between a market mortgage interest rate and the tax-exempt lending rate, calculated as the required discount on a 30-year mortgage prepaid in 12 years.

To calculate the tax expenditure associated with revenue bonds, we assumed that bond-buyers had an effective marginal tax rate of 30 percent which is probably lower than the average rate of bond holders, thus lowering the estimates of revenue losses. The 30 percent tax rate is the bracket used by Treasury in calculating the incremental impact of MRBs on the Federal deficit, although in aggregate the costs of all tax-exempts is calculated using a 40 percent marginal tax bracket. The 30 percent rate was used to take into account the fact that some bond buyers would actually be shifting from other partially taxed or tax-free investments.

MANY MRB LOANS SUBSTITUTE FOR LOANS THAT WOULD HAVE BEEN MADE WITHOUT THE SUBSIDY

Our 1982 report[1] analyzing options to provide countercyclical aid to the homebuilding industry found that MRBs would have been ineffective in creating net housing starts in early 1983 and that most assisted buyers could merely purchase more expensive homes. Our study presented one estimate that if $2.5 billion in

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[1] "Analysis of Options for Aiding the Homebuilding and Forest Products Industries" (GAO/CED-82-121).

mortgages were financed by MRBs, few additional housing starts would result, but the Treasury would lose $175 million per year for the term of the bonds, due to the bondholder's tax-exempt earnings.

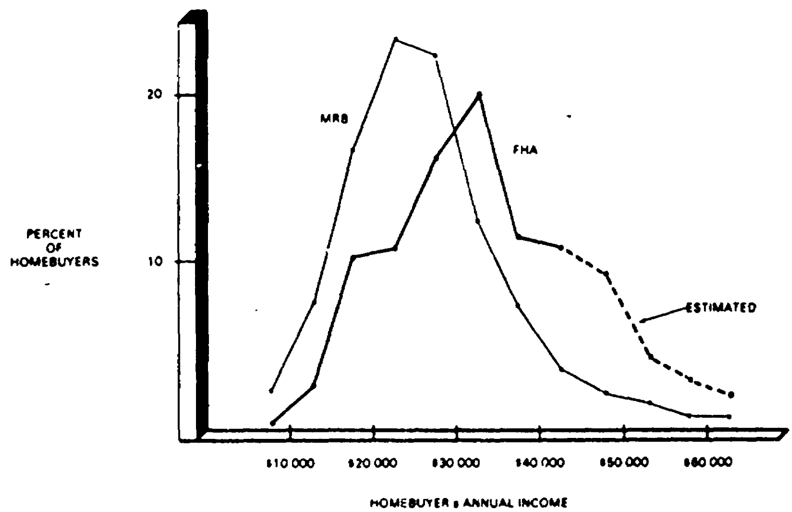
Our current study found that FHA's 203(b) mortgage insurance program served people who had similar incomes (and purchased similar priced houses) to those who were assisted by mortgage revenue bonds. FHA loan activity also includes second- (and third-) time homebuyers who could be expected to have higher incomes than first-time buyers. If information was separately available on the incomes and purchase prices of FHA first-time homebuyers, the income distributions of the two loan programs would likely be very similar. Thus, based on the results of the comparison shown in figure 1, we believe that most bond subsidized loans were made to buyers who very likely could have afforded to purchase homes without subsidy. It is also likely that many MRB homebuyers were therefore able to buy more expensive homes with the interest subsidy they received.

Incomes compared to those under FHA loans

We compared 1982 FHA homebuyer's incomes (January through September) nationwide with aggregated data from the 40 jurisdictions included in our study. While not in the same proportion, both FHA and MRB homebuyers were found in every income range including those which could be considered low- and moderate-income. For example, both the FHA and MRB programs had some homebuyers with incomes of less than $10,000. Loan activity existed under both programs at all income levels, even those over $45,000. Overall, MRB lending was relatively greater than FHA at income levels of $30,000 or less, indicating that there is likey some positive effect provided by income limits in those jurisdictions which effectively exclude the more affluent first-time buyers. Although the overlap between MRB and FHA loan activity contaminates this result somewhat, we also made State-by-State comparisons including comparisons for States where there was little overlap in activity and found identical patterns. These state level comparisons will be included in our final report.

FIGURE 1

COMPARISON OF MRB
AND FHA HOMEBUYER INCOMES



Purchase prices

The average purchase price of FHA-financed homes and MRB-financed houses in our sample was also about the same. The national average for bond-subsidized houses (new and existing combined) was $48,800 based on information provided by 37 of the 40 jurisdictions. FHA's average price nationwide was $48,700.

MORTGAGE REVENUE BONDS ADVERSELY AFFECT THE COST OF OTHEP TAX-EXEMPT BORROWING

MRBs now account for a substantial portion of the home mortgage market which, to some extent, leads to the displacement of traditional housing credit. The rapid growth of such bond financing at both the State and local levels increased total tax-exempt financing of housing from less than $2 billion in 1975 to over $14 billion in 1982, accounting for roughly 30 percent of all municipal bonds sold--the largest single use of tax-exempt financing.

As the volume expands, the costs of tax-exempt borrowing can be driven up with consequent damage to the financing of traditional municipal needs, such as roads, sewers, and public buildings. Issued in large volume, housing bonds can be expected to effect municipal borrowing rates. For example, a study issued by the Urban Institute in 1979 shows that for each billion dollars of new tax-exempt housing bonds injected into the bond market, the interest rates on other tax-exempt bonds is driven up .04-.07 percentage points.

The additional cost resulting from this increase in the interest rate is borne by State and localities on all their new issues. In 1982 approximately $10 billion in single-family mortgage revenue bonds were sold, while roughly $40 billion in traditional public purpose tax-exempt were sold by State and local governments. If each billion dollars of these housing bonds raised overall interest costs by .04 percent, then the additional costs to State and local governments is $160 million per year for each year the $40 billion in debt is outstanding.

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MAJORITY OF ASSISTED HOUSEHOLDS

WERE MIDDLE- AND UPPER-INCOME

The typical mortgage revenue bond homebuyer in 1982 was an individual or two persons between 20 and 35 years of age with an income between $20,000 and $40,000. We also found that 53 percent of the subsidized borrowers were among the more affluent half of the families in their States. About 25 percent of MRB loan funds went to low- or moderate-income households (those with less than 80 percent of median income). While borrowers with annual incomes below $15,000 (a more severe standard) accounted for 10 percent of the recipients. Three-quarters of the buyers had incomes above $20,000 and could likely have purchased anyway. Using a less stringent standard, 115 percent of median income (considered by the Congress in 1980), 36 percent of the borrowers had incomes above the cut off. This conclusion is based on comparing program activity to three different criteria--annual income, income as a percent of State and area median income, and income compared to the ceilings considered by the Congress in 1980.

THE INTENDED BENEFICIARIES

Mortgage revenue bonds issued by State and local governments were intended to provide homebuyers with lower interest rate mortgages while targeting such loans to those who would not ordinarily be able to buy homes. In the late 1970's, as other forms of mortgage finance adjusted to changes in the new regulatory environment for lenders, tax-exempt bond financing was developing. Issuance of MRBs grew rapidly when State and local governments concluded that they could sponsor revenue bond programs at little cost to themselves. This rapid growth led to congressional concern about the costs and inconsistent income targeting of loans to low- and moderate-income households. To address these problems, separate hearings were held by the House Committee on Ways and Means; the Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs; and the Subcommittee on Intergovernmental Relations, Senate Committe on Governmental Affairs. The resulting Mortgage Subsidy Bond Tax Act of 1980 placed restrictions on the bonds and, with minor exceptions, made them taxable after December 31, 1983. Approximately $10 billion in single-family MRBs were issued under these provisions during 1981 and 1982.

Although the Congress left the precise income targeting of MRB loans somewhat ambiguous, they clearly intended that the MRB program benefit low- and moderate-income households, particularly those that could not afford to purchase homes without assistance. Proponents of MRBs during the 1979 hearings were also adamant that the program be continued in order to help those that could not afford to purchase homes without assistance. This goal was further enunciated by the House of

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Representatives Committee on the Budget in its report on the proposed Mortgage Subsidy Bond Tax Act of 1980. Referring to targeting MRB assistance, the committee stated that:

"Individuals who have the greatest need for the subsidy are those of low or moderate income who have difficulty obtaining mortgage money and who are purchasing their first home."

The House and Senate conference report, just prior to the act's passage as part of the Omnibus Reconciliation Act of 1980, indicated the Congress' expectations that State and local governments would use revenue bonds primarily for persons of low- and moderate-income. The bill that the House conferees brought to the conference included specific income-targeting provisions requiring that

--half of the mortgage funds go to borrowers with incomes of 90 percent or less of the area median family income;

--the other half would go to homebuyers with family income no more than 115 percent of the area median family income; and

--one-third of the loans in target areas[2] could be made regardless of income, but the remaining homebuyers in target areas could not have incomes exceeding 140 percent of the statewide or area median income, whichever was larger.

The conference report of November 26, 1980, on mortgage subsidy bonds, deleted the Federal income limits of the House bill so that State and local governments could have sufficient flexibility to design programs for their particular needs. The conferees believed that purchase price ceilings and first-time homebuyer requirements, along with income limits imposed by the jurisdictions, would direct the subsidy to low- and moderate-income buyers.

ANNUAL INCOME OF MRB BORROWERS

Approximately 25 percent of the homebuyers in the 40 jurisdictions we studied had annual incomes under $20,000, while 28 percent made over $30,000, as shown in figure 2. About 15 percent made over $35,000 and only about 10 percent made under $15,000 annually (see table 5 which provides detailed information on the income distributions of subsidized homebuyers in the 40 jurisdictions that were lending during our study period).

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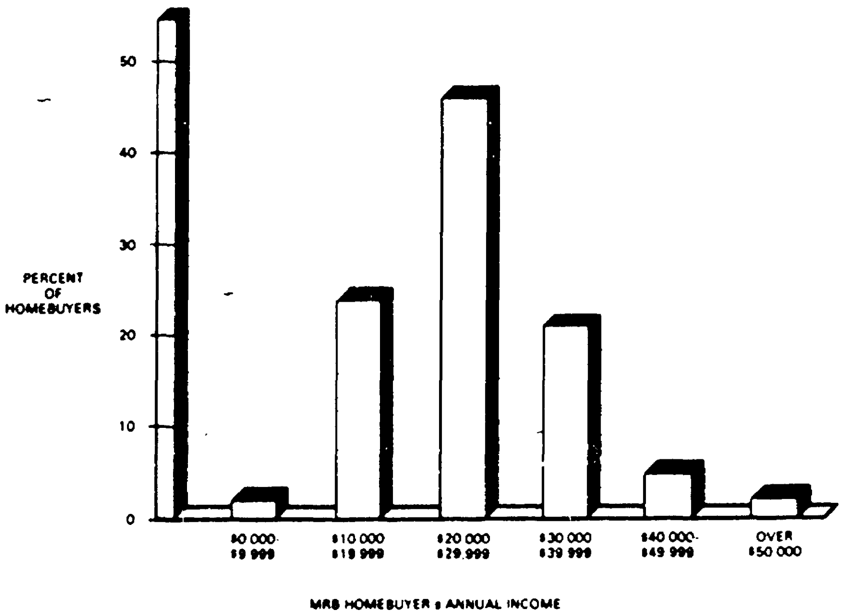
[2] Target areas for MRBs are defined as census tracts where at least 70 percent of the families have incomes no higher than 80 percent of the statewide median income or were areas of chronic economic distress.

FIGURE 2

DISTRIBUTION OF
MRB HOMEBUYER INCOMES



We also determined, using more detailed case files from six States, the extent to which bond proceeds were loaned to individuals at various income levels. Comparing funds lent to number of loans made for the six States, we found that higher income families received a disproportionate amount of the funds that were loaned in relation to the number of loans made. This occurred because higher income households generally buy more expensive homes. For example, table 2 illustrates that homebuyers with incomes over $30,000 received 37 percent of the loans as compared to 47 percent of the amount of funds loaned.

Table 2

Higher Proportion of Money Was
Made Available to Higher Income People
Based on a Six-State Analysis

Income (Thousands)	Percent of all loans made	Percent of all funds lent	Weighted average mortgage amount
$10-20	15	8	$24,603
20-30	48	45	45,177
30-40	22	25	55,622
40-50	10	15	70,693
Over 50	5	7	74,832
Average for 6,666 loans in 6 States			$48,377

MRB BORROWER INCOMES AS
COMPARED TO STATE INCOME LEVELS

As another means of analyzing MRB loan beneficiaries, we adjusted for cost-of-living differences between geographic areas by comparing MRB homebuyers' annual income to State median family income as determined by HUD. (See table 6 for information on each jurisdiction.) Using this measure of income, 53 percent of the borrowers were above median income and 47 percent were below (see table 3). About 45 percent were middle-income (80-120 percent of median income), 32 percent high-income (above 120 percent of median income), 20 percent moderate-income (50-80 percent of median income) and 3 percent low-income borrowers (below 50 percent of median). We show State and local results separately because the local bonds generally served somewhat higher income participants. We made no attempt to adjust homebuyer income for family size in this analysis. However, we compared MRB homebuyer income in six States with State family median incomes and local area median incomes adjusted for family size and found the results to be roughly equivalent.

Table 3

The Majority of Borrowers in 40 Jurisdictions Exceeded State Median Income

Percent of State family median income	Percent of homebuyers State bonds	Local bonds	Total
0-50	3	2	3
50-80	22	11	20
80-100	25	20	24
100-120	20	30	21
120-200	27	35	28
Over 200	3	2	4
Total	100	100	100

MANY MRB HOMEBUYERS EXCEEDED INCOME CEILINGS CONSIDERED BY THE CONGRESS IN 1980

About 64 percent of the 20,471 homebuyers in 40 jurisdictions (see table 4) would have qualified for bond-subsidized housing using the income ceilings considered in 1980 (see page 12). We based our analysis on income as a percent of State family median income. Because of the way our data was structured, our criteria differs somewhat from the criteria considered in 1980 in that we (1) analyzed the number of loans instead of the amount of funds, (2) used State family median income instead of area median income, and (3) did not analyze the third income ceiling provision on targeted areas because only 13 percent of the loans made during our study period were in target areas.

Table 4

Many Homebuyers Exceeded Income Guidelines Considered in 1980

Proposed income ceiling as a percent of State family median income	Percent allowed	Actual participants Percent	Number
90 percent or less	50	35	7,240
90 to 115 percent	50	29	5,865
Over 115 percent	Not allowed	36	7,366
Total		100	20,471

Table 5

Income Distribution Of MRB Homebuyers In 40 Jurisdictions

By Bond-Issuing Authority

Number of Participants by Income Level
(thousands)

Homebuyer income in thousands / Jurisdiction	0-15	15-25	25-35	35-55	55-75	Over 75	Total
Alaska	0	181	354	677	85	3	1,300
California							
Fairfield City	0	12	39	39	3	0	93
Fresno County	3	56	131	23	0	0	213
Newark City	1	9	56	153	28	5	252
Riverside County	1	18	114	20	0	0	153
Colorado							
Larimer County	4	72	70	0	0	0	146
Connecticut	32	869	1,060	175	4	0	2,140
Florida	25	61	23	0	0	0	109
Broward County	11	76	165	0	0	0	252
Dade County	4	31	100	0	0	0	135
Duval County	7	101	134	0	0	0	242
Hawaii	0	7	20	3	0	0	30
Idaho	35	288	35	0	0	0	358
Indiana	88	377	188	22	0	0	675
Kentucky	52	337	6	0	0	0	395
Louisiana	46	202	717	371	0	0	1,336
Maine	2	47	35	0	0	0	84
Maryland				0	0	0	
Montgomery County	5	154	445	4	0	0	608
Washington County	5	32	40	8	0	0	85
Michigan	0	13	59	0	0	0	72
Minnesota	3	20	15	0	0	0	38
Missouri	59	531	374	0	0	0	964
Montana	10	122	115	0	0	0	247

Table 5 (continued)

Homebuyer income in thousands Jurisdiction	0-15	15-25	25-35	35-55	55-75	Over 75	Total
Nebraska	154	308	127	0	0	0	589
New Hampshire	0	1	1	0	0	0	2
New Jersey	2	34	38	41	1	0	116
New York	33	327	636	595	45	4	1,640
North Carolina	54	371	0	0	0	0	425
Oklahoma	16	250	478	452	32	3	1,231
Pennsylvania	300	877	653	20	0	0	1,850
Rhode Island	420	985	285	22	0	0	1,712
South Dakota	0	18	21	0	0	0	39
Tennessee	503	669	26	0	0	0	1,198
Texas	0	2	2	0	0	0	4
East Texas	1	13	26	7	0	0	47
Gregg County	32	48	17	3	0	0	100
Tarrant County	39	104	95	24	0	0	262
Utah	0	13	12	0	0	0	25
Virginia	25	460	334	14	0	0	833
Wyoming	2	64	206	199	0	0	471
Total participants	1,974	8,160	7,252	2,872	198	15	20,471
Percent of participants	10	40	35	14	1	0	100

Table 6

Income Distribution Of MRB Homebuyers In 40 Jurisdictions, By Percent Of State Family Median Income By Bond-Issuing Authority

Number of Participants

Percent of State median income Jurisdication	0-50	50-80	80-100	100-120	120-200	200 and over	Total
Alaska	2	191	220	257	603	27	1,300
California							
Fairfield City	0	3	19	22	44	5	93
Fresno County	1	37	43	77	55	0	213
Newark City	1	6	8	37	159	41	252
Riverside County	1	7	32	55	58	0	153
Colorado							
Larimer County	2	22	52	67	3	0	146
Connecticut	37	803	962	222	115	1	2,140
Florida	6	25	25	22	31	0	109
Broward County	0	11	19	57	165	0	252
Dade County	0	4	6	25	100	0	135
Duval County	0	12	26	49	155	0	242
Hawaii	0	4	13	10	3	0	30
Idaho	3	70	141	129	15	0	358
Indiana	33	208	199	132	103	0	675
Kentucky	1	49	160	154	31	0	395
Louisiana	8	38	74	128	825	263	1,336
Maine	0	6	12	31	35	0	84
Maryland				0	0	0	
Montgomery County	3	89	208	295	13	0	608
Washington County	4	23	27	21	10	0	85
Michigan	0	6	18	48	0	0	72
Minnesota	0	7	12	18	1	0	38
Missouri	11	112	256	300	285	0	964
Montana	0	17	52	83	95	0	247

Table 6 (continued)

Percent of State median income / Jurisdication	0-50	50-80	80-100	100-120	120-200	200 and over	Total
Nebraska	67	144	171	101	106	0	589
New Hampshire	0	1	0	1	0	0	2
New Jersey	2	25	30	22	37	0	116
New York	21	203	324	343	707	42	1,640
North Carolina	6	85	135	199	0	0	425
Oklahoma	1	24	72	121	705	308	1,231
Pennsylvania	196	506	475	402	271	0	1,850
Rhode Island	133	854	418	174	133	0	1,712
South Dakota	0	0	6	5	28	0	39
Tennessee	93	410	345	256	94	0	1,198
Texas	0	0	1	1	2	0	4
East Texas	0	2	7	8	28	2	47
Gregg County	17	20	24	22	17	0	100
Tarrant County	17	37	56	42	110	0	262
Utah	0	2	9	8	6	0	25
Virginia	4	92	258	306	173	0	833
Wyoming	0	13	39	76	342	1	471
Total participants	670	4,168	4,954	4,326	5,663	690	20,471
Percent of participants	3	20	24	21	28	4	100

INCOME AND PURCHASE PRICE CEILINGS

HAVE BEEN INEFFECTIVE

The effectiveness of income and purchase price ceilings may be the key to targeting assistance to the intended beneficiaries. In passing the 1980 act, purchase price ceilings were adopted as an alternative to Federal income ceilings as a mechanism for targeting benefits to low- and moderate-income households. Most States and localities, however, set their own income ceilings, but at levels which generally did not target assistance to low- and moderate-income households. A few jurisdictions set more restrictive income ceilings which appeared to improve the percentage of loans going to the intended borrowers.

INCOME CEILINGS ALLOWED PARTICIPATION BY MIDDLE- AND UPPER-INCOME HOUSEHOLDS

With a few exceptions, jurisdictions set income ceilings which allowed the participation of relatively affluent households. The majority of the ceilings were in the $30,000 to $40,000 range. State ceilings for a family of four ranged from $22,000 in South Carolina to $59,977 in Arizona. For local jurisdictions income ceilings for a family of four ranged from $30,000 in Larimer County, Colorado, to $45,000 in East Texas. Two States and two local jurisdictions imposed no ceilings. One State had no income ceiling for loans made in specified areas.

We collected the criteria for income ceilings of every State that issued bonds after the 1980 act (Kansas, Ohio, and Washington had not) and for the 13 local jurisdictions included in our study (see table 7). Although the majority of jurisdictions had only one ceiling, 20 (17 State and 3 local jursidictions) had multiple ceilings. (Many of these jurisdictions and some others set additional income ceilings to adjust for family size but we based our analysis on ceilings for a family of four.) Many of the multiple ceilings at the 20 jurisdictions were to adjust for cost-of-living variability between locations. Three of the 20 jurisdictions set aside a certain amount of mortgage funds for use by low- or moderate-income households. For example, Indiana reserved 40 percent of its mortgage funds for borrowers whose incomes do not exceed 80 percent of area median income. For the 20 jurisdictions that had multiple ceilings, their lowest ceilings were as follows: three fell in the $15,000 to $20,000 range, four between $20,000 to $25,000, eight between $25,000 to $30,000, two between $30,000 to $35,000, two between $35,000 to $40,000, and one between $40,000 to 45,000. However, the majority of bond issuers set only one income ceiling. In our final report we will show that more restrictive income limits result in better targeting to low- and moderate-income households.

Table 7

Most Jurisdictions Have Income Ceilings Above $30,000 (note a)

Income range (Thousands)	Number of States with ceiling in income range	Number of localities with ceiling in income range
$20-25	1	0
25-30	5	1
30-35	20	5
35-40	12	1
40-45	4	4
45-50	0	0
50-55	1	0
55-60	1	0
Unlimited	3	2
Total	47	13

a/Summarized using the highest ceiling for a family of four within each jurisdiction.

PURCHASE PRICE CEILINGS ENCOURAGED PARTICIPATION BY MIDDLE- AND UPPER-INCOME HOUSEHOLDS

Purchase price ceilings did not effectively limit participation by upper-income people because the ceilings were set near the average purchase price in the area. The 1982 federally imposed price ceilings for homes in over 100 nontarget areas ranged from $136,980 in Hawaii (areas other than Honolulu) to $29,970 in Pennsylvania's northeast counties (see table 8). Taking the average of these price ceilings, we calculated the incomes required to purchase these highest priced homes. Buyers would have needed annual incomes of at least $30,000 and $25,000 respectively to purchase new and existing homes at these ceilings. Potential homebuyers would have needed annual incomes of $69,146 and $15,129, respectively, to qualify for loans at the highest and lowest ceilings in the country. We assumed a 30-year loan, 13 percent interest, 5 percent downpayment, and 25 percent of household income available for mortgage principal and interest payments, excluding taxes and insurance in making these affordability assessments.

Table 8

Incomes Required to Buy the Maximum Priced House Allowed by Federal Regulations Through August 1982

Ceiling	Required incomes		Price ceiling	
	New	Existing	New	Existing
Highest	$69,146	$65,421	$136,980	$129,600
Lowest	20,353	15,129	40,320	29,970
Average	30,325	25,154	60,074	49,830

The basis for establishing ceilings was changed by the Congress in August of 1982 to allow higher priced homes to qualify for MRB financing. Price ceilings were raised by about 22 percent in non-target areas and about 10 percent in target areas.

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

March 24, 1983

Mr. Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

The Senate Finance Committee is currently reviewing the use of tax-exempt bonds for single family and multifamily mortgages and would appreciate your assistance. I expect that the Committee will need to review the mortgage subsidy bond provision before its scheduled sunset at the end of the year.

By mid-April, the Committee would like to have information about the use of mortgage bonds during 1982 under the permanent rules of Public Law 96-499. The Committee is especially interested in the effectiveness of the provisions of the Mortgage Subsidy Bond Tax Act of 1980 that are intended to limit the program to certain homebuyers, and the efficiency of the mortgage subsidy bond program in general.

I understand that the GAO has been studying the mortgage subsidy bond program, and that a study will probably be completed within two months. It should be an extremely timely report. It would be helpful to the Committee if you could provide a short summary of your preliminary findings by mid-April. Specifically we would be interested in any information you have gathered regarding the extent to which lower income homebuyers are benefiting from the program, the effectiveness of Federal purchase price ceilings and state and local income limits in targeting loans to the intended households, and the efficiency of the mortgage bond program in general.

I recently asked the Congressional Budget Office to provide the Committee with information on bond issuances under the permanent rules of the mortgage bond program. I hope you will be able to coordinate your research with that of the CBO, in order to provide the Committee with a comprehensive understanding of the mortgage subsidy bond program. I appreciate your cooperation and assistance in this matter.

Sincerely yours,

BOB DOLE
Chairman

(382751)

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EXHIBIT 2

FEDERAL COST OF PROVIDING THE SAME BENEFIT TO HOMEBUYERS UNDER MORTGAGE REVENUE BONDS AND ALTERNATIVES

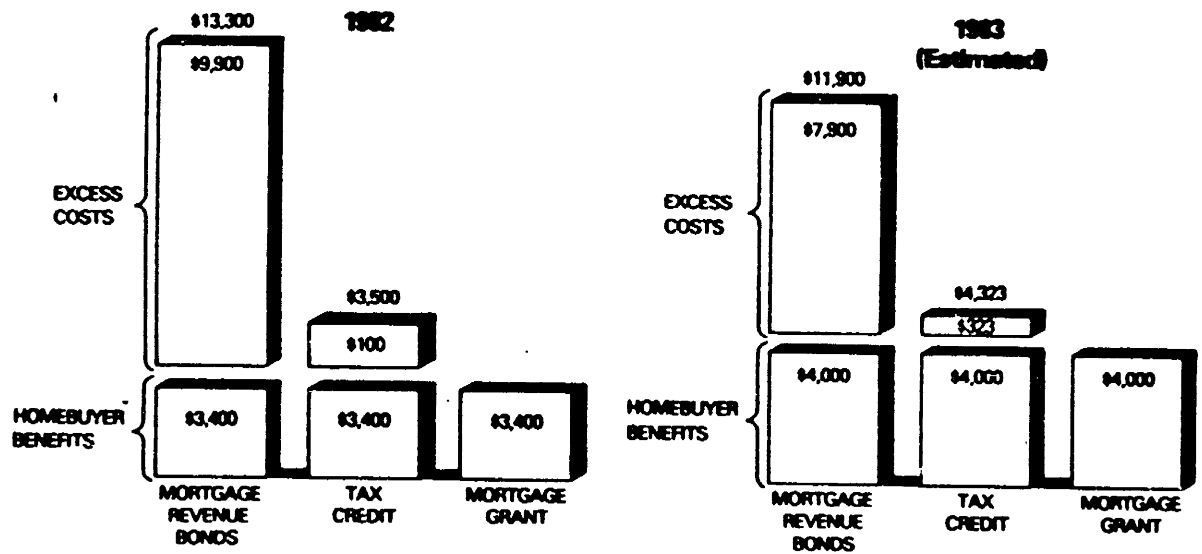

EXHIBIT 3

DISTRIBUTION OF MRB HOMEBUYER INCOMES

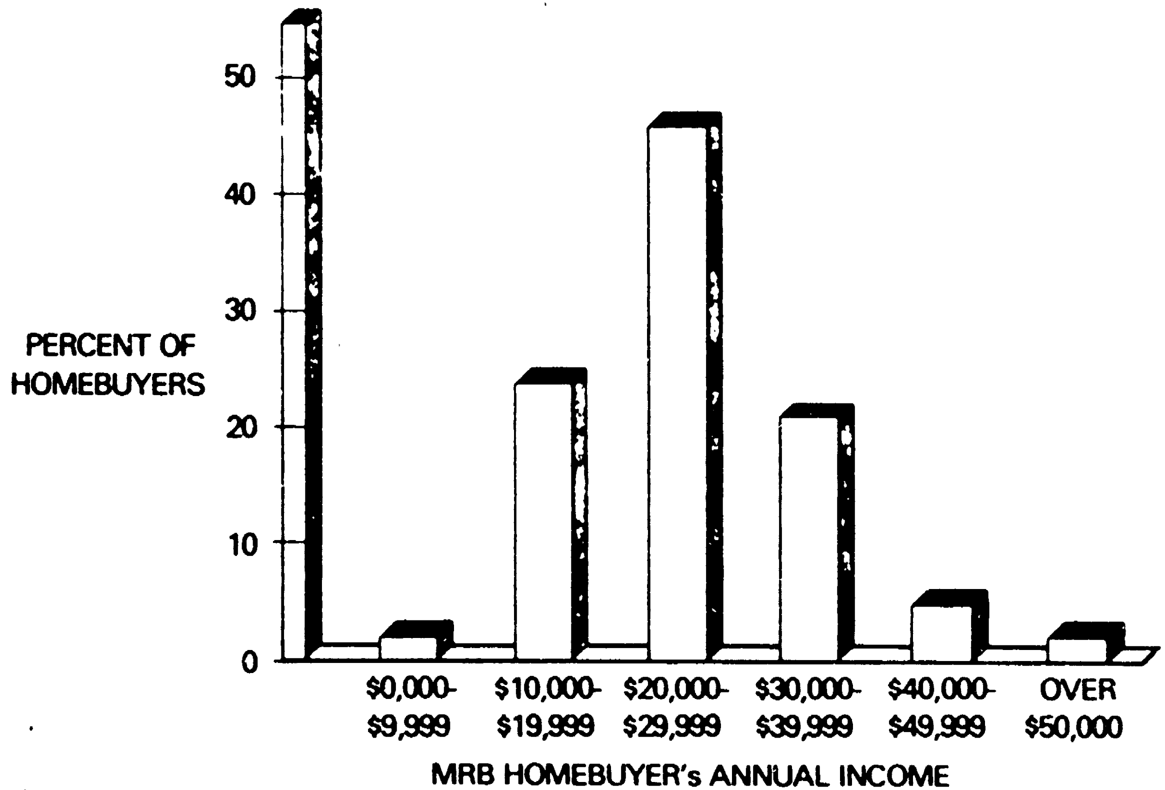

Exhibit 4

Income Distribution Of MRB Homebuyers In 40 Jurisdictions

By Bond-Issuing Authority

Number of Participants by Income Level

Homebuyer income in thousands Jurisdiction	0-10	10-20	20-30	30-40	40-50	Over 50	Total
Alaska	0	34	317	407	358	184	1,300
California							
Fairfield City	0	1	36	22	24	10	93
Fresno County	0	16	107	86	4	0	213
Newark City	0	5	29	82	77	59	252
Riverside County	0	2	71	77	3	0	153
Colorado							
Larimer County	1	23	119	3	0	0	146
Connecticut	0	264	1,419	394	53	10	2,140
Florida	6	50	51	2	0	0	109
Broward County	0	30	222	0	0	0	252
Dade County	0	10	125	0	0	0	135
Duval County	0	38	150	54	0	0	242
Hawaii	0	0	19	11	0	0	30
Idaho	0	146	207	5	0	0	358
Indiana	8	266	319	77	5	0	675
Kentucky	3	271	121	0	0	0	395
Louisiana	9	111	469	747	0	0	1,336
Maine	0	14	70	0	0	0	84
Maryland				0	0	0	
Montgomery County	0	42	335	231	0	0	608
Washington County	0	13	50	21	1	0	85
Michigan	0	2	53	17	0	0	72
Minnesota	0	10	27	1	0	0	38
Missouri	6	238	696	24	0	0	964
Montana	0	44	187	16	0	0	247

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Exhibit 4 (continued)

Homebuyer income in thousands Jurisdiction	0-10	10-20	20-30	30-40	40-50	Over 50	Total
Nebraska	53	250	257	29	0	0	589
New Hampshire	0	1	1	0	0	0	2
New Jersey	0	11	46	37	19	3	116
New York	6	124	555	557	286	112	1,640
North Carolina	6	220	199	0	0	0	425
Oklahoma	1	96	373	499	178	84	1,231
Pennsylvania	105	597	877	271	0	0	1,850
Rhode Island	58	929	617	105	3	0	1,712
South Dakota	0	7	26	6	0	0	39
Tennessee	134	790	274	0	0	0	1,198
Texas	0	0	4	0	0	0	4
East Texas	0	5	24	15	3	0	47
Gregg County	16	34	42	8	0	0	100
Tarrant County	13	76	107	66	0	0	262
Utah	0	2	21	2	0	0	25
Virginia	0	161	577	95	0	0	833
Wyoming	0	20	117	239	95	0	471
Total participants	425	4,953	9,316	4,206	1,109	462	20,471
Percent of participants	2	24	46	21	5	2	100

EXHIBIT 5

Household Size of MRB Borrowers in Eight States

Family Size	Alaska	Connecticut	Idaho	Indiana	Kentucky	New York	Oklahoma	Virginia	Total	Percent of homebuyers
	Number of Borrowers									
1	493	470	78	270	142	219	240	107	2,019	23
2	415	789	116	101	96	906	595	402	3,420	38
3	195	370	73	306	76	276	278	190	1,764	20
4	145	353	52	121	51	185	196	91	1,194	13
5	43	119	27	55	20	37	44	35	340	4
6	8	28	7	14	10	15	12	7	101	0
7	1	10	3	2	0	2	2	1	21	0
Over 8	0	1	2	2	0	0	0	0	5	0
Total	1,300	2,140	358	871	395	1,640	1,367	833	8,904	100

EXHIBIT 6

Age of MRB Homebuyers in Eight States

Age	Alaska	Connecticut	Idaho	Indiana	Kentucky	New York	Oklahoma	Virginia	Total	Percent of homebuyers
	Number of Borrowers									
0-20	32	14	6	42	17	6	53	8	178	2
21-25	368	597	139	307	153	465	520	301	2,850	32
26-30	452	761	118	295	119	645	408	286	3,084	35
31-35	239	419	42	119	64	290	138	136	1,507	17
36-40	96	187	22	47	17	121	84	54	628	7
41-45	51	70	10	20	11	50	49	32	293	3
46-50	20	44	4	15	7	25	16	4	135	1
51-55	17	19	3	15	3	21	14	6	98	1
56-60	13	15	5	2	3	8	15	1	62	1
Over 60	12	14	1	9	1	9	10	5	61	1
Total	1,300	2,140	350 a/	871	395	1,640	1,367	833	8,896	100

a/ Age information on 8 cases was unknown.

Exhibit 7

MRB Borrowers Who Could
Qualify for HUD Housing Subsidy Programs
In Eight States

State (Total Loans)	Section 8 a/				Section 235 b/	
	50% of median		80% of median		95% of median	
	Number	Percent	Number	Percent	Number	Percent
Alaska (1300)	0	0	3	0	190	15
Connecticut(2140)	5	0	151	7	630	29
Idaho (358)	2	1	34	9	119	33
Indiana (871)	7	1	157	18	374	43
Kentucky (395)	3	1	50	13	338	86
New York (1640)	6	0	68	4	274	17
Oklahoma (1367)	2	0	27	2	71	5
Virginia(833)	1	0	26	3	128	15
Total (8904)	26	0	516	6	2124	24

a/Under Section 8 Rental Assistance payments, HUD pays the difference between fair market rents and the tenant's contribution. Lower income families are eligible, defined as earning no more than 80 percent of the area median income, adjusted for family size and certain other factors. The Housing and Community Development Amendments of 1981 required that very-low-income people be given preference for Section 8 subsidies, defined as families earning no more than 50 percent of the area median income.

b/Under the Section 235 Homeownership Assistance for Low-and Moderate-Income Families, HUD insures loans to make homeownership available to families with incomes under 95 percent of area median family income. Also, under this program, HUD subsidizes the homeowner's interest rate to as low as 4 percent. The Section 235 income ceilings include hundreds of exceptions which generally raise the ceilings above the 95 percent of median standard.

EXHIBIT 8
Percent of Down Payment For MRB Borrowers In Eight States

Percent of Down Payment	Alaska	Connecticut	Idaho	Indiana	Kentucky	New York	Oklahoma	Virginia	Total	Number of homebuyers
	Percent									
0 - 9	88	46	1	42	71	2	66	88	50	4,447
10 - 19	7	27	91	27	23	58	20	8	29	2,598
20 - 29	3	15	5	17	6	24	9	3	12	1,102
30 - 39	1	7	2	6	0	8	3	1	5	394
40 - 49	*	3	1	4	0	4	1	0	2	204
50+	*	2	0	4	0	4	1	0	2	159
TOTAL	100	100	100	100	100	100	100	100	100	8,904

EXHIBIT 9
Amount of Down Payment By MRB Homebuyers In Eight States

Down Payment Amount	Alaska	Connecticut	Idaho	Indiana	Kentucky	New York	Oklahoma	Virginia	Total	Number of homebuyers
	Percent									
0- 5,000	69	51	70	69	89	39	71	90	63	5,571
5,001- 10,000	23	23	25	17	10	28	15	6	20	1,801
10,001- 15,000	3	11	3	8	1	13	6	3	8	685
15,001- 20,000	2	7	1	3	-	10	3	1	4	395
20,001- 25,000	1	4	1	2	-	4	2	*	2	203
25,001- 30,000	1	2	*	1	-	2	1	-	1	100
30,001- 35,000	1	1	*	*	-	2	1	-	1	70
35,001- 40,000	*	1	-	*	-	1	*	-	*	30
40,001- 45,000	*	*	-	*	-	1	1	-	*	21
45,001- 50,000	*	*	-	-	-	*	*	-	*	10
50,001- 75,000	*	*	-	-	-	*	*	-	*	17
75,001-100,000	-	-	-	-	-	-	-	-	-	1
100,000+										
TOTAL	100	100	100	100	100	100	100	100	100	8,904

* Less than 1/2 percent

EXHIBIT 10

STATE OR LOCALLY IMPOSED INCOME LIMITS FOR MRB HOMEBUYERS, RANKED BY PERCENT OF FAMILY MEDIAN INCOME FOR A FAMILY OF FOUR
(Includes all States that issued bonds during 1981 and 1982)

State	As a percent of HUD's State Family Median Income	Dollar Amount
Oregon	106	$26,000
Michigan	116	31,750 a/
Maryland	117	33,000 b/
North Carolina	118 (98)	23,500 (19,500) c/
Hawaii	126	36,873 d/
Maine	128	27,000
Colorado	129	32,000 e/
Missouri	129	28,000 f/
Rhode Island	133	32,500
Nevada	133	33,875 (23,750) g/
Wisconsin	139 (96)	34,000 (23,325) h/
Utah	143	34,000 i/
Minnesota	143 (106)	34,500 (25,500) j/
Delaware	144	37,500
Montana	147	31,500 k/
Indiana	148 (68)	35,500 (16,400) l/
Vermont	149	32,500
Kentucky	150 (136)	28,000 (25,500) m/
Nebraska	151	32,500
Pennsylvania	151 (141)	37,500 (35,000) n/
Idaho	152	33,000 o/
Iowa	153 (115)	34,300 (25,800) p/
Massachusetts	155	43,000 q/
Illinois	158	43,000
Tennessee	160	30,000 r/
South Carolina	163	32,200 s/
New Hampshire	163 (113)	40,000 (27,000) t/
North Dakota	165	33,000 u/
New Mexico	167	33,000 v/
Virginia	169 (95)	38,900 (22,000) w/
Texas	175	38,000 x/
Florida	175 (151)	35,400 (30,500) y/
Georgia	183 (131)	37,500 (26,900) z/
South Dakota	185	34,500 aa/

State	As a percent of State Family Median Income	Dollar Amount
West Virginia	186	32,700
Wyoming	186	45,000 bb/
California	188 (105)	50,250 (28,000) cc/
Louisiana	214	40,000
Arkansas	224	36,000 dd/
Alabama	227	42,000 ee/
Oklahoma	252 (196)	49,500 (38,500) ff/
Mississippi	255	39,000 gg/
Arizona	261	59,977 (27,589) hh/
Connecticut	Unlimited (87)	Unlimited (26,700) ii/
New Jersey	Unlimited (139)	Unlimited (41,900) jj/
Alaska	Unlimited	Unlimited
New York	Unlimited	Unlimited

City and County	As a percent of SMSA Family Median Income	Dollar Amount
Montgomery County, MD	108	$34,900 kk/
Larimer County, CO	126	30,000
Washington County, MD	126	40,900 ll/
Broward County, FL	130	30,680
Dade County, FL	150	34,800 mm/
Duval County, FL	152	32,600
Fresno County, CA	152 (101)	32,600 (21,800) nn/
Tarrant County, TX	158	40,000
Gregg County, TX	191	37,500
Riverside, CA	194	43,005
East Texas, TX	230	45,000
Newark, CA	Unlimited (120)	Unlimited (36,600) oo/
Fairfield, CA	Unlimited (150)	Unlimited (37,500) pp/

Kansas, Ohio and Washington did not issued tax exempt bonds for single-family housing in 1981 and 1982.

NOTE: Except as otherwise noted, we first determined the dollar amount of State or locally imposed income limits for a family of four from either the Bond Official Statement or directly from bond agency officials. We then compared the dollar limit to the 1981 State family median income (for State bonds) or to the 1981 SMSA/county family median income (for city and county bonds) as determined by HUD for a family of four. Parenthetical percentages represent lower percentages where income limits varied by location, new or existing construction, or targeting part of funds to lower income people.

FOOTNOTES

a/Michigan--Overtime earnings of up to $4,000 are excludable in meeting the income limit criteria.

b/Maryland--The income limit applies to two or more persons. The limit for a single person is $28,000.

c/North Carolina--Income limits differ between urban and rural areas and vary by family size. An adjustment of $500 is allowed for each member greater than four. Limits for a single individual range from $14,625 to $17,625. Net assets may not exceed $15,000, except persons between ages 62 and 64 may have net assets of up to $40,000, persons aged 65 may have $50,000, and handicapped persons may have $65,000.

d/Hawaii--Income limits are graduated from 1 to 8 or more household members. Limits for one and two members are $24,582 and $34,373, respectively. An amount of $1,250 is added for each member greater than two but not to exceed $41,873. Borrowers may not have assets (less liabilities secured by such assets and less 25 percent of the downpayment made to purchase the subject property) exceeding the maximum allowable adjusted gross income for a family of the same size.

e/Colorado--Income limit is $23,000 before taxes and withholdings and after deducting (a) a maximum of $12,000 ($3,000 for a co-mortgagor (spouse) and each dependent, except the spouse, and support payments not to exceed $3,000, for other minor children not residing with the household), (b) income from social security or pension for a person who is 62 years old or older or handicapped, (c) amounts equal to all household income considered unusual, temporary or non-related to household members regular employment. Also, a borrower's net worth, exclusive of downpayment and closing costs, may not exceed $35,000.

f/Missouri--Income limits of $28,000 applies to a family of one to four. The limit for a family of five to eight is $32,000.

g/Nevada--Income limit for one member household is $23,750, $27,125 for two, $30,500 for three, $36,625 for five, and $39,250 for six or more.

h/Wisconsin--Income limits are 125 percent of county median income.

i/Utah--Add $500 for each member greater than four and deduct $1,000 for each member less than four.

j/Minnesota--Limits range from $29,500 to $34,500 for new construction and from $25,500 to $29,500 for existing housing depending on geographic location.

k/Montana--Add/deduct $1,000 to the limit for each dependent greater/less than four.

l/Indiana--The income limits apply to 60 percent of mortgage loans and range from $25,600 to $35,500. Limits for the other 40 percent range from $16,400 to $22,720, which represent 80 percent of the median for the borrower's geographic area.

m/Kentucky--Income limits vary by area/location. Add/deduct $1,500 for each member greater/less than four.

n/Pennsylvania--Limits vary by geographic area.

o/Idaho--Add/deduct $1,500 for each member greater/less than four.

p/Iowa--Add/deduct $300.00 for each dependent family member greater/less than residing in household under 18, or over 18 with no income. Income may be increased by 10 percent for households having combined incomes. Additionally, the limits may be increased; by $300 if the head of household has secondary income, unusual income, or extraordinary medical costs.

q/Massachusetts--Add/deduct $1,500 for each dependent greater/less than four.

r/Tennessee--Income limits for 1, 2, 3, and 4 or more member households are $19,000, $24,000, $28,000, and $30,000, respectively.

s/South Carolina--Add/deduct $800 for each member greater/less than four.

t/New Hampshire--The income limits are six times the annual housing costs (principal, interest, and taxes) or $40,000 whichever is lower.

u/North Dakota--The limit applies to families of one to four members. Add $1,000 for each member greater than four.

v/New Mexico--Add/deduct $1,500 for each member greater/less than four.

w/Virginia--Income limits vary between newly constructed and existing dwellings, and by geographic location and family size. Adjustments for family size are $1,000 for the borrower, $2,500 for a working spouse ($1,000 if not working), and $1,000 for each dependent.

x/Texas--The income limit of $38,000 applies to a family unit. The limit for an individual borrower is $30,000.

y/Florida--The income limit can be the greater of 150 percent of county or state median family income. The income limit of $30,500 applies to counties using the State median family income limit.

z/Georgia--Income limits vary between newly constructed and existing dwellings, and by geographic location. Limits range from $32,500 to $37,500 for newly constructed units and $26,900 to $31,000 for existing dwellings. The authority may increase the income limit by as much as 10 percent in identified high housing cost areas.

aa/South Dakota--Add/deduct $1,000 for each member greater/less than four.

bb/Wyoming--The Housing Authority may waive the income limitation.

cc/California--Income limits vary by family size and geographic location. Income limit for a family of one range from $22,400-$39,900 and $25,200-$45,000 for two to three family members. For a family of four or more, limits range from $28,000 to $50,250.

dd/Arkansas--Add/deduct $2,000 for each member greater/less than four.

ee/Alabama--Add/deduct $1,000 for each dependent greater/less than four occupying the home.

ff/Oklahoma--For targeted areas, limits were $49,500, $47,300, and $46,650 in the Tulsa SMSA, Oklahoma SMSA, and other areas, respectively. Limits for non-targeted areas were $45,000, $43,000, and $38,500. Except for the head of household, $1,000 may be added or subtracted for members greater or less than four. Earnings of household members under 18 years old or handicapped are excluded in income determination. Also, a credit of $2,500 is excludable for wage earners over 18, other than the spouse or head of household. Other credits include unusual or temporary income and medical expenses not covered by insurance that is in excess of 3 percent of total adjusted gross income.

gg/Mississippi--Add/deduct $1,000 for each exemption greater/less than four.

hh/Arizona--The higher limit applies to target areas and the lower limit to non-target areas.

ii/Connecticut--The income limit varies by location and family size. Limits range from $24,000 to $30,500 for three or less members and $31,700 to $40,200 for seven or more. Loans in eligible areas may be made without regard to an income but two financial institutions must have refused the loan on its regular interest rate, loan term, and downpayment requirements.

jj New Jersey--There is no income limit for target areas.

kk Montgomery County, Maryland--Income limits for one, two, three, and five or more person households are $27,000, $32,900, $33,900, and $35,900, respectively.

ll Washington County, Maryland--Income limits for one, two, and three person households are $36,900, $38,900, and $39,900, respectively. Add $1,000 to $40,900 for each member greater than four.

mm Dade County, Florida--Income limits for five, six, and seven or more are $36,000, $37,200, and $38,400, respectively.

nn Fresno, California--The income limit of $32,600 applies only to new construction. One-half of funds reserved for existing units has an income limit of $27,200 and the limit for the other half is $21,800.

oo Newark, California--An income limit of $36,600 applies only to 7 percent of loans. There is no limit for 93 percent of loans because they were reserved for the agency's redevelopment areas.

pp Fairfield, California--Income limit of $37,500 applies only to purchases made outside the agency's redevelopment project area. Income limits for one and two/three member households are $30,000, and $33,750 respectively. There are no income limits in redevelopment areas.

EXHIBIT 11

Comparison of MRB Income Ceilings
During 1981/82 For a Family of Four

Income Category	Percent Range	Number of Jurisdictions: State Income Ceilings as a Percent of State Family Median Income	Number of Jurisdictions: Local Jurisdictions Income Ceilings as a Percent of SMSA Family Median Income	State & Local Combined
low and moderate	0-80	0	0	0
middle	81-100	0	0	0
middle	101-120	4	1	5
high	121-150	14	4	18
high	150-200	19	5	24
high	Over 200	6	1	7
high	No limit	4	2	6
Total		47	13	60

NOTE: Some jurisdictions had multiple income limits. For simplicity, this analysis compared the highs of those income ceiling ranges.

EXHIBIT 12

Comparison of MRB Income Ceilings Pre-and Post-Mortgage Subsidy Bond Tax Act of 1980 as a Percent of Family Median Income for a Family of Four

Income Category	Percent Range	State Income Ceilings as a Percent of State Family Median Income		Local Jurisdictions Income Ceilings as a Percent of SMSA Family Median Income	
		June 1978- Sept. 1980 Number	1981-1982 Number	June 1978- Sept. 1980 Number	1981-1982 Number
low and moderate	0-80	0	0	0	0
middle	80-100	7	0	1	0
middle	100-120	5	5	5	1
high	120-150	6	5	1	0
high	150-200	1	9	13	1
high	Over 200	2	0	21	0
high	No limit	2	4 a/	9	0
Total		23	23	50	2

a/Includes two States that had income limits for some areas.

NOTE: Some jurisdictions had multiple income limits. For simplicity, this analysis compares the highs of these income ceilings ranges.

EXHIBIT 13

FEDERAL PURCHASE PRICE LIMITS FOR MRB
SINGLE-FAMILY HOMES IN NON-TARGET AREAS

AREA	1982 NEW	1982 EXISTING	1983 NEW	1983 EXISTING
Alabama	$ 58,230	$ 50,490	$ 73,150	$ 57,970
Alaska	90,630	74,610	129,140	100,320
Arizona				
Phoenix	80,190	71,820	118,360	92,620
Tucson	74,880	59,670	92,840	74,140
Other	68,670	55,260	54,010	47,410
Arkansas				
Little Rock	55,890	55,260	a/	a/
Other	57,960	52,650	73,150	65,670
California				
Anaheim	104,760	110,430	150,040	124,850
Bakersfield	79,200	59,580	97,900	70,290
Fresno	81,540	52,020	106,260	64,790
Los Angeles	96,390	90,540	124,410	115,610
Oxnar-Simi Valley	97,740	86,580	132,890	116,820
Riverside	80,370	74,070	89,650	94,710
Sacramento	87,030	84,060	94,710	100,760
San Diego	96,930	88,200	115,060	100,210
San Francisco	114,210	96,660	149,380	119,790
San Jose	110,070	129,600	154,740	135,850
Santa Barbara	119,520	98,640	139,590	120,010
San Rosa	88,830	84,870	107,360	109,320
Stockton	60,030	55,980	71,500	65,340
Vallejo	83,520	75,960	102,740	91,410
Other	73,530	80,100	99,110	92,950
Colorado				
Denver	72,000	63,180	76,230	93,940
Other	70,650	49,410	89,540	62,920
Connecticut				
Bridgeport	66,330	75,600	82,830	97,570
Danbury	82,170	70,290	101,860	96,800
Hartford	75,420	59,580	99,330	72,710
New Haven	67,230	55,980	79,200	71,610
Norwalk	107,820	109,440	168,190	137,390
Stanford	127,800	128,340	163,350	164,120
Other	76,680	53,820	99,990	73,370
Delaware				
Wilmington	a/	a/	a/	a/
Other	67,680	52,290	60,060	58,410
Florida				
Daytona Beach	49,950	43,380	66,880	48,290
Fort Lauderdale	62,550	63,270	95,700	86,570

AREA	1982 NEW	1982 EXISTING	1983 NEW	1983 EXISTING
Fort Myers	$ 65,700	$ 56,610	$ 92,180	$ 106,590
Lakeland	54,900	34,560	70,730	48,510
Miami	72,270	65,250	97,680	92,510
Orlando	55,890	43,200	76,120	54,670
Sarasota	61,110	62,640	94,380	75,130
Tampa	64,890	47,430	83,820	65,340
West Palm Beach	54,810	61,380	93,720	94,600
Other	59,580	45,180	76,450	63,140
Georgia				
Atlanta	79,920	60,300	98,120	73,100
Other	53,370	42,210	67,760	53,240
Hawaii	a/	a/	139,700	121,000
Honolulu	105,300	98,910	a/	a/
Other	136,980	101,520	140,470	121,000
Idaho	70,650	60,390	100,430	81,840
Illinois				
Chicago	73,890	64,170	97,240	82,390
Other	66,060	39,060	78,540	52,800
Indiana				
Indianapolis	77,040	44,910	87,230	61,600
Other	50,850	41,490	68,860	39,380
Iowa	63,810	46,440	61,050	52,250
Kansas				
Wichita	64,710	45,540	73,700	86,020
Other	48,960	37,440	70,400	52,250
Kentucky				
Louisville	64,890	45,180	92,950	56,430
Other	52,560	39,870	72,490	54,560
Louisiana				
New Orleans	83,700	67,320	101,530	82,280
Other	69,210	50,580	81,290	63,360
Maine	66,150	52,380	61,600	59,620
Maryland				
Baltimore	76,050	52,830	85,800	83,930
Other	49,500	50,850	57,090	72,160
Massacusetts				
Boston	71,370	74,690	86,790	77,660
Other	58,230	48,780	71,170	56,430
Michigan				
Detroit	89,370	50,580	121,550	66,110
Other	69,750	40,500	80,410	56,980
Minnesota				
Minneapolis	83,880	61,920	103,070	81,620
Other	63,810	51,210	77,990	62,590
Mississippi	59,130	42,390	67,980	48,070
Missouri				
Kansas City	69,570	46,260	96,910	71,170
St. Louis	74,520	44,370	86,240	70,840

AREA	1982 NEW	1982 EXISTING	1983 NEW	1983 EXISTING
Other	$ 52,920	$ 42,390	$ 63,030	$ 49,390
Montana	71,370	56,070	70,950	66,880
Nebraska				
Lincoln	56,250	46,170	71,720	55,220
Other	45,630	36,000	57,090	45,980
Nevada	88,200	85,050	98,010	94,490
New Hampshire	56,070	48,960	62,700	63,690
New Jersey				
Long Branch	76,140	75,870	85,140	91,960
Newark	97,110	78,840	125,620	103,620
Other	69,750	63,900	86,680	74,360
New Mexico	58,410	41,760	91,960	57,530
New York				
Albany	61,920	42,930	78,430	51,480
Buffalo	63,000	44,730	82,500	51,260
Nassau	82,080	60,300	132,000	83,380
New York City	84,240	71,460	119,680	92,950
Rochester	63,450	42,390	76,340	56,540
Other	58,950	37,620	68,860	40,370
North Carolina				
Charlotte	69,750	53,370	81,400	69,190
Greensboro	79,920	41,220	84,480	51,370
Raleigh	66,150	43,920	87,340	47,630
Other	40,320	38,880	72,270	45,430
North Dakota	71,370	56,070	70,950	66,880
Ohio				
Cincinnati	68,850	52,740	92,400	56,980
Cleveland	77,580	53,640	117,370	71,280
Columbus	69,120	52,020	135,300	65,890
Dayton	76,140	39,960	103,070	49,280
Other	56,340	41,310	84,700	57,860
Oklahoma				
Oklahoma City	71,820	59,940	88,990	74,470
Tulsa	86,040	58,050	99,990	79,860
Other	60,840	41,580	88,110	60,720
Oregon				
Portland	68,850	55,620	99,660	80,520
Other	59,040	47,160	87,010	66,330
Pennsylvania				
Allentown	66,960	43,380	72,710	54,120
Harrisburgh	42,100	42,100	62,590	51,810
Northeast Counties	52,470	29,970	61,820	40,040
Philadelphia	63,270	46,890	86,570	59,950
Pittsburgh	69,390	52,020	99,660	60,500
Reading	63,090	36,810	75,240	44,000
Other	50,940	44,190	56,980	50,820

AREA	1982 NEW	1982 EXISTING	1983 NEW	1983 EXISTING
Rhode Island				
Providence	$ 64,620	$ 46,260	$ a/	$ a/
Other	66,150	52,380	76,890	53,130
South Carolina				
Columbia	72,450	58,050	88,440	73,700
Greenville	47,700	44,640	73,920	67,650
Other	61,470	48,510	80,960	56,870
South Dakota	71,370	56,070	70,950	66,880
Tennessee				
Chattanooga	53,100	54,270	74,800	62,590
Memphis	73,800	55,800	85,910	76,340
Nashville	60,030	56,610	74,030	62,810
Other	43,020	40,590	71,720	56,870
Texas				
Austin	70,200	63,720	95,370	81,180
Dallas	100,260	64,260	112,420	105,820
Houston	70,560	77,580	89,650	104,830
San Antonio	75,690	64,440	87,560	84,590
Other	57,780	45,450	80,410	55,990
Utah				
Salt Lake City	68,940	48,870	81,620	55,550
Other	82,530	49,410	68,090	60,610
Vermont	52,560	43,110	61,600	59,620
Virginia				
Norfolk	76,950	54,630	95,920	59,730
Richmond	60,750	54,360	77,220	58,410
Other	64,350	44,820	62,700	59,180
Washington				
Seattle	68,760	68,850	96,800	89,210
Other	65,340	51,660	85,030	62,810
West Virginia	50,400	45,810	61,600	55,990
Wisconsin	63,270	49,680	77,110	56,320
Wyoming	71,370	56,070	70,950	66,800
District of Columbia	90,090	83,880	120,010	112,090

a/Not specified

EXHIBIT 14

INCREASE IN AFFORDABILITY WITH AND WITHOUT SUBSIDY DURING 1982 FOR THREE INCOME LEVELS

HOMEBUYER ANNUAL INCOME	15,000	22,500	30,000
MONTHLY MORTGAGE PAYMENT BUYER CAN AFFORD	312	468	625

INCREASED HOME PRICES BUYERS COULD AFFORD IN 1982 WITH:

STANDARD MORTGAGE (15.5%) (NO SUBSIDY)	25,260	37,890	50,400
MRB LOAN (13.75%) (NO SUBSIDY) OR EQUIVALENT TAX CREDIT	28,200	42,300	56,400
GRADUATED PAYMENT MORTGAGE (15.5%) (NO SUBSIDY)	29,600	44,400	59,300

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Estimate of How Far Income Ceilings Could Have Been Lowered In 1983 Based on the Decline in Mortgage Interest Rates

Time period	Interest rate	Income required to afford the average MRB mortgage of $43,300
Late 1981	16.5	$ 28,800
Early 1983	12.5	22,176
Ceilings could have dropped by		$ 6,624

COMPARISON OF STATE INCOME CEILINGS IN 1981/1982 AND 1983

Jurisdictions	1981/1982	1983	Increase or (decrease) in 1983
Arkansas	$ 36,000	$ 46,000	$ 10,000
Hawaii	36,873	36,873	-0-
Idaho	33,000	33,000	-0-
Maine	27,000	24,000	(3,000)
Missouri	28,000	31,000	3,000
Montana	31,500	38,500	7,000
Oklahoma	49,500	49,500	-0-
Rhode Island	32,500	42,500	10,000
South Dakota	34,500	30,300	(4,200)
Utah	34,000	34,000	-0-
Average Income Ceiling	$ 34,287	$ 36,567	$ 2,280

<u>Methodology used to determine if MRB homebuyers could have purchased their homes without subsidy</u>

Our methodology is based on data provided on 7,604 MRB homebuyers in seven states (Connecticut, Idaho, Indiana, Kentucky, New York, Oklahoma and Virginia). We excluded the eighth state--Alaska--where we had details on each individual MRB homebuyer because interest rates charged homebuyers are subsidized by the State down to about 10 percent. The data based on the seven states includes the following information on each homebuyer: homebuyer annual income, purchase price, mortgage amount and interest rate. Using this data, we performed the following analysis:

--For each of the 7,604 homebuyers, we calculated the percent of annual income which lenders allowed for housing costs. Housing costs included principal and interest at the mortgage interest rate charged the homebuyer plus real estate taxes and insurance. From these percentages, we determined the criteria lenders used to qualify (approve) homebuyer mortgage loans.

--Next we determined what housing costs would have been for each of the 7,604 buyers including principal and interest on their loan at a conventional mortgage interest rate of 15.5 percent and real estate taxes and insurance.

--We then determined the percent of income which would have been used to pay housing costs at the conventional interest rate for each of the 7,604 homebuyers.

--As a final step, we determined which of the 7,604 homebuyers needed the MRB subsidy by comparing the criteria used by lenders to approve MRB loans with the percent of income which would have been used to pay housing costs at conventional interest rates. If the percentage of homebuyer income fell below the lenders criteria, we concluded that the homebuyer could have purchased in 1982 using a conventional or unsubsidized FHA mortgage.

Senator PACKWOOD. I assume, Mr. Birkle, if the Finance Committee chose to pursue some alternative to mortgage subsidy bonds, we could count upon you at GAO to give us the benefit of your technical expertise?

Mr. BIRKLE. Yes, sir. Mr. Gainer and his staff are prepared to do that.

Senator PACKWOOD. Let me ask you a further question in terms of philosophy. Would the argument that you raise against mortgage revenue bonds, that they are not the most efficient way to provide a subsidy to the homebuyer, also hold true for the variety of veterans bond programs that exist throughout the country?

Mr. BIRKLE. I am not familiar with those.

Senator PACKWOOD. They are programs that use tax exempt bond proceeds to help veterans buy homes.

Mr. GAINER. We think that the cost and the benefits are probably about the same, but those, of course, have in the past been exempted from the Mortgage Subsidy Bond Tax Act; and we presume that Congress might do the same thing if it made some change in the current legislation.

Senator PACKWOOD. We exempted veterans programs because they exist in a number of States, and have existed in many of them since the end of World War II. They have a long, and by and large a spotless history. So they are not affected at all by the sunset provision.

But I am curious if the criticisms would be analogous for both kinds of programs.

Mr. GAINER. We did not study either the incomes of the buyers or the actual interest rates under those programs. I would expect the interest rates are somewhat lower because they are general obligation bonds, which would bring down the cost of those bonds relative to revenue bonds. But the benefit provided home buyers still has to be fairly small relative to those costs.

Mr. BIRKLE. Also, you would have to consider what other options are available to the veterans. There are other options available in the housing area, in the area of programs administered by VA and HUD, that are available. So the program for veterans should be evaluated, considering what other options might or might not be available.

Senator PACKWOOD. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

It seems to me that the two hallmarks of the MRB program are flexibility, the ability of the State and local governments to respond to local needs, local housing needs; and the other is the question of affordability. Yet, this basically has not been addressed, as I understand it, in your preliminary report.

Why is this? Do you intend to do so?

Mr. BIRKLE. Do we intend to do so in our final report?

Senator ROTH. Yes.

Mr. GAINER. Yes, sir. While you were out of the room we added some statistics to the record that specifically addressed the question of affordability. If you would like, I could discuss those again.

Senator ROTH. Well, let me point out, is it not true that—and I am reading from a letter sent to Senator Dole from the Council of State Housing Agencies—that you limited your investigation to bonds issued from December 1981 through July 1982, which was admittedly a period of pretty high interest rates.

Mr. GAINER. Yes, sir.

Senator ROTH. And yet despite this rather narrow and atypical timeframe, GAO's findings show that housing bond programs did a remarkable job of enabling moderate income families to purchase moderately priced housing. For example—is this correct—for example, over two-thirds of MRB borrowers had incomes below 120 percent of median during this period, and almost half had incomes below median, is that correct? Is that your finding?

Mr. GAINER. That is true, sir.

Senator ROTH. Do you not think that is a pretty remarkable record of really helping those who need help?

Mr. GAINER. Well, in looking at statistics on about half of those loans where we calculated very carefully whether or not people could have afforded homes under the mortgage revenue bond program at market interest rates, we found that those below about $25,000 did receive some increase in their ability to buy, but it was only about $20 per month. Between $25,000 and $28,000 they bought about the same prices of homes that they could have bought at market interest rates, and above $28,000 they bought less expensive homes than they could have afforded at market interest rates in 1982.

Senator ROTH. What price home are you talking about?

Mr. GAINER. For example, at $25,000 income, people bought about $43,000 homes. At $15,000 income, people under the mortgage revenue bond program bought homes in the $25,000 range, and at $40,000 incomes they bought $60,000 homes.

Senator ROTH. One of the problems is that according to the data, there are few homes available within those price ranges. You admit that two-thirds of these were bought by people with an income of 120 percent of median, and almost half had incomes below median. It seems to me that that is a pretty good record for this program.

My final question at this stage would be who bears the risk in the mortgage revenue bond program?

Mr. GAINER. It is about 50/50 between private insurance companies and FHA and VA. About half of the loans, I believe, are issued by FHA and VA, and most of the loans placed without Government insurance are placed with private mortgage insurance unless buyers put down more than 20 percent of their income. When either FHA or private insurance is used, the buyers pay for that insurance.

Senator ROTH. That is all the questions I have.

Senator PACKWOOD. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

Mr. Birkle, I thought that the most telling part of your testimony was the extemporaneous comments you made after reading the prepared statement in which you indicated what is obvious to everyone in this country, that there is a serious problem. And all you were asked to do really was to assess the cost effectiveness of this program as opposed to two alternatives.

Mr. BIRKLE. That is correct.

Senator MITCHELL. Of course, it is significant, as became clear during the Secretary's testimony, that those who oppose the mortgage revenue bond program and use this report as a means of opposing it also vigorously oppose the alternatives which you were asked to study and which you suggest are more cost effective.

Now, on that score you stated in your prepared statement that you arrived at this conclusion of more cost effectiveness using reasonable assumptions.

Now, it is my understanding that the assumptions you used to evaluate the cost of the alternatives were not identical to the situation which prevailed during the period of the study. For example, you assumed in analyzing the effectiveness or the efficiency of the alternatives a conventional mortgage rate of 15¾ percent, while at that very time the actual rate was 16½ percent.

Why did you use a figure less than what actually prevailed in assessing the efficiency of the alternatives? Is not inevitably the result of that to produce a more favorable analysis and produce precisely what this report did produce?

Mr. GAINER. If one is to analyze two alternatives and do it month by month, you can lose perspective as to what is happening in general. If you look at any given month during 1982, you will find significant fluctuations from the interest rates we used, and you will find that in some cases mortgage revenue bond interest rates were well below those of conventional rates.

Toward the end of 1982 you will find that most revenue bond loan rates were above the conventional rate. On average in 1982 the conventional interest rate was around 15.5 percent, and on average the mortgage bond interest rate for bonds sold in 1982 was about 13.75. In fact, about half of the issues that we studied were issues that went out in December 1981, and most of those were about 13.75 effective interest rate. That includes points charged by the State agencies and local agencies.

Mr. BIRKLE. Also, there would not have been any need on our part to use a lower interest rate than what we should have. You are talking about a significant additional cost here, $2.66 billion. We used what we thought was a reasonable average interest rate for the time period covered by the study, and even if it was a half a percent or a whole percent different, it would not have made that much difference in the dollars. It was still shown to be a big dollar savings if we financed the assistance to low and moderate income people through some other program.

Senator MITCHELL. I understand that, Mr. Birkle, but I would like to have you recalculate the efficiency based upon the rate which actually prevailed, not the rate which you feel was a reasonable assumption. And although it may not have eliminated entirely the favorability of the alternatives, it would have made it more realistic. And I will ask you to do that so that we can have a better basis for comparison.

Mr. BIRKLE. We will check that carefully before our final report comes out and make any adjustment that might be needed. But the interest rate was not really an assumption. It was what the actual rate was on the average for the time period in the report. But as I said, we will check that over again.

Senator MITCHELL. I respectfully disagree with you. The interest rate which you used in calculating the efficiency of the alternatives was lower than the average interest rate which prevailed during the time period of the study.

Mr. BIRKLE. We will check that carefully.

Senator MITCHELL. Now, your report states, and I quote directly, that "Purchase price ceilings did not effectively limit participation by upper income people." Someone who reads that report and has not been present in this hearing, I think, would have a different understanding of what is upper income.

This exchange today has indicated that you describe as upper income people who make between $20,000 and $30,000 a year and people who make $25,000 to $28,000 a year; and I think that flies in the face of common understanding of the American people today, of what is or is not upper income.

And while it has become obvious as a result of this questioning and the more precise details provided that the kind of language used in a report I think leads one to believe—people who make $20,000 a year are not affluent by any common understanding in the United States of America in 1983.

Mr. GAINER. If I could clarify, Senator, we were not using the $20,000 as equivalent to upper income. Upper income we were defining as——

Senator MITCHELL. I beg to differ with you, Mr. Gainer. Mr. Birkle said in his testimony, referring to the distribution of MRB home buyer incomes, that it did not limit participation by affluent families. He used a percentage which indicated that his definition of affluent fell below the $29,000 income level, and Senator Packwood asked him that question. And your phrase in the report is "upper income people."

Mr. BIRKLE. We did not label the people as affluent. We just said they were more affluent than those that——

Senator MITCHELL. Maybe you should have used the words "less poor." [Laughter.]

Senator PACKWOOD. George, let us ask him this so we have the percentage exactly. Mr. Birkle, I am looking at your chart showing the distribution of mortgage revenue bond home buyer incomes. According to this chart, about 45 percent of the people using the MRB program had incomes between $20,000 and $29,999 about 25 percent had incomes between $10,000 and $20,000, and 3 to 4 percent had incomes below $10,000. Is that about right?

Mr. BIRKLE. Yes, sir.

Senator PACKWOOD. Therefore, in terms of the distribution of the income, about 70 to 75 percent of the people who took advantage of this program had incomes of $30,000 or less.

Mr. BIRKLE. That is correct.

Senator PACKWOOD. I think all Senator Mitchell and I are saying is that in our judgment if you asked the average American if an annual income of $20,000 to $30,000 makes a person or family affluent or even upper income, most of them would say no, that is not upper income; that is just middle income, average.

Senator MITCHELL. And I would like to flesh that out a little bit with a few more statistics. It is unclear how you could reach the conclusion you did, the median price of a home purchased in 1982 with the mortgage revenue bond was 65 percent of the median price of all homes purchased.

The median income of a person, a home buyer who purchased a home with a mortgage revenue bond, was less than 65 percent of the median income for all home buyers during that period. And as Senator Roth pointed out, he said about two-thirds of all beneficiaries under the mortgage revenue bond program had income below 115 or 120 percent of the median income of the area in which the home buyer was located.

Now, those statistics are compelling in favor of a conclusion that the price ceilings did effectively limit participation by upper income people. I think your statement would be accurate if you just deleted the word "not."

What I think has to be pointed out here is that that statement is a subjective conclusion based upon what you now make clear is the relative affluence of people, and the use of the phrases "affluent" and "upper income" really, I think, do not—are used in a context that simply does not support the conclusion of the report.

I recognize that this is a subjective judgment, but I just wanted to tell you that I look at the same figures and reach the opposite conclusion from that which you reach.

Now, in your report you further make the assertion that three out of four of the home buyers who participated in the mortgage revenue bond program would have purchased a home anyway.

Now, in the time period you surveyed, conventional mortgage rates exceeded 16 percent; the median price of a home purchased was $67,800; and 84 percent of all homes purchased during 1982 had a price greater than $40,000.

Now, given that circumstance, what methodology did you use to reach the conclusion that 75 percent of the home buyers under the revenue mortgage bond program would have purchased a home anyway?

Mr. GAINER. We looked at income compared to the purchase price of homes and the mortgages on those homes, and then we calculated what price home people in each income group could afford. And we found that under the mortgage revenue bond program that once you got above $25,000, people generally bought homes at prices they could have afforded with 15.5 percent interest, or they bought homes cheaper than those they could have afforded with 15.5 percent interest.

Between about $20,000 and $25,000 they bought homes that were about the same cost as homes they could have purchased without assistance. Below $20,000 they clearly received some benefit from the program in that they bought homes more expensive than we estimated they could have bought without the assistance. That leads us to the conclusion that 75 percent could have bought the homes they bought during 1982 without assistance.

Senator MITCHELL. But the key phrases in your answer, of course, are the words "could have afforded," and what statistical basis did you use to support your conclusion with respect to each of those home buyers? How do you make a judgment that someone could have otherwise afforded a home?

Mr. GAINER. We used a very conservative estimate of what they could afford, namely 25 percent of their income as a mortgage payment. Actually, today, particularly as income goes up above $25,000, mortgage lenders will use a much higher figure to qualify people for mortgages. So we think that even using the statistics that we did and the assumptions that we used, there were probably people who we said received benefit who really did not.

Senator MITCHELL. Did you take into account the problems confronting a home buyer with respect to amassing a downpayment wholly irrespective of the 25 percent of income for mortgage payments?

Mr. GAINER. Yes, sir. In the mortgage revenue bond program the average downpayment was about 12 percent. That would be higher than the downpayment for FHA loans, lower than the downpayment for conventional loans, and much higher than most first-time home buyers (exhibits 8 and 9).

Senator MITCHELL. Well, I know, but I do not follow you. You were arriving at a conclusion that a person could purchase a home absent the existence of the mortgage revenue bond program, so the amount of downpayment necessary under the mortgage revenue bond program is an irrelevant factor in that calculation.

Now, how do you determine that a home buyer in those circumstances had both the ability to meet the downpayment and the mortgage payment obligations during the time of home ownership?

Mr. BIRKLE. Well, the people who were buying under the mortgage revenue bond program had 12 percent of the purchase price as a downpayment. That would be a good indication that with that kind of a downpayment they could afford to go regular FHA.

Senator MITCHELL. But it is not an indication that they could have gone conventional.

Mr. BIRKLE. Conventional downpayments tended to be higher.

Senator MITCHELL. Right. Did you just assume, then, that—is it fair to say that you assumed that since a person was eligible under the mortgage revenue bond program and was required to meet a 12-percent downpayment requirement, and that since FHA requires a lesser downpayment, that therefore automatically any such person would have been able to purchase another home because he could have met the FHA downpayment requirement?

Mr. GAINER. They could have purchased with FHA, and they very likely could have purchased with conventional with MGIC insurance. Most of the loans that had less than 20 percent downpayments under MRBs did have some kind of insurance, so that it would be the same kind of situation. It would be an insured loan.

Mr. BIRKLE. And that was based on the people not spending but about 25 percent of their income for their mortgage payments.

Senator MITCHELL. I understand that. I do not want to prolong this because there are other panels. I wish you would write out specifically the methodology used, and what I would like to know is did you make an individual calculation in each case, an individual assessment and then add them all up and find out that three out of four could have purchased alternatively, or did you kind of look at these numbers that we are talking about and then say well, it looks like approximately 75 percent could have done it?

Mr. BIRKLE. We will supply that for the record (exhibit 16).

Senator MITCHELL. I would like it in as much precise detail as possible. And I have some other questions regarding this report that I would like to submit in writing. We have other panels, people who have come a long way. We would like to give them the opportunity to be heard. I would like to submit those.

Mr. BIRKLE. We would be glad to supply answers for the record.

Senator MITCHELL. Thank you very much, Mr. Birkle and Mr. Gainer.

Senator PACKWOOD. Bill, any other questions?

Gentlemen, thank you very much.

Has Dr. Rivlin arrived yet? If not, let us go on to the panel of Terence Golden and Ronald Bean testifying on S. 1061.

Go right ahead, Mr. Golden.

STATEMENT OF TERENCE C. GOLDEN, MANAGING PARTNER, TRAMMELL CROW RESIDENTIAL COMPANIES, DALLAS, TEX.

Mr. GOLDEN. Mr. Chairman, my name is Terry Golden, and I am the managing partner of the Trammell Crow Residential Companies. We are an apartment development company with headquarters in Dallas, Tex. We build apartments currently in Massachusetts, Maryland, Virginia, Florida, Georgia, Texas, and Oklahoma.

Senator PACKWOOD. Let me say I am going to hold the rest of our witnesses to our time limit. We frequently allow government witnesses to go beyond that. But your entire statement and its supplement will be in the record.

Mr. GOLDEN. Thank you very much, and I will endeavor to be brief within the time limits.

This year we will build approximately 7,000 apartments. We do use tax-exempt bond financing. This year we will have approximately used about $120 million worth of bond financing and have used FSLIC guaranteed financing in the past.

The Trammell Crow Residential Companies are here today to support the passage of Senate bill 1061. We believe that the FSLIC bond program is not in the best interest of the country. I would like to explain briefly why.

As I go through my comments, I have passed out some exhibits. I would like to go very quickly through those exhibits and just briefly itemize why we feel the way we do.

Senator PACKWOOD. Are the exhibits the explanatory charts?

Mr. GOLDEN. That is correct.

If you look at page 1 there entitled "FSLIC Financing Activity Today, or Summary." Many have argued that the FSLIC bond program supports housing in areas where it is needed, principally in the Midwest and in the heavily industrialized Eastern States.

What we would like to point out in this exhibit, when you look at the results of the FSLIC bond activity to date—and this is, by the way, the complete activity to date—that virtually all of the financing that has been done has been done in the South, the Southwest, and the Far West, and not in those areas most in need of it. In fact, less than 8 percent of the FSLIC financing done to date was done in the North and in the Midwest.

Turning to page 2, many have argued that the program provides housing to individuals of low and moderate income. The point I would like to make here is that the fact that in the markets where this financing is heavily in use, namely the Southern and Western

States, the median incomes in these particular cities are so high that an individual who would qualify for low and moderate income there would probably be less than what the Congress initially intended when the tax-exempt bond program was in effect.

As an example, if you will look in Houston, the median income in Houston is currently $33,100. An individual in that market would be termed low and moderate income if his income were $26,000.

I would point out that a conventionally financed apartment in that market, that the profile of that renter in that particular unit does not differ at all from the profile of the renter in a FSLIC-financed project. So in terms of the overall effectiveness of the program in these markets where there are high median incomes and the cost of construction is relatively low, the effect of the program has limited meaning.

If you will turn to page 3, I would like to make my next point, and that is that what is happening in those markets where the FSLIC bond programs are actually being used is that it is causing projects to be built in markets which are already significantly overbuilt.

When the program was put in effect 3 years ago and there were conversations about the need for multifamily housing, I could understand the arguments for perhaps using the FSLIC guarantee as well. But as you can see from the development activity that has taken place in those markets, there has been significant construction already taking place, and in fact, most of the markets listed on that table are in an overbuilt condition.

And just referencing Houston as an example, you will notice that the vacancy rates at the end of 1982 were 16 percent and already creeping up in the first 3 months of 1983 to 18 percent.

In 1982, 40,000 units—were permitted in Houston for delivery in 1983. Houston is in a very difficult situation as far as we are concerned as builders. Yet despite that, during the first quarter of this year, FSLIC-financed projects financed an additional 3,472 units.

What we feel like we have here is a situation very similar to what we had with the REIT's in the early 1970's, and that is too much money supply in a market, and it is overfueling the supply of apartments in that market.

Cheap financing artificially stimulated by tax-exempt financing by FSLIC is causing major problems. We feel that the program is causing problems to the building industry itself. And I think if you will look here at just a brief summary of several representative S&L's that are involved in this FSLIC financing, you will notice that they are significantly underfinanced themselves, and that because of their own needs for profits that they are very active in the financing market.

We feel that many of the projects that are financed by FSLIC bonds are going to have problems because of the inexperience of the lenders involved, their need for immediate earnings, and the fact that the markets are overbuilt.

Because the S&L's themselves have a limited amount of equity, we think that eventually the Government itself will have to step in.

If there is any question you would like to ask, I would be happy to answer them.

[The prepared statement of Terence Golden follows:]

TESTIMONY ON S. 1061

TO: United States Senate Committee on Finance
Subcommittee on Taxation and Debt Management

FROM: Terence C. Golden, Managing Partner
Trammell Crow Residential Companies

DATE: May 13, 1983

My name is Terence C. Golden. I am the Managing Partner of the Trammell Crow Residential Companies ("Trammell Crow"). Trammell Crow is based in Dallas, Texas, and is actively engaged in developing single and multifamily housing throughout the United States, especially in Texas, Oklahoma, Georgia, Florida, Virginia, Maryland and Massachusetts. Our company constructed over 5,000 rental apartments in 1982. To build these units, Trammell Crow used over $150 million in tax exempt bond financing in 1982 and over $60 million in FSLIC backed bond financing in the first four months of 1983.

As a major housing developer, Trammell Crow is very concerned with the proliferation of a new financing device called "FSLIC or FDIC-Backed Bonds." While the proceeds of these bonds have been used for a variety of purposes, Trammell Crow is primarily interested in multifamily housing revenue bonds, and I will focus my testimony on the FSLIC-FDIC backed bonds used to finance multifamily housing. Since the bonds are secured by certificates of deposit from savings and loan associations or banks, they are insured by the federal government through the Federal Savings and Loan Insurance Corporation ("FSLIC") or the Federal Deposit Insurance Corporation ("FDIC").

We believe that FSLIC-FDIC backed bonds are wrong from the standpoint of public policy, and in the long run, will be harmful to the housing and banking industries. Consequently, Trammell Crow strongly supports S. 1061, which would deny tax exempt status to bonds backed by a federal depository insurance agency.

Background

By way of background, the FSLIC-backed bond program is explained in a letter dated November 3, 1982, from A. Patrick Doyle, Deputy General Counsel of FSLIC, a copy of which is attached as Exhibit A. The program for FDIC-backed bonds is similar. Briefly, bonds which are exempt from federal income tax under I.R.C. Section 103(b)(4)(A) are issued by political subdivisions or other appropriate issuing entities. The bond proceeds are deposited in an institution ("Lender") whose accounts are insured by FSLIC or FDIC in exchange for a Certificate of Deposit ("CD") which is issued in the name of the trustee and pledged as security for principal and interest payments on the bonds. The bonds are generally rated "AAA" on the basis of the FSLIC or FDIC guarantee. Without this guarantee, the bonds in most cases would probably not be rated at all. The Lender in turn makes a loan to the developer, secured by a mortgage on the developer's multifamily housing project at an interest rate which is usually higher than the interest paid on the CD. The Lender services the loan, earns points and other fees upon making the loan and is at risk if for any reason the loan goes into default.

The bonds result in new deposits and consequently produce attractive fees for the lending institutions. The developer receives a loan at a subsidized interest rate. Both the developer and the lending institution benefit at the federal government's expense. The government loses the tax income on the bond interest and takes the risk of having to bail out the lending institution if the loan goes into default and the lending institution consequently becomes insolvent.

In consequence, the FSLIC-FDIC backed bonds have been enormously popular. Since October 1982 when the program started, over $3.2 billion of these bonds have been issued. Had the program not been stopped by the news release which the Treasury Department issued on March 4, 1983, advising that Treasury would seek legislation to deny tax exempt status to FSLIC-FDIC backed bonds issued after April 15, the program would have continued to expand.

The chart labeled "FSLIC Financing Activity - First Six Months" which I have attached as Exhibit B shows that approximately $1.25 billion of bonds had been issued by early March 1983 and that over $3.2 billion of bonds had been issued by the end of April. Trammell Crow estimates that the industry could easily generate over $36 billion of FSLIC-FDIC backed bonds over the next five years if Congress and Treasury retreat from their commitment to stop the program. (See chart labeled "FSLIC Financing Activity Forecast," attached as Exhibit C.)

<u>Reasons to Stop FSLIC-FDIC Backed Bond Programs</u>

Trammell Crow believes the FSLIC-FDIC backed bond program should be stopped for a number of reasons.

1. <u>Program Encourages Housing Only in Strong Markets</u>.

The policy justification for the tax exempt FSLIC-FDIC backed multifamily revenue bond program is that it stimulates the building industry and encourages apartment construction for people with low and moderate incomes. In parts of the North and East, which have experienced net out-migration, a weak local economy and consequently, a poor housing market, there may well be a policy justification for federal assistance to encourage the construction of multifamily housing. However, in markets like Houston, Texas, Los Angeles, California or Atlanta, Georgia, which have enjoyed a strong local economy and a strong housing market and where the population has a high median income, , we believe that an adequate number of apartments would be built without FSLIC-FDIC backed bonds.

In fact, as the chart which is attached as Exhibit D shows, approximately 65% of all FSLIC-FDIC backed bonds were issued in Texas, California, Oklahoma, Louisiana, Arkansas, Florida, Colorado, Arizona, Georgia and Missouri, which have relatively strong local housing markets. The stimulus provided by the FSLIC-FDIC bond programs was not needed in these markets, and in fact probably created an artificially high level of supply which may be harmful to the industry in the long run. The FSLIC-FDIC backed bond program stimulated very little apartment development in weaker housing markets, like Detroit, Cleveland and Philadelphia. Also, since housing financed with FSLIC backed bonds was built primarily in markets with high median incomes, very few apartments were developed for poor people who the program is theoretically intended to serve.

FSLIC-FDIC backed bonds are also not necessary to stimulate the housing industry. The housing industry has rebounded strongly in recent months because of generally lower interest rates. As long as interest rates stay at tolerable levels, the housing industry will do very well without the additional subsidy provided by FSLIC-FDIC backed bonds.

2. Oversupply in Local Markets

When allowed to work without government subsidies, the housing market creates its own balance of supply and demand. In Houston, Texas, for example, an area which I know especially well, there has been a strong demand for apartments for several years. In response, a lot of apartments were built, leading to an oversupply of apartments, which is reflected in a vacancy rate that currently stands at 18%. Despite the oversupply, since October 1982, approximately $117 million of FSLIC-backed bonds were issued in the Houston area to build approximately 3,472 additional apartment units. Similarly in San Antonio, Texas, an area in which permits for only 10,711 multifamily dwelling units were issued in 1982, approximately $162 million of FSLIC-backed bonds were issued between October 1982 and April 25, 1983 to build approximately 4,803 additional units. San Antonio has had a strong housing market in the past but currently has a vacancy rate of 17%. (The chart attached as Exhibit E demonstrates the overbuilding in various market areas which has been accelerated by the FSLIC-FDIC backed bonds program.)

Many of the projects that will be built with the proceeds of these FSLIC-backed bonds are only marginally viable from an economic standpoint. They will be built because FSLIC-backed bonds provide an easy source of low interest money. Easy money inevitably leads to overbuilding.

The situtation is analogous to the situation that existed in the early and mid 1970s when Real Estate Investment Trusts, under great pressure to place

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their money, made large loans under favorable terms for marginal projects. Both the developers that built the projects and the REITs suffered massive losses when the projects subsequently defaulted.

We believe that FSLIC-FDIC backed bonds are too much of a good thing. The double subsidy resulting from the tax exemption and the federal guarantee encourages developers to build marginal projects which would not otherwise make economic sense. The resulting housing glut in certain Sunbelt markets will do the housing industry much more harm than good.

3. Effect on Banking Industry

Because the lender need not use its own money to make a FSLIC or FDIC backed bond loan, and because the lender is often inexperienced in multifamily housing, the lender often does not make its underwriting decisions as carefully as it should. The lender sees a quick fee and does not focus on the fact that it is actually making a loan to a developer that might well not qualify for a loan under normal circumstances. The developer often has no equity in the project and no personal liability on the loan.

In a typical FSLIC backed bond deal, a lender earns a 3-1/2 point fee and an interest spread of 150 basis points above the bond rate. If a lending institution does ten $10 million deals, it would earn $3.5 million in points immediately and $1.5 million in fees every year thereafter over the term of the bonds. FSLIC backed bonds are consequently a very lucrative business for the savings and loan institutions.

Attached as Exhibit F is a list of ten savings and loan institutions chosen at random from a list of potential FSLIC lenders maintained by Merrill

Lynch Pierce Fenner & Smith, Inc. Several of these institutions, which are not in strong financial shape to start with, made FSLIC backed bond loans in amounts substantially in excess of the net worth of the institutions. Although I have not studied in depth the particular projects for which these loans were made, these are the kind of loans which may come back to haunt the savings and loan industry, and FSLIC, in the future. The FSLIC-FDIC backed bond program tempts lending institutions to make poor underwriting decisions to generate quick income and is consequently not in the best interest of the banking industry.

Policy on Federal Guarantee of Private Debt

Finally, Trammell Crow does not believe that the federal government should guarantee private. debt. FSLIC-FDIC bonds are so attractive in the investment market that they tend to freeze out private debt and even state, local and federal government debt. The private sector simply cannot produce financing products which can compete with a federally guaranteed, tax exempt bond. These bonds also result in massive losses to the federal treasury.

Since no strong public policy is served by continuing the FSLIC-FDIC backed bond program, Trammell Crow believes the program should be eliminated. The benefits of the program are far outweighed by the damage the program will do to the housing industry and the banking industry and by the tax loss to the federal government.

EXHIBITS

EXHIBIT A to Testimony of
Terence Golden on S. 1061

Federal Home Loan Bank Board

[illegible] G Street [illegible]
Washington, D.C. [illegible]552

Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

November 3, 1982

Gentlemen:

This is in response to your several inquiries, including letters dated August 25, October 15, and October 18, 1982, requesting the opinion of this Office on the extent of insurance coverage for certain certificates of deposit ("CD's") of an institution whose accounts are insured by the Federal Savings and Loan Insurance Corporation ("FSLIC"). The CD's would be held by a trustee as security for the benefit of bondholders in conjunction with an issuance of tax-exempt bonds.

According to your proposal, a political subdivision or other entity (including a non-profit corporation) organized under state law to act on behalf of a political subdivision of the state will issue revenue bonds for the purpose of financing a residential development. The development will be operated in a manner that will permit the interest payable on the bonds to qualify for tax-exempt status under Section 103(b)(4)(A) of the Internal Revenue Code. Pursuant to an underwriting agreement, the issuer will sell the bonds to underwriters, who will resell them to the general public. The underwriters will deliver the proceeds of the sale of the bonds for the account of the issuer to a commercial bank acting as trustee pursuant to a trust indenture between itself and the issuer. The bondholders will be the beneficiaries under this trust indenture. The trustee will deposit the proceeds in an institution ("lender") whose accounts are insured by the FSLIC, in exchange for a CD or CD's in an amount equal to the deposit and bearing interest at or above the rate of interest payable on the bonds. The CD's will be issued the name of the trustee or, if in the name of the issuer, will be endorsed and assigned or pledged as collateral to the trustee and transferred to it irrevocably in trust to secure payment of the principal and interest on the bonds. The interest earned on the CD's will be used by the trustee to pay the interest due on the bonds, and the proceeds of the CD's will be used to retire the bonds at maturity. The CD's and the account records of the lender will disclose that the CD's are held under the trust indenture for the exclusive benefit of the bondholders and that the issuer is the settlor of the trust.

Pursuant to a deposit agreement between the lender and the issuer, the lender will be required to make a mortgage loan to finance the construction of the development with the funds received from the trustee. When the deposit is made, the lender will be required to pay to the issuer a non-refundable program participation fee equal to the necessary debt service reserves for the bonds and costs of issuance under the trust indenture. The fee may or may not be reimbursed to the lender by the developer of the project.

FSLIC Insurance Coverage

You have requested the views of this Office regarding the extent to which FSLIC insurance would cover the beneficial interests in the CD's created for the bondholders by the trust indenture and deposit agreement. The Board's Insurance Regulations define a "trust estate" as "the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statutes, but does not include any interest retained by the settlor." 12 C.F.R. § 561.4 (1982) (as amended, 47 Fed. Reg. 20,748 (1982)). The regulations provide that:

> [a]ll trust estates for the same beneficiary invested in accounts established pursuant to valid trust arrangements created by the same settlor (grantor) shall be added together and insured up to $100,000 in the aggregate, separately from other accounts of the trustee of such trust funds or the settlor or beneficiary of such trust arrangements.

12 C.F.R. § 564.10 (1982) (as amended, 47 Fed. Reg. 20,748 (1982)). This insurance coverage is conditioned by section 564.2(c)(1), which provides that "trust estates . . . in the same trust . . . will be separately insured if the value of the trust estate is capable of determination, as of the date of default, without evaluation of contingencies" other than those covered by the present worth tables in the Federal Estate Tax Regulations. 12 C.F.R. § 564.2(c)(1) (1982) (as amended 47 Fed. Reg. 20,748 (1982)).

Assuming that the trust indenture in your proposal creates an irrevocable express trust for the benefit of the bondholders that is valid under state law, it is our view that the interests of the bondholders in the CD's would be insurable as trust estates as provided by § 564.10, subject to compliance with the recordkeeping requirements (discussed below) of 12 C.F.R. § 564.2 (1982). Accordingly, the interest of each bondholder in the CD's would be separately insured as a trust estate to $100,000 together with all other trust estates created by the same settlor for the same beneficiary invested in accounts of the same institution. Further, as we understand the proposal, the CD's, at all times while the bonds are outstanding, will be held by the trustee for the exclusive benefit of the bondholders. In these circumstances, the value of each bondholder's interest in the CD's, the trust estate, may be determined without evaluation of any contingency.

Recordkeeping Requirements

Your letter raises additional questions regarding the records that must be maintained for insurance purposes in instances where bonds have been transferred, but the transfer has not yet been recorded by the trustee, or where the bonds are held in the name of a nominee for the true owners. You have inquired as to the extent of insurance coverage if an insured institution defaults subsequent to either the delivery of a negotiable bond to a transferee or subsequent to the assignment of a non-negotiable bond or certificate of interest, but, in each case, prior to the registration of the bond by the trustee in the name of the transferee. In other instances, investors may own bonds through a nominee, in whose name the bonds will be registered with the trustee. You have inquired whether the FSLIC will consider the investors to be the owners of the bonds and, thus, for insurance purposes, beneficiaries of the trust estates in the CD's.

The recordkeeping requirements of the Insurance Regulations provide that the "account records of the insured institution shall be conclusive as to the existence of any relationship pursuant to which the funds in the account are invested and on which a claim for insurance is founded." 12 C.F.R. § 564.2(b)(1) (1982). The regulations further provide that once the existence of a relationship that may provide the basis for additional insurance is disclosed by the account records of an insured institution, "the details of the relationship and the interests of other parties in the account must be ascertainable either from the records of the association or the records of the account holder maintained in good faith and in the regular course of business." 12 C.F.R. § 564.2(b)(2) (1982).

EXHIBIT B to Testimony of
Terence Golden on S. 1061

FSLIC FINANCING ACTIVITY: FIRST SIX MONTHS

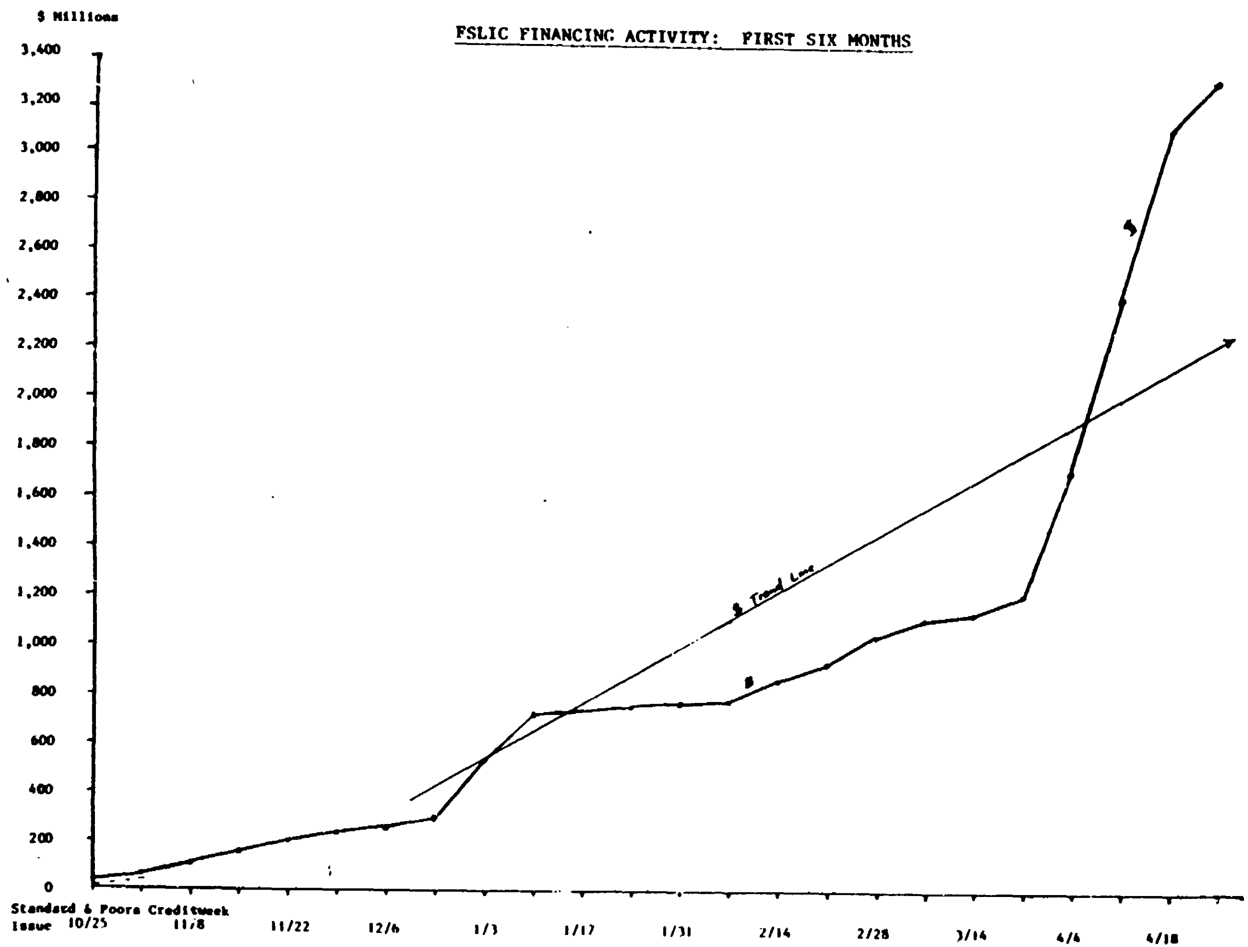
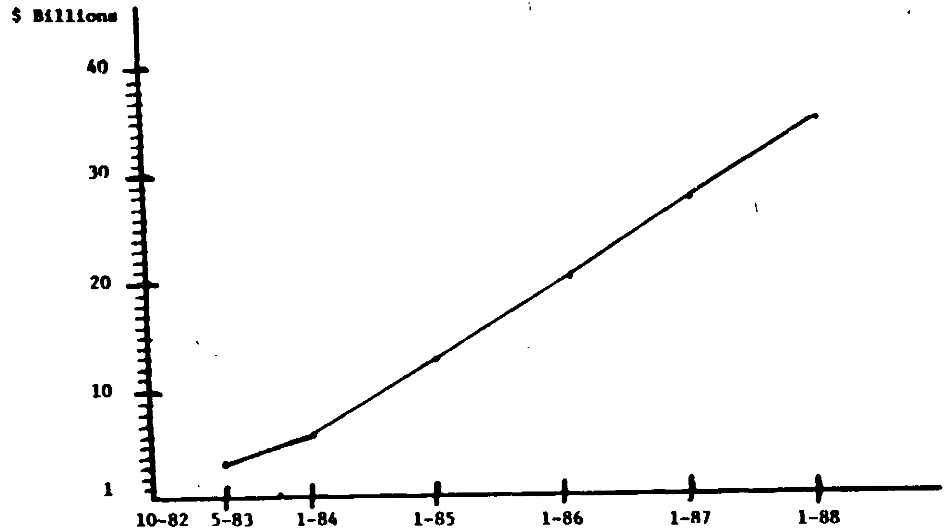


EXHIBIT C to Testimony of
Terence Golden on S. 1061

FSLIC FINANCING ACTIVITY
FIVE YEAR FORECAST (APARTMENTS ONLY)*



Forecasted Activity By Year

Period	Amount (In Billions)	Cumulative Amount (In Billions)
10-1-82 - 5-1-83	$3.299 (actual)	$3.299
5-1-83 - 12-31-83	3.201	6.49
1-1-84 - 12-31-84	6.8	13.29
1-1-85 - 12-31-85	7.2	20.49
1-1-86 - 12-31-86	7.6	28.09
1-1-87 - 12-31-87	8.0	36.09

*These estimates of FSLIC Bond Activity are made by Trammell Crow Residential Companies assuming that the Program is permitted to continue in its present form.

EXHIBIT D to Testimony on
Terence Golden on S. 1061

1982 - 1983 FSLIC FINANCING ACTIVITY SUMMARY
By State

STATE	NO. OF ISSUES	AMOUNT	RANK
Texas	116	$1,098,189,000	1
California	32	453,130,000	2
Oklahoma	25	243,355,000	3
Arizona	29	202,765,000	4
Louisiana	18	192,840,000	5
Florida	22	152,900,000	6
Arkansas	12	131,275,000	7
Colorado	14	121,870,000	8
Georgia	7	81,700,000	9
Missouri	9	64,050,000	10
Alabama	12	63,900,000	11
Utah	7	48,715,000	12
Tennessee	11	48,115,000	13
Minnesota	12	43,804,000	14
Pennsylvania	5	43,600,000	15
Ohio	11	40,240,000	16
Maryland	7	39,490,000	17
Illinois	7	36,279,000	18
Delaware	4	26,700,000	19
Puerto Rico	1	25,995,000	20
Kansas	7	24,950,000	21
Nevada	6	20,850,000	22
West Virginia	10	18,635,000	23
North Dakota	1	18,000,000	24
Mississippi	2	8,275,000	25
Kentucky	2	8,150,000	26
Alaska	1	7,990,000	27
Michigan	1	7,825,000	28
Montana	1	7,000,000	29
Indiana	1	5,000,000	30
Nebraska	2	4,430,000	31
New Jersey	2	3,907,000	32
Iowa	2	3,050,000	33
Virginia	1	2,400,000	34
TOTAL	400	$3,299,374,000	
TOTAL OF TOP TEN		$2,134,734,000	

5-10-83

EXHIBIT E to Testimony of
Terence Golden on S. 1061

OVERBUILDING - THE FSLIC BOND PROGRAM'S IMPACT ON APARTMENT CONSTRUCTION

AREA	$ VOLUME	FSLIC FINANCED APARTMENTS**	MULTI FAMILY BUILDING PERMIT ACTIVITY (# OF UNITS) 1982	1981	1980	1979	VACANCY RATE 12-82	3-83
Austin, Texas	$197,465,000	5,842	4,788*	8,000*	2,510	2,001	6%	8%
Dallas/Ft. Worth, Texas	205,839,000	6,090	38,846*	10,457*	1,618	1,410	6%	9%
Houston, Texas (Harris County)	117,355,000	3,472	40,480*	14,896*	11,712	20,948	16%	18%
San Antonio, Texas (Bexar County)	162,345,000	4,803	10,711*	3,583*	4,044	5,576	16%	17%
Oklahoma City, Oklahoma	48,400,000	1,432	4,655*	855*	920*	657*	2%	12%
Tulsa, Oklahoma	95,300,000	2,820	4,975*	1,407*	N/A	N/A	2%	14%
Tuscon, Arizona (Pima County)	103,780,000	3,070	3,689*	1,847*	2,187*	3,543*	5%	11%
Shreveport, Louisiana	13,400,000	396	1,121*	340*	335*	290*	7%	7%
Little Rock, Arkansas (Pulaski and Puline Counties)	71,500,000	2,115	1,529	468	527	492	0-4%***	

* SMSA
** Assumes Average Unit Cost of $33,800
** From Little Rock, Arkansas, Chamber of Commerce

EXHIBIT E-1 to Testimony of
Terence Golden on S. 1061

MEDIAN INCOME FOR SELECTED CITIES WHERE FSLIC BONDS HAVE BEEN ISSUED

AREA	MEDIAN INCOME *	LOW & MODERATE INCOME (80% of Median)
Austin, Texas	$27,900	$22,320
Dallas/Ft. Worth, Texas	29,800	23,840
Houston, Texas (Harris County)	33,100	26,480
San Antonio, Texas (Bexar County)	23,100	18,480
Oklahoma City, Oklahoma	27,600	22,080
Tulsa, Oklahoma	27,900	22,320
Tuscon, Arizona	24,900	19,920
Shreveport, Louisiana	24,400	19,520
Little Rock, Arkansas	27,700	22,160

*SMSA

EXHIBIT F to Testimony of
Terence Golden on S. 1061

FSLIC LENDER SUMMARY +
(All Figures in $ Millions)

5/18/83

Savings & Loan	Assets	Date	Net Worth	Net Worth as % of Assets	FSLIC BONDS GENERATED	Profits Lost F.Y.	Profit as % of Assets	Profit as % of Net Worth
1st Federal of Arkansas	$ 674.6	9/30/82	($29.5)	(4.4%)	$126.045	($52.9)	(7.8%)	(179.3%)
Alliance S & L - Houston	25.6	6/30/82	2.3	9.0%	6.470	.1	.4%	4.3%
1st Federal of Arizona	2,561.3	12/31/82	70.3	2.7%	19.800	5.6	.2%	8.0%
Savers's Federal S & L of Ark.	507.9	9/30/82	11.0*	2.2%*	164.095	(4.4)*	(.9%)*	(40.0%*)
University Savings	2,305.7	6/30/82	87.5	3.8%	158.920	4.0	.7%	4.6%
Alamo Savings of Texas	575.2	12/31/82	14.8	2.6%	28.784	3.7	.6%	25.0%
1st Savings of Port Neches,TX	47.6	6/30/82	2.1	4.4%	10.00	(.3)	(.6%)	(14.3%)
San Antonio Savings	1,300.7	9/30/82	58.5	4.5%	33.200	(1.7)	(.1%)	(2.9%)
United Finance Group	1,850.9	12/31/82	47.6	2.6%	0	(18.6)	(1.0%)	(39.1%)
Surety Savings Assn.	130.2	12/31/81	3.6	2.8%	11.100	.2	.2%	5.6%
Pioneer Savings & Trust	149.0	12/31/82	4.8*	3.2%*	7.00	(.1)*	(.1%)*	(2.1%)*

* Figures based on Regulatory Accounting Procedures.

+These institutions were chosen at random from the pool of FSLIC Lenders.
**Figures from Standard & Poor's AAA-L Internal Revenue New Ratings.

Exhibit G is in the [illegible] committee files.

Senator PACKWOOD. I have no questions, but let me compliment you on the quality of your evidence. I think this is the kind of evidence that Senator Mitchell would have been very pleased to have seen when he sat on the court for a number of years. You make a very, very compelling case in a very short period of time with those statistics. I cannot tell you how much I appreciate it.

Mr. GOLDEN. Well, I appreciate being here and seeing the process at work. Thank you.

Senator PACKWOOD. George.

Senator MITCHELL. I have no questions.

Senator PACKWOOD. Thank you very much, Mr Golden.

Next we will take the Honorable Bill Clinton, the Governor of the State of Arkansas, who is representing the National Governors' Association, and the Honorable Vincent Thomas, mayor of Norfolk, Va., testifying on behalf of the U.S. Conference of Mayors.

I believe Senator Mitchell wants to say a few words before you start.

Senator MITCHELL. Senator Pryor, who is a distinguished member of this committee, could not be present this morning and asked me in his behalf to extend to Governor Clinton his very best and welcome you here, and to say that we all look forward, all members of the committee, to your testimony, Governor, along with that of the mayor.

Governor CLINTON. Thank you very much.

Senator PACKWOOD. Governor, Please go ahead?

STATEMENT OF HON. BILL CLINTON, GOVERNOR, STATE OF ARKANSAS, ON BEHALF OF THE NATIONAL GOVERNORS' ASSOCIATION, ACCOMPANIED BY RICHARD GELTMAN, STAFF DIRECTOR, COMMITTEE ON COMMUNITY AND ECONOMIC DEVELOPMENT, NATIONAL GOVERNORS' ASSOCIATION

Governor CLINTON. Mr. Chairman and members of the committee, I am here today representing not only my State but also the National Governors' Association and its Committee on Community and Economic Development, a committee which is chaired by my colleague, Governor Bond from Missouri, who concurs in the remarks that I am about to make.

In summary, the National Governors' Association strongly supports S. 137, which eliminates the December 31, 1983, sunset of the revenue mortgage bond program. That program addresses the lack of affordable housing in our country and in my State.

Affordable housing, assisted by the mortgage revenue bond program, contributes to the economic development of both the housing industry and the States' economy as a whole. The program allows the States a mechanism to access capital markets to make funds available which would otherwise be out of reach of many moderate-income first home buyers.

The program functions also in my State and generally throughout the Nation at relatively low cost to the Federal Government.

The National Governors' Association is firmly committed to maintaining the ability of States to provide housing finance assistance and especially to assist first-time home buyers.

At our winter meeting in Washington this past month the Governors unanimously adopted a policy position in support of the elimination of the sunset date of December 31, 1983. The policy reads, and I quote:

The mortgage revenue bond program is an important vehicle for the financing of home ownership and rental housing in areas where the private sector is not adequately meeting the demand. The Congress passed the Mortgage Subsidy Bond Tax Act of 1980 in order to place significant restrictions on the existing program, and thereby meet perceived abuses and reduce the level of use. There is no need to further restrict the program. Congress should avoid or remove unnecessary restrictions on States' use of mortgage revenue bonds. Congress must eliminate the provision that sunsets the mortgage revenue bond program on December 31, 1983.

The NGA support is reflective of the support for the program of the individual Governors and their States. Just last week Governor Spellman of Washington signed into law, State legislation creating the State of Washington's Housing Finance Agency. The addition of Washington brings to 49 the number of States which now have statewide housing finance agencies empowered to provide homeownership financing; 49 of the 50 States have acted in this area to date.

Since the inception of the program in Arkansas in 1977, we have authorized six bond issues totaling over $400 million in mortgages supporting the financing of over 9,100 single-family homes. Last month, the housing develpment agency in my State sold $26.365 million in single-family mortgage revenue bonds providing 30-year fixed mortgages at a mortgage interest rate of 9.625 percent, which will benefit approximately 600 home buyers in our State.

As housing has become more and more unaffordable to the majority of Americans, tax-exempt revenue bonds have become more and more a greater source of housing financing. In 1982, 10 percent of all new-single family housing was financed by mortgage revenue bond programs. In 1982 somewhere between one-third and one-sixth of first-time home buyers purchased a home with the help of mortgage revenue bond financing.

As market rates have dropped recently, so have MRB rates to permit assistance to even lower income families. In 1981 the mortgage revenue bonds' median income was at 81 percent of the national median. In 1982 at the height of the recession and high interest rates, it rose but still to only 96 percent of the national median income.

Both as a housing and an economic development tool, mortgage revenue bonds are vital for Arkansas—just as vital now as they were in 1977 when I sponsored legislation to increase our bonding authority to $600 million.

Unemployment in our State last year was over 10.2 percent, and contract construction employment has fallen substantially and steadily since 1979. The ratio of owner-occupied housing units to total households has risen by only 10.4 percent since 1960. The median household income in Arkansas in 1980 was $12,132, which will support monthly mortgage payments of only $252, according to the standard methodology requiring 25 percent of income to be devoted to the monthly mortgage payment. Therefore, even at an interest rate of 12 percent, a family at this income level would not be able to purchase new or existing single-family housing at the median 1982 price using credit from private sources.

The mortgage revenue bond program has allowed State governments to pursue a strategy of economic growth rather than stagnation and has given many, many of our citizens the opportunity to purchase their first home.

I would like to say that I commend the administration for its concern for erosion of the Federal Treasury. I understand that, and I respect it. But it seems ironic to me that looking at all the various estimates which have been presented to this committee for revenue loss—Professor Kormendi said we will lose a total of $790 million by the outyear of this program, in 1988. Mrs. Rivlin estimates another $2.8 billion in revenue loss over the 5-year period. Treasury estimates something like $5 billion perhaps over 20 years.

At a time when we have a third-year tax cut that will cost the Treasury $30 billion and indexing which will cost the Treasury substantially more, and both of those programs do not have the restrictions and protections that this program has—that is, you know, every time you lose a Federal tax dollar in this program, it is because money, by definition, is being spent to put people to work in good, productive jobs, and to further a legitimate social objective of all of our States in this Nation—it would seem to me to be the better part of wisdom to allow this program to continue and to suspend the sunset. Even though it will cost some money, it certainly will not cost nearly as much money as other Federal programs already on the books. And it will be absolutely essential to our State. I hope that you will continue it. I commend the Senators who are cosponsors of this bill.

Thank you very much, Mr. Chairman.

[The prepared statement of Gov. Bill Clinton follows:]

National Governors' Association

Scott M. Matheson
Governor of Utah
Chairman

Raymond C. Scheppach
Executive Director

TESTIMONY OF
THE HONORABLE BILL CLINTON
GOVERNOR OF ARKANSAS

TO

THE SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT

COMMITTEE ON FINANCE
U.S. SENATE

REGARDING
THE MORTGAGE REVENUE BOND PROGRAM

May 13, 1983

HALL OF TI E STATES • 444 North Capitol Street • Washington, D.C. 20001 • (202) 624-5300

Mr. Chairman and Distinguished Senators, good morning.

Today, I am here before you as a representative of the National Governors' Association and its Committee on Community and Economic Development. The issue on which I will speak to you is financing for homeownership, funding that is critical to the economic health of our different States and to the well-being of our citizens.

My testimony can be summarized as follows:

NGA supports S. 137, the Housing Finance Opportunity Act of 1983, which eliminates the December 31, 1983 sunset of the Mortgage Revenue Bond Program. The Mortgage Revenue Bond Program addresses the lack of affordable housing in this Nation. The Mortgage Revenue Bond Program provides affordable homeownship financing for first-time homebuyers. Affordable housing assisted by the Mortgage Revenue Bond Program contributes to the economic development of both the housing industry and the State economy as whole. The MRB Program is a mechanism that gives States access to capital markets to make funds available for moderate income first-time homebuyers, funds that would be otherwise out of their reach. The program, which leverages significant State contributions, functions at a relatively low federal cost.

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NGA and State Support for Mortgage Revenue Bonds

NGA is firmly committed to maintaining the ability of the States to provide housing finance assistance, especially for first-time homebuyers. At NGA's winter meeting here in Washington, D.C. this past March, the Governors adopted a policy position in support of the elimination of the sunset date of December 31, 1983, and the provision of mortgage financing for first-time homebuyers. NGA's policy position reads:

> The Mortgage Revenue Bond Program is an important vehicle for the financing of home ownership and rental housing in areas where the private sector is not adequately meeting the demand. The Congress passed the Mortgage Subsidy Bond Tax Act of 1980 in order to place significant restrictions on an existing program, and thereby meet perceived abuses and reduce the level of use. There is no need to further restrict the program. Congress should avoid or remove unnecessary restrictions on States' use of mortgage revenue bonds. Congress must eliminate the provision that "sunset" the Mortgage Revenue Bond Program on December 31, 1983.

NGA support reflects the support for the program in the individual States. Just this last week Governor John Spellman signed into law State legislation creating the State of Washington's Housing Finance Agency. The addition of Washington brings to 49 the number of States which now have Statewide housing finance agencies empowered to provide homeownership financing.

Since the inception of the Mortgage Revenue Bond Program in Arkansas in 1977, we have authorized 6 bond issues, totaling over $400 million in mortgages, supporting the financing of 9,000 single family homes. Just last month, the housing development agency sold $26.4 million in single family mortgage revenue bonds, providing 30-year mortgages at a mortgage interest rate of 9.625 percent to benefit approximately 600 homebuyers in my State.

While I am here testifying before you, I would be remiss if I failed to note that Governor Kit Bond of the State of Missouri, Chairman of NGA's Committee on Community and Economic Development, is one of the principle spokesmen for the Mortgage Revenue Bond Program and this policy position. He has been actively attempting to persuade the Administration and Treasury to support mortgage revenue bonds.

The Mortgage Revenue Bond Program addresses significant problems.

Lack of Affordable Housing

Housing prices rose faster than incomes from 1970 to 1980. In 1970 the median family income was approximately $10,000 while the median new single family home cost $23,000. In 1980, the median family income was $23,500, but the median new single family home price was $70,000. In the same period mortgage interest rates doubled from 8 percent to 16 percent. We have reached a point where only 15 percent of first-time homebuyers can afford to purchase the median priced new house — a sharp drop from the 50 percent who could do so 10 years ago. Today, housing prices and interest rates are so high that a majority (60 percent) of existing homeowners could not afford to purchase their present homes without the benefit of their accrued equity. The building industry is depressed, and new households have little hope for homeownership.

In some growth areas such as the Sunbelt, the Mountain States and the West Coast, median housing prices increased from 2½ to 6 times median incomes between 1970 and 1980.

Housing demand will increase. The 1950's "baby boom" is projected to result in 9 million new households in the next 5 years, a 15-percent increase over the high level of household formations that occurred from 1975 to 1980.

The cost of financing a home is expected to remain high in the 1980's. During the late 1970's, the "real" rate of mortgage interest was near zero — the mortgage interest levels were at or below the rate of general inflation. Now the "real" interest rate is clearly positive —mortgage interest levels are five to six points above the general inflation rate, and lending institutions are not likely to give housing the favorable treatment it received in the 1970's.

Interest rates are coming down with the reduction in general inflation. This drop in mortgage interest rates, however, may only rekindle the rise in housing prices, given a shortgage of new housing and pent-up demand.

Responses to Lack of Affordability

In the early 1970's, homebuyers were able to make some financial adjustments to meet higher prices and interest rates. They increased their incomes by increasing the number of household members working. Between 1970 and 1980, households with two working members rose from 40 to 60 percent of total households. Moreover, first-time homebuyers began to spend a larger share of their gross income on housing — the proportion went from 25 percent to 30 percent. But such future adjustments will be difficult. People cannot do much more to increase their spending for housing without cutting back substantially on other expenditures such as food, clothing and education.

As housing clearly became unaffordable to the majority of the Nation's population two years ago, tax-exempt revenue bonds represented the one solution. In 1982, 10 percent of all new single-family housing was financed by MRB's, and one out of every three to six first-time homebuyers purchased a home with the help of MRB financing. Since they first began homeownership programs in the early 1970's, State housing finance agencies (HFA's) have provided below-market rate mortgage loans for 440,000 households. In addition, local HFA's have provided mortgage loans for some 250,000 households. State and local HFA's together have provided well over $1 billion in low interest rate loans for home improvements and energy conservation for existing housing. In 1981, according to the Council of State Housing Agencies, MRB borrowers' median income was at 81 percent of the national median. In 1982, during the depths of the recession, borrowers' median income was still only at 96 percent of the national median income despite the use of the MRB program as a countercyclical device.

Affordable Housing Essential to Economic Development

As a Governor, I can assure you that the tax-exempt revenue bond program at the State level is successful because it provides more than affordable mortgage money for our deserving citizens. Tax-exempt bonds for homeownership serve a larger role in relation to State economic development strategies. This program has been critical to the ability of our States affected by rapid energy development such as Wyoming and Montana to provide housing opportunities for the influx of labor needed to produce the energy this country requires. At the same time, tax-exempt bonds for homeownership have served as a stabilizing force for homeownership in the cities and the neighborhoods of our northeast and midwest. The redevelopment of our tax base in the industrial heartland is vital to the continued health of our national economy.

As Governors, we are responsible for the growth and productivity of both our economic and human resources. In the past five years, the ability of State housing finance agencies to produce lower interest funds for homeownership has meant an increase in affordable housing opportunity. It has also maintained a faltering housing industry by providing thousands of jobs in our construction and building materials industry. It is estimated by the Council of State Housing Agencies that the 690,000 home purchases, of which about 345,000 were for new housing financed by State and local HFA's, created over 439,000 jobs, generating $3.7 billion in tax revenues and total economic activity of $36.6 billion. In Missouri, for example, new construction financed by MRBs has created many jobs, and the program as a whole has generated between $25.7 million and $27.3 million in federal, State and local tax revenue, net of foregone taxes.

Both as a housing and as an economic development tool, MRBs are as vital for Arkansas now as they were in 1977. Unemployment in Arkansas in 1982 was 10.2 percent, and contract construction employment has fallen substantially from its peak in 1979. The ratio of owner-occupied housing units to total households has risen by only 10.4 percent since 1960. The median household income in Arkansas in 1980 was $12,132 which will support monthly mortgage payments of only $252 according to the standard methodology. Even at an interest rate of 12 percent, a family at this income level would not be able to purchase new or existing single-family housing at the median 1982 price using credit from private sources.

The Mortgage Revenue Bond Program has allowed State government to pursue a strategy of economic growth, rather than stagnation. It has given our citizens an opportunity to purchase their first home.

Providing Capital for Housing

I have been describing the benefits of tax-exempt financing we can all see, such as the young families buying their first home, the new construction in our States, and the industry being developed as a result of our ability to offer affordable financing for housing. An unseen but real benefit of tax-exempt bonds is allowing the State to seek funds from capital markets to increase money for housing, thereby making money available to low and moderate income families who would otherwise be foreclosed from financing a home purchase. Because of the State access to capital markets, the States are able to provide the type of financing to meet the needs of the current economic climate. From the end of 1981 through 1982, mortgage money through State housing finance agency programs was virtually the only available and affordable financing. Now State programs are available to give the qualified consumer low interest, low-downpayment, fixed-rate, 30-year mortgages which, as you know, is no longer economically feasible for many of our traditional lending institutions. As conventional interest rates are dropping, so are the interest rates of State programs allowing us to serve even lower income families.

Low Federal Cost and Major State Contributions

While the benefits of MRB's are significant, the cost to the federal government is relatively small. Moreover, States, themselves, have made major financial contributions to the program. According to Professor Roger Kormendi, the cost of continuing the federal tax exemption for MRB's is $15 million in fiscal year 1984 up to $324 million in fy 1988, for a five year total of $790 million. At the State level in 1982 alone, State housing finance agencies contributed $155 million to 61 single family housing issues. Part of these contributions came from earnings of the agencies and part came from State appropriations and loans.

The Mortgage Revenue Bond Program is important because it helps meet the needs of the States to:

- provide affordable homeownership financing for first-time home-buyers;
- contribute to the economic development of both the housing industry and the State economy as a whole;
- allow access to private capital markets for housing finance otherwise out of the reach of many citizens; and
- provide assistance at a low federal and State cost.

NGA fully supports the continuation of Mortgage Revenue Bond Program as demonstrated in the adoption of the policy position earlier this year. Governor Bond joins me and the other members of the Committee on Community and Economic Development in encouraging you to adopt the Housing Finance Opportunity Act of 1983.

Mr. Chairman, I'd be glad to entertain any questions you may have.

Senator PACKWOOD. As you are aware, Governor, there are 73 Senators who agree with your statement. I hope that will be enough to get it through.

Mr. Mayor.

STATEMENT OF HON. VINCE J. THOMAS, MAYOR, NORFOLK, VA., ON BEHALF OF THE U.S. CONFERENCE OF MAYORS

Mr. THOMAS. Mr. Chairman, I am Vincent J. Thomas, mayor of Norfolk, Va., and I am representing the U.S. Conference of Mayors; and you have my prepared statement.

My statement tracks very closely the eloquent statement by Governor Clinton, so I will not repeat those items by reading them. But I would like to make a few comments on the housing bonds, and then just to comment briefly on the matter of State and local tax deductibility and on IRB's.

As to housing bonds, the Conference of Mayors supports strongly S. 137 to repeal the sunset provision on mortgage revenue bonds. I call to your attention that that sunset provision was to allow review which is currently in progress. I would submit that it is a very bad time to interfere in any way with the recovery of the housing industry in the United States. We are looking at that to be one of the leaders of the recovery, and it seems to me that housing bonds fill a gap in the market which very badly needs to be filled.

Let me comment a little about what is happening in Norfolk, Va. We are an old city. We are 300 years old. We do not have very much land on which to build houses, but we have an old housing stock. We have issued locally, $17.2 million in mortgage revenue bonds which have financed 1,200 loans for housing rehabilitation. We feel that it is absolutely necessary that cities have very strong code enforcement programs, and if we are to make these work from a political standpoint and from an economic standpoint, we have to have a source of funds available so homeowners can meet the demands of that housing code enforcement program. And this has done wonders for many of our aging neighborhoods. And with the cost of new construction being what it is, we would be absolutely derelict in our duty if we did not save every possible square foot of current housing that we can.

We have just had an issue of $750,000 for single-family rehabilitation to carry on this program. We are active with the State in the program of the Virginia Housing Development Authority and have used $1.7 million which represents 42 loans for low- and moderate-income new construction. That is an average of about $40,000. And even with a downpayment, a modest downpayment, that does not buy a whole lot of housing. So this is really a program for low- and moderate-income people.

Mayors need this tool to be flexible in providing housing for its people, particularly those of low and moderate income. We think that the changes in 1980 have removed all of the abuses that brought the program under some criticism.

Incidentally, Mayor Feinstein of San Francisco has sent in information about the mortgage revenue bond program in San Francisco, and that is described here in this statement.

We are disturbed about the possibility of any changes in the deductibility of local and State tax revenues. This is a very necessary political tool for local and State politicians when considering any matters of tax increase. So we urge you to continue this historic tax relationship between the Federal, State, and local governments.

We also strongly urge that Congress do nothing further to limit or attempt to limit industrial revenue bonds. The past year has been one of great uncertainty with respect to IDB's with mayors not knowing the outcome until late in the last session. Restrictions which were adopted place sensible limits on the use of these bonds. Consequently, we should not reopen this fight.

Mr. Chairman, I thank you for this opportunity to testify. The Conference of Mayors is using its best efforts to convince all mayors that they must make responsible uses of MRB's and IRB's, these bonds, that there must be adequate public input into the use of them, and that they should be consistent with the economic development program of the city.

I thank you. I am sorry I did not have any charts. Real mayors do not use charts.

[The prepared statement of Mayor Vince Thomas follows:]

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TESTIMONY OF MAYOR VINCENT J. THOMAS
NORFOLK, VIRGINIA

on behalf of

THE U.S. CONFERENCE OF MAYORS

on the subject of

MORTGAGE REVENUE BONDS

before the

SENATE FINANCE COMMITTEE

May 13, 1983

Mr. Chairman, Members of the Finance Committee, thank you for the opportunity to testify on behalf of the U.S. Conference of Mayors on the subject of mortgage revenue bonds and the elimination of the sunset provision which applies to these bonds.

As you know, Mr. Chairman, when the Congress adopted the Mortgage Subsidy Bond Tax Act of 1980, a provision was included to "sunset" mortgage revenue bonds for ownership housing after December 31, 1983. After that date, no such bonds will be tax exempt.

The purpose of this sunset provision was to provide the Congress an opportunity to review housing bond programs and to evaluate whether these bonds are meeting Congressional objectives.

Based on my own experience and the experience of other Mayors, I believe that MRBs have been used in an effective manner to stimulate homeownership by low- and moderate-income families. In addition, MRBs have proven to be an important development tool for cities in stablizing and upgrading neighborhoods.

The need for such assistance is great. Despite the recent drop in mortgage interest rates, the cost of housing is still beyond the means of many families -- especially first time housebuyers -- a situation which is likely to persist throughout the decade. Moreover, the prediction is that mortgage interest rates will remain relatively high, which exacerbates the affordability problem.

There are significant economic benefits which accrue to a community as a result of the use of mortgage revenue bonds. It is estimated that nationwide the bonds issued by state and local housing finance agenices have financed 690,000 house purchases, generated 439,000 jobs, and increased federal, state, and local revenues by more than $3.5 billion.

I know you are hearing today from many other witnesses who are more expert than I in defense of the economic benefits, efficiency, cost, and the credit market effects of mortgage revenue bonds. However, the Conference of Mayors believes that many of the costs and inefficiencies which have been cited by the Treasury Department and the General Accounting Office are overstated. For example, the GAO claims that MRBs account for a "substantial" portion of the home mortgage market. Yet, in 1982, they accounted for only 6-7 percent. The GAO calls those over 120 percent of the median the "upper income" and the "more affluent." I would guess that these people would not consider themselves to be more affluent homebuyers.

Mr. Chairman, many of the problems and abuses associated with MRBs were corrected in the 1980 legislation. In 1980, the Congress focused on three major problems with MRBs -- the growth in MRB issues, costs and earnings that were considered to be excessive, and the perception that MRBs were benefiting some households that did not need the assistance. These concerns were adequately addressed with the volume cap, arbitrage restrictions and purchase price and eligibility limits.

Housing activity is an important element in the economic recovery of our nation and our cities. The depression in the housing industry is one of the major contributors to the high unemployment rates in many cities. MRBs offer cities one tool to stimulate the production and sale of housing for lower- and middle-income families, and the creation of much-needed jobs.

Mortgage revenue bonds are also a vital tool for urban redevelopment. San Francisco recently targeted a MRB issue to low- and moderate-income purchasers in blighted redevelopment areas. The loans were made as shared appreciation mortgages in which the city pays a portion of the purchaser's monthly payment in exchange for a proportional share of the property's appreciation at the time of resale. At no time will the owner be entitled to less than half of the property's appreciation. The city's portion of the mortgage payment was funded by contributions from downtown office builders. This way, low-income people who might in normal circumstances be displaced by an area's rehabilitation, are able to remain in their neighborhood as well as accumulate a valuable property asset. Rather than fight government attempts at neighborhood revitalization out of fear for their personal future, residents have been encouraging and cooperative as these plans are implemented.

I would like to respond briefly to one criticism often made of mortgage revenue bonds -- that these bonds have led to an increase in tax-exempt interest rates and a declining spread between these rates and taxable interest rates. I do not think the dismal state of the municipal bond market can be blamed on the issuance of MRBs or IDBs. Historically, the spread between tax-exempt and taxable bond rates has not tracked with the volume of tax exempt securities issued. Rather, the difficulties cities have encountered in the bond market in recent years are the result of many other factors -- high interest rates generally, tax law changes which have reduced the demand of both individuals and institutions for municipal bonds, declining bond ratings, and the large volume of Treasury borrowing. The result of all these factors has been an inability of many cities to issue general obligation bonds for important capital projects.

Mr. Chairman, I would like to make two brief comments on whatever comprehensive tax bill this Committee may be considering later this year. First, the Conference of Mayors is concerned that the Congress not tamper with the deductibility of state and local taxes. It is extremely difficult politically to propose and adopt tax increases at the local level, however important the services which such taxes will finance. The deductibility of such tax increases is often one of the major "selling points" at the local level. I think it is vitally important -- and I know other Mayors and Governors would agree with me -- to continue this historic tax relationship between the federal, state, and local governments.

Secondly, I would hope that the Congress would do nothing further to limit or attempt to limit industrial revenue bonds. The past year has been one of great uncertainty with respect to IDBs,with Mayors not knowing the outcome until late in the session. The restrictions which were adopted place some sensible limits on the use of these bonds. Consequently, we should not reopen this fight.

Mr. Chairman, I thank you for this opportunity to testify on mortgage revenue bonds, a subject of considerable importance to cities around the country. We look forward to working with you to adopt legislation, now supported by more than two-thirds of the Senate, to repeal the sunset provision and allow the continued use of mortgage revenue bonds.

Senator PACKWOOD. That is often why you get elected mayor and Governor.

Let me give you just one word of warning, Mr. Mayor, about industrial revenue bonds. This committee, by and large, and a majority of the Senate, is sympathetic to the use of these bonds for housing. We are clearly somewhat sympathetic to the use of other revenue bonds for legitimate purposes. But we have seen abuses in the industrial revenue bond department where businesses are using them with the connivance of local officials to subsidize very healthy and profitable businesses.

And I understand all of our States like to take businesses from other States if we can get them, and they are using industrial revenue bonds to beggar thy neighbor. And one day there will be a reaction in Congress because of what I regard as undue greed on the part of a number of people who are using those bonds for purposes that we never intended.

It has nothing to do with the housing bonds we're talking about today. We have not seen that abuse in the MRB program.

But just take it as a word of warning that that day may be coming if the abuses we seen in that area continue.

Mr. THOMAS. We have taken that warning long before now, Senator, and have urged our fellow mayors to use these bonds responsibly. In our city last year—and I do not have those figures—I remember that we issued about $32 million worth of bonds for about 32 projects. That is $1 million average per project. You cannot move people from California to Norfolk, Va., for a million dollars. So our revenue bonds are strictly local issues going to local people to help our local economic situation. And so we are working hard to be able to retain the privilege of using these bonds and will continue to do so.

Senator PACKWOOD. It goes further than attempting to take business from other States. I do not think these industrial revenue bonds were ever designed to underwrite K-Marts or McDonalds or businesses of that nature; and they have been used for that purpose. All I am saying is one day there will be a reaction, maybe further than you wish, because people have allowed the bonds to be used for purposes that we never intended they be used for.

Mr. THOMAS. Well, our list of users are not household names.

Senator PACKWOOD. Senator Roth.

Senator ROTH. I would like to underscore what the chairman has just said. I think the success in maintaining both these programs depend upon them being well administered at the local level. And one of the things, one of the few things that pleased me in the GAO report was its finding that the program was helping the moderate income or less than median income. I think that is a very important factor.

I am one who is a strong proponent of State and local control in many areas, and I think the mortgage revenue bond has worked very well.

I wonder, do you feel this program has, as some people claim, adversely affected borrowing in the municipal market for your other needs?

Governor Clinton.

Governor CLINTON. Senator Roth, we have a lot of municipal borrowing in other areas in our State, but I do not think there is any doubt that in the Nation as a whole there is a market for this sort of issue. As there is more money to be invested, the more the demand is for municipal securities and the larger the market will become. I do not think there is any question about that.

But I can honestly say that all of our people who are conversant with the needs of both the housing and public facilities sectors of our economy are still strongly in favor of this, and I think particularly with regard to the limits which were imposed in the Mortgage Subsidy Bond Tax Act of 1981.

The total amount of money that we can now have in mortgage bonds is relatively insignificant, even in a small State like Arkansas, compared to the opportunities in the market. So I would say that there is not a crowding problem of any measurable significance.

Senator ROTH. Mayor Thomas.

Mr. THOMAS. I would generally agree with that. We feel that there are many factors bearing on the tax exempt market these days: High-interest rates generally, tax law changes which have reduced the demands of both individuals and institutions for municipal bonds, declining bond ratings, and the large volume of Treasury borrowing.

So we find it very hard to believe there are major effects in view of the historical evidence that the spread between tax exempt and taxable bonds has not tracked with the volume of tax-exempt securities issued.

Senator ROTH. As I said earlier, one of the advantages of this program is that it does give the State and local officials the flexibility, the authority to shape a housing program according to local needs.

I do not know, Governor Clinton, whether you were here during testimony by Buck on behalf of the Treasury, but are there any other programs, housing programs, that would do a better job for your particular needs, or give you the flexibility?

Governor CLINTON. Senator, I doubt it? I have been very impressed, but I have to tell you, I have a vested interest in this. Our housing legislation was enacted when Senator Pryor, your colleague, was Governor, but we only had a $15 million authority at that time. Then when I became Governor, we increased the authority to $600 million, and this year we took the aggregate limits off. Of course, the Federal legislation limits how much we can do annually, and we have done a lot in multifamily housing. We have done some kind of innovative single-family work and are prepared to do some more.

Our agency is run very efficiently, and I think the flexibility that this mechanism provides us is extremely valuable to target the real needs of our State. We are dealing now with a policy question at the local level which is one that you have permitted us to deal with—the question of to what extent local agencies should issue a portion of the $200 million allocation a year and how we should deal with that issue.

All of this framework gives every State the ability to work out its own problems in its own way. I think it is a very good piece of legislation. I hope you will continue it.

Mr. THOMAS. May I make another comment? We just last week floated a $40 million issue at 7.72 percent, and we have an AA rating. And I think that that would indicate that those with strong credit can still get good tax-exempt rates. Unfortunately, with the economy the way it is, cities are having problems maintaining their ratings.

Governor CLINTON. Senator, if I might just add one thing, I have always been strongly supportive of and grateful for the efforts of the Farmers' Home Administration, the VA, section 8 housing and all of that. There is no question that in the aggregate, if you add all those efforts up in our state, a lot of people still fall within the cracks and are significantly benefitted by this program—people that would be in the income level that I think 100 percent of the Senate would think would be appropriate beneficiaries.

Senator ROTH. Thank you very much.

Senator PACKWOOD. George.

Senator MITCHELL. Thank you, Mr. Chairman.

I think it is significant that organizations such as the National Association of Governors and the U.S. Conference of Mayors support this legislation, and I commend both witnesses on their testimony.

I would like to ask a question based upon the colloquies that all three of the Senators had with the previous witnesses.

As you will recall, if you were present during that testimony, the witnesses commenting on the GAO report used the phrase "upper income" and "affluent" to describe families with total household incomes of between $20,000 and $30,000.

Now, it is one of the axioms of American politics that mayors are the closest to the people, and I guess governors and State legislators next, and Members of Congress being in Washington are further away.

So let me ask you whether based upon your own experience, your own observations of day-to-day life in your area, first, Mayor, and then Governor, do you think most of the people in your community, Mayor, regard someone with an income of $20,000 to $30,000 as being affluent or an upper income family?

Mr. THOMAS. We are a relatively nonaffluent community. I would not call that in this day and time an affluent income, no, sir.

Senator MITCHELL. And would you say that a program which channeled approximately 75 percent of the assistance to households with incomes of less than $30,000 a year would then be a relatively well-targeted program to meet the needs of low- and middle-income Americans for housing?

Mr. THOMAS. I would certainly agree with that and go back to my testimony, that $1.7 million supporting 42 loans is an average of $40,000 in the single family market. I do not know what you can get in that range these days. I wish we could find out.

Senator MITCHELL. Governor, would you care to comment on those questions?

Governor CLINTON. Senator, I would generally concur with what has been said. Our experience may be atypical because Arkansas is

49th among the 50 States in per capita income, and while Pulaski County, the county in which our capital city is located, I think $30,000 would not be regarded as an outlandish income or something that would be inappropriate to receive this sort of assistance.

In many of our rural counties, that would be a very high income indeed, but if you look in those same counties the average home price is not $69,000. It is $40,000 or $42,000, and the people that are getting the benefits of these mortgage programs are people with incomes still $14,000, $15,000, $16,000, $17,000—down in that range—so it varies.

I think what you will find if you go back and look at what the median income of people benefiting from this program has been, if interest rates drop again and the conventional market can absorb more homebuyers and finance more housing construction, that if that happens, which is beginning, we hope—thank goodness—to happen now, you are going to have people benefited by this program that are lower and lower and lower income, I think, because they will be buying the less expensive houses, wherever they are located.

So I would say to you, yes, I agree with you and the inference of your question and the conclusion of the mayor, but I would say it is even more true in low-income States and the rural areas where the program is plainly helping only those it was designed to help.

Senator MITCHELL. Thank you very much.

Senator PACKWOOD. Governor, Mr. Mayor, thank you very much. We appreciate your being patient and waiting to testify.

Mr. THOMAS. May I say one final thing? I appreciate very much your comments and those of Senator Roth about industrial revenue bonds and I assure you that those comments will be passed along to my colleagues.

Senator PACKWOOD. Thank you.

I see that Dr. Rivlin has arrived, so we will back up and take her next. Doctor, I am going to have to leave before you finish so let me thank you in advance for coming.

I also want to welcome Gregg Smith, who is here as the administrator of the Oregon Housing Division. I have dealt with Gregg over the years on this issue. I will not be able to stay for his testimony, but I welcome him here. Good to see you, Gregg.

STATEMENT OF DR. ALICE RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE, ACCOMPANIED BY PEARL RICHARDSON, TAX ANALYSIS STAFF, AND MARTHA SMITH, TAX ANALYSIS STAFF

Ms. RIVLIN. Thank you, Mr. Chairman. I am delighted to be here. I have with me today Pearl Richardson and Martha Smith, from our Tax Analysis Staff, who did much of the work that is represented by this testimony.

Senator ROTH. It looks like a sexist panel—all women. We are delighted to have you all here.

Ms. RIVLIN. Mr. Chairman, the Congress is faced this year with a decision on whether to continue to let tax-exempt State and local bonds be used to finance single-family homes or to allow this authority to expire on December 31, 1983, as it is now scheduled to do. The revenue consequences of this decision are significant.

Single-family mortgage revenue bonds are projected to cost $7.9 billion in lost revenue over the 1984–88 period under the present law, and $10.7 billion if the expiration or the sunset provision does not take effect. Hence, you have to weigh those revenue losses against the benefits to be gained.

Let me summarize fairly briefly because I think we go over some ground you have gone over before. As you know, the revenue bonds were really a phenomenon of the 1970's. Local governments and housing agencies first issued tax-exempt bonds for single-family housing in 1978. Because the interest paid on these bonds is tax-exempt, the Federal Government gives up revenue to subsidize house purchases.

The issuance of these bonds grew rapidly in the 1970's. Concern was expressed and in 1980 Congress passed the Mortgage Subsidy Bond Tax Act, which restricted the use of the bonds and also contained the sunset provision. The restrictions were eased somewhat in the tax action of last year.

As a result of the new restrictions, the volume of single-family housing bonds dropped sharply in 1981. The drop was also a result of other housing market phenomena. The volume picked up substantially in 1982.

Over the last year, we have seen substantial use of these bonds, but at the same time the relative advantage of tax-exempt status has diminished. This can be explained partly by the recent tax rate cuts that have reduced individual demand for tax-exempt bonds and partly by the marked increase in the volume of all tax-exempt issues, including industrial development bonds.

In 1982, tax-exempt interest rates were approximately 20 percent lower than comparable taxable rates, down from a 30-percent average differential during the previous 10 years.

Turning to the effects of targeting under the 1980 act, the 1980 act targeted mortgage assistance in various ways: It focused aid on low-income areas, and areas of chronic economic distress; it imposed home purchase-price limits; and it made assistance available only to first-time home buyers, except in targeted areas.

I think it is only fair to say that the experience under these provisions has varied a great deal. Some states target as much as they can and some do not.

TARGETED AREAS

As to targeted areas, the 1980 act required that a specified portion of bond proceeds be lent to people buying homes in targeted areas. The amount may be either 20 percent of an issue's lendable proceeds or 40 percent of average annual home mortgages within targeted areas in the issuer's jurisdiction, whichever is less.

The act defined "targeted areas" as those census tracts where 70 percent of the families have income of not more than 80 percent of the statewide median income or areas of chronic economic distress approved by the Secretaries of Treasury and HUD.

When the act was passed, most States contained census tracts that qualified automatically as targeted areas. Since that time, many States have sought to have specific economically distressed areas approved as targeted areas. Thirty-eight have achieved this.

Applications propose areas as small as city neighborhoods and as large as two-thirds of a State. A Treasury Department regulation limiting targeted areas to 20 percent of a State's population was in place until May 1982. Since then, the total population living in targeted areas has risen well above 20 percent in several States and reached as high as 50 percent in a few States.

States and localities issuing bonds often seek to minimize the burden of the targeted area requirements by allocating as few bond funds to targeted areas as is allowable. The majority of issuers make their allotments to targeted areas on the basis of the market share rule, thereby enabling them to set aside less than 20 percent of their mortgage funds for the targeted areas.

Issuers are able to set aside much less than 20 percent of their mortgage funds when the targeted areas in their jurisdiction are very small, when there have been few recent homes sales in the targeted areas, or when the price sales of homes located in targeted areas have been quite low.

PURCHASE PRICE LIMITS

Then there are the purchase price limits. The 1980 act limited the use of bonds to the financing of houses costing no more than 90 percent of the average area purchase price for a home not located in a targeted area and 110 percent of the average area purchase price for a home in a targeted area. TEFRA increased those limits to 110 and 120 percent respectively.

Average home prices, obviously, vary greatly from State to State, and even from city to city, and thus purchase price limits vary as well. The IRS published a listing of average area purchase prices that implied purchase price limits in 1982 ranging from $49,000 to about $167,000 for new homes not located in targeted areas and from $37,000 to $158,000 for existing homes, assuming the homes were financed by bonds issued after TEFRA's enactment. The price limits in targeted areas were almost 10 percent higher.

Although most issuers in 1982 used the estimates of average area purchase prices provided by the IRS to calculate their purchase price limits, a few State and local issuers chose to set higher purchase price limits based on their own estimates of average area purchase prices. For example, Alaska's Housing Finance Corporation set a purchase price limit of $128,000 for new houses when the limit calculated by the IRS would have been $111,000. Any way you look at it, it is expensive to buy a house in Alaska. On the other side, several other issuers set some or all of their purchase price limits below those allowable under the 1980 act.

As can be seen, limits based on average area purchase price allocate Federal assistance very unevenly, with more affluent areas receiving a larger share of the Federal subsidy. This effect is often exaggerated when issuers use their own estimates of their area's average purchase price. The effectiveness of purchase price limits in targeting assistance toward low-income areas also varies greatly among States and localities because of differences in program design.

In any event, most purchase price limits indirectly target aid by income because they discourage many middle- and upper-income buyers from seeking bond-subsidized mortgages.

INCOME LIMITS

In addition, most states and localities impose explicit income limits on homebuyers, although such limits are not federally required. A sample of 40 State issues in 1982 shows income limits ranging from between $16,000 and $36,000 in Indiana, to between $26,000 and $60,000 in Arizona. In a sample of 28 local issues, income limits spanned a narrower range—from between $26,000 and $50,000 in San Francisco to between $28,000 and $60,000 in Tucson.

Three States and several localities imposed no income limits. The use of income limits, obviously, varies widely, making only upper- and upper-middle-income buyers ineligible in many cases.

OPTIONS

Now for the options. As the sunset date for single-family mortgage revenue bonds approaches, the Congress must choose whether to let this authority terminate, extend it in its current form, or extend it in some altered form. If the current law remains in effect, the authority for single-family mortgage bonds will expire at the end of the year.

At that time, approximately, $39 billion, in bonds will be outstanding. Revenue losses associated with these bonds will be about $1.5 billion in 1983, rising to $1.7 billion in fiscal 1984. Subsequently, the revenue loss will level off and begin to decline gradually. Total estimated revenue losses for fiscal years 1984 through 1988 with the sunset amount to $7.9 billion.

If, on the other hand, the sunset date is repealed, revenue losses over the 1984-88 period are estimated at $10.7 billion. The difference of approximately $2.8 billion understates the revenue effects of the continued use of the bonds, however. Every time a State or local government issues a mortgage revenue bond—or, for that matter, any tax-exempt bond—the Federal Government sustains revenue losses for as long as the debt is outstanding.

Most mortgage bonds have staggered or serial maturities of up to 30 years. Ten years after a bond is issued, more than 80 percent of the issue will still be outstanding. Accordingly, a more appropriate way to look at the cost of mortgage revenue bonds is to calculate the amount of subsidy commitment over the life of the bonds.

To illustrate this point, although the substantial revenue loss of not repealing mortgage revenue bonds would amount to an estimated $2.8 billion over the next 5 fiscal years, during the same period, the Federal Government would commit itself to $24.1 billion in net new subsidies for single-family homes, as shown in table 2. The present value of that commitment would be $11.8 billion. The present value of the commitment is the multiyear stream of revenue losses discounted back to the present.

Although mortgage revenue bonds involve a multiyear commitment, the long-term costs of the new issues do not appear in the budget documents. The full cost of most direct housing assistance programs, however, now do appear in the budget, with the amount of budget authority expected to pay the full 15- to 30-year expense set aside at the time new commitments are made.

Regardless of how the costs are budgeted, tax-exempt bonds are generally less efficient than direct subsidies. That is, a smaller portion of the Federal expenditure or revenue loss is realized in subsidy by the home buyers. A CBO analysis undertaken a few years ago indicated that in the case of tax-exempt mortgage bonds approximately 54 percent of the subsidy went to the home buyers. Most of the remainder went to bondholders and intermediaries, including issuers, underwriters, and bond counsel. A small portion of the subsidy represented an offset for the lower mortgage interest deductions of program recipients. In contrast, the section 235 direct mortgage assistance program was 90-percent cost efficient. Apart from direct subsidy programs, more efficient means of assisting home buyers may even be available within the tax system, such as direct tax credits for home buyers.

If the use of the bonds is continued, the Congress could target the subsidy more narrowly on low- and moderate-income households by placing Federal income limits on home buyers or by limiting the subsidy to home buyers who forgo the deduction of mortgage interest from taxable income. Although income limits would concentrate the subsidy on those home buyers most in need of financial aid, they would probably not reduce the volume of mortgage revenue bonds significantly unless they were very low.

Requiring a choice between interest deductions and the bond subsidy could have a greater effect on volume, as would more stringent State-by-State caps on volume. Income ceilings would involve administrative problems of monitoring compliance and making adjustments for regional cost-of-living variations. Limiting the subsidy to home buyers who forgo the deduction of mortgage interest would be an administratively simple way to target assistance to lower income households.

Taxpayers in higher marginal brackets would be better off taking the interest deduction and would automatically exclude themselves from the program. Lower income home buyers benefit little or not at all from mortgage interest deductions and so would prefer the bond subsidy.

Finally, Mr. Chairman, if the Congress decides not to repeal the sunset provision in the Mortgage Subsidy Bond Act of 1980, it may wish to consider new restrictions on the use of tax-exempt bonds for private and quasi-public purposes in order to keep deficits from climbing higher. At present, mortgage bonds are subject to State-by-State volume limits.

The Congress may wish to consider similar limits for tax-exempt bonds that finance industrial development, pollution control, private hospitals, port and airport facilities, trade shows and convention centers, and other privately owned facilities. It may also want to reconsider the restrictions that the administration and the Senate Finance Committee proposed last year, which would have required that private investment financed with tax-exempt bonds be depreciated over longer recovery periods than those permitted under current law.

If the committee should want to explore any of these other options, we would be happy to provide assistance.

[The prepared statement of Dr. Alice Rivlin follows:]

Statement by

ALICE M. RIVLIN
DIRECTOR

CONGRESSIONAL BUDGET OFFICE

Before the

Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate

May 13, 1983

Congressional Budget Office
Congress of the United States

Mr. Chairman, the Congress is faced this year with a decision on whether to continue to let tax-exempt state and local bonds be used to finance single-family homes, or to allow this authority to expire on December 31, 1983, as it is now scheduled to do. The revenue consequences of this decision are significant. Single-family mortgage revenue bonds are projected to cost $7.9 billion in lost revenue over the 1984-1988 period under present law, and $10.7 billion if the expiration or "sunset" provision does not take effect.

My testimony this morning will cover three areas:

- o Conditions that led up to the Mortgage Subsidy Bond Tax Act of 1980;
- o Experience since the 1980 act; and
- o Policy alternatives that the Congress might wish to consider.

CBO has prepared for the record a more detailed paper on recent trends in mortgage revenue bond financing. This statement will briefly summarize the main points of that report.

BACKGROUND

In the early 1970s, state housing agencies began issuing tax-exempt bonds for owner-occupied housing in significant and increasing quantities. Local governments and housing agencies first issued tax-exempt bonds for single-family housing in 1978. Because the interest paid on these bonds is tax-exempt, the federal government gives up revenue to subsidize home purchases. State and local governments issue bonds at relatively low tax-exempt rates and relend the proceeds at slightly higher rates for mortgages, making below-market mortgage rates available to many homebuyers.

In response to a surge in bond issues for owner-occupied housing and associated revenue losses, the Congress passed the Mortgage Subsidy Bond Tax Act of 1980. This legislation sharply restricted the use of these bonds in order to reduce revenue losses and to target assistance more effectively. The act contained a sunset provision that ends the use of bonds for single-family homes after 1983. In the meantime, the act set state bond volume limits and home purchase price limits, introduced targeted area requirements, and restricted the subsidy principally to first-time homebuyers. The Tax Equity and Fiscal Responsibility Act of 1982 eased some of the restrictions in the 1980 act relating to the first-time homebuyer rule, purchase price limits, and arbitrage limitations.

EXPERIENCE SINCE THE 1980 ACT

The volume of single-family housing bonds dropped sharply in 1981 after limits were imposed in 1980, but then grew again in 1982, reaching a level about equal to the 1980 volume. These fluctuations were a response to interest rates and housing market conditions as well as to the provisions of the 1980 and 1982 acts.

The Volume of Mortgage Revenue Bonds

After a sharp rise in the issuance of housing bonds from $1.4 billion in 1975 to $14.0 billion in 1980, total housing bond volume dropped precipitously to $4.8 billion in 1981. The drop in volume was largely the result of the federal restrictions enacted in December 1980 and the high market interest rates prevailing during the year. After the market conditions improved during the summer of 1982, many jurisdictions were able to issue bonds more easily. In 1982, tax-exempt bonds for housing finance totaled $14.4 billion--$8.8 billion for single-family housing, $5.1 billion for multi-family rental housing, and $0.5 billion for veterans' housing (see Table 1). In that year, housing bonds accounted for 17 percent of all new long-term tax-exempt issues; bonds for owner-occupied housing alone accounted for 10 percent.

Mortgage bond interest rates declined steadily through most of 1982, along with rates for tax-exempt bonds generally. At the same time, the relative advantage of tax-exempt financing diminished. This can be explained partly by the recent tax rate cuts that have reduced individual demand for tax-exempt bonds and by the marked increase in the volume of all tax-exempt issues, including industrial development bonds. In 1982, tax-exempt interest rates were approximately 20 percent lower than comparable taxable rates, down from a 30 percent differential during the previous ten years. Although the spread between taxable and tax-exempt rates has narrowed, lower interest rates in general have brought many potential homebuyers back into the market. Thus, if the sunset date for mortgage revenue bonds is repealed, the volume of issues is likely to rise steadily over the next several years.

TABLE 1. VOLUME OF TAX-EXEMPT HOUSING BONDS, 1975-1982

Year	Total Volume Tax-Exempt Bonds	Total Housing Bonds	Total State Revenue Bonds: Single-Family	Total State Revenue Bonds: Multi-family	Total Local Revenue Bonds: Single-Family	Total Local Revenue Bonds: Multi-family[a]	Total Veterans' General Obligation Bonds
			In Millions of Dollars				
1975	30,090	1,436	---	869	---	2	565
1976	34,962	2,741	680	1,420	---	21	620
1977	46,766	4,398	959	2,633	---	241	584
1978	48,979	6,946	2,792	1,748	619	735	1,155
1979	47,991	12,072	3,333	1,929	4,491	729	1,590
1980	54,086	14,048	4,974	1,379	5,524	839	1,332
1981	56,548	4,834	1,662	711	1,186	405	870
1982	86,351	14,432	5,212	2,784	3,571	2,360	480
			Percent of Total Volume of Tax-Exempt Bonds				
1975	100	5	---	3	---	---	2
1976	100	8	2	4	---	---	2
1977	100	9	2	6	---	1	1
1978	100	14	6	4	1	2	2
1979	100	25	7	4	9	2	3
1980	100	26	9	3	10	2	2
1981	100	9	3	1	2	1	2
1982	100	17	6	3	4	3	1
			Percent of Total Volume of Housing Bonds				
1975	N/A	100	---	61	---	---	39
1976	N/A	100	25	52	---	1	23
1977	N/A	100	22	60	---	5	13
1978	N/A	100	40	25	9	11	17
1979	N/A	100	28	16	37	6	13
1980	N/A	100	35	10	39	6	9
1981	N/A	100	34	15	25	8	18
1982	N/A	100	36	19	25	16	3

NOTE: 1982 figures are preliminary.

SOURCES: Total tax-exempt bond volume figures calculated by The Bond Buyer and the Congressional Budget Office. Housing bond volume figures calculated by the Office of Financial Management, Department of Housing and Urban Development, and the Congressional Budget Office.

a. Includes bonds issued for permanent financing under Section 11(b), bonds for urban redevelopment housing projects, and other local issues for multifamily, rental housing issued under Sections 103A and 103b(4)(A).

Targeting Under the 1980 Act

The Mortgage Subsidy Bond Tax Act of 1980 targeted mortgage assistance by:

- o Focusing aid on low-income areas and areas of chronic economic distress;
- o Imposing home purchase-price limits; and
- o Making assistance available only to first-time homebuyers, except in targeted areas.

Experience under these provisions has varied widely. Some housing agencies and local governments have targeted their programs as much as possible on economically distressed areas and low-income homebuyers (and might have done so without federal requirements), while others have sought to minimize the impact of the act's targeting provisions in order to improve the financial backing behind the bonds and to reassure bondholders. Since the 1980 act was passed, new legislation and regulatory changes have eased the targeting provisions of the act.

Targeted Areas. The 1980 act required that a specified portion of bond proceeds be lent to people buying homes in targeted areas. (The amount may be either 20 percent of an issue's lendable proceeds or 40 percent of average annual home mortgages within targeted areas in the issuer's jurisdiction, whichever is less.) The act defined targeted areas as those census tracts where 70 percent of families have incomes of not more than 80 percent of statewide median income, or areas of chronic economic distress if so approved by the Secretaries of the Treasury and the Department of Housing and Urban Development.

When the 1980 act was passed, most states contained census tracts that qualified automatically as targeted areas. Since July 1981, however, 38 states have also had specific economically distressed areas approved as targeted areas. Applications propose areas as small as city neighborhoods and as large as two-thirds of a state. A Treasury Department regulation limiting targeted areas to 20 percent of a state's population was in place until May 1982. Since then, the total population living in targeted areas has risen well above 20 percent in several states, reaching as high as 50 percent in a few states.

States and localities issuing bonds often seek to minimize the burden of the targeted-area requirements by allocating as few bond funds to targeted areas as is allowable. The majority of issuers make their allotments to targeted areas on the basis of the market-share rule, thereby enabling them to set aside less than 20 percent of their mortgage funds for targeted areas. Issuers are able to set aside much less than 20 percent of their mortgage funds when the targeted areas in their jurisdiction are very small, when there have been very few recent home sales in targeted areas, or when the sales prices of homes located in targeted areas have been quite low.

Purchase Price Limits. The 1980 act limited the use of bonds to the financing of houses costing no more than 90 percent of the average area purchase price for a home not located in a targeted area and to 110 percent of the average area purchase price for a home located within a targeted area. TEFRA eased these limits by raising them to 110 and 120 percent, respectively.

Average home prices vary greatly from state to state and even from city to city, and thus purchase price limits vary as well. The Internal Revenue Service (IRS) published a listing of average area purchase prices that implied purchase price limits in 1982 ranging from about $49,000 to about $167,000 for new homes not located in targeted areas and from about $37,000 to about $158,000 for existing homes, assuming the homes were financed by bonds issued after TEFRA's enactment. The price limits in targeted areas were 10 percent higher.

Although most issuers in 1982 used the estimates of average area purchase prices provided by the IRS to calculate their purchase price limits, a few state and local issuers chose to set higher purchase price limits, based on their own estimates of average area purchase prices. For example, Alaska's Housing Finance Corporation set a purchase price limit of $128,000 for new houses when the limit calculated according to IRS data would have been $111,000. On the other side, several other issuers set some or all of their purchase price limits below those allowable under the 1980 act.

As can be seen, limits based on average area purchase price allocate federal assistance very unevenly, with more affluent areas receiving a larger share of the federal subsidy. This effect is often exaggerated when issuers use their own estimates of their area's average purchase price. The effectiveness of purchase price limits in targeting assistance toward lower income areas also varies greatly among states and localities because of differences in program design. In any event, most purchase price limits indirectly target aid by income because they discourage many middle- and upper-income homebuyers from seeking bond-subsidized mortgages.

Income Limits. In addition, most states and localities impose explicit income limits on homebuyers, although such limits are not federally required. A sample of 40 state issues in 1982 shows income limits ranging from between $16,000 and $36,000 in Indiana to between $26,000 and $60,000 in Arizona. In a sample of 28 local issues, income limits spanned a narrower range, from $26,000 in San Francisco to $60,000 in Tucson, Arizona. Three states and several localities imposed no income limits at all. The use of income limits obviously varies widely, making only upper-and upper-middle income homebuyers ineligible in many cases.

OPTIONS

As the sunset date for single-family mortgage revenue bonds approaches, the Congress must choose whether to let this authority terminate, extend it in its current form, or extend it in some altered form. If current law remains in effect, the authority for single-family mortgage bonds will expire at the end of the year. At that time, $39.4 billion in bonds will still be outstanding. The revenue losses associated with these bonds will total $1.5 billion in 1983 and will rise to $1.7 billion in fiscal year 1984. Subsequently, the revenue loss will level off and begin to decline gradually. Total estimated revenue losses for fiscal years 1984 to 1988 amount to $7.9 billion.

If, on the other hand, the sunset date is repealed, revenue losses over the 1984 to 1988 period are estimated at $10.7 billion. The difference of approximately $2.8 billion understates the revenue effects of the continued use of the bonds, however. Every time a state or local government issues a mortgage revenue bond (or, for that

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matter, any tax-exempt bond), the federal government sustains revenue losses for as long as the debt is outstanding. Most mortgage bonds have staggered or serial maturities for up to 30 years. Ten years after a bond is issued, more than 80 percent of the issue will still be outstanding. Accordingly, a more appropriate way to look at the cost of mortgage revenue bonds is to calculate the amount of subsidy commitment over the life of the bonds.

To illustrate this point, although the additional revenue loss of not repealing mortgage revenue bonds would amount to an estimated $2.8 billion over the next five fiscal years, during the same period the federal government would commit itself to $24.1 billion in net new subsidies for single-family homes (see Table 2). The present value of the commitment would be $11.8 billion. (The present value of the commitment is the multiyear stream of revenue losses, discounted for the fact that losses in the later years have a lower current cost than those in the early years.) Although mortgage revenue bonds involve a multiyear commitment, the long-term costs of new issues do not appear in budget documents. The full costs of most direct housing assistance programs, however, now appear in the budget, with an amount of budget authority expected to pay the full 15- to 30-year expense set aside at the time that new commitments are made.

Regardless of how costs are budgeted, tax-exempt bonds are generally less efficient than direct subsidies--that is, a smaller proportion of federal expenditure is realized in subsidy by the homebuyers. A CBO analysis undertaken a few years ago indicated that, in the case of tax-exempt mortgage bonds, approximately 54 percent

TABLE 2. NET NEW SINGLE-FAMILY MORTGAGE BOND REVENUE LOSSES FROM REPEAL OF THE SUNSET PROVISION, 1984 to 1988 (In billions of dollars, by calendar year except as noted)

	1984	1985	1986	1987	1988	Total[a]
Estimated Bond Issues	10.4	13.0	16.9	20.4	23.6	84.3
Federal Subsidy Over the Term of the Bonds	3.5	4.2	5.0	5.4	5.9	24.1
Present Value of the Subsidy Commitment	1.7	2.1	2.6	2.6	2.9	11.8
Fiscal Year Revenue Losses	0.1	0.2	0.5	0.8	1.2	2.8

a. Totals may not add because of rounding.

of the subsidy went to the homebuyers. Most of the remainder went to bondholders and intermediaries, including issuers, underwriters, and bond counsel. A small portion of the subsidy represented an offset for the lower mortgage interest deductions of program recipients. In contrast, the Section 235 direct mortgage assistance program was 90 percent cost-efficient. Apart from direct subsidy programs, more efficient means of assisting homebuyers may be available within the tax system, such as direct tax credits for homebuyers.

If the use of the bonds is continued, the Congress could target the subsidy more narrowly on low- and moderate-income households by placing federal income limits on homebuyers or by limiting the subsidy to homebuyers who forgo the deduction of mortgage interest from taxable income. Although income limits would concentrate the subsidy on those homebuyers most in need of financial aid, they would probably not reduce the volume of mortgage revenue bonds significantly unless they were very low. Requiring a choice between interest deductions and the bond subsidy could have a greater effect on volume as would more stringent state-by-state caps on volume. Income ceilings would involve administrative problems of monitoring compliance and making adjustments for regional cost-of-living variations. Limiting the subsidy to homebuyers who forgo the deduction of mortgage interest would be an administratively simpler way to target assistance to lower-income households. Taxpayers in higher marginal brackets would be better off taking the interest deduction and would automatically exclude themselves from the program. Lower-income homeowners benefit little or not at all from mortgage interest deductions and so would prefer the bond subsidy.

Finally, if the Congress decides not to repeal the sunset provision in the Mortgage Subsidy Bond Tax Act of 1980, it may wish to consider new restrictions on the uses of tax-exempt bonds for private and quasi-public purposes in order to keep deficits from climbing higher. At present, mortgage bonds are subject to state-by-state volume limits. The Congress may wish to consider similar limits for tax-exempt bonds that finance industrial development, pollution control, private hospitals, port and airport facilities, trade show and convention centers, and other privately owned facilities. It may also want to reconsider the restrictions that the Administration and the Senate Finance Committee proposed last year, which would have required that private investment financed with tax-exempt bonds be depreciated over longer recovery periods than those permitted under current law.

MORTGAGE REVENUE BONDS IN 1982

Special Study

Prepared at the Request of
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Committee on Finance
United States Senate

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MORTGAGE REVENUE BONDS IN 1982

The tax-exempt status of newly issued, single-family mortgage revenue bonds is scheduled to "sunset," or expire, on December 31, 1983. Despite federal restrictions on the use of housing bonds enacted in 1980 and the difficulties of a recessionary marketplace, housing bonds have continued to be a popular vehicle for state and local governments that aim to assist homebuyers and the housing industry. This report provides information about the issuance of mortgage revenue bonds in 1982, as background to the current debate on the sunset provision.

Legislative History

Although the first tax-exempt housing bonds were issued just after World War I, state housing agencies did not begin to issue tax-exempt bonds for rental and owner-occupied housing in any great quantity until the early 1970s. Local governments and housing agencies first issued tax-exempt bonds for single-family housing in 1978. Because the interest paid on these bonds is tax-exempt, the federal government gives up revenue to subsidize home purchases. (See Section 103A and Section 103b(4)(A) of the Internal Revenue Code.) State and local governments issue bonds at relatively low tax-exempt rates and relend the proceeds at slightly higher rates for mortgages. Below-market mortgage rates are thus made available to many homebuyers.[1]

In response to a surge in the issuance of these bonds, the Mortgage Subsidy Bond Tax Act of 1980 (MSBTA) sharply restricted the use of tax-exempt bonds for housing in an attempt to reduce revenue losses and to target assistance more effectively. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) eased slightly some of the restrictions in MSBTA for single-family bonds relating to the first-time homebuyer rule, purchase price requirements, and arbitrage limitations. Also, the income requirements for Section 103b(4)(A) bonds for rental housing were clarified. TEFRA did not modify prior law relating to state bond volume limits, requirements for funds in targeted areas, the registration requirement, or the rules specific to veterans' housing, rental housing, and home-improvement loans.[2]

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1. See Congressional Budget Office, The Mortgage Subsidy Bond Tax Act of 1980: Experience Under the Permanent Rules (March 1982); and Congressional Budget Office, Tax-Exempt Bonds for Single-Family Housing (April 1979).

2. See Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (December 31, 1982), pp. 116 and 120-23.

Volume of Mortgage Revenue Bonds, 1975-1982

Tax-exempt bond issues for housing finance totaled about $1.4 billion in 1975, $6.9 billion in 1978, and $14.0 billion in 1980. Starting in 1978, much of the growth in volume resulted from local governments and local housing agencies entering the tax-exempt housing bond market. After the sharp rise in the issuance of housing bonds in 1975-1980, the volume dropped precipitously to about $4.8 billion in 1981, largely because of the restrictive legislation passed in December 1980 and the high market interest rates prevailing during the year. During 1982, however, mortgage interest rates fell, making more would-be homebuyers able to afford mortgages. As a result, the 1980 volume level was regained and surpassed. Preliminary estimates put the total for 1982 at about $14.4 billion, with single-family housing accounting for about $8.8 billion of that amount (see Table 1).[3]

In 1980, states and state agencies issued $5 billion in owner-occupied (single-family) housing bonds; they issued only $1.7 billion in 1981 and then came back with $5.2 billion in 1982. Local issues for owner-occupied housing totaled $5.5 billion in 1980, $1.2 billion in 1981, and $3.6 billion in 1982. Bonds issued under Sections 103A and 103b(4)(A) for multifamily, rental housing totaled $4.3 billion in 1982, with about $2.7 billion issued by states and about $1.6 billion issued by localities. General obligation bonds issued by states for veterans' single-family housing totaled about $0.5 billion in 1982. These issues, however, are not subject to most of the restrictions enacted in MSBTA.

Housing bonds accounted for 17 percent of all new long-term tax-exempt issues in 1982. Bonds for single-family houses alone accounted for 10 percent. Mortgage bond interest rates declined steadily throughout 1982, along with rates for tax-exempt bonds generally. In January 1982, the Bond Buyer index for tax-exempt revenue bonds stood at 14.2 percent; by December, it had declined to 10.7 percent. Although interest rates were lower in absolute terms, the relative advantage of tax-exempt financing diminished in 1982 for several reasons, including a marked increase in the volume of all tax-exempt issues and the recent tax rate cuts that have reduced individual demand for tax-exempt bonds. In 1982, tax-exempt interest rates were approximately 20 percent lower than comparable taxable rates. During the previous ten years, by contrast, tax-exempt interest rates were on average about 30 percent lower than comparable taxable rates.

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3. All figures in this section are from the Office of Financial Management, Department of Housing and Urban Development. The 1982 figures are preliminary. The types of housing bonds included in the overall totals are single-family, multifamily, home-improvement, and veterans' general obligation bonds issued under Sections 103A and 103b(4)(A), and multifamily bonds for rental housing issued under Section 11b.

TABLE 1. VOLUME OF TAX-EXEMPT HOUSING BONDS, 1975-1982

Year	Total Volume Tax-Exempt Bonds	Total Housing Bonds	Total State Revenue Bonds: Single-Family	Total State Revenue Bonds: Multi-family	Total Local Revenue Bonds: Single-Family	Total Local Revenue Bonds: Multi-family[a]	Total Veterans' General Obligation Bonds
			In Millions of Dollars				
1975	30,090	1,436	---	869	---	2	565
1976	34,962	2,741	680	1,420	---	21	620
1977	46,766	4,398	959	2,633	---	241	584
1978	48,979	6,946	2,792	1,748	619	735	1,155
1979	47,991	12,072	3,333	1,929	4,491	729	1,590
1980	54,086	14,048	4,974	1,379	5,524	839	1,332
1981	56,548	4,834	1,662	711	1,186	405	870
1982	86,351	14,432	5,212	2,784	3,571	2,360	480
			Percent of Total Volume of Tax-Exempt Bonds				
1975	100	5	---	3	---	---	2
1976	100	8	2	4	---	---	2
1977	100	9	2	6	---	1	1
1978	100	14	6	4	1	2	2
1979	100	25	7	4	9	2	3
1980	100	26	9	3	10	2	2
1981	100	9	3	1	2	1	2
1982	100	17	6	3	4	3	1
			Percent of Total Volume of Housing Bonds				
1975	N/A	100	---	61	---	---	39
1976	N/A	100	25	52	---	1	23
1977	N/A	100	22	60	---	5	13
1978	N/A	100	40	25	9	11	17
1979	N/A	100	28	16	37	6	13
1980	N/A	100	35	10	39	6	9
1981	N/A	100	34	15	25	8	18
1982	N/A	100	36	19	25	16	3

NOTE: 1982 figures are preliminary.

SOURCES: Total tax-exempt bond volume figures calculated by The Bond Buyer and the Congressional Budget Office. Housing bond volume figures calculated by the Office of Financial Management, Department of Housing and Urban Development, and the Congressional Budget Office.

a. Includes bonds issued for permanent financing under Section 11(b), bonds for urban redevelopment housing projects, and other local issues for multifamily, rental housing issued under Sections 103A and 103b(4)(A).

Housing Market Conditions in 1981 and 1982

State and local issuers were able to sell very few housing bonds in 1981. Difficult market conditions and new federal requirements aimed at increasing targeting and efficiency caught them in a bind; at the same time that home mortages--even when subsidized by tax-exempt financing--were becoming increasingly unaffordable for many homebuyers, the 1980 legislation reduced the pool of homebuyers eligible to receive tax-exempt financing on mortgage loans.

Mortgage interest rates (recorded at the time of closing) peaked at about 16 percent in the fall of 1981 and have drifted down to between 12 and 13 percent since then. The high mortgage rates prevalent in 1981 and much of 1982 made mortgages financed with tax-exempt bonds highly attractive because of the large differential between market and subsidized rates. Many programs were able to offer 14 percent mortgage loans when the commercial mortgage rate in their region was as high as 16 or 17 percent. (Of course, many potential homebuyers could not afford even the subsidized mortgages.) As commercial mortgage rates declined, however, the differential between market and subsidized rates narrowed because tax-exempt bond yields did not drop as much or as fast as mortgage rates. As mortgage rates fell during the summer of 1982, many issuers were forced to redeem bonds because they could find even fewer home purchasers interested in the mortgages they were offering than earlier in the year. The lower interest rates in late 1982 brought many potential homebuyers back into the housing market, thus increasing the demand for bond-financed as well as conventionally financed mortgages.

As a result of high mortgage rates combined with a recessionary economy, housing starts in both 1981 and 1982 were the lowest they had been in the postwar period. Sales of new houses fell in 1982 to the lowest level since 1963 when such statistics were first collected. Sales of previously occupied houses fell to the lowest level since 1970.[4] The decline in mortgage rates toward the end of 1982 has stimulated the housing market, however, and the National Association of Homebuilders predicts that about 580,000 new one-family homes will be sold in 1983, well over the 545,000 total for 1980.[5]

Important Trends in Bond Financing in 1982

Original-Issue Deep-Discount Bonds. In response to high and unpredictable mortgage rates, several state and local issuers of mortgage revenue bonds chose to

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4. James L. Freund, "The Housing Market, Recent Developments and Underlying Trends," Federal Reserve Bulletin (February 1983), pp. 61-63.

5. Telephone conversation with William Young, Economics Division, National Association of Home Builders (April 14, 1983).

issue deep-discount bonds as an alternative to conventional current coupon bonds. At least 20 state issues (both single-family and multifamily) and at least three local issues used discount bonds. Discount bonds work by offering coupon payments well below the market rate of return (some, in fact, offer no coupon payments at all). The issuer, therefore, must sell these bonds at a substantial discount from par in order to make them competitive in the marketplace. Bondholders earn both coupon payments and the appreciation from the discounted price to par value as their bonds mature. The advantage discount bonds have for the issuer is that they decrease required coupon payments to bondholders, thus easing cash flow problems in the early months of an issue when all the intended mortgage loans have not yet been made.

FSLIC and FDIC Certificates of Deposit. At least 24 local multifamily bonds issued under Section 103b(4)(A) in 1982 were backed by certificates of deposit from federally insured financial institutions. These bonds are effectively backed by a federal guarantee. Because the certificates of deposit are pledged to secure repayment of these bonds, the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Deposit Insurance Corporation (FDIC) guarantee repayment up to $100,000 per bondholder.

The Department of the Treasury announced on March 4, 1983, that it was drafting legislation to ban the issuance of such bonds after April 15, 1983 (unless a binding commitment had been made before the Treasury announcement). This legislation (S. 1061) has been introduced by Senator Robert Dole. Also, Representative J.J. Pickle has introduced a bill (H.R. 1635) that would deny tax exemption after April 14, 1983, for bonds backed by FSLIC and FDIC insurance. This method of providing added security for multifamily, loans-to-lenders mortgage revenue bonds was important in 1982 and early 1983. It has probably been discontinued since April 15, however, because bond counsel are not likely to approve FSLIC- or FDIC-guaranteed bonds sold after April 15 while the legislation is pending.

1982 Single-Family Housing Bond Issues In Detail

The following sections describe a sample of 1982 single-family mortgage revenue bond issues. The sample includes 40 of the 65 state single-family issues sold in 1982 and 28 of the 119 local single-family issues. Tables 2 and 3 provide specific information for each issue studied.

Summary. Experience with the targeted area requirements has shown highly variable results; some issuers target their programs as much as possible on low-income areas (and might do so without federal requirements), while others seek to minimize targeted-area financing in order to improve the financial backing behind the bonds and reassure bondholders. Purchase price limits have a fairly strong general targeting effect because they discourage many middle- and upper-income homebuyers from seeking these subsidized mortgages. Most issuers also impose income limits on homebuyers to target the loan assistance, even though income limits are not federally

TABLE 2. STATE HOUSING AGENCIES: SAMPLE OF BONDS ISSUED IN 1982 FOR OWNER-OCCUPIED HOUSING

Issue	Date of Sale	Bond Amount (millions of dollars)	Net Interest Cost (percents)	Type of Obligation of the Issuer[a]	Mortgage Rate (percents)[b]
Alabama HFA 1982 Series B	12/9/82	100.000	10.76	LO	11.270
Alaska HFC 1982 Second Series	11/24/82	100.000	11.54	GO	10.000
Arizona HFRB Series 1982	11/8/82	27.200	9.92	LO	11.050
Arkansas HDA 1982 Series A	7/27/82	100.000	13.13	SO	12.950
California HFA 1982 Series B	12/17/82	101.775	10.50	SO	mixed
Colorado HFA 1982 Series A	7/29/82	66.050	12.78	SO	12.750
Connecticut HFA 1982 Series B	9/10/82	150.000	11.06	GO	11.750
Delaware SHA 1982 Series A	6/24/82	40.000	13.33	SO	13.750
Florida HFA 1982 Series A	6/15/82	150.000	13.50	N/A	13.500
Georgia RFA 1982 Series A	9/17/82	50.000	10.70	GO	11.875
Hawaii HA 1982 Series A	7/16/82	60.000	13.00	SO	13.250
Illinois HDA 1982 Series A	7/30/82	90.000	11.85	GO	12.950
Indiana HFA 1982 Series A	4/6/82	75.000	N/A	SO	13.780
Iowa HFA 1982 Issue A	9/3/82	14.080	11.70	GO	12.525
Louisiana HFA Series 1982A	8/23/82	100.000	12.60	SO	13.250
Maine SHA 1982 Series B	6/10/82	53.920	12.92	SO	13.250
Maryland CDA 1982 Series A	3/19/82	65.000	13.27	SO	13.900
Massachusetts HFA 1982 Series A	8/10/82	200.000	13.57	SO	13.700
Minnesota HFF 1982 Series B	8/12/82	41.900	11.57	GO	15.250
Mississippi HFC Series 1982	8/20/82	150.500	11.26	GO	12.250
Missouri HDC Series April 15, 1982	3/31/82	50.000	13.25	N/A	13.870
Montana BH 1982 Series A	4/6/82	55.000	13.50	GO	12.500
Nebraska MFF 1982 Series B	7/21/82	89.410	11.52	GO	13.625
Nevada HD 1982 Issue A	7/14/82	60.000	14.00	SO	12.250
New Hampshire HFA 1982 Series A	7/1/82	167.255	13.06	SO	13.250
New Jersey MFA 1982 Series I	10/7/82	239.000	10.60	GO	11.000
New Mexico MFA 1982 Series A	9/1/82	98.655	10.54	SO	12.120
New York SMA Series 3	7/8/82	250.000	13.22	GO	14.000
North Dakota HFA 1982 Series A	7/15/82	28.940	12.77	LO	13.500
Oregon, State of, 1982 Series A	9/24/82	125.000	11.19	SO	11.750
Pennsylvania HFA 1982 Series A	4/1/82	100.000	13.73	GO	14.050
Rhode Island HMFC 1982 Series I	7/23/82	30.850	13.30	SO	13.750
South Carolina SHA 1982 Series A	9/21/82	82.265	N/A	SO	11.950
Tennessee 1982 Series A	7/27/82	150.000	12.75	GO	12.750
Texas HA 1982 Series A	7/9/82	100.000	13.72	LO	14.000
Utah HFA 1982-First Series	5/28/82	121.765	12.68	SO	12.000
Vermont HFA 1982 Series A	7/15/82	35.000	13.45	GO	13.500
Virginia HDA 1982 Series B	11/9/82	166.109	9.42	GO	10.420
West Virginia HDF Series A	3/5/82	25.000	13.85	SO	12.950
Wisconsin HFA 1982 Series A	7/1/82	100.000	13.80	GO	13.750

N/A = information not available.

a. LO = limited obligation
SO = special obligation
GO = general obligation

b. Mortgage interest rates are sometimes lower than the yields on the bonds because of additional funds from fees or contributions from the issuer.

TABLE 2. (Continued)

Issue	Type of Mortgage[c]	Percentage Distribution of Funds Including Contributions and Fees (percents): Mortgages	Other	Percent of Loan Funds Reserved for Targeted Areas	Applying for New Targeted Areas?[d]
Alabama HFA 1982 Series B	Level:30	90	10	20	No*
Alaska HFC 1982 Second Series	GEM:19	99	1	0	No
Arizona HFRB Series 1982	Level:30	92	8	N/A	No*
Arkansas HDA 1982 Series A	GEM:20	92	8	1	Yes*
California HFA 1982 Series B	mixed	96	4	20	Yes*
Colorado HFA 1982 Series A	GEM:17	73	27	N/A	Yes*
Connecticut HFA 1982 Series B	GEM:17	83	17	20	No*
Delaware SHA 1982 Series A	Level:20	93	7	4	No
Florida HFA 1982 Series A	GEM:16	89	11	12	No*
Georgia RFA 1982 Series A	GEM:18	92	8	20	Yes*
Hawaii HA 1982 Series A	GEM:19	86	14	8	No*
Illinois HDA 1982 Series A	GEM:17	79	21	5	No*
Indiana HFA 1982 Series A	Level:25	84	16	20	No*
Iowa HFA 1982 Issue A	Level:30	93	7	0	No
Louisiana HFA Series 1982A	Level:30	92	8	2	Yes*
Maine SHA 1982 Series B	Level:20	85	15	N/A	No
Maryland CDA 1982 Series A	Level:30	93	7	20	Yes*
Massachusetts HFA 1982 Series A	Level:30	91	9	2	No
Minnesota HFF 1982 Series B	Level:30	90	10	4	No*
Mississippi HFC Series 1982	GEM:16	81	19	N/A	Yes*
Missouri HDC Series April 15, 1982	Level:19	91	9	6	No
Montana BH 1982 Series A	Level:25	84	16	1	No*
Nebraska MFF 1982 Series B	Level:30	80	20	0.1	No*
Nevada HD 1982 Issue A	GEM:16	92	8	5	No
New Hampshire HFA 1982 Series A	Level:25 to 30	29	71	20	No*
New Jersey MFA 1982 Series 1	Level:30	91	9	20	No*
New Mexico MFA 1982 Series A	Level:30	74	26	3	No
New York SMA Series 3	Level:30	87	13	20	Yes*
North Dakota HFA 1982 Series A	GEM:20	89	11	0	Yes
Oregon, State of, 1982 Series A	Level:30	74	26	20	No*
Pennsylvania HFA 1982 Series A	Level:30	90	10	20	Yes*
Rhode Island HMFC 1982 Series 1	GEM:17	93	7	N/A	No
South Carolina SHA 1982 Series A	Level:30	95	5	21	No*
Tennessee 1982 Series A	GEM:16	81	19	20	No*
Texas HA 1982 Series A	Level:30	86	14	20	Yes
Utah HFA June 1982	GEM:16	78	22	0.1	No*
Vermont HFA 1982 Series A	Level:25	84	16	0	No*
Virginia HDA 1982 Series B	Level:30	97	3	19	Yes*
West Virginia HDF Series A	GEM:16	88	12	20	Yes*
Wisconsin HFA 1982 Series A	Level:30	91	9	10	No*

c. Level = level payment mortgage amortized over the specified numbers of years.
GEM = growing equity mortgage paid off at the specified number of years.

d. * = This state has applied for and received designation of at least one targeted area from the Secretaries of the Treasury and of Housing and Urban Development since the regulations for the Mortgage Subsidy Bond Tax Act were published in July 1981. The

TABLE 2. (Continued)

Issue	Purchase Price Limits for a One-Family Residence in a Non Targeted Area: New (thousands of dollars)	Existing (thousands of dollars)	Below, Equal, or Above IRS Safe-Harbor Purchase Price Limits	Number of Lenders	Income Limit for a Household of Four (thousands of dollars)[e]
Alabama HFA 1982 Series B	71	62	Equal	39	42
Alaska HFC 1982 Second Series	128	105	Above	N/A	no limit
Arizona HFRB Series 1982	84	68	Below or Equal	6	26 to 60
Arkansas HDA 1982 Series A	56 to 58	53 to 55	Equal	140	34
California HFA 1982 Series B	52 to 101	---	Below or Equal	24	28 to 50
Colorado HFA 1982 Series A	71 to 72	49 to 63	Equal	N/A	32
Connecticut HFA 1982 Series B	73 to 93	60 to 80	Below or Equal	60	27 to 34
Delaware SHA 1982 Series A	67	52	Equal	24	38
Florida HFA 1982 Series A	50 to 72	35 to 65	Equal	73	31 to 35
Georgia RFA 1982 Series A	65	52 to 53	Below or Equal	67	27 to 38
Hawaii HA 1982 Series A	105 to 113	100 to 102	Equal	24	N/A
Illinois HDA 1982 Series A	66 to 74	39 to 64	Equal	N/A	35
Indiana HFA 1982 Series A	51 to 75	41 to 45	Below or Equal	65	16 to 36
Iowa HFA 1982 Issue A	78	57	Below or Equal	13	25 to 34
Louisiana HFA Series 1982A	69 to 84	51 to 67	Equal or Above	70	40
Maine SHA 1982 Series B	55	50	Below	28	27
Maryland CDA 1982 Series A	---	49 to 60	Below or Equal	24	33
Massachusetts HFA 1982 Series A	58 to 71	46 to 58	Below or Equal	128	28 to 32
Minnesota HFF 1982 Series B	60 to 70	50 to 60	Below	171	26 to 35
Mississippi HFC Series 1982	59	42	Equal	33	39
Missouri HDC Series April 15, 1982	53 to 75	42 to 46	Equal	31	28
Montana BH 1982 Series A	65	56	Below	110	32
Nebraska MFF 1982 Series B	46 to 56	36 to 46	Equal	43	33
Nevada HD 1982 Issue A	75	75	Below	14	34
New Hampshire HFA 1982 Series A	56	49	Equal	51	27 to 40
New Jersey MFA 1982 Series 1	85 to 119	78 to 96	Equal	N/A	no limit
New Mexico MFA 1982 Series A	77	67	Equal	26	33
New York SMA Series 3	59 to 84	38 to 71	Equal	51	no limit
North Dakota HFA 1982 Series A	71	56	Equal	28	33
Oregon, State of, 1982 Series A	60	55	Below	42	25
Pennsylvania HFA 1982 Series A	42 to 69	30 to 52	Equal	74	35 to 37
Rhode Island HMFC 1982 Series 1	65 to 66	46 to 52	Equal	N/A	33
South Carolina SHA 1982 Series A	53	50	Below	49	32
Tennessee 1982 Series A	40 to 52	33 to 49	Below	106	30
Texas HA 1982 Series A	58 to 100	45 to 78	Equal	104	38
Utah HFA June 1982	70 to 83	49	Equal	24	34
Vermont HFA 1982 Series A	53 to 57	43 to 56	Equal or Above	21	33
Virginia HDA 1982 Series B	61 to 86	43 to 80	Below	97	24 to 45
West Virginia HDF Series A	50	46	Equal	23	33
Wisconsin HFA 1982 Series A	63	50	Equal	367	23 to 34

(Continued)

application and/or designation may have occurred, however, after the bond issue listed in this table. For example, Vermont reserved no funds for targeted areas in the issue listed, but has applied for and received designation of a targeted area since then.

e. When there is a range of income limits within a given state, the limits generally vary according to geographic location or according to whether the mortgagor is buying new or existing housing.

TABLE 3. LOCALITIES AND LOCAL HOUSING AUTHORITIES: SAMPLE OF BONDS ISSUED IN 1982 FOR OWNER-OCCUPIED HOUSING

Issue	Date of Sale	Bond Amount (millions of dollars)	Net Interest Cost[a] (percents)	Type of Obligation of the Issuer[b]
Palm Springs, CA Issue of 1982	3/5/82	19.300	12.83	SO
Denton Co., TX Series 1982	3/11/82	25.850	13.55	LO
Coon Rapids, MN Series 1982	4/27/82	30.000	N/A	SO
Fairbanks North Star, AK Series 1982	4/30/82	35.000	N/A	SO
Cameron Co., HFC, TX 1982 Series A	5/5/82	30.000	N/A	LO
Central California MA, 1982 Series A	5/20/82	30.000	N/A	LO
Bexar Co. HFC, TX Series 1982	5/25/82	69.210	N/A	LO
San Mateo Co., CA 1982 Series A	6/8/82	40.860	13.01	LO
Volusia Co. HFA, FL Series 1982	6/10/82	11.905	N/A	LO
Wichita, KS 1982 Series A	6/23/82	30.000	N/A	LO
Denver City and Co., CO 1982 Series A	6/29/82	26.625	N/A	SLO
Atlanta URFA, GA Series 1982	7/16/82	30.000	N/A	LO
Tucson IDA and Pima Co. IDA, AZ Series 1982	7/19/82	51.875	11.54*	SO
New Castle Co., DE 1982 Series A	7/23/82	50.000	13.31	LO
Broward Co. HFA, FL 1982 Series A	7/29/82	34.300	13.59*	LO
Santa Fe Springs RA, CA 1982 Series A	8/3/82	9.580	12.51	SO
St. Louis, MO Series 1982 A	8/6/82	20.180	12.66	LO
Albuquerque, NM	8/23/82	19.100	11.83	SO
Maricopa Co. IDA and Phoenix IDA, AZ Series 1982	8/27/82	113.000	N/A	LO
Jefferson Co., CO 1982 Series A	9/13/82	19.875	N/A	SLO
Cobb Co. HA, GA Series 1982	10/1/82	10.165	11.04	LO
Prince George's Co. HA, MD 1982 Series A	10/8/82	35.950	N/A	LO
San Francisco, CA 1982 Bonds Series A	10/8/82	60.000	N/A	LO
Allegheny Co. RFA, PA 1982 Series A	11/12/82	25.000	N/A	LO
Montgomery Co. HOC, MD 1982 Series A	12/3/82	37.495	N/A	LO
Cook Co., IL 1982 Series A and Series B	12/8/82	70.000	N/A	LO
Los Angeles Co., CA 1982 Issue B	12/14/82	75.000	N/A	SLO
Northern Kentucky Series 1982	12/21/82	15.750	N/A	LO

N/A = information not available.

a. * = Information provided in GAO preliminary list of single-family issues.

b. SO = special obligation
LO = limited obligation
SLO = special, limited obligation

Table 3. (Continued)

Issue	Mortgage Rate (percents)[c]	Type of Mortgage[d]	Distribution of Funds Including Contributions and Fees: Percent for Mortgages	Distribution of Funds Including Contributions and Fees: Percent for Other Uses	Percent of Loan Funds Reserved for Targeted Areas[e]
Palm Springs, CA Issue of 1982	13.125	Level:30	93	7	0.0
Denton Co., TX Series 1982	13.55	N/A:20	96	4	N/A
Coon Rapids, MN Series 1982	13.00	Level:30	87	13	N/A
Fairbanks North Star, AK Series 1982	10.00	N/A:N/A	95	5	0.0
Cameron Co., HFC, TX 1982 Series A	13.375	GEM:15	93	7	?
Central California MA, 1982 Series A	12.125	Level:30	84	16	?
Bexar Co. HFC, TX Series 1982	13.125	GEM:15	92	8	?
San Mateo Co., CA 1982 Series A	13.00	Level:30	93	7	0.0
Volusia Co. HFA, FL Series 1982	12.875	GEM:14	94	6	1.1
Wichita, KS 1982 Series A	13.40-13.825	GEM:17	91	9	N/A
Denver City and Co., CO 1982 Series A	12.99	GEM:15	87	13	?
Atlanta URFA, GA Series 1982	13.375	GEM:16	93	7	22.0
Tucson IDA and Pima Co. IDA, AZ Series 1982	12.95	GEM:15	88	12	5.2
New Castle Co., DE 1982 Series A	13.625	Level:25	88	12	5.5
Broward Co. HFA, FL 1982 Series A	12.75	GEM:16	69	31	N/A
Santa Fe Springs RA, CA 1982 Series A	13.05	Level:30	87	13	N/A
St. Louis, MO Series 1982 A	13.00	Level:30	93	7	5.0
Albuquerque, NM	12.35	GEM:15	91	9	N/A
Maricopa Co. IDA and Phoenix IDA, AZ Series 1982	11.625	GEM:15	90	10	20.8
Jefferson Co., CO 1982 Series A	11.95	GEM:15	90	10	0.0
Cobb Co. HA, GA Series 1982	11.80	GEM:16	90	10	8.1
Prince George's Co. HA, MD 1982 Series A	10.50	GEM:19	92	8	0.0
San Francisco, CA 1982 Bonds Series A	10.75	Level:30	91	9	2.8
Allegheny Co. RFA, PA 1982 Series A	11.375	Level:30	93	7	0.7
Montgomery Co. HOC, MD 1982 Series A	N/A	Level:30	72	28	N/A
Cook Co., IL 1982 Series A and Series B	11.50	GEM:19	92	8	2.2
Los Angeles Co., CA 1982 Issue B	10.625	Level:30	95	5	8.0
Northern Kentucky Series 1982	11.49	Level:20	93	7	0.0

c. Mortgage interest rates are sometimes lower than the yields on the bonds because of additional funds from fees or contributions from the issuer.

d. Level = level payment mortgage amortized over the specified number of years.
GEM = growing equity mortgage paid off at the end of the specified number of years.

e. ? = There are funds set aside for targeted area loans, but the amount is not specified in the official statement.

Table 3. (Continued)

	Purchase Price Limits for a One-Family Residence in a Nontargeted Area (thousands of dollars)		Below, Equal, or Above IRS Safe-Harbor Purchase Price Limits	Number of Lenders	Income Limit for a Household of Four[f] (thousands of dollars)
	New	Existing			
Palm Springs, CA Issue of 1982	80	---	Equal	1	34
Denton Co., TX Series 1982	100	64	Equal	12	38
Coon Rapids, MN Series 1982	94	94	Above	6	31
Fairbanks North Star, AK Series 1982	101	82	Above	N/A	N/A
Cameron Co., HFC, TX 1982 Series A	74	51	N/A	7	50
Central California MA, 1982 Series A	74	80	N/A	3	32 to 43
Bexar Co. HFC, TX Series 1982	76	64	Equal	14	38
San Mateo Co., CA 1982 Series A	127	119	Above	2	26 to 43
Volusia Co. HFA, FL Series 1982	58	50	Above	4	33
Wichita, KS 1982 Series A	65	46 to 72	Equal	12	No limit
Denver City and Co., CO 1982 Series A	72	63 to 71	Equal	18	42
Atlanta URFA, GA Series 1982	79	74 to 116	Equal or Above	7	30 to 38
Tucson IDA and Pima Co. IDA, AZ Series 1982	75	60	Equal	9	28 to 60
New Castle Co., DE 1982 Series A	68	52	Equal	7	No limit
Broward Co. HFA, FL 1982 Series A	63	63	Equal	7	33
Santa Fe Springs RA, CA 1982 Series A	96	---	Equal	1	N/A
St. Louis, MO Series 1982 A	63	55	Below	12	31
Albuquerque, NM	77	67	Above	5	34
Maricopa Co. IDA and Phoenix IDA, AZ Series 1982	80	72	Equal	33	28 to 60
Jefferson Co., CO 1982 Series A	77	88	Equal	21	42
Cobb Co. HA, GA Series 1982	79	60	Above	13	40
Prince George's Co. HA, MD 1982 Series A	110	103	Above	N/A	N/A
San Francisco, CA 1982 Bonds Series A	114	97	Below	N/A	26 to 50
Allegheny Co. RFA, PA 1982 Series A	85	64	Equal	8	N/A
Montgomery Co. HOC, MD 1982 Series A	70	70	Below	5	35
Cook Co., IL 1982 Series A and Series B	90	78	Equal	27	N/A
Los Angeles Co., CA 1982 Issue B	150	111	Above	2	29 to 44
Northern Kentucky Series 1982	84	64	Above	8	N/A

(Continued)

N/A = The requirement to reserve loan funds for targeted areas was not mentioned in the official statement.

f. When there is a range of income limits within a given locality, the limits generally vary according to geographic location or according to whether the mortgagor is buying new or existing housing.

required. These limits vary widely, however, making only upper- and upper-middle income homebuyers ineligible in many cases.

Mortgage revenue bonds provide financing mostly for detached homes, townhouses, and condominiums. Mortgages may be structured either as traditional 20- to 30-year level-payment mortgages or as growing equity mortgages and accelerated principal payment mortgages, where the mortgagor pays less interest in the beginning years, making it up in the later years.

The bond issues vary in type of obligation--special, limited, or general. The type of obligation depends upon the credit ratings of the state and the issuing agency and upon the issuer's need for added security. On average, about 85 to 90 percent of the total available funds in a given issue went toward mortgage loans. The number of lenders committed to make mortgage loans was larger for state programs and smaller for local programs.

The information below expands on this summary. It is based on the official statements for each issue and telephone conversations with officials of issuing agencies. Additional information was provided by the Office of Financial Management and the State Agency Division, both in the Department of Housing and Urban Development, the General Accounting Office, and the Council of State Housing Agencies. All 1982 state single-family issues together averaged $80 million in 1982, with New York issuing the largest at $250 million and Idaho issuing the smallest at $4.345 million. The average size for all local single-family issues in 1982 was $30 million, with Maricopa County, Arizona, and the City of Phoenix jointly issuing the largest at $113 million, and Raeford, North Carolina, issuing the smallest at $950,000.[6]

Targeted Area Requirement. The 1980 Act requires that the lesser of 20 percent of lendable proceeds or 40 percent of the mortgage market share for targeted areas be set aside for mortgages in targeted areas. Targeted areas are qualified low-income census tracts or areas approved by the Secretaries of the Treasury and the Department of Housing and Urban Development to be areas of chronic economic distress. The safe-harbor rule for determining 40 percent of market share in targeted areas is 40 percent of the average annual aggregate principal amount of mortgages in targeted areas within the issuer's jurisdiction during the preceding three years. Of the 40 state issues examined, 15 set aside 20 percent or more of lendable proceeds for mortgages in targeted areas, and 16 used the market-share safe-harbor rule that enabled them to set aside between 0 and 20 percent. Four states had no targeted areas in their jurisdictions or had unpopulated targeted areas and so they did not set aside any proceeds. Information was not available for five states. Of the 28 localities studied, only 2 set

6. There may be some very small local bond issues not included in the Department of Housing and Urban Development's listing, mainly because of private placements.

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aside 20 percent or more, and 13 set aside between 0 and 20 percent. Six localities did not set aside any proceeds for targeted areas because there were none within their jurisdictions, and no mention was made of the targeted area requirement in the official statements of seven others.

Since the regulations came out in July 1981, 40 out of 50 states have applied for approval of additional areas as targeted areas. Thirty-eight of these states have had applications approved. (Localities may not apply independently for areas of chronic economic distress to be approved as targeted areas. Each application must be made by a state governor. The background materials for the application, however, may be prepared by a locality or a housing finance agency.) The 65 newly approved targeted areas and the 30 areas still pending approval vary greatly in size and population. After May 1982, when the Treasury Department removed the cap limiting targeted areas to 20 percent of a state's population, several states applied for additional designated areas to be approved. Applications propose regions as small as city neighborhoods and as large as two-thirds of a state. At present, the population living in targeted areas generally cannot exceed about 50 percent of a state's total population. Federal approval for designating more than half a state as a target area is unlikely because such approval depends upon proving a given area's special chronic economic distress as compared with statewide averages for income, housing stock, and other measures.[7] The 20 percent population cap, however, served to focus the targeting mechanism more narrowly than the present guidelines.

Purchase Price Limits. The 1980 act included home purchase price limitations as well as targeted area requirements. The limits are specified as a percentage of the average area purchase price where the home is located. Before the 1980 legislation was amended by TEFRA, the limits were set at 90 percent of the average area purchase price for a home not located in a targeted area and at 110 percent of the average area purchase price for a home located within a targeted area. TEFRA eased these limits by raising them to 110 percent of the average area purchase price for a home not located in a targeted area and to 120 percent of the average area purchase price for a home located within a targeted area.

The IRS issued a listing of safe-harbor estimates of average area purchase prices for issuers to use in calculating purchase price limits.[8] Some 1982 issuers, however,

7. Telephone conversations with John Kozak, State Agency Division, Department of Housing and Urban Development (March 17, 1983 and April 12, 1983).

8. Department of the Treasury, Internal Revenue Service, News Release No. IR-81-91 (August 6, 1981). An updated listing of average area purchase prices was recently released for bonds issued December 29, 1982 through December 31, 1983. See Department of the Treasury, Internal Revenue Service, News Release No. IR-82-157 (December 29, 1982).

chose to use their own estimates of average area purchase prices for calculating the purchase price limits in their jurisdictions. Twenty-one of the 40 state issues sampled used only the safe-harbor average area purchase prices to determine their purchase price limits. Two states used their own estimates of average area purchase price for some portion of their jurisdiction and set limits equal to or above those implied by the safe-harbor estimates. Eight states chose to set their limits below the federal limits for some portion of their jurisdiction. Eight states set the limits for all areas in their jurisdiction below those implied by the safe-harbor estimates and one (Alaska) set all its limits above. Thirteen of the 28 local issues examined adopted purchase price limits determined by the safe-harbor estimates. One issuer (Atlanta) relied on the safe-harbor estimates and its own calculations for different areas, calculating purchase price limits equal to and above those implied by the safe-harbor figures. Nine issuers relied on their own calculations to set all their limits above, and three others chose to set all their limits below those implied by the safe-harbor estimates. Information was not available for two local issuers.

Income Limits. Limits on a homebuyer's income are another way state and local governments target their mortgage loan programs. The 1980 act did not include any requirement for income limits, but most issuing jurisdictions studied impose some sort of income limit. For 36 of the state issues sampled, the income limit for a household of four ranged from a lower limit of $16,000 (in Indiana) to an upper limit of $60,000 (in Arizona). Three states--Alaska, New Jersey, and New York--impose no limit on the income of participating mortgagors. Information was only available for 22 out of the 28 local issues sampled. (The other six issues make no mention of income limits in their official statements.) For the 20 local issues that had them, the income limit for a household of four ranged from $26,000 to an upper limit of $60,000. Jurisdictions often set up a range of limits that vary according to family size, geographic area, and whether the mortgagor is buying new or existing housing or whether the mortgagor has special circumstances such as a medical disability. It would appear that localities set income limits less frequently than states, and that when they do set them, those limits are apt to be slightly higher.

Type of Housing Financed. Housing agencies issue single-family bonds to finance several types of homes: traditional detached one-family houses, attached townhouses, condominiums, cooperative units, modular homes (permanently affixed manufactured housing), and owner-occupied two- to four-family houses (when previously occupied). Almost every state and local issuer in the sample allowed financing for condominiums as well as detached and attached homes. Modular homes are allowed financing by most state programs, but several local issuers do not finance them. One explanation could be that modular homes are often more popular in rural areas where people own land but have little capital to buy housing with. Issuers vary in allowing the financing of existing two-to four-unit family homes. (New two- to four-unit residences are not allowed under MSBTA.) Some issuers restrict multiple-family homes to duplexes or triplexes; several do not provide financing for any multiple-family homes at all. Cooperative units seem to be financed rarely under these bond programs. Coops are uncommon in many parts of the country, and the fact that coop-buyers purchase shares in a corporation rather than an actual physical structure may make many issuers disallow them. The eligibility of coops for tax-exempt financing was clarified in TEFRA.

Housing bonds may be used to provide financing for both new and existing homes. In response to the particular conditions of the housing market in their areas, some issuers limit their programs to all new or all existing homes. Other issuers prescribe specific percentages for new and existing homes, while still others finance mortgage loans on a first-come, first-served basis, making a prediction of the percentages for new and existing homes impossible. Local issuers limit their issues to only new housing more frequently than state issuers. In these cases, the intent of the programs is usually to subsidize particular development or redevelopment projects where specific builders have been granted contracts.

Type of Mortgage. Mortgages were offered either as conventional level payment mortgages or as growing equity mortgages (GEMs). Growing equity mortgages prescribe growing monthly payments in the first few years (usually five to ten) of the mortgage loan and then level payments for the remainder of the loan. Because the increases in payments go toward paying off principal, these are sometimes called accelerated principal payment mortgages. Fifteen out of 40 state issues studied provided for growing equity mortgages, to be paid off over 16 to 20 years. California offered both 30-year level and 20-year growing equity mortgages. Twenty-four states offered only level-payment mortgages, to be paid off over 20 to 30 years. Fourteen of the local issues studied offered GEMs, to be paid off over 14 to 19 years. Twelve offered level-payment mortgages to be paid off over 20 to 30 years, and information was not available for two issues. Single-family mortgage programs using GEMs are often able to attract more homebuyers because of the reduced monthly payments in the early years of the mortgage. Many housing agency officials, however, chose to structure their single-family programs with level-payment mortgages because they felt that potential homebuyers in their region would prefer conventional mortgages to the new and unfamiliar GEMs.

Type of Obligation. The sample of state single-family issues included limited obligation, special obligation and general obligation bonds. The sample of local issues includes limited obligation, special obligation, and special, limited obligation bonds. Limited and special obligation bonds usually have access only to the issuing agency's nonattached assets (mainly the agency's general fund) in case additional money is needed to pay bondholders because of a shortfall in earnings. Attached assets are mortgages and other assets pledged to the payment of other bonds issued by the agency. General obligation bonds usually have some guarantee of support from the state's general funds, if necessary. For some issues, the guarantee was in the form of a so-called moral obligation, where the governor or the state treasurer promises to go to the state assembly to apply for an appropriation in the case of an issue's threatened shortfall, or in the form of guaranteed access to other assets of the agency or the state. Sixteen out of the 40 state issues studied were called general obligation bonds while none of the 28 local issues studied was.

Percentage of Total Funds Used for Mortgages. For the state issues sampled, the percentage of total available funds set aside for mortgages averaged 85 percent; the local issues sampled averaged 90 percent. The rest of the funds were used for reserves, the underwriters' discount, original issue discount, capitalized interest, or other costs of issuance. Total available funds include bond proceeds, agency or state contributions, and any fees paid by lenders, builders, buyers, or sellers.

Number of Lenders. Private banks, savings and loans, and mortgage companies request to participate in any given issuer's housing program. The portion of bond proceeds to be used for mortgage loans is allocated to eligible lenders who then commit to loan out their allocation within a prescribed period. Lenders who are unable to loan out their full allocation might have to forfeit a commitment fee and have the remainder of their allocation transferred to another lender. The state issues sampled show a wide dispersion of lending activity; 35 state issues had an average of 110 participating lenders. (Information for five states was not available.) The local issues sampled had many fewer participating lenders; for 25 issues, there was an average of 10 lenders participating in each program. The difference between the state and local dispersion of allocations can be explained by the fact that localities are much smaller than states and that local programs are more often organized with a cooperative arrangement between the issuer and specific builders and lenders.

APPENDIX TABLES

TABLE A-1. STATE MORTGAGE REVENUE BOND ISSUES FOR OWNER-OCCUPIED HOUSING, 1982

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Alabama						
11/11	1982-Series A	100,000	10.76	31*	A1	AA	Goldman Sachs
12/9	1982-Series B	100,000	10.76*	30	A1	AA-	Goldman Sachs
	Alaska						
3/4	Home Improvement Bonds	15,000	13.43*	15	A	A	Salomon Brothers
9/9	1982-First Series	85,000	N/A	18	Aa	AA	Salomon Brothers
11/24	1982-Second Series	100,000	11.54*	17	Aa*	AA-	Salomon Brothers
	Arizona						
11/8	Series A 1982	27,200	9.92*	30		AA-*	Rauscher Pierce Refsnes
	Arkansas						
7/27	1982-Series A	100,000	13.13	20	A1	AA	E.F. Hutton
	California						
3/24	1982-Series	30,000	N/A	N/A	Aa*		Merrill Lynch White Weld
7/23	1982-Series A	31,500	12.95	17	A1	A+	Merrill Lynch White Weld
10/14	1982-Series A	212,000	10.25*	32	A1*	A+	Merrill Lynch White Weld
12/17	1982-Series B	101,775	10.50*	31	A1	A+	Merrill Lynch White Weld
	Colorado						
7/29	1982-Series A	66,050	12.78	19	Aa	AA-	Smith Barney Harris Upham
	Connecticut						
9/10	1982-Series B	150,000	11.06	18	Aa	AA-	Salomon Brothers
9/20	1982-Series	36,600	N/A	30			Goldman Sachs
11/30	1982-Series	50,000	9.73	18*	Aa*	AA	Salomon Brothers
	Delaware						
6/24	1982-Series A	40,000	13.33	22	Aa	AA-	Morgan Guaranty Trust
	Florida						
6/15	1982-Series A	150,000	13.50	18	A1	A	Salomon Brothers
	Georgia						
9/17	1982-Series A	50,000	10.70*	20*	A1	AA	Dean Witter Reynolds
	Hawaii						
7/16	1982-Series A	60,000	13.00	19	A1	A	Merrill Lynch White Weld
	Idaho						
12/17	1982-Series A	4,345	N/A	N/A			Salomon Brothers

TABLE A-1. (Continued)

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Illinois						
7/30	1982-Series A	90,000	11.85	18	A1	AA	Smith Barney Harris Upham
	Indiana						
4/6	1982-Series A	75,000	N/A	26	Aa	AA	First Boston Corp.
	Iowa						
9/3	1982-Series A	14,080	11.70	31	A+		Blyth Eastman Paine Webber
	Louisiana						
8/23	1982-Series A	100,000	12.60	32	Aa	AA	E.F. Hutton
	Maine						
6/10	1982-Series B	53,920	12.92	20	A1	AA	Morgan Guaranty Trust
	Maryland						
3/19	1982-Series A	65,000	13.27	32	Aa		Matthews & Wright
10/8	1982-First Series	87,514	10.97	32	Aa*		Salomon Brothers
	Massachusetts						
8/10	1982-Series A	200,000	13.57	32	Aa	A	Blyth Eastman Paine Webber
	Michigan						
4/20	1982-Series	30,000	11.42	15	A	A-	E.F. Hutton
	Minnesota						
6/3	1982-Series A	30,000	12.41	11		A+	Blyth Eastman Paine Webber
8/12	1982-Series B	41,900	11.57	11	A1	A+	Blyth Eastman Paine Webber
11/24	1982-Series C	45,000	N/A	32	A1	A+	Blyth Eastman Paine Webber
12/1	1982-Series A	4,400	N/A	N/A		A+	Blyth Eastman Paine Webber
	Mississippi						
8/20	1982-Series	150,500	11.26	17	A1	A+	Goldman Sachs
	Missouri						
3/31	1982-Series	50,000	13.25	20	Aa	AA	Smith Barney Harris Upham
8/24	1982-Series	49,995	11.09	18	Aa	A+	Morgan Guaranty Trust
	Montana						
4/6	Series 1982 A	55,000	13.50	25	Aa	AA	First Boston Corp.
	Nebraska						
3/29	1987-Series	37,715	12.72	30		AA	Lehman Brothers Kuhn Loeb
6/3	1982-Series A	9,795	12.80	15			Lehman Brothers Kuhn Loeb
7/21	1982-Series B	89,410	11.52	31	Aa	AA	Lehman Brothers Kuhn Loeb

TABLE A-1. (Continued)

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Nevada						
7/14	1982-Issue A	60,000	14.00	16	A1	AA-	Dean Witter Reynolds
	New Hampshire						
7/1	1982-Series A	167,255	13.06	31	Aa	A+	Kidder Peabody
	New Jersey						
4/14	1982-Series	36,170	13.04	20	A1	A	Goldman Sachs
10/7	1982-Series 1	239,000	10.60	31	A1	A	Goldman Sachs
	New Mexico						
9/1	1982-Series A	98,655	10.54	32	A+	AA	Smith Barney Harris Upham
	New York						
7/8	1982-Series 3	250,000	13.22	30	Aa	A+	Goldman Sachs
12/2	1982-Series 4	151,620	N/A	30	Aa	A+	Salomon Brothers
	North Dakota						
7/15	1982-Series A	29,940	12.77	16	Aa	AA-	Salomon Brothers
	Oklahoma						
12/31	1982-Series A	25,000	8.70*	10*		A+	Stifel Nicolaus
	Oregon						
9/24	1982-Series A	125,000	11.19	31	A1	A+	Blyth Eastman Paine Webber
	Pennsylvania						
4/1	1982-Series A	100,000	13.73	30	A	A+	Goldman Sachs
8/18	1982-Series B	115,000	12.43	31	A1	A+	Goldman Sachs
	Rhode Island						
7/23	1982-Series 1	30,850	13.30	18	A1	A+	Kidder Peabody
12/30	1982-Series 2	41,141	10.11	17*	A1*	A+*	Kidder Peabody
	South Carolina						
9/21	1982-Series A	82,265	N/A	31	Aa	A+	Morgan Guaranty Trust
	South Dakota						
6/3	1982-Series	24,100	13.04	30	Aa	AA	Warburg Paribas Becker
	Tennessee						
7/27	1982-Series A	150,000	12.75	17	A1	A+	Salomon Brothers
	Texas						
7/9	1982-Series A	100,000	13.72	31	Aa	A	Goldman Sachs

TABLE A-1. (Continued)

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Utah						
5/28	1982-First Series	121,765	12.68	16	A1	AA	Bache Halsey Stuart Shields
	Vermont						
7/15	1982-Series A	35,000	13.45	27	Aa	AA-	Goldman Sachs
	Virginia						
7/20	1982-Series A	100,000	12.94	32	Aa	A+	Citibank, N.A.
11/9	1982-Series B	166,109	9.42	32	Aa	A+	E.F. Hutton
	West Virginia						
3/5	1982-Series A	25,000	13.85	16	A1	A+	Goldman Sachs
	Wisconsin						
7/1	1982-Series A	100,000	13.80	31	Aa	AA-	Blyth Eastman Paine Webber
12/9	1982-Issue II	50,000	10.67	31	Aa	AA-	Blyth Eastman Paine Webber

SOURCE: Office of Financial Management, Department of Housing and Urban Development.

* This information was provided by the Council of State Housing Agencies.

NOTE: Some of these bond issues may be transitional issues, and therefore not subject to the new rules in MSBTA and TEFRA.

TABLE A-?. LOCAL SINGLE-FAMILY MORTGAGE REVENUE BONDS, 1982

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
1/21	Dade Co., FL	40,000	N/A	14			E.F. Hutton
2/23	Atlanta, GA	49,000	N/A	N/A			E.F. Hutton
3/3	Richmond, CA	59,000	13.12	18	Aa		Dean Witter Reynolds
3/5	Palm Springs, CA	19,300	12.83	31		AA	Shearson/American Express
3/11	Denton Co., TX	25,850	13.55	22		A	Kidder Peabody
3/26	Lancaster, CA	33,400	12.92	19		AA	Miller & Schroeder
3/26	Seal Beach, CA	18,200	N/A	33		AA	Miller & Schroeder
4/7	Orange Co., CA	54,060	13.00	31		AA	Warburg Paribus Becker
4/13	Gregg Co., TX	20,000	13.93	22		A	Kidder Peabody
4/16	Haywood-Union City, CA	22,400	N/A	31		AA-	Stone & Youngberg
4/20	San Diego, CA	35,165	N/A	32		AA	E.F. Hutton
4/22	Harris Co., TX	63,560	13.21	31		AA	Lehman Brothers
4/27	Coon Rapids, MN	30,000	N/A	32		A+	Miller & Schroeder
4/27	Santa Clara Co., CA	34,160	12.38	31		AA	Warburg Paribus Becker
4/28	Capital Area HFC, TX	24,950	13.30	32		AA	Kidder Peabody
4/29	San Pablo, CA	25,200	12.04	13		A	Dillon, Read
4/30	Pittsburg, CA	32,235	N/A	31		A	Dean Witter/Reynolds
4/30	Fairbanks North Star, AK	35,000	N/A	20	Aa	AA	John Nuveen & Co.
5/5	Cameron Co., TX	30,000	N/A	15		A	Boettcher & Company
5/6	Jefferson Co., TX	37,900	N/A	31		A+	Lehman Brothers/Kuhn Loeb
5/10	El Paso, TX	42,500	N/A	15		AA	Rauscher Pierce Refsnes
5/12	Monrovia, CA	9,065	N/A	32		AA	E.F. Hutton
5/13	Clay Co., FL	12,850	N/A	31		A-	William R. Hough
5/14	Hidalgo Co., TX	24,800	13.12	15		A	Boettcher & Company
5/14	Contra Costa Co., CA	62,400	12.87	27		AA	Dean Witter/Reynolds
5/17	Central Texas, TX	17,000	13.17	15		A+	Howard, Weil Labouisse
5/17	Lubbock, TX	25,000	13.17	15		A+	Howard, Weil Labouisse
5/17	Midland Co., TX	20,000	13.12	15		A+	Howard, Weil Labouisse
5/17	Tarrant Co., TX	43,855	N/A	31	Aa	AA-	Lehman Brothers Kuhn Loeb
5/18	Sacramento Co., CA	31,900	N/A	32			Blyth Eastman Paine Webber
5/18	Benton Co., TX	30,815	10.00	32		AA	Kidder Peabody
5/20	Ventura Co., CA	36,200	N/A	21		A+	Miller & Schroeder Municipals
5/20	Central Calif., CA	30,000	N/A	30		AAA	Shearson/American Express
5/25	Bexar Co., TX	69,210	N/A	17		A	Boettcher & Coompany
6/3	Orange Co., FL	34,800	12.82	17		A+	Merrill Lynch/White Weld
6/3	Livermore/ San Leandro, CA	35,820	12.60	33		AA-	Shearson/American Express
6/8	San Mateo Co., CA	40,860	13.01	31		AA-	First Boston Corp.
6/10	Volusia Co., FL	11,905	N/A	14		A	William R. Hough
6/10	Pittsburgh, PA	15,000	13.34	31	Al	A	Dillon, Read & Company
6/16	Corpus Christi, TX	30,000	N/A	31		AA	E.F. Hutton
6/18	Southeast Texas, TX	60,000	13.17	15		A+	Howard, Weil Labouisse
6/23	Wichita, KS	30,000	N/A	18	Al	AA	E.F. Hutton
6/23	Concord-Walnut Creek, CA	32,000	13.01	32		AA-	E.F. Hutton
6/24	Escambia, FL	26,830	N/A	31		A	William R. Hough

TABLE A-2. (Continued)

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
6/25	Palm Beach Co., FL	26,370	13.59	16		AA	Merrill Lynch/White Weld
6/29	Denver (City and County), CO	26,625	N/A	16		A	E.F. Hutton
6/29	Manatee Co., FL	6,830	N/A	N/A			William R. Hough
6/30	Polk Co., Fl	11,925	N/A	31		A+	William R. Hough
7/9	Orange Co., CA	49,150	N/A	33		AA	Warburg Paribus Becker
7/12	Simi Valley, CA	50,000	N/A	33		AA-	Stone & Youngberg
7/12	Ontario, CA	31,200	N/A	33		AA-	Miller & Schroeder
7/15	Tulare Co., CA	31,200	N/A	32		A+	Dean Witter/Reynolds
7/16	Atlanta, GA	30,000	N/A	16	A1	AA-	Merrill Lynch/White Weld
7/16	Olathe, KS	30,000	13.10	32		AA	Blyth Eastman/Paine Webber
7/19	Tucson and Pima Cos., AZ	51,875	11.54	17		AA-	Rauscher Pierce Refsnes
7/21	Brevard Co., Fl	30,000	N/A	22		AA-	Kidder Peabody
7/21	San Bernardino Co., CA	58,750	N/A	33		AA-	Miller & Schroeder
7/22	Lee Co., Fl	20,090	13.43	22		AA-	Bache Halsey Stuart Shields
7/23	New Castle Co., DE	50,000	13.31	25		AA	L.F. Rothschild
7/26	Oakland, CA	61,740	13.10	31			Goldman Sachs
7/29	Broward Co., Fl	34,300	13.59	17	A1	A+	Merrill Lynch/White Weld
7/30	Los Angeles Co., CA	53,200	N/A	33		AA-	Warburg Paribus Becker
8/3	Santa Fe Springs, CA	9,580	12.51	25		AAA	L.F. Rothschild
8/3	West Covina-Baldwin Park, CA	18,900	12.76	17		A+	Rauscher Pierce Refsnes
8/6	St. Louis Co., MO	21,180	12.66	32		A+	Stifel, Nicolaus
8/6	St. Charles Co., MO	23,300	N/A	32		A+	Geo. K. Baum
8/12	Los Angeles, CA	30,000	N/A	32			Salomon Brothers
8/18	Adams Co., CO	10,595	N/A	16		A+	E.F. Hutton
8/18	Pleasanton-Newark, CA	25,340	N/A	31		AA	Dean Witter/Reynolds
8/20	Fresno Co., CA	38,000	N/A	30			Goldman Sachs
8/23	Albuquerque, NM	19,100	11.83	16		A+	E.F. Hutton
8/27	Maricopa Co/Phoenix, AZ	113,000	N/A	18	A1	AA-	Rauscher Pierce Refsnes
8/31	Jackson Co., MO	25,900	N/A	32			Stern Brothers & Co,
9/2	St. Louis, MO	20.180	N/A	30			Drexel, Burnham Lambert
9/3	Northern California	60,000	12.94	20		AA-	Dean Witter/Reynolds
9/3	Jefferson Parish, LA	19,175	N/A	20		AA	Shearson/American Express
9/8	Kern Co., CA	29,200	N/A	N/A		AAA	Shearson/American Express
9/10	Pittsubrgh, PA	11,000	N/A	N/A		A	Dillon, Read & Company
9/13	Jefferson Co., CO	19,875	N/A	17		A+	E.F. Hutton
9/15	Baltimore, MD	50,000	11.75	N/A		AA	Alex Brown & Sons
9/15	Stockton-Vacaville, CA	19,540	11.75	32			Shearson/American Express
9/17	Orange Co., CA	26,135	N/A	33		AA	Warburg Paribus Becker
9/27	Baltimore, MD	4,600	11.25	10			Baker, Watts & Company
10/1	Cobb Co., GA	10,165	11.04	16			Merrill Lynch/White Weld
10/1	Dekalb Co., GA	10,040	11.04	16			Merrill Lynch/White Weld
10/1	Gwinnet Co, GA	7,615	11.04	16			Merrill Lynch/White Weld
10/1	Reno Co., KS	20,000	N/A	21		AAA	Kirchner, Moore & Company

TABLE 2. (Continued)

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
10/8	Prince George's Co., MD	35,950	N/A	20		A+	Baker, Watts & Company
10/8	City & Co. San Francisco, CA	60,000	N/A	32			Shearson/American Express
10/13	El Paso Co., CO	15,295	N/A	N/A			Boettcher & Company
10/13	Los Angeles, CA	20,700	N/A	N/A		AAA	Shearson/American Express
10/14	E. Baton Rouge, LA	30,000	N/A	20		AA-	Shearson/American Express
10/15	Milpitas, CA	15,555	9.68	20		A	Miller & Schroeder
10/21	St. Cloud, MN	10,000	N/A	20		A	Dain Bosworth
10/21	Sauk Rapids, MN	8,000	N/A	20		A	Dain Bosworth
11/1	Saline Co., KS	32,540	N/A	32		AAA	Kirchner Moore
11/3	Marin Co., CA	9,300	N/A	32		A-	Shearson/American Express
11/12	Allegheny, PA	25,000	N/A	32			Russell, Rea & Zappala
11/15	San Bruno, CA	91,000	N/A	N/A			Shearson/American Express
11/15	Kansas City, KS	19,000	N/A	32			Stern Brothers
11/17	Pasadena, CA	33,325	N/A	29			Shearson/American Express
11/18	Duluth, MN	1,000	N/A	12			Dain Bosworth
12/1	Raeford, NC	950	N/A	N/A			Wertheim and Co.
12/2	Labette Co., KS	14,165	N/A	12			Kirchner, Moore & Company
12/2	St. Paul, MN	16,500	N/A	32			Piper, Jaffray & Hopwood
12/3	Montgomery Co., MD	37,495	N/A	32			Merrill Lynch/White Weld
12/3	Ventura Co., CA	33,800	N/A	22		A+	Miller & Schroeder
12/8	Cook Co., Il	70,000	N/A	20	A1		1st Nat'l. Bank of Chicago
12/14	Los Angeles Co., CA	75,000	N/A	28			Blyth Eastman/Paine Webber
12/20	Santa Rosa-Martinez, CA	19,000	N/A	32		A+	Dean Witter/Reynolds
12/20	Santa Cruz-Hayward, CA	21,370	N/A	N/A			Miller & Schroeder
12/21	Northern Kentucky, KY	15,750	N/A	18			Fox, Reusch
12/21	Cook Co., Il	31,075	N/A	29		AAA	Blyth Eastman/Paine Webber
12/27	Brooklyn Center, MN	31,758	N/A	32		AA	Miller & Schroeder
12/27	Boulder Co., CO	10,000	N/A	18			E.F. Hutton
12/30	Mesa Co., CO	14,450	N/A	17		A-	George K. Baum & Company
12/30	Floyd and Johnson Cos., KY	15,250	N/A	N/A			Seasongood and Mayes

SOURCE: Office of Financial Management, Department of Housing and Urban Development.

NOTE: Some of these bond issues may be transitional issues, and therefore not subject to the new rules in MSBTA and TEFRA.

TABLE A-3. VETERANS' GENERAL OBLIGATIONS BONDS, 1982

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
5/21	California	50,000	10.93	N/A	Aa	AA	Bank of America
8/3	Oregon	100,000	10.47	N/A	A1	AA	Morgan Guaranty Trust
8/24	California	100,000	9.44	N/A	Aa	AA+	Bank of America
8/25	Wisconsin	30,000	9.20	N/A	Aa		Smith Barney Harris Upham
11/1	Oregon	200,000	N/A	N/A	A1	AA	Salomon Brothers

SOURCE: Office of Financial Management, Department of Housing and Urban Development.

TABLE A-4. STATE MORTGAGE REVENUE BOND ISSUES FOR MULTIFAMILY, RENTAL HOUSING, 1982

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Alaska						
8/2	1982-Series A	2,390	13.18	41		AA	John Nuveen & Co.
	Arkansas						
6/17	1982-Series A	153,075	12.42	41	Aa	AA	E.F. Hutton
	California						
6/1	1982-Series	45,600	12.42	42		AA	Merrill Lynch White Weld
9/10	1982-Series A	75,090	11.25	42	A1		Merrill Lynch White Weld
11/12	1982-Series B	31,845	N/A	32	A1*	AAA	Merrill Lynch White Weld
	Colorado						
5/13	1982-Series A	104,735	11.12	43	Aa	AA	Smith Barney Harris Upham
10/20	1982-Series B	28,780	8.54*	42		AA+	Smith Barney Harris Upham
11/17	1982-Series A	32,000	9.50*	12*		AAA-L*	Smith Barney Harris Upham
	Connecticut						
4/2	G.O. Bonds	75,000	11.10	N/A			Citibank
4/23	1982-Series	51,270	12.62*	32	Aa	AA-	Salomon Brothers
	Delaware						
9/24	1982-Series A	71,900	10.97	32	A+	A+	Salomon Brothers
	District of Columbia						
8/10	1982-Series	57,480	12.22	40	Aa	AA+	Salomon Brothers
	Florida						
6/29	1982-Series A	47,000	13.23	42	Aa	AA	Merrill Lynch White Weld
9/28	1982-Series B	3,435	N/A	42*	Aa*	AA*	William R. Hough & Company
12/1	1982-Series ABC	31,350	10.00*	20		AAA	Merrill Lynch White Weld
	Illinois						
4/7	1982-Series A	88,420	N/A	31	A	A+	Smith Barney Harris Upham
6/10	1982-Series B	64,260	10.39	44	A1	AA	Smith Barney Harris Upham
11/24	1982-Series C	72,090	N/A	43	A1*	AA*	Smith Barney Harris Upham
	Indiana						
8/12	1982-Series	8,790	13.05	42	Aa*		First Boston Corp.
	Iowa						
9/27	1982-Series C	17,555	11.07	40		Aa	Blyth Eastman Paine Webber

TABLE A-4. (Continued)

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	Louisiana						
8/23	1982-Series A	73,640	11.82	42	Aa	AA	E.F. Hutton
	Maine						
2/25	1982 Series	23,280	13.68	31	A1	AA	Salomon Brothers
10/13	1982-Series C	5,340	N/A	32			Private Placement
11/24	1982-Series D	2,190	N/A	31			Private Placement
	Maryland						
5/7	1982-Series A	32,335	N/A	42	Aa		Matthews & Wright
7/29	1982-Series B	16,510	N/A	42	Aa		Merrill Lynch White Weld
8/18	1982-Series	34,500	N/A	20			Alex Brown & Sons
9/14	1982-Series C	66,740	11.13	20	Aa*		Merrill Lynch White Weld
	Massachusetts						
5/21	1982-Series A:3	37,890	12.38*	32	A1	A+	Blyth Eastman Paine Webber
9/1	1982-Series A	17,700	11.72	42	Aa*	AA*	Blyth Eastman Paine Webber
9/17	1982-Series A:4	63,000	11.76	32	A1*	A+*	Blyth Eastman Paine Webber
12/16	1982-Series B:4	45,300	N/A	31			Blyth Eastman Paine Webber
	Michigan						
7/21	1982-Series	32,670	N/A	33	A1	A+	E.F. Hutton
	Minnesota						
3/3	1982-Series A	40,920	13.56	32	A1	A+	Blyth Eastman Paine Webber
4/15	1982-Series B	7,210	N/A	N/A			Blyth Eastman Paine Webber
8/1	1982-Series C & D	9,575	N/A	N/A			Private Placement
	Missouri						
9/27	1982-Series	1,025	13.97	31			Salomon Brothers
5/18	1982-Series	7,425	9.58*	42		AA*	Salomon Brothers
	Montana						
5/27	Series 1982A	1,945	12.91*	40	Aa*		First Boston Corp.
	Nebraska						
9/10	1982-Series	2,945	N/A	41		AAA*	Lehman Brothers Kuhn Loeb
	Nevada						
2/8	1982-Series	2,180	14.00	34	Aa	AAA	Dean Witter Reynolds
4/15	1982-Series	3,105	11.00*	32			Dean Witter Reynolds
10/26	1982-Series B	2,625	N/A	32	Aa	AAA	Dean Witter Reynolds

TABLE A-4. (Continued)

Sale Date	Issue	Amount (thou-sands of dollars)	Net Interest Cost (per-cents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	New Hampshire						
3/19	1982-Series	35,415	13.16	32	A1	A+	Kidder Peabody
9/16	1982-Series 2	1,650	12.60	31	A1	A+	Private Placement
	New Jersey						
10/	1982A	4,570	9.50*	31			Private Placement
11/1	1982 A	9,470	12.00*	32		AA*	Bear Sterns
	New York						
1/6	1982-Series	2,515	13.38	41	Aa	AAA	L.F. Rothschild
5/7	1982-Series	53,650	12.75	40	Aa	AAA	Salomon Brothers
8/13	1982-Series B	40,950	11.22	42	Aaa*	AAA	Salomon Brothers
8/20	1982-UDC Series A	12,000	N/A	10			Dillon Reed
12/2	1982-Series A	6,550	10.67*	42	Aa*	AA	Private Placement
	North Carolina						
4/8	1982-Series	7,420	N/A	N/A			Alex Brown & Sons
5/13	1982-Series A	52,000	9.95*	42	Aa	AAA	Alex Brown & Sons
	North Dakota						
11/23	1982-Series	11,365	9.22	8		AAA+*	Rauscher Pierce Refsnes
	Oregon						
5/4	1982-Series	17,740	12.07	41	Aa	AA	Kidder Peabody
10/13	1982-Series	47,150	9.48	42	A1	AA	Salomon Brothers
	Pennsylvania						
1/28	1982-Series J	24,640	14.56	31	A1	A+	Goldman Sachs
3/26	1982-Series K	22,500	13.72	31		A+	Goldman Sachs
7/8	1982-Series	62,370	12.98	42	Aa	A+	Goldman Sachs
9/2	1982-Series L	28,730	N/A	43	A1*	A+*	Goldman Sachs
10/29	1982-Series B	14,210	9.70	N/A	A	A+	Goldman Sachs
11/19	1982-Series M	20,835	N/A	32	A1	A+	Goldman Sachs
	Puerto Rico						
3/15	1982-Series	75,000	12.34	27	Aa	AAA	Lehman Brothers Kuhn Loeb
	Rhode Island						
5/27	1982-Series A	50,155	12.85	27	A1	A+	Kidder Peabody
	South Carolina						
6/25	1982-Series A	24,960	11.47*	43	Aaa*	AA*	Morgan Guaranty Trust
9/7	1982-Series B	5,160	11.69*	43	Aaa*	AA*	Morgan Guaranty Trust

TABLE A-4. (Continued)

Sale Date	Issue	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
	South Dakota						
3/15	1982-Series	13,595	N/A	40			A.G. Becker
	Texas						
10/15	1982-Series	69,920	9.55*	23*	Aa		Goldman Sachs
	Utah						
5/6	1982-Series A	17,015	12.93*	42		AA*	Blyth Eastman Paine Webber
10/14	1982-Series B	5,565	9.94	42		AA*	Bache Halsey Stuart Shields
	Vermont						
5/27	1982-Series	8,250	12.96	32	A1*	A	Goldman Sachs
	Virginia						
6/15	1982-Series A	256,970	11.50	35	A1	AA	E.F. Hutton
	West Virginia						
3/25	1982-Series	4,055	13.75	31		A	Goldman Sachs
9/14	1982-Series	1,785	11.62	21			Goldman Sachs
12/3	1982-Series A	22,450	N/A	42	Aa	AA	Goldman Sachs
	Wisconsin						
3/18	1982-Series	76,725	13.37	32	A1	A+	Smith Barney Harris Upham
	Wyoming						
5/26	1982-Series A	3,270	13.09*	42		AA*	First Boston Corp.
9/17	1982-Series B	2,710	N/A	41			First Boston Corp.
12/17	1982-Series C	2,430	N/A	41		AA	First Bonston Corp.

SOURCE: Office of Financial Management, Department of Housing and Urban Development.

* The Council of State Housing Agencies provided this information.

NOTE: Some of these issues may be transitional and therefore not subject to the new rules in MSBTA and TEFRA.

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TABLE A-5. LOCAL NON-11b ISSUES FOR MULTIFAMILY, RENTAL HOUSING, 1982

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
1/4	Clay County, FL	12,000	N/A	11	A1		William R. Hough
2/18	Panhandle Regional TX	17,005	12.26	7	Aaa		Kidder Peabody
2/22	Atlanta, GA	49,000	N/A	20	Aaa		E.F. Hutton
3/8	Tarrant Co., TX	48,800	11.63	N/A	Aaa		Lehman Brothers Kuhn Loeb
3/15	Maricopa Co., AZ	75,300	N/A	N/A			N/A
3/16	St. Louis Co., MO	23,840	N/A	N/A			Kirchner Moore
3/18	Los Angeles, CA	18,040	N/A	N/A			Sutro and Co.
4/16	Ontario, CA	5,000	N/A	25	Aaa		Dean Witter Reynolds
4/20	Oklahoma Co., OK	63,900	N/A	N/A	Aaa		Kidder Peabody
4/22	Phoenix, AZ	7,000	N/A	N/A			Dillon Reed
4/23	New York City, NY	173,775	N/A	42			Goldman Sachs
4/26	Dade Co., FL	2,595	N/A	10		BBB	Arch W. Roberts
4/29	El Paso, TX	6,290	N/A	N/A			Rauscher Pierce Refsnes
4/29	Harris Co., TX	20,655	N/A	N/A			Rauscher Pierce Refsnes
4/29	Odessa Co., TX	8,530	N/A	N/A	Aaa		Rauscher Pierce Refsnes
5/1	Oakland, CA	2,925	N/A	15	Aaa		N/A
5/3	Nassau Co., FL	5,760	N/A	7		A	William R. Hough
5/4	St. Tammany, LA	20,915	N/A	N/A	Aaa		Howard, Weil Labouisse
5/7	Austin/Midland/ Bexar, TX	25,470	N/A	20	Aa1	AA-	First Southwest Company
5/12	Volusia Co., FL	7,090	N/A	11	A1		William R. Hough
5/17	Minneapolis, MN	21,100	N/A	11	Aa1		Dain Bosworth
5/17	Tarrant Co., TX	22,895	N/A	N/A	Aaa		Lehman Brothers Kuhn Loeb
5/18	Gurnee, Il	11,235	N/A	N/A			Boettcher and Co.
6/1	Norwalk, CA	3,195	N/A	N/A			Boettcher and Co.
6/8	Spartanburg, SC	3,495	N/A	10			Matthews & Wright
6/22	Loma Linda, CA	4,000	12.46	N/A	A1		Miller & Schroeder
6/28	Evanston, WY	8,365	N/A	N/A		AA	E.F. Hutton
6/30	Dade City, FL	11,300	N/A	30			Buchanan & Company
7/15	New Bedford, MA	5,615	N/A	N/A			Kirchner Moore
8/9	Salinas-Monterey-Marina, CA	9,685	N/A	32		A-	Stone and Youngberg
8/12	Lancaster, SC	1,928	N/A	N/A			Interstate Securities Corp.
8/13	Port Arthur, TX	8,150	N/A	N/A		AAA	Boettcher and Co.
8/27	Palm Beach, FL	40,000	11.75	N/A			William R. Hough
8/27	Prince George's Co., MD	29,600	N/A	24		A-	Cranston Securities
9/9	Orange Co., CA	2,375	N/A	15		AAA	1st Interstate Bank of CA
9/14	Albany, NY	14,690	N/A	30			Bankers Trust
9/15	Los Angeles, CA	10,165	N/A	32		AAA	Dain Bosworth
9/22	St. Paul, MN	5,800	N/A	10			Piper, Jaffery & Hopewood
9/24	Allentown, PA	4,560	N/A	32			L.F. Rothschild
9/29	Montgomery Co., MD	12,500	N/A	22	A		Merrill Lynch/White Weld
9/30	Orange Co., CA	7,605	N/A	N/A			1st Interstate Bank of CA
10/12	Los Angeles, CA	45,775	N/A	N/A			Kidder Peabody
10/18	Palm Beach, FL	24,950	N/A	N/A			William R. Hough
10/19	Tulsa Co., OK	10,930	N/A	N/A		AAA-L	Rotan Mosle Inc.
10/28	New York City, NY	35,215	N/A	N/A			Blyth Eastman Paine Webber

TABLE A-5. (Continued)

Sale Date	Issuer	Amount (thousands of dollars)	Net Interest Cost (percents)	Term	Ratings M	Ratings S&P	Lead Underwriter
10/26	Pulaski Co., AR	21,340	N/A	N/A		AAA-L	Shearson/American Express
11/3	Tulsa Co., OK	8,290	N/A	N/A			Shearson/American Express
11/9	Tulsa Co., OK	24,880	N/A	N/A		AAA-L	Rotan Mosle, Inc.
11/18	Howard Co., MD	6,100	N/A	N/A			Baker, Watts and Co.
11/22	Pima Co., AZ	31,800	N/A	10		AAA	Rauscher Pierce Refsnes
11/23	Panhandle Regional, TX	42,200	N/A	12		AAA-L	Kidder Peabody
11/29	Canadian Co., OK	9,175	N/A	N/A		AAA-L	Rotan Mosle, Inc.
11/29	Orange Co., CA	7,315	N/A	N/A			Ist Interestate Bank of CA
12/1	Philadelphia, PA	8,000	N/A	N/A			Merrill Lynch White Weld
12/1	Oakland, CA	16,600	N/A	N/A		AAA-L	E.F. Hutton
12/1	San Bernadino, CA	7,005	N/A	14		AAA	Cranston Securities
12/1	Grady Co., OK	2,850	N/A	12		AAA-L	Leo Oppenheim & Company
12/1	Comanche Co., OK	5,215	N/A	12		AAA-L	Leo Oppenheim & Company
12/1	Jackson Co., OK	2,850	N/A	12		AAA-L	Leo Oppenheim & Company
12/1	Lakewood, CO	17,970	N/A	N/A		AAA-	Boettcher and Company
12/2	Allegheny Co., PA	1,800	N/A	31		AAA	Russell Rea & Zappola
12/2	Austin, TX	26,630	N/A	20	Aa		E.F. Hutton
12/6	Clay Co., TX	20,000	N/A	N/A		AAA-L	Kidder Peabody
12/8	Escambia Co., FL	4,830	N/A	11		AAA	William R. Hough
12/10	Abilene, TX	7,530	N/A	N/A		AA+	Rotan Mosle, Inc.
12/10	Harris Co., TX	30,175	N/A	10		AAA-L	Rauscher Pierce Refsnes
12/10	Travis Co., TX	11,700	N/A	10		AAA-L	Rauscher Pierce Refsnes
12/10	Galveston, TX	9,920	N/A	10		AAA-L	Rotan Mosle, Inc.
12/10	Pulaski Co., AR	18,265	N/A	N/A		AAA-L	Shearson/American Express
12/10	Harris Co., TX	33,300	N/A	N/A			Bankers Trust Co.
12/13	DeSoto, TX	8,090	N/A	N/A		AAA-L	Rotan Mosle, Inc.
12/14	Southeast Texas, TX	39,495	N/A	N/A			Shearson/American Express
12/15	San Buenaventura, CA	16,000	N/A	15		AAA-L	Shearson/American Express
12/15	Clay Co., FL	20,000	N/A	N/A			Merrill Lynch White Weld
12/16	Gregg Co., AR	9,575	N/A	12		AAA-L	Kidder Peabody
12/16	Denton Co., TX	29,065	N/A	N/A			Kidder Peabody
12/17	Minneapolis, MN	12,000	N/A	N/A			Dain Bosworth
12/17	Vista, CA	8,710	N/A	15		AAA-L	Shearson/American Express
12/17	San Diego, CA	19,655	N/A	23			Goldman Sachs
12/18	Heart of Texas, TX	23,000	N/A	12		AAA-L	Kidder Peabody
12/21	New Orleans, LA	18,555	N/A	13		AAA-L	Shearson/American Express
12/21	Southeast Texas, TX	39,495	N/A	10		AAA-L	Rotan Mosle Inc.
12/22	Midland, TX	17,470	N/A	12		AAA-L	Rotan Mosle Inc.
12/22	Kern Co., CA	2,498	N/A	N/A			Security Pacific Nat'l. Bank
12/23	San Bernardino, CA	7,005	N/A	24		AAA	Cranston Securities, Inc.
12/28	Harris Co., AR	23,260	N/A	10		AAA-L	Rauscher Pierce Refnses
12/28	DeKalb Co., GA	18,700	N/A	22		AAA	Dean Witter
12/29	Napa Co., CA	3,125	N/A	19		AAA	Newman Associates
12/30	Santa Rosa, CA	5,870	N/A	15		AAA	Newman Associates
12/30	St. Louis, MO	4,320	N/A	11		AA-	Mercantile Trust

SOURCE: Office of Financial Management, Department of Housing and Urban Development.

NOTE: Some of these issues may be transitional, and therèfore not subject to the new rules of MSBTA and TEFRA.

Senator ROTH [presiding]. Thank you, Dr. Rivlin.

There seems to be some disagreement as to the cost of these mortgage revenue bonds. Are you at all familiar with the studies of Prof. Roger Kormendi?

Ms. RIVLIN. I know that there is such a study. Mrs. Richardson may be more familiar with it.

Senator ROTH. Well, according to the professor, the costs are substantially less. I would be interested, if you are not familiar with him, if you would have his approach analyzed and give us the benefit of your opinion as to what the difference is between the approach used in government and in what he is propounding.

Ms. RIVLIN. We will be happy to do that. As you note, the Treasury, the Joint Tax Committee, and we all seem to have the same general view of it, and he has a different one. Mrs. Richardson may want to comment briefly.

Ms. RICHARDSON. We would be happy to give the committee a memorandum explaining the differences in approach. Without getting into technicalities now, I would say that we and Treasury have looked at the Kormendi-Nagle method. We think at this point that we are coming up with better estimates than the Kormendi-Nagle model yields. It is possible that if we developed a more sophisticated model we might come up with different revenue estimates. They would not necessarily be as low as the Kormendi-Nagle estimates, nor would they necessarily be lower than estimates that we now have.

But we would be happy to furnish the committee with, more detailed information

Senator ROTH. In preparing the memorandum, I would appreciate that, it would be most helpful if you would point out the basis of differences, I mean, where it is a matter of judgment, if it is, so that we know why the economic models come out with these different results.

In other words, I do not want a defense of your own approach, but why the differences.

Ms. RICHARDSON. I understand.

Ms. RIVLIN. We will do that.

Senator ROTH. Now, the GAO did point out in its study that over two-thirds of MRB borrowers had incomes below 120 percent of median and almost half had incomes below median in the timeframe of the study. It also found that an average price for homes financed under this program was $48,800, which is well below the national median for new and used homes.

Would you agree that that is a pretty good performance under the circumstances, that considering the advantages of flexibility that we give the State and local government that it does appear that this program is pretty much directed at those who need help?

Ms. RIVLIN. I think the GAO results show that, by and large, the substantial portion of the funds go to low- and moderate-income families. This is partly because the States have imposed income limits and because the targeting measures work that way. The results vary greatly from State to State however, as we pointed out.

Senator ROTH. That was one of the principal concerns with the program initially, that it was going to be utilized primarily by those not in need. I must say I think the record of performance by the State and locals is very encouraging.

Senator Mitchell.

Senator MITCHELL. Thank you, Senator.

Dr. Rivlin, before you came in we had some lengthy colloquy trying to find out what people mean when they use certain phrases. In your testimony you used the phrase "middle income home buyers," "upper income home buyers," "upper-middle income home buyers," and now, in oral testimony, you have used the phrase "low income home buyers" and "moderate income home buyers."

Would you tell us, please, what do you mean by any or all of these phrases? What do you understand them to mean?

Ms. RIVLIN. By "low" and "moderate" I mean below and around the median. We can give you more specific definitions in any particular instance, but I think the easiest definitions have to do with where you stand in relationship to the median income.

Senator MITCHELL. Well, in, around, and below the median? Could I take that to mean that if someone is at or below the median you would regard them as being low or moderate income depending upon how far they are from the median?

Ms. RIVLIN. It depends on the context, but the GAO report found that slightly less than half of the people involved in this program were below the median for their area. I would say that means approximately half of the funds are going to low- and moderate-income families.

Senator MITCHELL. Well, you see, what emerged was the GAO report which concludes that the program has not been successful in preventing upper income families from receiving benefits. It turned out in the discussion, at least at the outset of the discussion, the definition of "upper income" and "affluent" included households with incomes of between $20,000 and $30,000 a year, and I think that the phrases "moderate," "middle," "upper middle," and "upper" mean different things to different people.

Ms. RIVLIN. They also mean different things in different areas, so I think it is important to know which area you are talking about.

On the higher end, the GAO found that around a third of the recipients had incomes that were more than 120 percent of the median for their area. That does not make them terribly affluent, but it puts them at the higher end.

Senator MITCHELL. Would you regard a person or a family that has an income of $20,000 a year as affluent or upper income anywhere in the United States?

Ms. RIVLIN. Annual income of $20,000?

Senator MITCHELL. $20,000 a year. Would you describe or would you consider it an accurate description to say that a family anywhere in the United States who has an income of $20,000 a year can be described as affluent or upper income?

Ms. RIVLIN. Probably not, but I would like to know, before I get pinned down, whether they live in a rural county in Maine or whether they live in Manhattan. I think that makes a difference.

Senator MITCHELL. I said anywhere in the United States. Take the most rural county in Maine. Would you regard a family with an income of $20,000 a year as affluent?

Ms. RIVLIN. Probably not affluent, but you certainly know of counties in which that is not a bad income.

Senator MITCHELL. It is an inaccurate way to describe—it costs a lot to live in a rural county in Maine. Food costs as much, if not more, than in the urban centers.

Ms. RIVLIN. Senator, I do not know exactly what we are arguing about.

Senator MITCHELL. I do not think we are arguing. We have had these phrases bandied about, and all of these statements use—you used five different ones here and I am trying to pin it down so that we can understand what we are talking about.

This program helps—I am for this program. I am biased at the outset, and it helps people who I think are not affluent or not upper income, who need help and who cannot buy homes without it, as people who make $20,000, $25,000, $26,000, $27,000 a year, and by any standard definition of the phrase in this country, by the common accepted American usage the average—not only average but almost every American in the street, they are not affluent Americans.

That is the only point I am trying to make.

Ms. RIVLIN. Right, and the Congress can set limits where it wants to. My only point is that it is useful to look at the relationship to the median income in the area, and you can set it at the median or you can set it at 120 percent of the median, whatever seems to you to be sensible.

Senator MITCHELL. You refer in your statement at page 9 to a CBO analysis undertaken a few years cgo, and that is regarding the statement of the percentage of the subsidy that goes to home buyers. Can you tell me when that study was made?

Ms. RIVLIN. In 1979.

Senator MITCHELL. Have there been any changes in the law since then that would affect the conclusion reached in that study?

Ms. RIVLIN. Possibly.

Senator MITCHELL. So that would it be fair to say that a more current study now would probably result in a figure substantially higher than that?

Ms. RIVLIN. No, not necessarily. We are talking about the efficiency of the subsidy—how much goes to the home buyer as opposed to the bondholder and the underwriter and so forth. Changes in the law would probably not affect that at all.

Senator MITCHELL. One of the problems, Doctor, in this whole discussion of efficiency and cost effectiveness is that the GAO report which is the centerpiece of this hearing analyzes the cost effectiveness of this program in relation to two alternatives.

As I said before you came in, the problem is that those who use the GAO report to oppose this program on the grounds that it is not the most cost-efficient method of doing it are also vigorously opposed to any other method of dealing with the problem. It seems to me to be a kind of circular kind of reasoning.

I am against this program because it is not the most cost efficient, and here is another way that is more cost efficient. Well, then, are you for that other one? Oh, no, I am against that too. It just seems to me to be kind of a circular problem that does not deal with the reality of Americans trying to buy homes.

Ms. RIVLIN. Senator, I am not for or against anything. My only job is to point out as clearly as possible what it might cost and what the options are. That is our entire job.

Senator MITCHELL. I understand that, but you know very well, Doctor—you have been around here a long time and you are familiar with politics—that you come in here and say that you could have direct subsidies to home buyers and you know very, very well that the administration, which vigorously opposes the mortgage revenue bond program, is not going to come up here and say well, now, here is a better way to do it. Let's have direct subsidies to home buyers.

That is what the problem is.

Ms. RIVLIN. Well, we do have direct subsidies to home buyers under some programs, and I believe the Congress can do what it wants to. If it wants to redesign these programs, it can do it.

SENATOR MITCHELL. Well, thank you very much, Doctor. If my remarks indicated, I certainly did not intend any criticism of you or the authors of your statement and the study.

Thank you.

Senator ROTH. Thank you, Dr. Rivlin, and those who are here with you.

At this time I would like to call forward a panel consisting of James Follain, Kenneth Johnson, David Schoepf, and John Arbib.

I might say, Senator Mitchell, as they come forward, what concerns me is that the explosion of costs in housing means that less and less people are able to purchase it, and it bothers me when people are saying that the affluent are getting the advantage, because I think your point is very well made.

Even the middle class is finding it very difficult to purchase their own homes, and I think that is a development to try to offset by one means or another. I appreciate your support.

Gentlemen, I would ask that each of you summarize, if you would, your testimony. The full statements will be included in the record as if read and, with that, would you please start in whatever order you care and give your name and background.

STATEMENT OF JAMES R. FOLLAIN, JR., ASSOCIATE PROFESSOR OF ECONOMICS, MAXWELL SCHOOL, SYRACUSE UNIVERSITY

Mr. FOLLAIN. I am Jim Follain from Syracuse University. I am an economist.

There are a number of ways we could talk about the pros and cons of mortgage revenue bonds. I would like to focus on the affordability problem because it seems this is the primary reason we have these bonds, to somehow combat the affordability problem.

The version of the problem upon which the bill and the idea is based is that high rates of inflation and high nominal interest rates tend to make homeownership more expensive. A number of economists, including myself, have done a lot of work the last few years analyzing the affordability problem in the context of an inflationary environment, and what I want to do today is just bring to bear some of the conclusions of that work to the question we are discussing today.

I will just give a very brief summary of my opinion and then try and make a couple of points from my prepared statement.

I am opposed to the idea of renewing the MRB legislation for three reasons. First, it is based upon an idea or an understanding of the affordability problem that I do not think holds up under careful analysis, and I will go into that in a little bit of detail.

Second, there are other alternatives to combat the problems caused by inflation and high nominal interest rates. What I am talking about are alternatives to the standard mortgage instrument like the graduated payment mortgage and the price level adjusted mortgage.

Senator MITCHELL. What was the last phrase?

Mr. FOLLAIN. Price level adjusted mortgage.

Third, homeownership, because of our Tax Code, is already the recipient of sizable subsidies and I do not think more subsidies are needed at this time.

The key idea here is what is the affordability problem. Now when economists look at the affordability problem, they focus in on a concept called the user cost of capital. It is an inflation-adjusted, after-tax measure of how much it costs to own and occupy a house.

We look at the interest deductibility, the fact that capital gains are essentially untaxed, and take into account the capital gains homeowners enjoy during inflationary environments. If you look at that measure, you see all during the 1970's, despite large increases in nominal interest rates and mortgage rates, you see this after-tax cost of housing actually declining. So under certain circumstances one can see the simple idea that high nominal mortgage rates makes for expensive homeownership is simply not true. In the prepared statement I go into this in more detail.

There is a version, however, of the affordability problem that is quite serious. Inflation and high nominal interest rates have a big effect on this version. That is, inflation coupled with the standard, fixed payment mortgage, tend to tilt the real burden of mortgage payments to the early years of the mortgage, years in which most young people have the most difficulty in affording a house.

But the villain is not just inflation. It is inflation plus the standard fixed payment mortgage and some of the suggestions that I and some other economists have made involve getting rid of the standard fixed payment mortgage or its close relative, the adjustable rate mortgage, in favor of some instrument that tilts payments more in line with the tilting of incomes.

Senator MITCHELL. Do you think that should be done by some Federal law?

Mr. FOLLAIN. The things I was suggesting are modest ways of encouraging people either to make some of these loans, maybe a modest subsidy perhaps—much more modest than the tax exempt approach—to either make the graduated payment or make the price level adjusted mortgage more appealing to lenders and, possibly, to the consumer. Possibly you might have the Government insure the price level adjusted mortgage in the same way it insures FHA graduated payment mortgages.

There is another possibility, and that is to rethink the laws regarding taxing of cash versus accrued income for S&L's, savings and loans, because I think one of the deterrents to the adoption of these things is the liquidity problem they have had in the last 2 years. It has shied them away from making loans that result in a postponement of the income that they normally receive.

That is basically it. I would be glad to answer any questions.

Senator ROTH. Thank you. I think we will hear from each one and then we will ask questions of the panel. Mr. Johnson.

[The prepared statement of Mr. Follain follows:]

Statement of James R. Follain, Jr.
Before the Subcommittee on Taxation and Debt Management
of the Senate Committee on Finance
Hearings on Mortgage Revenue Bonds
(S. 137)

May 13, 1983

* Follain is an Associate Professor of Economics in the Maxwell School of Syracuse University and a member of the Metropolitan Studies Program.

INTRODUCTION

The housing affordability problem has been the subject of much attention over the past five to ten years. The attention has been sparked by the rise in the rate of inflation and the subsequent rise in interest rates and housing prices. The standard version of the affordability problem states that inflation damages homeownership opportunity and the demand for owner-occupied housing because of its effect upon nominal interest rates, house prices and nominal mortgage payments. One response to the affordability problem is the tax-exempt mortgage revenue bond. It is, essentially, a subsidy program designed to reduce the cost of homeownership, and, thus, counteract some of the damage done by inflation.

There is an alternative view of the affordability problem that has quite different implications for policy. The alternative view is based upon a large amount of research that has been done by a number of economists, including myself. What I would like to do today is provide a statement of the alternative view and its implications for this particular policy issue -- that is, should the legislation authorizing tax-exempt mortgage revenue bonds be extended?

THE AFFORDABILITY PROBLEM

When people talk about the affordability problem, they usually speak of movements over time in the size of the downpayment and monthly mortgage payments needed to purchase a particular kind of house. For example, the monthly payments made by someone who purchased an average-priced home (about $29,000) in 1970 at a 9 percent mortgage rate would be $186, assuming a 20 percent downpayment of $5,800. To purchase the same house in 1980 at a mortgage rate of about 15 percent and a price of about $70,000, mortgage payments would have been $708 and the downpayment on an 80 percent loan would have been $14,000--280 percent and 140 percent increases, respectively. Median family income, on the other hand, has increased only about 90 percent between 1970 and 1980. Consequently, a potential homeowner with an average income had to devote a much larger fraction of his income to housing in the first year of the mortgage than he did in 1970, and he needed a great deal more for a downpayment.

The good news is that the first year in the life of the mortgage is its most expensive, and relative costs will decline thereafter. Standard underwriting criteria require that the monthly income of a borrower be at least four times the monthly mortgage payment. So, for example, a person buying a $70,000 home at a 15 percent mortgage rate requires a monthly income of at least four time $708--about $34,000 a year. If that income keeps pace with double-digit inflation--10 percent a year, for example--then the percentage of income taken by a fixed-rate payment will decline dramatically over the life of the mortgage. Eight years after purchase, the ratio will be about 12.5 percent, and after 24 years, the payments will requires less than 3 percent of income. Thus, inflation makes homewonership more difficult to attain because it tilts the real financial burden to the early years of the mortgage. The affordability problem is, therefore, more accurately labeled a cash-flow problem. The relatively higher payments come due at times when most households are least able to afford them.

Inflation is a major cause of this problem because, in the long run, interest rates and inflation rates move hand-in-hand. A rough rule of thumb is that over the long haul, long-term interest rates equal about 3 percent plus what people expect, on average, inflation to be. Since inflation and inflationary expectations have been increasing dramatically, so have mortgage interest rates and housing prices.

Inflation is not the only culprit, however. Some blame must be placed on the standard mortgage instrument with its fixed monthly payments. As long as inflation persists, the real value of the payments declines throughout the life of the mortgage.

It is well known that the federal tax system grants special privileges to homeowners. One subsidy derives from the fact that homeowners do not have to report the implicit rental income derived from homeownership. That is, a landlord must pay income tax on rent received; but if the owner occupies the home and in effect is his own renter, he pays no income tax on what can be viewed as the rent he pays to himself. Recent research by a number of economists has shown that tne size of this subsidy in constant dollars actually grows as tne rate of inflation increases. For many households, this means that the worse the inflation becomes, the cheaper homeownership is relative to other goods in the economy, including renter-occupied housing.

A simple example can demonstrate this point. The cost of homeownership is comprised of four components: interest costs; the opportunity cost of not being able to earn explicit interest on the amount of equity; property taxes;

and miscellaneous costs such as insurance, maintenance, and depreciation. Subtracted from these expenses are the accruing capital gains earned by appreciation of the value of the house. The expenses that are deductible from income, weighted by the marginal tax rate of the homeowner, are also subtracted.

In the second column of the table, the costs to a person who buys a $50,000 house when inflation is expected to be about 3 percent a year are shown. Recalling the link between long-term interest rates and the rate of inflation, the mortgage interest rate is assumed to be 6 percent. Property tax is set at 1 percent of the value, the miscellaneous expenses at 2 percent, and the marginal income tax rate of the person at .25 (i.e., the persons is in the 25 percent tax bracket). If the equity were invested elsewhere, 6 percent annual earnings are assumed. The tax advantages reduced the cost by about 29 percent, leaving after-tax costs at $177.50 a month.

Inflation and the Monthly After-Tax Cost of a Hypothetical $50,000 Owner-Occupied Home

	Annual	Inflation	Rate
	0%	3%	9%
Mortgage Rate	3%	6%	12%
Expenses	$250	$375	$625
interest expense	100	200	400
lost interest on equity	25	50	100
property taxes	42	42	42
miscellaneous	83	83	83
Accruing capital gains	0	125	375
Before-Tax Cost	250	250	250
Tax savings	41.75	72.50	135.50
.25 x interest expense	25	50	100
.25 x lost interest on equity	6.25	12.50	25
.25 x property taxes	10.50	10.50	10.50
After-Tax cost of owner-occupied housing	208.25	177.50	114.50

Columns one and three contain the same information for two other rates of inflation, 0 and 9 percent. Comparison of the three columns shows clearly the effect inflation has upon inflation and tax adjusted housing costs. As inflation increases, real after-tax housing costs decline.

The example is obviously highly stylized, but recent theoretical work by several economists has shown that the point made by the example holds under reasonably general circumstances. The result is that in the long run, the after-tax cost of owner-occupied housing decreases relative to the price of other goods (including rented housing) as inflation, and hence, inflationary expectations increase. This result holds for those who itemize deductions. There is still an effect for those taking the standard deduction, but it is smaller and depends upon the amount of equity a person has in the house.

IMPLICATIONS OF THIS VIEW

Given this view of the affordability problem, there are at least three questions that can be raised that are relevant to today's hearings. First, what is the net effect of inflation upon housing choices? On the one hand, it is shown that inflation coupled with the standard fixed payment mortgage does cause a cash-flow problem for the household. This has the potential to reduce housing demand and homeownership opportunity given standard underwriting criteria that fix the amount a person can borrow as a function of the ratio of the initial mortgage payment to household income in the first year of the mortgage. On the other hand, since inflation reduces the real after-tax cost of owner-occupied housing, inflation provides a stimulus for households to buy more owner-occupied housing and to become an owner-occupant sooner than they otherwise might. Which of these two effects dominates? The research done suggests that inflation has a net positive effect upon housing demand at low to moderate rates of inflation, say zero to 7 percent per year. At higher rates of inflation, say the double-digit range, the cash-flow problem dominates and housing demand and the demand for homeownership are actually less than at zero inflation.

The second question is whether new direct subsidy programs like the tax exempt mortgage revenue bond are really needed to stimulate housing demand in an inflationary environment? Or, can the combination of the existing tax code and an alternative mortgage instrument like the Graduated Payment Mortgage (GPM) be just as effective? The answer suggested by recent research is that new programs are not needed and that alternative mortgage instruments like the GPM can be quite effective. For example, Alm and Follain compare the effects of a price-level adjusted mortgage (PLAM) and a direct interest subsidy program like the tax-exempt mortgage revenue program and find that the PLAM increases demand by about 18 percent over what it would be if only the standard fixed payment mortgage was available whereas the direct interest subsidy program increases demand by about 10 percent.* Now, clearly, direct interest subsidy programs could be developed that are more stimulative, but the point is clear. Alternative mortgage instruments have significant potential in an inflationary environment given the existing tax codes that already favor homeownership.

Finally, do we really want more direct subsidy programs? Admittedly, this is a large and difficult question, and the answer depends, at least partly, on the point of view of the person asking the question. As an economist, I have taken the view of one and ask whether we want more from an efficiency point of view. To provide some insights about this question, I have built a model with my colleague James Alm of Syracuse University of a typical consumer who is making long-term housing choices in a world of inflation, tax codes that favor homeownership and imperfections in the mortgage market.** Then we ask how much is our typical consumer willing to pay for an additional unit of housing mortgage market.** Then we ask how much is our typical consumer willing to pay for an additional unit of housing relative to its cost? We conclude that the answer is around 50-60 cents on the dollar. That is, the subsidies built into the tax system have already encouraged our typical consumer to purchase much more housing than is optimal from an efficiency point of view. Thus, the answer to this last question is a resounding no, unless there are enormous externalities associated with homeownership.

CONCLUSION

The implications of this discussion are, I think, quite clear. The analysis suggests that continuation of the tax-exempt mortgage bond legislation is not necessary. There are two reasons for this point of view. First, we already subsidize homeownership quite a alot. Indeed, there is a built-in subsidy scheme that ensures that as inflation increases, so does the subsidy. Evidence has shown that the size and impact of this built-in subsidy is large and significant. Second, there are other alternatives programs that might be tried that do not require new appropriations. That is, alternative mortgage instruments like the graduated payment mortgage and the price-level adjusted mortgage are capable of providing the consumer adequate protection from the damage that inflation can inflict upon the demand for owner-occupied housing in this country.

My suggestion is that consideration be given to programs that might further encourage the use of alternative mortgages like the Graduated Payment Mortgage or the Price Level Adjusted Mortgage. For example, tax laws might be adjusted so that lenders are taxed based upon cash income instead of accrued income. Also, the government could consider insuring price-level adjusted mortgages just as it currently insures graduated payment and conventional loans. Finally, it might consider a moderate subsidy plan to encourage lenders and consumers to use some of these alternatives. Given these days of tight budgets and high unemployment, these relatively inexpensive alternatives seem well worth trying before we authorize the continuation of more expensive tax-exempt mortgage revenue bond approach.

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* James Alm and James R. Follain, Jr., Tax Expenditures and Other Programs To Stimulate Housing: Do We Really Need More? Occasional Paper Number 64 of the Metropolitan Studies Program at Syracuse University, 1983.
* Ibid.

SUMMARY

A common belief is that housing is more costly and homeownership more difficult to attain in an inflationary environment. The tax-exempt mortgage revenue bond (MRB) program is a subsidy scheme based, at least in part, upon this belief. Should the legislation authorizing the use of the MRBs be continued? I think not for three reasons.

First, the common belief as to the effect of inflation upon housing costs and homeownership opportunity is flawed. In fact, just the opposite can be argued if one considers a more complete and accurate measure of housing costs -- the inflation adjusted after-tax cost of owner-occupied housing. Analysis by several economists of this more theoretically correct measure of housing costs shows that increases in the rate of inflation actually reduce the cost of owner-occupied housing. Therefore, it is not at all obvious that a subsidy program like the MRB is needed.

Second, there are other less expensive alternatives that might be tried to counter any difficulties inflation poses for homeownership opportunity. The problem caused by inflation for those seeking to buy a home is best described as a cash-flow problem. Consumers are required to make larger mortgage payments in real terms in the early years of the mortgage during an inflationary environment when only a standard fixed-payment mortgage or its close relative the adjustable rate mortgage is available. Alternative mortgage instruments like the graduated payment mortgage and the price-level adjusted mortgage have been shown to be quite effective in alleviating the cash-flow problem. Encouragement of these alternatives should be considered instead of extending the MRB legislation.

Third, we already have sizeable subsidies to homeownership, more are not needed. The generous provisions in the tax code already result in homeowners purchasing more housing than is efficient from an economic point of view. For example, a recent study concluded that a typical homeowner values an additional unit of housing at about 50-60 percent of its cost. Two consequences of this overinvestment in housing are that not as much investment takes place in other sectors of the economy and tax rates are higher than they otherwise might be.

22-947 O - 83 - 15

STATEMENT OF KENNETH JOHNSON, DEPUTY DIRECTOR OF HOUSING, ST. PAUL, MINN., ON BEHALF OF THE ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES

Mr. JOHNSON. Thank you, Senator Roth, Senator Mitchell. I am Ken Johnson. I serve as deputy director for housing for the Department of Planning and Economic Development for the city of St. Paul, Minn. I am also a member of the board of directors of the Association of Local Housing Finance Agencies. I am here, of course, today to testify in support of S. 137. You have our full statement, I think, for the record.

The Association of Local Housing Finance Agencies, or ALHFA, represents housing agencies in all parts of the country. We include rural areas, suburban townships, and large cities. We are a diverse group of local government agencies with one common goal, and that is to provide a decent quality and affordable housing.

For most Americans, as you know, owning a home is the dream of a lifetime and a home is the most expensive purchase we make. The largest hurdle to be overcome in realizing the achievement of that dream is, of course, financing, and this is where MRB's help alleviate the problem.

In recent years, the Federal Government has systematically withdrawn from its role in providing affordable housing and if there are programs which provide direct subsidy for home purchases, as Dr. Rivlin suggested, we in the localities do not know what they are.

Single-family MRB's have provided the flexibility heretofore unavailable to us in the localities through programs tailor made to meet our cities' and counties' affordable housing demand. In contrast to the old Federal grant system, MRB-assisted financing requires a significant dollar investment from the beneficiary, a personal commitment which may be absent in former HUD programs, for example, when the Federal Government simply wrote a check for that home purchase.

In the last 2 years, we have collectively in the ALHFA group helped in the purchase of 73,000 homes. Survey data from our members suggests the median income of program beneficiaries was nearly $10,000 less than the average home buyer's 1981 median income nationwide.

Since ALHFA was formed last year, I have met many of my colleagues around the country and have had a chance to learn about a number of the programs which they have been running and, I think, as a group we can say that the local officials who run MRB programs are responsible, professional people. We follow our projects, I think, from the gleam in the homebuilder's eye to the gleam in the homeowner's eye.

I think local officials are accessible. Our offices are only a bus ride away from our customers and our customers do show up at our offices, as I am sure they often do in yours. So we think we are accessible. We are there to remedy problems when things do occasionally go awry.

And our cities do make financial contributions to our MRB programs. San Francisco, for example, recently contributed $5 million of city funds to its most recent single family issue. It even has the project's developers contributing to assist in the financing of the homes.

In my 14 years of municipal development I have met many prospective homeowners. In St. Paul, for example, over 2,300 households have purchased homes through our city's single family MRB programs, and the availability of these mortgages stimulated the construction of over 1,200 new single-family homes in St. Paul and substantial rehabilitation of another 500 homes.

Who did the mortgages go to? In St. Paul, our mortgages went to households with incomes averaging $26,087. That is 83 percent of our area's median income of $31,600. I in think most cities—Senator Mitchell talked a while ago about the definition of terms—I think in most of our cities the term we generally follow is the term which I think originated with the Housing and Community Development Act of 1974, which is, low- and moderate-income households being 80 percent of an area's median income, and that is the term we as members of ALHFA follow and CSHA as well.

I believe it is fair to say that, without exception, the purchasers of these homes could not afford to buy a house without the MRB program. With respect to the purchase price of the home, our average purchase price of a home in St. Paul is $75,515, while our average purchase price of MRB-financed homes is $66,237, which is 87 percent of the median purchase price of homes in St. Paul.

Senator MITCHELL. Mr. Johnson, you realize that what you just said is directly contradictory to what GAO representatives testified here this morning when they said that in their judgment 75 percent of those who purchase homes with the mortgage revenue bonds could have purchased homes without the program.

Mr. JOHNSON. Yes, Senator Mitchell, I realize that. It is our view that that is not the case. We have worked with the Council of State Housing Finance Agencies and are preparing a response to the GAO report which I think will be submitted today or shortly thereafter, and that is one of the points we wish to directly contradict in the report.

Senator MITCHELL. You are saying that based on your experience their conclusion in that regard is incorrect?

Mr. JOHNSON. That is correct. I do not want to take any more of the committee's time, but I want to make one brief observation regarding homeownership.

As we all know, people work hard to get and keep and defend their homes. Our homes are precious possessions. We at the local level see our prospective homeowners coming to us for assistance.

We want to take issue also with the allegation that most people could have purchased a home anyway. That is simply not the case. One of the responses we will make, for example, is that the average income of MRB purchasers nationwide is something like $10,000 below the average income of FHA purchasers nationwide. So we think it is a valuable tool.

We thank you very much for your hearing our position this morning and we urge passage of S. 137 without amendment. Thank you.

Senator ROTH. Thank you, Mr. Johnson. Mr. Arbib.

[The prepared statement of Mr. Johnson follows:]

STATEMENT OF

KENNETH JOHNSON, MEMBER OF THE BOARD OF DIRECTORS

OF THE

ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES

BEFORE THE

COMMITTEE ON FINANCE

ON S. 137

THE HOUSING FINANCE OPPORTUNITY ACT OF 1983

FRIDAY, MAY 13, 1983

Good morning, Mr. Chairman and members of the Committee. My name is Kenneth Johnson. I am Deputy Director of Housing for the City of Saint Paul, and I serve on the Board of Directors of the Association of Local Housing Finance Agencies (ALHFA). I am here today to testify in support of S. 137, the Housing Finance Opportunity Act of 1983 as introduced by Senator William Roth (R-Del.) and Senator George Mitchell (D-Me.).

ALHFA represents housing agencies in all regions of the United States. Our members include agencies in rural areas, suburban townships and large cities. Some ALHFA members have responsibility for all aspects of community development while others only supervise housing finance programs. We are a diverse group, with one common goal: to provide high quality, affordable housing for households which are otherwise unable to purchase homes.

Financing is the single greatest hurdle faced by those who wish to buy a home. For most Americans, owning a home is the dream of a lifetime. A home is the most expensive purchase most Americans make, and often our only investment. It is difficult enough for most people to buy a house, but for those with low and moderate incomes, it is virtually impossible to afford conventional mortgages.

Single-family mortgage revenue bonds (MRBs) alleviate this problem. As interest rates climbed in the late 1970's, many individuals--who otherwise might have been able to buy homes--found that inflation diluted downpayments which had been laboriously set aside. At the same time, inflation drove housing prices higher and higher and a tight money policy made interest rates border on the absurd. "Good buys" in housing became harder and harder to find.

The development of single-family financing through tax-exempt bonds was a response to this need for low-cost housing finance. The precipitous introduction of legislation in 1979 to limit the use of the bonds because of perceived "over-use" and consequent revenue loss resulted in an unfortunate screeching halt to all single-family projects.

Congress recognized the unfairness of that approach and enacted transition rules which enabled many stalled projects to be completed. But purchase price limitations were imposed on single-family bond programs by the Mortgage Revenue Bond Act of 1980 (P.L. 96-499). This limitation accomplished exactly what seemed to be the Congress' intent: to severely restrict the use of single-family mortgage revenue bonds and to target their use to low and middle income families. In addition, P.L. 96-499 provided a "sunset" date on the program of December 31, 1983 so that the program would die unless

Congress acted positively to extend this financing incentive. ALHFA believes that a review of the use of single-family mortgage revenue bonds will reveal the solid accomplishments of state and local agencies.

Since regulations have been issued, local housing agencies have been active in providing homes at a time of inordinately expensive homes and mortgages. In the last two years, we have collectively helped in the purchase of 73,000 homes. Survey data from our members suggests the median income of a program beneficiary was $29,213 or 107 percent of our jurisdictions' area medians--nearly $10,000 less than the average homebuyer's 1981 income of $39,100. A compilation of local issuers' volume (Exhibit A) is at the conclusion of my remarks and I ask that it be printed in the hearing record.

Since AHLFA was formed late last year, I have met many of my colleagues around the United States and learned about their programs. I have heard about shared-appreciation mortgages in San Francisco, California and the extraordinary rehabilitation programs in Pittsburgh, Pennsylvania. I have met dedicated and responsible professionals who follow their projects from the gleam in the developer's eye to the gleam in the homeowner's eye. And these local officials are still there to remedy problems that sometimes develop when things go wrong.

The differences between local and state housing finance agencies are not great, but they are significant. San Antonio is a long way from Austin, Texas. When a project is financed by the San Antonio agency, the residents are certain to let that agency hear about any problems--from leaky faucets to irregular garbage collection.

Yet since state administered projects are run out of state capitals like Austin, officials of those agencies are less likely to be faced with these complaints, simply by virtue of the distance involved. But local agencies and local officials are always accessible because our officers are only a bus ride away and our customers show up in our offices--just as they occasionally show up in yours.

And our cities make financial contributions to our single-family projects: San Francisco contributed $5 million to its most recent single-family issue and even has the project's developers assisting in the financing of the purchase of those homes.

But there is a special satisfaction working in a local agency and dealing so personally with the people we serve. I have met many prospective homeowners in my 14 years in municipal development. In my home city of Saint Paul, Minnesota, over 2,300 households have purchased homes through our city's single-family mortgage revenue bond programs. The availability of these mortgages also stimulated the construction of over 1,200 new single-family homes and the substantial rehabilitation of another 500 homes.

These mortgages went to households with incomes averaging $26,087--only 87 percent of the area's median income of $30,000. And, while the average sale price of a home in Saint Paul is $75,515, the average MRB-financed home is 87 percent of that--$66,237.

I believe it is fair to say that without exception, the purchasers of these homes could not afford to buy a house without the mortgage revenue bond program. Their incomes are limited, over 90 percent of them had been renters and most of them had been looking for a home for some time.

Our experience in Saint Paul is echoed in other cities represented by ALHFA members. Look, for example, at Los Angeles, which is the most expensive housing market in the country. Under P.L. 96-499, the purchase price limitation for single-family bond programs in Los Angeles is $113,000 for new housing and $105,100 for existing housing. Despite the home purchases financed in the last four years, Kathleen Connell, the Director of Housing in Los Angeles, who serves as ALHFA's president, is certain that there are many other individuals and families in the Los Angeles area who want to own their own homes, but cannot afford to do so.

Even in cities which have prevailing housing prices which sound more reasonable, single-family bonds play an important role in financing first-time home purchases. For example, the purchase price limitations in Wichita, Kansas, one of our member cities, is $67,000 for new housing and $78,200 for existing housing. Yet the Wichita Housing Finance Authority issued $30 million in bonds last year, assisting 149 households in the purchase of their first homes limiting recipients to an income of $37,500. The average price of homes purchased with these mortgages is only $49,000 or 74 percent of the purchase price limits imposed under P.L. 96-499. Summaries of the Wichita area program and the El Paso County program (Exhibits B and C) are included with my testimony and I ask that they be printed at the conclusion of my remarks.

And in El Paso County, Colorado, a large county which includes the city of Colorado Springs as well as rolling rural foothills of the Rocky Mountains, Frank Barber, a member of ALHFA's Board of Directors, administers a program which provides homes to people with average annual incomes of only $15,096.

I mention the El Paso County program because it falls within the rigid confines in the preliminary draft of the General Accounting Office report--a $20,000 income being a suggested cutoff for eligibility for a MRB-assisted loan. And for the same reason, I will mention one aspect of the mortgage revenue bond program in Pittsburgh, Pennsylvania.

Paul Brophy, Executive Director of the Urban Redevelopment Authority of Pittsburgh, is one of the innovative thinkers in the urban renaissance of our older cities. In one part of Pittsburgh, individuals can obtain MRB loans to rehabilitate houses in virtually uninhabitable structures in downtown Pittsburgh--and for these renovation projects, no income limits are imposed. The program is enormously successful, and popular as well. Surely this is a good use of tax-exempt finance: renovating an old downtown by attracting not only commercial and industrial activity, but residents, too.

I understand this Committee's concern that state and local programs which have impact on federal revenues warrant periodic review. It is the Congress' responsibility and duty to be absolutely certain that revenues are foregone only for useful purposes and fine causes.

The members of ALHFA are certain that providing quality housing at affordable prices is perhaps one of the most useful and finest services our tax dollars can provide. I welcome this opportunity to respond to your inquiries. But I urge this Committee to report S. 137 favorably and without amendment.

In closing I wish to make one brief observation regarding home ownership. Earlier this year, ALHFA's Board of Directors met with staff members of most of the Senators who serve on this committee. I was dismayed when one staffer asked why Congress should endorse any program or incentive which encourages home ownership. I am reasonably certain that the question was rhetorical.

At the time, I was speechless, but let me respond to the question now. People want to own their homes. People work hard to get, to keep, and to defend their homes. Our homes are among our most precious possessions, and of all the great societal changes this nation has wrought, home ownership is certainly one of which we can be most proud.

I do not say home ownership is an inalienable right, but it is certainly an integral part of the average American's life, liberty and pursuit of happiness.

Thank you, Mr. Chairman.

EXHIBIT A

Local Issuance of
Single Family Mortgage Revenue Bonds*, 1979-1982
($ Million)

State	1979	1980	1981	1982
Alaska	89.6	0	0	0
Arizona	0	133.0	0	164.9
Arkansas	572.4	204.7	0	30.8
California	732.3	1067.7	237.7	1102.1
Colorado	413.5	322.9	251.2	155.5
Connecticut	0	10.6	0	0
Delaware	146.0	90.0	0	50.0
Florida	0	628.8	382.5	215.9
Georgia	0	0	0	155.2
Illinois	448.2	51.8	20.0	101.1
Indiana	0	8.5	0	0
Iowa	20.0	0	0	0
Kansas	169.7	496.2	382.4	156.2
Kentucky	119.4	0	0	48.2
Louisiana	743.3	506.1	0	49.2
Maryland	56.8	68.0	140.9	128.1
Michigan	0	14.0	0	0
Minnesota	162.9	67.3	120.	66.3
Missouri	0	0	0	71.0
Mississippi	15.0	0	0	0
New Mexico	113.7	31.6	20.2	0
North Dakota	9.0	0	0	0
Oklahoma	236.6	579.9	0	0
Pennsylvania	23.5	13.3	33.0	33.0
South Dakota	0	62.1	0	0
Tennessee	0	200.3	0	0
Texas	184.5	889.5	0	455.3
West Virginia	347.	115.3	0	0
Total	$4,603.4	$5,561.6	$1,587.9	$2,982.8

* NOTE: No single family mortgage revenue bonds were issued by local agencies in the following states: Alabama, District of Columbus, Hawaii, Idaho, Maine, Massachusetts, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, Utah, Vermont, Virginia, Washington, Wisconsin and Wyoming.

Number of Single Family Units Resulting From Local Bond Issuance*

State	1979	1980	1981	1982
Alaska	1400	0	0	0
Arizona	0	2100	0	2600
Arkansas	9200	3300	0	500
California	11700	17100	3800	17600
Colorado	6600	5200	4000	2500
Connecticut	0	200	0	0
Delaware	2300	1400	0	800
Florida	0	10100	6100	3500
Georgia	0	0	0	2500
Illinois	7200	800	300	1600
Indiana	0	100	0	0
Iowa	300	0	0	0
Kansas	2700	7900	6100	2500
Kentucky	1900	0	0	800
Louisiana	12000	8100	0	800
Maryland	900	2000	2300	2000
Michigan	0	200	0	0
Minnesota	2600	1100	1900	1100
Missouri	0	0	0	1100
Mississippi	200	0	0	0
New Mexico	1800	500	300	0
North Dakota	100	0	0	0
Oklahoma	3800	9300	0	0
Pennsylvania	400	200	500	500
South Dakota	0	1000	0	0
Tennessee	0	3200	0	0
Texas	3000	14200	0	7300
West Virginia	5600	1800	0	0
Total	73600	89800	25400	47700

* NOTE: No single family mortgage revenue bonds were issued by local agencies in the following states: Alabama, District of Columbia, Hawaii, Idaho, Maine, Massachusetts, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, Utah, Vermont, Virginia, Washington, Wisconsin, and Wyoming.

Methodology For Converting Single Family Bond Volume to Housing Units

# of Units = $\frac{\text{Bond Volume}}{\text{Average Mortgage Amount}}$. % of proceeds used for mortgages

# of Units = $\frac{\$2,982,800,000}{\$55,000}$. (.88)

= 54,233 . (.88)

= 47,700

1) Bond Volume -- Bond Volume derived from the Public Securities Association's computer file.

2) Average Mortgage Amount -- Derived from Council of State Housing Authorities (CSHA) annual survey of its members. From July 1981 to June 1982, the average mortgage financed with bonds was $55,000. Applying this to earlier years, probably understates the number of units financed in those years.

Also, since the figure is a nationwide average, activity in high-cost states (e.g. California) may be overestimated, while activity in low-cost states may be underestimated.

3) Percent of Proceeds for Mortgages -- Not all bond proceeds are used for mortgages. Based on a 1981 Congressional Budget Office study, an average of 12 percent of bond proceeds are used to cover administrative costs, costs of issuance, reserve funds, and underwriter/counsel fees.

4) Result rounded to nearest hundred so as not to overstate the accuracy of the estimates.

EXHIBIT B

SUMMARY OF WICHITA & SEDGWICK COUNTY KANSAS BOND ISSUES

1979

Issuer:	Urban Renewal Agency
Amount of Issue:	$9,230,000
Types of Loans:	a. First mortgage/rehab b. Subsidized home improvement c. Regular home improvement d. landlord improvement
Total No. of Units:	359 ($7,700,400)
Interest Rate:	8.3% (3% subsidized)
Income Limits:	None for first mortgage/rehab, regular home improvement, and landlord improvement loans

Subsidized Income Limits:

Family Size	Amount
1	$ 9,700
2	$10,950
3	$12,200
4	$13,450
5	$14,700
6	$15,900
7	$17,000
8+	$18,450

Issuer:	City of Wichita
Amount of Issue:	$30,000,000
Types of Loans:	First mortgage
Total No. of Units:	610
Income Limits:	$25,000

1980

Issuer:	Urban Renewal Agency
Amount of Issue:	$5,000,000
Types of Loans:	Landlord Improvement Loans and First Mortage Loans
Total No. of Units:	124 residential, 15 commercial
Interest Rate:	9%
Income Limits:	none

Issuer:	Sedgwick County, Kansas
Amount of Issue:	$60,000,000
Types of Loans:	First Mortage Loans
Total No. of Units:	1,312
Income Limits:	$37,500

1981

Issuer: City of Wichita
Amount of Issue: $4,500,000
Types of Loans: Home Improvement Loans
Total No. of Units: 365 to date*
Interest Rate: 13.25% regular, 4% subsidized
Income Limits: $37,500 for regular loan
Subsidized Income Limits:

Family Size	Amount
1	$12,900
2	$14,700
3	$16,550
4	$18,400
5	$19,550
6	$20,700
7	$21,850
8+	$23,000

*$428,000 remains to be spent

Issuer: Sedgwick County, Kansas
Amount of Issue: $40,000,000
Types of Loans: First mortgage
Total No. of Units: 789
Income Limits: $37,500

Sedgwick County also participated in an issue by Seward/Saline Counties in Kansas. Sedgwick County received approximately $35,000,000 in that issue.

1982 THIS ISSUE IS THE ONLY ONE REQUIRED TO HAVE FIRST-TIME HOMEBUYERS

Issuer: City of Wichita/Sedgwick County
Amount of Issue: $30,000,000
Types of Loans: First mortgage
Total No. of Units: 149 to date*
Income Limits: $37,500

*$21,000,000 remains to be spent

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EXHIBIT C

EL PASO COUNTY

LAND USE DEPARTMENT

27 EAST VERMIJO
COLORADO SPRINGS, COLORADO 80903

MEMORANDUM

TO: Board of County Commissioners

FROM: Bill Wildman, Director of Land Use BW

DATE: February 3, 1981

SUBJECT: El Paso County Mortgage Revenue Bond Program

Although the final results on the Mortgage Revenue Bond Program are not yet in, data now available indicates that 706 applications have been processed through the program. This represents a total $26,051,400.00. The remaining funds are now being loaned by existing institutions and we expect nearly a 100% completion rate on loans. A summary of the results of the program follows below:

- Average purchase price - $42,500.00.
- Average mortgage value - $36,900.00.
- Average principle and interest payment - $307.33.
- Average income per recipient - $1,375.00 per month ($16,500 per year). (This represents the income of the borrower plus comaker if applicable.)
- Median year built for house - 1963.
- Average age of the home buyer - 28 years old. (The youngest buyer was 18; the oldest, 72.)
- Monthly housing expense at present - $255.50.
- Monthly housing expense proposed after purchase - $415.00.
- Average monthly income of the borrower - $1,258.00. (This converts to $15,096 per year.)

- Marital status of borrower - 56.5% were married; 6.3% were divorced; 37.2% were unmarried.
- One person households made up 49.4% of the loans made; two person, 21.7%; three person, 18%; four person, 7%; five person, 3.1%; and six or more person, .9%.
- 77.6% of the buyers were households headed by males; 22.4% of the buyers were households headed by females.

The data indicates that the majority of persons utilizing the program were persons who would be unable to afford to buy a home if they had to purchase a house at conventional, VA or FHA interest rates. The program has been successful in getting approximately 730 families into ownership of homes that they would not have otherwise owned given the economic circumstances in the County.

	Date of Issue	Amount of Issue	Interest Rate of Mortgage	# of Mortgage Loans	Income Guidelines	House Price Guidelines	Number of Lenders
1st Issue	12/1/79	$30,000,000 (Authorized for: $65,000,000	9 3/8%	743 loans	$16,500 max income + $1,500/ dependent	$62,000 max pur. price	20
2nd Issue	8/25/81	$18,350,000	12 3/4%	320 loans expected	$31,500 + $2,000/dep.	New-$70,600 Existing-$49,400 TA New-$86,300 TA Exist.-$60,300	15
3rd Issue Series B	9/30/82	$15,295,000	12½%	230 loans expected	$36,000 + $ 4,000 + $ 2,000/dep.	New - $80,350 Exist.-$60,390 TA New-$94,200 TA Exist.-$65,800	15
Series A	10/19/82	$35,000,000	12½%	550 loans expected	" "	New-$103,000 Exist.-$78,000	15

All Issues: $98,645,000
1,850 Loans Expected

Chronology of 1979 Series A & B

November 2, 1978 - Board of County Commissioners discussed issuing M.R.B. for low to medium income households; Established Bond Committee;

December 28, 1978 - Committee presented findings to Board of County Commissioners - Need for $55-60 million and recommended Bond Program to finance mortgages; Board of County Commissioners approved recommendation;

March 26, 1979 - Board of County Commissioners considered and approved Committee's recommendations to issue $65 million in two series: Series A of $30 million and Series B of $35 million

Reason for two series: to allow County more flexibility in structuring program, i.e., adjustment of income eligibility requirements for "B" if "A" was high or low.
Insulate "B" from adverse financial impacts of trial rehab. program.
Retain flexibility for any changes in State law and adverse Federal legislation such as targeting, income and purchase price limitations, and first time homebuyer and spread points.

November 15, 1979 - Board of County Commissioners authorized issuance and sale of $30 million Series A.

STATEMENT OF JOHN A. ARBIB, CHAIRMAN, MORTGAGE FINANCE SUBCOMMITTEE ON STATE AND LOCAL HOUSING FINANCE AGENCIES, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. ARBIB. My name is John Arbib. I am chairman of the Subcommittee of the Mortgage Finance Committee of NAHB on State and local housing finance agencies. I am on the Board of Directors of NAHB and I am chairman of the Florida Housing Finance Agency, and I am a homebuilder, incidentally—single family homebuilder.

I am representing here today the 110,000 members of NAHB. The written statement says that we have 107,000. Business has improved, so the membership today is 110,000.

First of all, I would like to thank Chairman Packwood and Senators Roth and Mitchell, for the support that you have given to this particular issue, which we think is critical to the housing industry and to financing low- and moderate-income housing in this country.

We believe that mortgage revenue bonds represent an efficient and effective program for helping moderate-income households gain a foothold in homeownership these days. Mortgage revenue bonds have successfully filled the affordability gap for hundreds of thousands of moderate income first-time home buyers. Since the beginning of the program, mortgage revenue bonds altogether have financed some 700,000 homes, probably 70 percent of which were before the restrictions that came into being in 1980 and probably about 200,000 units after that. Perhaps 60 percent of these were existing houses and 40 percent were new construction houses.

Assertions that mortgage bonds help people who could have purchased homes without mortgage bond assistance simply ignore the realities of the housing market, particularly the milieu that we have had during this past year.

The median income of State mortgage bond program beneficiaries was $18,500 in 1981 and $23,500 in 1982. The median income of households receiving FHA, loans $33,000, was about $10,000 above the mortgage bond programs. And the median income of households receiving conventional mortgage loans was about $20,000 above mortgage revenue bond recipients, or $39,000 in 1981. I think that these figures quite clearly indicate that mortgage revenue bonds provided housing for a great number of people who otherwise could not have afforded homeownership.

I am not responding verbally to the GAO report because that is taken up in quite some detail in our written report, and it is also taken up in a letter from our president, Harry Pryde of NAHB. But I found, for example, that the bar chart presented by GAO which showed most home purchases by households in the middle-income range, did not take into effect what Dr. Rivlin said about the differences from community to community and from State to State on income levels and cost of housing.

Senator MITCHELL. Mr. Arbib, is that not, as Senator Roth has so often pointed out, one of the advantages of this program in that it is flexible and does permit maximum adaptation to local circumstances?

Mr. ARBIB. That is exactly right, and I think that the GAO figures do not take that into account, at least in the charts that we saw.

One thing that I would like to point out, is that as interest rates decline, the housing finance agencies are better able to address that portion of the market they were created to address. There is always a level of people below the area of conventional interest rates that cannot afford housing, and while reserved funds financed housing at relatively high rates, as high as 13 percent last year, conventional rates were up as high as 17½ percent. Today housing finance agencies can provide rates that are 10 percent or below. And I think that is a very important factor to remember.

I am sorry that my time is up, but I would like to request that you please do what you can to seek early enactment of S. 137. I am available for questions if you wish.

[The prepared statement of John Arbib follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

COMMITTEE ON FINANCE

UNITED STATES SENATE

on

SINGLE FAMILY MORTGAGE REVENUE BONDS

MAY 13, 1983

Mr. Chairman and Members of the Committee:

My name is John Arbib and I am a homebuilder and developer from Pembroke Pines, Florida. I am also Chairman of the National Association of Home Builders' Mortgage Finance Subcommittee on State and Local Housing Finance Agencies as well as Chairman of the Florida Housing Finance Agency. I am presenting this statement on behalf of the more than 107,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry.

Mr. Chairman, NAHB wholeheartedly supports The Housing Finance Opportunity Act of 1983, S.137, to repeal the sunset date on single family mortgage revenue bonds. I want to commend you and Senators Roth and Mitchell for your leadership on the issue of providing a workable mortgage revenue bond program.

The overwhelming support of the Senate for continuation of this program is clearly indicated by the 73 co-sponsors on S.137, 13 of whom are members of the Senate Finance Committee. 294 members of the House have also co-sponsored the counterpart House bill, H.R.1176. In total, two-thirds of the Members of Congress have co-sponsored the Housing Finance Opportunity Act of 1983.

We strongly urge this Committee to seek early enactment of S.137. Expeditious passage of this legislation is necessary to allow states and localities sufficient time to plan and implement their housing programs.

MORTGAGE REVENUE BONDS

Tax-exempt revenue bonds provide a major housing opportunity for low and moderate income families. Since the early 1970's, states and localities have provided financing for approximately 700,000 buyers of new and existing units. State Housing Finance Agencies located in 48 states, the District of Columbia, Virgin Islands and Puerto Rico, as well as hundreds of local housing agencies, are authorized to finance below market mortgages for primarily first-time homebuyers through the sale of tax-exempt bonds. In conjunction with the private sector, housing finance agencies target diverse programs financed with bond proceeds to address the needs of their low and moderate income families.

The following analysis details the social and economic benefits and costs of the mortgage revenue bond program. But first, Mr. Chairman, I would like to comment on a recent General Accounting Office Report, "The Costs and Benefits of Single Family Mortgage

Revenue Bonds: Preliminary Report." Mr. Chairman, our research indicates that the GAO Report is inaccurate and misleading. I will not attempt a detailed rebuttal to the GAO Report at this time since attached to this testimony is a letter from Harry Pryde, President of NAHB, to Chairman Dole, which details the many methodological problems with this study. At this point, I will highlight some of the major faults of the GAO Report. The thrust of my testimony also addresses the costs and benefits of mortgage revenue bonds, some of which are also discussed by GAO.

"The Costs and Benefits of Single Family Mortgage Revenue Bonds: Preliminary Report," U.S. General Accounting Office

Given my experience with state and local housing finance agency programs, I was quite surprised to read the recent U.S. General Accounting Office Report concluding that mortgage revenue bond-financed homeownership programs are largely ineffective in aiding low and moderate income homebuyers. The report concludes that mortgage bond programs are from two to six times more costly than alternative homeownership assistance programs. This report also finds that these housing bonds drive up interest rates in the municipal credit market.

The GAO study is based on bonds issued from December 1981 to July 1982, a period in which interest rates reached the highest level since the Civil War. Boyond the fact that GAO has selected an inappropriate time to evaluate the effectiveness of mortgage revenue bonds in serving lower income households, GAO severely understates the benefits of mortgage revenue bonds and overstates the costs. Their analysis is both biased and misleading.

GAO critizes the fact that the median income of mortgage bond program beneficiaries was about $23,500 during the period of this study. Considering that the median income of homebuyers receiving conventional loans in 1981 was $39,196, I would conclude that mortgage bond programs are very effectively targeted. Moreover, the average price of a mortgage bond-financed home, according to GAO's own findings, was about 60% of the national average. How can GAO conclude that state income and federal purchase price limits on bond-financed housing are ineffective?

GAO somehow concludes that three out of every four mortgage revenue bond beneficiaries could have purchased a home without assistance in 1982. Mr. Chairman, with interest rates over 16% last year, very few households with incomes in the low $20,000 income range could find affordable housing.

The cost of mortgage revenue bonds is also greatly overstated by GAO because they employ an inflated cost calculation methodology and understate the actual interest rate reduction that is obtained by the issuance of mortgage bonds. GAO incorrectly assumes that every dollar invested in tax-exempt bonds displaces a dollar of investment in taxable corporate bonds. Other municipal finance experts calculate the expenditure cost of mortgage revenue bonds to be one-third of the GAO estimate.

Furthermore, mortgage revenue bonds issued by state housing finance agencies in 1982 actually reduced interest rates by almost 4%, rather than 2-1/2% as reported by GAO. Hence, by this one inaccurate assumption, GAO concludes that mortgage revenue bonds are more costly, and less efficient than hypothetical program alternatives.

Finally, GAO concludes that the high volume of mortgage revenue bonds drives up municipal interest rates and costs states and local governments millions of dollars in high interest payments on tax-exempt borrowing. GAO not only overestimates the 1982 volume of single family mortgage revenue bonds by almost $2 billion, and their share of the municipal market, but the assumed credit market effects are not borne out by history. Despite the development of mortgage revenue and industrial development bonds in the early 1970's, the spread between taxable and tax-exempt bonds is currently the same as it was 20 years also.

In general, the GAO Report is flawed to the point that I doubt it will be useful in honestly evaluating the costs and benefits of mortgage bonds.

SOCIAL AND ECONOMIC BENEFITS OF MORTGAGE REVENUE BONDS

Affordability: Revenue bonds address housing needs not served by the conventional market by reducing mortgage interest rates by 2%-3% below conventionally financed mortgages, and even more when conventional rates are inordinately high. During 1982, for instance, the average interest rate for State Housing Finance Agency mortgages was 12.48%. This interest rate was almost 4% below conventional rates for that time period. This substantial spread in interest rates qualifies many additional moderate income households for mortgage loans. Over 6.5 million additional working families are able to purchase a home with a 12.5% revenue bond mortgage rate when conventional rates are 16.5%, since monthly payments are reduced by $138 per month. As interest rates continue to drop, mortgages financed with revenue bonds are able to serve an even larger segment of the targeted population.

More specifically, the Council of State Housing Agencies found the median income of mortgage bond programs beneficiaries to be $18,467 per year in 1981 and $23,511 per year in 1982. (This is based on a sample of 12 State Housing Finance Agencies, stratified by region, age of agency and debt oustanding.) In contrast, the U.S. League of Savings Associations reports that the median income of homebuyers recieving conventional loans in 1981 was $39,196.

According to the GAO, the average purchase price of homes financed by mortgage revenue bonds in 1982 was $48,800. Conversely, in 1982, the average purchase price of a new and existing home was $83,900 and $80,500, respectively. Thus, housing financed by mortgage bonds was about 60% less than the national average in 1982.

According to GAO, $43,300 was the 1982 average revenue bond mortgage amount. Given a 1982 average mortgage interest rate of 16.2%, an income of over $28,000 per year would be required to qualify for this mortgage. Alternatively, a family earning $22,000 per year would qualify for this same mortgage, financed with mortgage revenue bonds, because of the substantial reduction in the interest rate.

To what extent, Mr. Chairman, was affordable housing available to moderate income homebuyers in 1982? At the average 1982 conventional mortgage rate of 16.2%, a family earning $23,500 per year could afford only a $36,000 mortgage. However, there was very little decent housing available for less than $40,000 last year. In fact, there were only 66,000 new homes built in 1982 for under $50,000 and only 16.4% of all existing homes sold for less than $40,000. The limited number of homes priced at these levels provides the moderate income homebuyer with little or no opportunity to choose how or where to live even if affordable can be found.

Targeted Program: The Mortgage Subsidy Bond Tax Act of 1980 ensures that mortgage revenue bonds serve a legitimate public purpose by imposing strict limits on both recipients served and homes financed by the program. Federal law directs proceeds to mostly first-time homebuyers, specifies purchase price limits and encourages lending in distressed areas. Furthermore, most states and localities establish income limits and other targeting requirements to meet regional housing objectives.

New Federalism Tool: At a time when the federal government is increasing its reliance on state and local governments to provide traditional forms of federal assistance, it does not make sense to eliminate a program which is fulfilling this goal. By utilizing the mortgage revenue bond program, states and localities were successfully practicing the "new federalism" long before this term was coined.

Revenue bonds have provided states and localities the flexibility to design programs to respond to changes in the housing market. In this way, housing agencies maintain the efficiency and effectiveness of their programs. For instance, in order to respond to the rising yield curve present in the tax-exempt bond market in 1981 and the first half of 1982, housing agencies replaced 30-year bonds with shorter-term securities to reduce the cost of borrowing. New mortgage instruments were simultaneously developed, such as the growing equity mortgage, in lieu of the traditional 30-year fixed-rate mortgage. Housing agencies are now in a unique position to combine different bond structures and security instruments to respond to changing economic climates, as was demonstrated during the latter half of 1982 when interest rates declined. Thus, a variety of lower cost financing programs can be provided.

In addition to ownership assistance, housing finance agencies have successfully developed other bond-financed programs to meet the special needs of their residents. Home improvement, energy conservation and other programs targeted to the elderly and handicapped are just a few examples of the innovative capability of housing agencies. A strong state and local role in housing is undoubtedly in the national interest.

Housing Activity Generated By Mortgage Revenue Bonds: Since the early 1970's, states and localities have provided below market rate loans to finance nearly 700,000 new and existing homes for primarily first-time homebuyers through the use of revenue bonds. One billion dollars in bonds provides financing for approximately 20,000 units, about one-third of which are newly constructed units. 1982 bond proceeds totalling more than $8 billion provided financing for almost 100,000 units. 35,000 of these were new units, which represented approximately 8.5% of all new single family sales.

SOCIAL AND ECONOMIC COSTS OF REVENUE BONDS

Interest Rate Effects - Opponents of revenue bonds contend that municipal interest rates are adversely affected by an increase in the supply of these bonds. Consequently, other municipal borrowers are driven out of the market. This impact of housing bonds on the market, however, has been restricted by Congressionally imposed volume caps. Congress limited the annual issuance of housing bonds from 1981 to 1983 to $10-$15 billion, but so far less than one-half of this volume has actually been used. In 1982, for example, single family revenue bond issuarce totalled approximately $8.1 billion, representing approximately 10.5% of the municipal market, and 60% of the authorized mortgage bond volume. 1981 volume amounted to less than 20% of the authorized volume.

Furthermore, the credit market impact of housing bond volume has been overstated. Critics contend that the spread between municipal bond and taxable bond interest rates has been reduced due to the growth of tax-exempt bonds. Even though municipal bond volume increased dramatically in the 1970's and 1980's, the comparable taxable/tax-exempt interest rate spread is the same as it was twenty years ago.

One overstated estimate of the adverse effect of revenue bonds on other municipal interest rates is George Peterson's conclusion, in the 1979 Urban Institute Report entitled "Tax-Exempt Financing of Housing Investment," that each $1 billion of bonds increases tax-exempt rates by four to seven basis points. Peterson assumes that an increase in tax-exempt volume continually attracts lower marginal bracket taxpayers away from their taxable investments because higher bracket taxpayers have absorbed as much tax-exempt debt as they can afford. Subsequently, tax-exempt interest rates must increase to attract the lower marginal bracket investors.

Peterson, however, ignores the fact that investors purchase bonds for other reasons than rate of return, such as their role in a total portfolio and their relative risk. Thus, tax-exempt bonds are not necessarily purchased by only investors at the margin. As a matter of fact, Professors Roger Kormendi and Thomas Nagle contend that 83% of all increases in tax-exempt volume are purchased by above-margin taxpayers. (See Roger C. Kormendi and Thomas T. Nagle, University of Chicago, "The Interest Rate and Tax Revenue Effects of Mortgage Revenue Bonds", April, 1980). They estimate that each billion dollars of bonds increases tax-exempt rates by only one basis point or about one-quarter of the Peterson estimate.

It seems that demand for tax-exempt bonds is equally, if not more, responsible than volume for municipal interest rate levels. In recent years, factors affecting demand for municipal bonds and adversely affecting interest rates include: reduction in the maximum income tax bracket from 70 to 50 percent, thereby forcing an increase in municipal rates to attract investors; creation of additional competition in the tax-exempt market caused by an increase in tax-exempt or partially tax-exempt investments created by the 1981 Tax Act, such as All-Savers certificates and safe harbor leases; and a major decrease of institutional investors in tax-exempt bonds in the past couple of years.

Efficiency of Bonds - Some suggest that a more cost-effective direct subsidy could provide the same benefits as mortgage revenue bonds. It is argued that revenue bonds are inefficient because, in order to attract marginal investors who demand higher tax-exempt rates, they inadvertently provide windfalls to high income investors.

This rationale has two flaws. First, it is evident during this time of fiscal constraint that an alternative direct subsidy will not be forthcoming. Even if implemented, however, a direct federal subsidy will not only be more costly, due to an increase in administrative costs, but will also deprive states and localities the considerable flexibility they now experience to respond to regional housing needs. In addition, the change in the tax rate on unearned income from 70% to 50% reduces the windfall to high tax bracket investors.

Revenue Loss to Treasury - The Joint Committee on Taxation recently released preliminary revenue loss estimates for continuation of the mortgage revenue bond program. The Committee estimates that the program will result in a revenue loss of $59 million in FY'84, and totalling $2.159 billion for a five year period through FY'88. Based on the Committee's economic assumptions, it can be estimated that the federal government will lose a little more than $20 million per year for every billion of revenue bonds issued through FY'88. This analysis, however, incorrectly assumes that every dollar invested in tax-exempt bonds displaces a dollar of investment in taxable bonds. This unrealistic assumption fails to account for net new savings going into tax-exempt bonds and substitutions of lesser taxed investments for tax-exempt bonds. Investors are likely to exchange tax-exempt or partially taxable assets to purchase revenue bonds. Thus, the revenue loss is significantly less than estimated by the Joint Tax Committee. In fact, other municipal finance experts indicate that the revenue loss is approximately one-third the amount calculated by the Joint Committee on Taxation.

This estimated revenue loss ignores the positive economic impact of revenue bonds. One billion dollars in revenue bonds, which provides financing for approximately 7,000 newly constructed units, generates about $140 million in wages by creating about 7,500 jobs in construction, land development, manufacturing, wholesale trades, transportation, mining and other industries directly related to the homebuilding process. These units also generate over $62 million in federal, state and local taxes. The total positive economic impact is estimated at $619 million. (The economic impact of $1 billion of revenue bonds is actually understated since it is based on benefits derived only from new construction, and not from existing units.) The attached Table describes the economic impact of 1,000 new single family units financed by revenue bonds (see attached).

Thus, Mr. Chairman, NAHB concludes that the benefits of mortgage revenue bonds more than outweighs the costs. We believe that the December 31, 1983 sunset date should be repealed to help thousands of first-time homebuyers each year achieve the dream of homeownership.

Thank you for the opportunity to present our views on this issue. I would be pleased to answer any questions you may have.

ECONOMIC IMPACT OF 1,000 NEW SINGLE FAMILY UNITS
FINANCED BY TAX-EXEMPT MORTGAGE REVENUE BONDS

Average Value Per Unit - $50,000

EMPLOYMENT IMPACT

	Man Years*	Wages
Construction:		
On Site	316	$6,891,400
Off Site	61	1,301,200
TOTAL	377	8,192,600
Other Industries:		
Manufacturing	239	3,873,400
Wholesale Trade, Transportation & Services	214	2,777,100
Mining and All Others	87	1,759,000
TOTAL	540	8,409,500
Land Development	142	3,000,000
TOTAL ALL INDUSTRIES	1,060	$19,602,100

* A man year equals one job for one man for one year.

TAX IMPACT

Federal Taxes	
Federal Personal Income Tax	$2,463,800
Federal Corporate Income Tax	2,554,200
Social Security Tax	2,607,200
TOTAL	7,625,200
State Personal Income Tax	331,300
Local Real Estate Tax	909,600
TOTAL TAX IMPACT	$8,866,100
TOTAL ECONOMIC IMPACT**	$88,495,600

** The total economic impact is derived from taking the value of the units, subtracting the value of the raw land, and employing a multiple of two to reflect additional economic activity generated.

Source; NAHB Economic Policy Analysis Division

Revised 05/10/83

National Association of Home Builders

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Harry Pryde
1983 President

May 10, 1983

The Honorable Robert J. Dole
Chairman
Committee On Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the 110,000 members of the National Association of Home Builders, I am writing to convey our deep concern with a recent U.S. General Accounting Office report concluding that mortgage revenue bond-financed homeownership programs are largely ineffective in aiding low and moderate income homebuyers. ("The Costs and Benefits Of Single Family Mortgage Revenue Bonds: Preliminary Report," April 18, 1983). The report also concludes that mortgage bond programs are from two to six times more costly than alternative homeownership assistance programs. As well, the report finds that these housing bond programs have had a significant negative effect by driving up interest rates in the municipal credit markets.

As you know, the National Association of Home Builders is a strong supporter of mortgage revenue bonds. We see mortgage revenue bonds as a key means of helping first-time homebuyers achieve the dream of homeownership. The U.S. League of Savings Associations reports that first-time homebuyers have made up a successively smaller share of the market each year since 1977. There is a genuine need for a program to help our young people get a foothold in homeownership.

We believe that the GAO study is both biased and misleading. A major fault of the GAO report is that it is based on the period from December 1981 to July 1982, a period in which interest rates reached the highest levels since the Civil War. Because mortgage bond yields are related to market interest rates in general, the incomes of program beneficiaries had to be somewhat higher than in prior years. This letter reviews some of the other major faults in the report. A one-page attachment summarizes our concerns.

<u>Homebuyers Assisted By Mortgage Bond Programs</u>

Despite GAO's conclusions, the actual beneficiary income data cited by GAO indicate that mortgage revenue bond programs have been very successful

Homebuyers Assisted By Mortgage Bond Programs cont'd.

in targeting their benefits to households that have been priced out of the homeownership market. Although GAO does not state what the median income of mortgage bond and FHA program beneficiaries actually was, the graph they supply on page 9 of Appendix II suggests that the median for the mortgage bond program beneficiaries was about $23,500 per year and the median for FHA borrowers was about $33,000 per year.

The Council of State Housing Agencies found the median income of mortgage bond program beneficiaries to be $18,467 per year in 1981 and $23,511 per year in 1982.* In contrast, The U.S. League of Savings Associations reports that the median income of homebuyers who received loans from S&Ls in 1981 was $39,196.

In 1982, the average purchase price of a new home in the United States was $83,900. The average price of an existing home was $80,500. GAO's finding that mortgage bond-financed housing had an average price of $48,800 — about 60% of the national average — does not support GAO's conclusion that the purchase price limits on bond-financed housing are ineffective.

It seems to me that what we have here is a very successful program for helping modest income first-time homebuyers to buy a home. GAO's unsupported assumption that three out of four program beneficiaries would have purchased a home without assistance doesn't stand up under close scrutiny.

Given a 1982 mortgage rate of 16.2%, an income of over $28,000 per year would be required to afford a $43,300 mortgage (GAO found that the 1982 average loan financed through mortgage bonds was $43,300). The average 1982 mortgage bond program interest rate of 12.48% would make that same mortgage affordable to a family with an income of about $22,000 per year. At the average 1982 conventional mortgage rate of 16.2%, a family earning $23,500 per year could afford only a $36,000 mortgage. There was very little decent housing selling for less than $40,000 last year. In fact, there were only 66,000 new homes built in 1982 that had a purchase price under $50,000 and only 16.4% of all existing homes sold had a price below $40,000. How GAO can conclude that, in 1982, three out of every four households receiving mortgage revenue bond financed loans could have found an affordable home without mortgage bond financing is baffling to me.

The Cost of Mortgage Bond Programs

The General Accounting Office overstates the cost of mortgage revenue bonds by using an inflated cost calculation methodology and understating the actual interest rate reduction that is obtained by the issuance of mortgage bonds.

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*Based on a sample of 12 state HFAs, stratified by region, age of agency and debt outstanding.

GAO assumes that every dollar invested in tax-exempt bonds displaces a dollar of investment in taxable corporate bonds. This unrealistic assumption fails to account for net new savings going into tax-exempt bonds and for substitutions of lesser taxed investments for tax-exempt bonds. For these reasons, and others, Professor R[illegible]r Kormendi of the University of Chicago calculates the revenue expenditure cost of mortgage bonds to be one half to one third the GAO estimate.

GAO also appears to understate the interest reduction provided by mortgage revenue bonds in order to make unfavorable cost comparisons with hypothetical program alternatives.

In the case of 1982 mortgage revenue bond mortgage interest rates, GAO assumes that the Daily Bond Buyer revenue bond index is a satisfactory proxy for mortgage bond rates during the year. This is a poor assumption because the net interest cost for single family mortgage bond issues consistently has been below the Bond Buyer index. The Council of State Housing Agencies maintains a comprehensive listing of state HFA mortgage bond issues. In 1982, the weighted average net interest cost of state housing finance agency issues was 11.92%, 57 basis points less than the GAO assumption. Based on a comprehensive listing of state HFA bond issues for 1982, the weighted average mortgage rate for 1982 programs was 12.24%.

GAO assumes an average spread of 243 basis points between mortgage bond programs and the conventional market in 1982. Taking the state agency average mortgage rate and factoring in two discount points, the effective mortgage rate of 12.48% is 127 basis points below the GAO estimate of 13.75%. This 370 basis point spread would increase the GAO calculation of the efficiency of mortgage bonds by 52%.

Credit Market Effects of Mortgage Bonds

GAO asserts that revenue bonds are adversely affecting the cost of other tax-exempt borrowing. First of all, GAO is wrong to assume the 1982 volume of tax-exempt single family bonds was $10 billion since the total volume was $8.1 billion. GAO asserts that housing bonds made up 30% of the municipal market in 1982. The Public Securities Association reports that long-term municipal bond volume totalled $77.3 billion in 1982. Our calculations indicate that single family bonds made up about 10.5% of the municipal market and all housing bonds made up about 17% of the market--not 30% as GAO asserts.

Second, GAO's calculation about the credit market effects of housing bond issues and the resultant costs to state and local government are not borne out by history. In 1962, when mortgage revenue bonds did not exist, interest rates on municipal bonds reached their lowest level in the past twenty five years and tax-exempts sold at 73% of the taxable rates. In 1980, when $10 billion in mortgage bonds were marketed and total municipal issues had quadrupled from 1962, the market offered a more favorable spread for municipal bonds--71%--than the golden days of 1962.

~~The Peterson~~ study cited by GAO in their assessment of the credit market effects of mortgage bonds has questionable methodology. By isolating the tax-exempt bond market from the rest of the capital markets, Mr. Peterson greatly overstates the effect of changes in municipal volume on bond interest rates.

It appears that throughout the study GAO has looked for evidence to support its conclusions rather than attempt a balanced and useful evaluation. The GAO study is flawed to the point that NAHB doubts it will be useful in honestly evaluating the costs and benefits of single family mortgage revenue bonds.

When I first read the GAO report, I was surprised by the conclusions. Upon studying the methodology, I am now surprised that a Congressional support agency would publish such a report.

Please contact Bob Bannister, Senior Staff Vice President for Governmental Affairs (822-0470) if the National Association of Homebuilders can be of any further assistance.

Sincerely,

Harry Pryde

Harry Pryde
President

cc: Senate Finance Committee Members
House Ways and Means Committee Members

Attachment

"THE COSTS AND BENEFITS OF SINGLE FAMILY MORTGAGE REVENUE BONDS: PRELIMINARY REPORT"
U.S. GENERAL ACCOUNTING OFFICE'"

GAO's Preliminary Conclusions	NAHB's Response
I. Beneficiaries of Mortgage Revenue Bonds	
• Program is not targeted — recipients could have afforded homes without assistance given their average income of approximately $23,500 per year.	• The afforability of homeownership for households earning $23,500 per year is significant. In contrast, the median income of homebuyers who received conventional loans in 1981 was $39,196.
• In 1982, the average purchase price of a home (new and existing) financed by mortgage revenue bonds was $48,800.	• In comparison, the average purchase price of a new and existing home was $83,900 and $80,500, respectively in 1982.
• Three out of four program beneficiaries would have been able to purchase a home without government assistance.	• Given the average income of $23,000 for mortgage revenue bond recipients found by GAO, along with the average 1982 conventional mortgage interest rate of 16.2%, such a family could afford only a $36,000 mortgage. However, there was very little decent housing available for less than $40,000 last year.
II. Cost of Mortgage Revenue Bonds	
• The Treasury will lose approximately $13,300 per loan for revenue bond financed housing in 1982.	• The cost methodology employed by GAO overstates the cost of mortgage revenue bonds because it incorrectly assumes that every dollar invested in tax-exempt bonds displaces a dollar of investment in taxable corporate bonds. The loss to the Treasury Department has been calculated by public finance experts to be about one-third the GAO estimate.
• By assuming a revenue bond average mortgage rate of 13.75%, GAO estimates that revenue bond financing reduces interest rates by by approximately 2-1/2%.	• Given the appropriate 1982 state agency average mortgage rate of less than 12-1/2%, revenue bonds provided nearly a 4% reduction in interest rates. Thus, mortgage revenue bonds provide considerably more interest subsidy than assumed by GAO.
III. Credit Market Effects of Mortgage Revenue Bonds	
• The high volume of mortgage revenue bonds adversely affects the cost of other municipal borrowing.	• GAO not only overestimates the 1982 volume of single family mortgage bonds by almost $2 billion, but the assumed credit market effects do not reflect reality. Despite the development of mortgage revenue bonds in the early 1970's, the spread between taxbable and tax-exempt bonds is currently the same as it was 20 years ago.

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in targeting their benefits to households that have been priced out of the homeownership market. Although GAO does not state what the median income of mortgage bond and FHA program beneficiaries actually was, the graph they supply on page 9 of Appendix II suggests that the median for the mortgage bond program beneficiaries was about $23,500 per year and the median for FHA borrowers was about $33,000 per year.

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GAO assumes an average spread of 243 basis points between mortgage bond programs and the conventional market in 1982. Taking the state agency average mortgage rate and factoring in two discount points, the effective mortgage rate of 12.48% is 127 basis points below the GAO estimate of 13.75%. This 370 basis point spread would increase the GAO calculation of the efficiency of mortgage bonds by 52%.

Credit Market Effects of Mortgage Bonds

GAO asserts that revenue bonds are adversely affecting the cost of other tax-exempt borrowing. First of all, GAO is wrong to assume the 1982 volume of tax-exempt single family bonds was $10 billion since the total volume was $8.1 billion. GAO asserts that housing bonds made up 30% of the municipal market in 1982. The Public Securities Association reports that long-term municipal bond volume totalled $77.3 billion in 1982. Our calculations indicate that single family bonds made up about 10.5% of the municipal market and all housing bonds made up about 17% of the market--not 30% as GAO asserts.

Second, GAO's calculation about the credit market effects of housing bond issues and the resultant costs to state and local government are not borne out by history. In 1962, when mortgage revenue bonds did not exist, interest rates on municipal bonds reached their lowest level in the past twenty five years and tax-exempts sold at 73% of the taxable rates. In 1980, when $10 billion in mortgage bonds were marketed and total municipal issues had quadrupled from 1962, the market offered a more favorable spread for municipal bonds--71%--than the golden days of 1962.

The Peterson study cited by GAO in their assessment of the credit market effects of mortgage bonds has questionable methodology. By isolating the tax-exempt bond market from the rest of the capital markets, Mr. Peterson greatly overstates the effect of changes in municipal volume on bond interest rates.

It appears that throughout the study GAO has looked for evidence to support its conclusions rather than attempt a balanced and useful evaluation. The GAO study is flawed to the point that NAHB doubts it will be useful in honestly evaluating the costs and benefits of single family mortgage revenue bonds.

When I first read the GAO report, I was surprised by the conclusions. Upon studying the methodology, I am now surprised that a Congressional support agency would publish such a report.

Please contact Bob Bannister, Senior Staff Vice President for Governmental Affairs (822-0470) if the National Association of Homebuilders can be of any further assistance.

Sincerely,

Harry Pryde

Harry Pryde
President

cc: Senate Finance Committee Members
House Ways and Means Committee Members

Attachment

"THE COSTS AND BENEFITS OF SINGLE FAMILY MORTGAGE REVENUE BONDS: PRELIMINARY REPORT"
U.S. GENERAL ACCOUNTING OFFICE'"

GAO's Preliminary Conclusions	NAHB's Response
I. Beneficiaries of Mortgage Revenue Bonds	
• Program is not targeted — recipients could have afforded homes without assistance given their average income of approximately $23,500 per year.	• The afforability of homeownership for households earning $23,500 per year is significant. In contrast, the median income of homebuyers who received conventional loans in 1981 was $39,196.
• In 1982, the average purchase price of a home (new and existing) financed by mortgage revenue bonds was $48,800.	• In comparison, the average purchase price of a new and existing home was $83,900 and $80,500, respectively in 1982.
• Three out of four program beneficiaries would have been able to purchase a home without government assistance.	• Given the average income of $23,000 for mortgage revenue bond recipients found by GAO, along with the average 1982 conventional mortgage interest rate of 16.2%, such a family could afford only a $36,000 mortgage. However, there was very little decent housing available for less than $40,000 last year.
II. Cost of Mortgage Revenue Bonds	
• The Treasury will lose approximately $13,300 per loan for revenue bond financed housing in 1982.	• The cost methodology employed by GAO overstates the cost of mortgage revenue bonds because it incorrectly assumes that every dollar invested in tax-exempt bonds displaces a dollar of investment in taxable corporate bonds. The loss to the Treasury Department has been calculated by public finance experts to be about one-third the GAO estimate.
• By assuming a revenue bond average mortgage rate of 13.75%, GAO estimates that revenue bond financing reduces interest rates by by approximately 2-1/2%.	• Given the appropriate 1982 state agency average mortgage rate of less than 12-1/2%, revenue bonds provided nearly a 4% reduction in interest rates. Thus, mortgage revenue bonds provide considerably more interest subsidy than assumed by GAO.
III. Credit Market Effects of Mortgage Revenue Bonds	
• The high volume of mortgage revenue bonds adversely affects the cost of other municipal borrowing.	• GAO not only overestimates the 1982 volume of single family mortgage bonds by almost $2 billion, but the assumed credit market effects do not reflect reality. Despite the development of mortgage revenue bonds in the early 1970's, the spread between taxhable and tax-exempt bonds is currently the same as it was 20 years ago.

05/10/83

Senator ROTH. Mr. Schoepf.

STATEMENT OF DAVID SCHOEPF, VICE CHAIRMAN, SUBCOMMITTEE ON FEDERAL TAXATION, NATIONAL ASSOCIATION OF REALTORS, WASHINGTON, D.C.

Mr. SCHOEPF. Thank you, Senator.

I am Dave Schoepf a member of the National Association of Realtors from Fort Thomas, Ky. I serve as vice chairman of the legislative subcommittee on Federal taxation of the National Association of Realtors.

The National Association of Realtors represents some 600,000 realtor-realtor associates in 50 States in this country, plus the many millions of homeowners that presently own property and those that potentially would like to be homeowners in the near future.

As in the past, the National Association of Realtors would love and would very much encourage the private sector to provide 100 percent of the financing for all of the home mortgage needs of the people in this country. However, our association believes that this is not always possible, particularly at times of high-interest rates which create the lack of affordable home mortgages for many of our citizens. Even though interest rates have declined recently, we see economic evidence to indicate that rates may again ascend beginning in 1985. Record budget deficits in the future have kept real big-term interest rates high—the resulting program affordability, problems can be met with the mortgage revenue bond program.

The mortgage revenue bond program that we are discussing this morning is an integral part of the home financing options package that is available to the citizens of the United States. The National Association of Realtors encourages the passage of Senate bill 137 that would continue to allow mortgage revenue bonds to be available to those citizens that require this type of home financing during times of high or rising interest rates.

I thank you very much. And we encourage the passage of Senate bill 137.

Thank you, sir. I would be happy to answer any questions.

[The prepared statement of David Schoepf follows:]

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
before the
SENATE FINANCE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT
by
DAVID SCHOEPF
May 13, 1983

My name is David Schoepf. I am from Fort Thomas, Kentucky, and I am a member of the NATIONAL ASSOCIATION OF REALTORS®. I also serve as Vice Chairman of the REALTORS® Legislative Subcommittee on Federal Taxation.

On behalf of the more than 600,000 members of the NATIONAL ASSOCIATION OF REALTORS®, we greatly appreciate the opportunity to present our views in support of legislation to permit the continued availability of mortgage revenue bonds, S. 137, and in support of legislation disallowing tax-exempt status to industrial development bonds (IDBs) guaranteed by the federal government, S. 1061.

The majority of my statement will focus on S. 137. Briefly on S. 1061, the NATIONAL ASSOCIATION OF REALTORS® believes the industrial development bond program has merit and we will continue to work with Congress to develop reasonable IDB restrictions. However, providing federal insurance to a tax-exempt obligation is viewed by this Association as an unnecessary benefit which can easily be removed. We therefore support enactment of S. 1061.

BACKGROUND

Approximately one year ago this Subcommittee held hearings on the need for legislative and administrative changes in the mortgage revenue bond program. At that time the NATIONAL ASSOCIATION OF REALTORS® testified in support of easing certain excessive mortgage revenue bond issuing restrictions. Such restrictions had in 1981 virtually shut down the availability of mortgage revenue bonds despite an economic climate which would not allow the private sector to provide mortgage funds at a reasonable cost to the home-buying public. Many of the excessive mortgage revenue bond issuing restrictions, such as arbitrage, first-time homebuyer and purchase price limitations were relaxed and the mortgage revenue bond program was made more workable.

During much of 1982 interest rates remained quite high; however, the more reasonable issuing requirements allowed the mortgage revenue bond program to be available as an alternative mortgage financing source. Because of this mortgage revenue bond availability, homeownership affordability became more than an elusive dream for thousands of homeowners. We supported the changes made last year and urge Congress to continue the program as currently existing.

Now that interest rates have decreased somewhat, mortgage revenue bond opponents suggest that the program may no longer be needed and that Congress should allow the program to sunset as scheduled on December 31, 1983.

The NATIONAL ASSOCIATION OF REALTORS® believes that allowing this form of homeownership assistance to expire would be premature. The Association is not convinced that the affordability crisis has ended and we support the elimination of the December 31, 1983 sunset date which would provide the continued availability of mortgage revenue bonds as a device to provide low-cost single-family home financing during times of high or rising interest rates.

S. 137

We appreciate the Subcommittee holding this hearing and applaud Senators Roth and Mitchell for introducing S. 137 and the other 71 members of the U.S. Senate who have cosponsored this legislation.

Historically, the mortgage revenue bond program was established to help those potential homebuyers who otherwise could not qualify for home financing from more traditional private sector sources. In other words, those individuals who could not afford a home.

Studies conducted by the NATIONAL ASSOCIATION OF REALTORS® indicate that homeownership affordability has recently improved. The decline of mortgage interest rates and the improving economy have combined to give a very strong beginning to the housing recovery.

The recovery of housing markets is due to the relatively improved affordability situation. Lower mortgage interest rates, relatively stable home prices and modest gains in family income have combined to produce ten consecutive months of improving affordability. In March, the Housing Affordability Index, developed by the NATIONAL ASSOCIATION OF REALTORS®, stood at 81.8, which means that a family earning the median income of $24,150 had 81.8 percent of the income needed to qualify for the purchase of a median-priced existing single-family home. This is an improvement over May of 1982 when the Affordability Index stood at its lowest point of 65.2 percent.

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Housing Affordability Index

	Median-priced Existing Home	Mortgage Rate	Monthly P & I Payment	Payment as % Income	Median Family Income	Qualifying Income	Affordability Index
1977	$42,900	9.02%	$277	20.7%	$16,010	$13,279	120.6%
1978	48,900	9.58	330	22.4	17,640	15,834	111.4
1979	55,700	10.92	422	25.7	19,680	20,240	97.2
1980	62,200	12.95	549	31.3	21,023	26,328	79.9
1981	66,400	15.12	677	36.3	22,388	32,485	68.9
1982	67,800	15.38	702	35.4	23,800	33,713	70.6
1982							
Mar	$67,000	15.65%	$706	37.2%	$22,741	$33,873	67.1%
Apr	67,100	16.00	722	37.9	22,859	34,650	66.0
May	67,800	16.11	734	38.3	22,976	35,242	65.2
Jun	69,400	15.56	727	37.8	23,094	34,893	66.2
Jul	69,200	15.52	723	37.4	23,212	34,707	66.9
Aug	68,900	15.59	723	37.2	23,329	34,706	67.2
Sep	67,300	15.27	692	35.4	23,447	33,236	70.5
Oct	66,900	14.95	675	34.4	23,565	32,380	72.8
Nov	67,700	14.29	654	33.1	23,682	31,401	75.4
Dec	67,800	13.95	641	32.3	23,800	30,609	77.4
1983							
Jan	$68,100	13.54%	$626	31.4%	$23,917	$30,035	79.6%
Feb[r]	68,200	13.40	621	31.0	24,033	29,791	80.7
Mar[p]	69,300	13.04	615	30.6	24,150	29,520	81.8

[r]revised.

[p]preliminary.

The NATIONAL ASSOCIATION OF REALTORS® Affordability Index strongly disagrees with a preliminary report released by the General Accounting Office which states: "three-quarters of the buyers (in 1982) had incomes above $20,000 and could likely have purchased homes" without the availability of mortgage revenue bonds. The Affordability Index shows that in 1982 the median-priced existing home was $67,800--and the affordability index was 70.6 percent--meaning that a family earning $23,800 had only 70 percent of the income needed to qualify for that home purchase.

Despite recent economic improvements there is reason to be concerned about future homeownership affordability . Interest rates have fallen but real long-term interest rates, the level of interest rates above the inflation rate, remain at historically high levels. The primary factor behind these high real rates is the prospect of federal budget deficits in excess of $200 billion per year for the foreseeable future. Borrowing to finance deficits this size has placed and will continue to place upward pressure on interest rates and is "crowding out" the demands for credit by consumers and businesses. Further, credit markets continue to expect a resurgence of inflation since the Federal Reserve Board is under immense political pressure to lower interest rates by increasing the supply of money much faster than its stated target growth rates. Resolution of the current federal budget stalemate through substantial spending cuts would ease both the total demand for credit and the expectations of future inflation and allow further declines in long-term rates.

The following economic expectations are the results of an extensive nationwide survey of REALTORS® conducted in mid-April in order to determine members' attitudes on issues which impact the real estate industry. The complete published report is entitled "Attitudes of the Real Estate Industry," and is available from the Economics and Research division of the NATIONAL ASSOCIATION OF REALTORS®.

Expected Inflation Rates

At the time of our survey inflation was running at about 4 percent a year. Real estate professionals generally expect these current low inflation rates to remain over the next six months. However, a majority expect a higher rate of inflation over the next two years.

EXPECTED INFLATION RATES
(Percentage Distribution)

	Higher	About the Same	Lower
April 1983--Next 6 Months	17	67	16
Next 2 Year	74	13	13

Expected Mortgage Rates

The shorter term outlook for mortgage rates is more optimistic than the longer term view. At the time of our April survey interest rates on conventional fixed-rate loans were running around 13 percent. About half of all real estate professionals expect mortgage rates to remain stable over the next six months, with more than a third calling for lower rates. However, a majority expect increases in rates over the next two years.

EXPECTED MORTGAGE RATES
(Percentage Distribution)

	Higher	About the Same	Lower
April 1983--Next 6 Months	13	49	39
Next 2 Years	56	18	26

Expected Credit Availability

As in the past couple of years real estate professionals are less concerned about the availability of mortgage credit than its cost. Most respondents across the country expect credit availability to remain about the same or increase in the short run. The long run expectation is generally less optimistic, with one in every four respondents expecting credit to become less available over the next two years.

EXPECTED CREDIT AVAILABILITY
(Percent Distribution)

	More Available	About the Same	Less Available
April 1983--Next 6 Months	43	52	6
Next 2 Year	46	29	25

These economic expectations of real estate professionals taken together with economic forecasts from a wide range of economists indicate the current U.S. economic outlook includes a slowly declining level of interest rates throughout 1983 and 1984 followed by increased interest rates beginning in 1985. For example, the NATIONAL ASSOCIATION OF REALTORS®' financial market forecasting model predicts "new home mortgage rates" of 12.97% in

1983 and 12.94% in 1984, increasing to 13.77% in 1985, suggesting that homeownership affordability likely will continue as a significant problem throughout the rest of the decade.

Housing affordability problems can be eased if the mortgage revenue bond program is not sunsetted at the end of 1983. Mortgage revenue bonds traditionally provide mortgages with interest rates about 2 percentage points below the conventional market and even lower during very high interest rate periods. The following table shows how a 2 percentage point interest rate reduction affects the income needed to purchase a home.

ANNUAL INCOME NEEDED TO SUPPORT MONTHLY HOUSING COSTS*

	Purchase Price**		
	$40,000	$60,000	$80,000
Interest Rate			
9%	$15,571	$21,358	$27,146
11%	17,696	24,546	31,395
13%	19,909	27,866	35,823
15%	22,186	31,281	40,376
17%	24,505	34,760	45,014

*Income estimates based on the following assumptions: 90% loan to value ratio: 30 year mortgage term: other housing expenses (taxes and insurance) estimated at $100 per month; and 30% housing expense to income ratio.

**The weighted average sales price for new and existing homes in the United States in 1982 was $81,000.

For example, this table shows that it takes almost $28,000 in income to buy a $60,000 house at 13 percent interest, while a family with income less than $25,000 could buy the same house at 11 percent. In 1982, when the spread between mortgage revenue bond loans and conventional mortgages averaged 3.8 percentage points, the effect on affordability was even more dramatic. When conventional rates were 17 percent, it took nearly $35,000 in income to buy a $60,000 home. Mortgage revenue bonds allowed a family with about $28,000 to buy that same home.

CONCLUSION

The NATIONAL ASSOCIATION OF REALTORS® believes that in the long run, residential mortgage financing should be provided by the private sector of the economy. However, even though interest rates have recently declined somewhat, we see economic evidence to indicate that rates may again ascend beginning in 1985. In order to meet housing credit demands during this period of rising interest rates we strongly urge that Congress enact S. 137 and allow the existing mortgage revenue bond program to continue.

Senator ROTH. Thank you.

The first question I would like to ask is that under present market conditions—hopefully we are beginning to move out of a recession, and market conditions are better—can it be argued that we do not need the program today as we did in the past?

Everybody can have a crack at it. I will ask everyone please to try to be brief.

Dr. Follain.

Mr. FOLLAIN. To the extent that the bill was addressed at the affordability problem as it was in the late 1970's and early 1980's, the need for the bill is much less.

Senator ROTH. We do not need it, according to you.

How about Mr. Johnson?

Mr. JOHNSON. I think Mr. Arbib said it rather well. I think that as interest rates move down, MRB's simply allow us to reach further down in the income spectrum of society among persons who are renters now who when interest rates are higher we could not even reach with MRB financing. But as interest rates fall, we can take a larger number and a larger proportion of renters out of that category and put them into home ownership. I think it is needed.

Mr. ARBIB. I have made my statement.

Mr. SCHOEPF. I have to agree with the comments of the gentleman who just finished. There is always somebody in this country that needs this program in order to be able to buy their first home especially during times of rising interest rates. And during times of high-interest rates the very low income people, that would also like to be homeowners in this country, are those reaping the benefits of this program.

Thank you.

Senator ROTH. Well, you hit the nail on the head. One of my concerns and one of the purposes of this program has been to help those first purchasers. I am not sure how your testimony, Dr. Follain, how would you help the first purchaser?

Personally, from my own observation, I think the young, in particular, who are out to buy a new home are having tremendous difficulties buying a home. But if I understand your testimony, you do not really feel that is true.

Mr. FOLLAIN. Well, the point of view I am expressing from is that we are in a world where we have sizable subsidies already, and we are talking about increasing the subsidy. If there was a discussion of the possibility of rearranging the current subsidy and maybe putting lids on interest deductibility or something like that, lids on the amount of interest one can deduct from income, then I would be more supportive. It would be redistributing the subsidy that we already have.

What we are talking about though, is increasing the subsidy. We made some estimates of the efficiency of the current subsidy. We developed a model and asked the question: How much is a household willing to pay for an additional unit of housing given current subsidies to housing? It is very difficult to come up with good numbers there, but our estimate suggests that numbers like 50 to 60 cents on the dollar are correct. We have so subsidized homeownership that the willingness to pay for housing is much less than it costs society. This opinion is that of an economist coming at it from a very economic point of view.

Senator ROTH. And, of course, you are talking about mortgage interest and all the various help?

Mr. FOLLAIN. Yes.

Senator ROTH. I can only speak for one Senator, but frankly, as far as I am concerned, part of the great American dream is homeownership. I think that, and having good schools for your children, are very important goals, and I am very much concerned.

I will be candid. There are a lot of people who today believe we should not encourage homeownership, that it does not meet the needs of today, and we as a country cannot afford it. I disagree sharply. I think that we have to try to make housing available as in the past, and one of the things that bothers me is that the exploding costs that resulted from inflation have made housing unreachable for many of our people.

I have one last question, and then I will ask Senator Mitchell. Are there any other programs that would do a better job in this area? You have sat here, gentlemen, during the testimony of some of the others. Are there other, better approaches that provide greater flexibility?

Mr. SCHOEPF. Not to our knowledge at this time, sir. The National Association of Realtors is always willing to look at alternative programs. We have not seen one alternative suggestion come forth that we feel is as beneficial and as targeted as this current mortgage revenue bond program.

Mr. ARBIB. Let me just say that I agree with that. During this last year when we confronted wildly fluctuating rates, I think the housing finance agencies did some very ingenious things to make these programs work. For example, the growing equity mortgage [GEM] was created largely in response to high-interest rates. In the milieu of the high-interest rates housing finance agencies were able to sell bonds at a rate that enabled us to produce affordable mortgages.

On other occasions we used zero coupon bonds, which was also something that was untried; but it enabled us again to sell a bond issue that, in turn, produced mortgage money. Given the current targeting restrictions and mortgage requirement, some ingenuity on the part of the housing agencies is necessary to sell bonds to provide mortgage money.

Mortgage revenue bonds are a very efficient mechanism for producing mortgages for low- and moderate-income people.

Mr. JOHNSON. Local government agencies I am sure would agree. We know of no mechanism which is as cost effective as mortgage revenue bonds and still maintains the important flexibility for States and localities to design their own programs tailored to their own needs with their own median incomes in mind and their own average sales prices in mind.

I could read you a whole litany of programs which HUD attempted in the 1960's and 1970's—221(d)(3), HOPLIFT, 312 and so on. All those programs are effectively gone today, and so they are not an alternative. The alternatives that the GAO report suggests and compares I think you will find when you look at the response which will be submitted to the GAO report, that depending upon the assumptions used, as was so adequately pointed out in discussions earlier this morning, the relative costs of mortgage revenue bonds in comparison to those other alternatives are a function of the assumptions. And if you change the assumptions slightly to adjust for what we think are more realistic bases, you will find that it can be plausibly pointed out that mortgage revenue bonds are the cheapest of the alternatives proposed by GAO.

Senator ROTH. I would also point out we have not had the scandals attached to this program that we did in some of the past programs, which I think is a very important factor.

Senator Mitchell.

Senator MITCHELL. Mr. Johnson, is what you are saying that the alternatives—that is, the direct mortgage subsidy or the tax credit—would not be more cost efficient as alleged by the GAO, and would also not permit the local flexibility which the mortgage revenue bond program permits?

Mr. JOHNSON. That is correct. It is a function of the assumptions used. And in our response to the GAO report, the CSHA response, which ALHFA endorses, I think those arguments will be demonstrated.

Senator MITCHELL. So your argument is that since there is no relative cost-benefit the other way, you might as well use a proven program that does permit the maximum flexibility and adaptability to local circumstances, which everyone agrees vary widely across the country?

Mr. JOHNSON. Yes, that is true. If I could add one thing, Senator Mitchell, I think that local housing finance agencies and cities and counties have adjusted during the past few years to the withdrawal of the Federal role in housing rather well, and mortgage revenue bonds represent one tool and instrument which we have used to do that—not the only one but an important one. And I think we have learned to adjust rather well to the environment of no direct Federal appropriations for housing programs.

But we think we need the tools to continue that job, and we think the tools need to be local resources which we design and which are not dependent upon Federal appropriations.

Senator MITCHELL. I would like to ask each of you to comment briefly, because we have another panel, and it is running late, on the two suggestions made by Dr. Rivlin as to what Congress could do if the use of bonds is continued.

First, she said the Congress could target the subsidy more narrowly on low- and moderate-income households by placing Federal income limits on home buyers. Do you favor or oppose that, and briefly, why?

And second, the same questions on posing the possibility of limiting the subsidy to home buyers who forego the deduction of mortgage interest taxable income.

Why do we not start with the representative of the realtors?

Mr. SCHOEPF. On the limiting of this subsidy to those people that would forego the deductibility of mortgage interest, I think we then eliminate a group of people that may in the beginning be in the position where mortgage deductibility is not useful and that through years of work become more affluent and grow into a little higher tax bracket where they may want to move over. Clearly, the mortgage revenue bond progran and deductibility, of mortgage interest serve different income populations.

I think that one of the things that is the beauty of mortgage revenue bonds is the way it is set up, and its availability to be used by the different States as they see fit. The requirements, the incomes, the type of housing and the cost of housing varies in each of the 50 States.

Senator MITCHELL. So you are opposed to that limit?

Mr. SCHOEPF. I am opposed to that limit, yes.

Senator MITCHELL. What about the targeting of the subsidy more narrowly by placing Federal income limits on home buyers?

Mr. SCHOEPF. The National Association of Realtors is also opposed to that due to the fact that We think it is difficult to target for a dynamic situation that exists differently in each of the 50 States. What may be good in Kentucky where I live may be disastrous in New York or California, and I think it would be difficult to impose income limits on a Federal level.

Senator MITCHELL. Well, of course, you already have Federal limits on purchases which relate to the median income in the area. Could you not do the same thing with respect to home buyer income?

Mr. SCHOEPF. It creates more of a difficulty, I believe, to put this forward on a State basis.

Senator MITCHELL. Mr. Arbib, would you comment on those two?

Mr. ARBIB. Yes; I agree with Mr. Schoepf's comments in regard to limiting, the subsidy to certain homebuyers, because I think if a revenue bond beneficiary does forego the tax deductibility but subsequently his/her tax bracket increases, his choice might prove to be a hardship in the future. This, by the way, is not anything that has been discussed by NAHB, and we do not have a policy on it.

As far as additional targeting by income restrictions, most of the States and local authorities already have income limitations. I know the Federal Housing Finance Agency does, because our constitution requires that we cannot assist households beyond the low-, moderate-, or middle-income level. All of our local authorities likewise have defined income levels.

And I do not think the Federal Government needs to impose income limits, because they are already limited by the current purchase price restrictions. And the very fact that the 1982 median sales price of mortgage revenue bond financed houses was 40 percent less than conventionally financed houses indicates that we are doing the job under the current limitations.

Senator MITCHELL. But, Mr. Arbib, what about the argument that you who voluntarily impose income limits thereby suffer disproportionately in those areas or localities which do not impose such limits thereby obtain a greater portion of whatever funds are available?

Mr. ARBIB. Well, the total amount of funds available, as you know, is 9 percent of the total mortgage activity averaged over the last 3 years; so there is only a limited amount of funds, and then 50 percent of that is basically allocated to the local housing authorities, and 50 percent to the State authorities.

And I think that, by and large, the agencies at all levels have been able to utilize their moneys as efficiently as is possible.

Just one more comment. Some of the local authorities which did limit incomes rather severely, found they had difficulty in putting the mortgage money out because area purchase prices were too high to reach the intended beneficiaries of the program.

Senator MITCHELL. Mr. Johnson.

Mr. JOHNSON. I would endorse what was said on the question of the choice between the deductibility and the MRB subsidy. I would offer two observations on the question of limits.

One is that the GAO report seems to contend, for example, that purchase, Federal purchase price limits have not had the effect of targeting these funds to persons of low- and moderate-income groups. And as we discussed this morning, I do not think we necessarily agree that that is at all true.

Also, I think that if you were to impose income limits in addition to the purchase price limits, it would assume that someone who was an affluent buyer, wishes to buy a low-cost house. GAO's own statistics show a $48,800 average MRB buyer's purchase price for the unit. I do not think that that is the kind of unit in most of our localities that affluent people are interested in buying. And so that is a fact of the marketplace that needs to be contended with.

Also, as a matter of fact, most States and localities do have income limits in place already.

Senator MITCHELL. In other words, you agree with the observation by Dr. Rivlin earlier in her statement that indirectly the purchase price limitation has the effect of serving as an income limitation?

Mr. JOHNSON. I think indeed it does in the marketplace. The other observation I would have—and again, it is an issue of local flexibility—has to do with what I hope would be other good and valid objectives and goals for the use of MRB's having to do, for example, with revitalization of our older urban centers.

In Pittsburgh, for example, where my colleague Paul Brophy runs the Urban Redevelopment Agency, they do have a small program using MRB's which has no income limits. But I think it is important to understand that that particular small program serves an area which has virtually uninhabitable homes, a situation like some of the situations in many of our urban areas which have been deserted.

And I think a strategy which is designed to encourage reinvestment by homeowners in such an area to preserve the vitality of our central cities needs to be considered a valid objective. And a pure Federal income limit would not allow that kind of local flexibility.

Senator MITCHELL. Dr. Follain.

Mr. FOLLAIN. There are really two problems with the subsidy to homeownership. One is the efficiency one I mentioned before. The other is the inequity of the subsidy. Higher tax bracket people benefit much more. So the extent that both of these result in a redistribution of the subsidy toward people taking the standard deduction, I think they are very good ideas. And I suspect you could hit both groups equally well just by adjusting the income limits on the first idea you suggested.

So on equity grounds, yes, both are good ideas.

Senator MITCHELL. Thank you very much, gentlemen.

Senator ROTH. Thank you very much again, gentlemen, for your contribution.

At this time we call the final panel forward, which includes James Heltzer, who will be accompanied by Jay Jenson. Mr. Heltzer is the executive director of the Minneapolis Community Development Agency.

I am particularly pleased to call forward Robert S. Moyer, who is director of the Delaware State Housing Authority; Greg Smith, the administrator for Oregon Housing Division; and Sharon Lunner, director of the Maine State Housing Authority. Then we also have Arthur White, chairman of the Connecticut Housing Finance Authority, and Barbara Feldman, deputy director, State of New York Mortgage Agency.

I want to welcome you here, Mr. Moyer. One of my reasons for the enthusiasm in this program is that this gentleman, as chairman of the Delaware State Housing Authority, has been responsible for more than 3,500 low- and moderate-income Delaware families obtaining housing through this program; and I think this is an accomplishment that has made me particularly enthusiastic about the program.

But, gentlemen, we are very happy to welcome you. Maybe you would like to welcome——

Senator MITCHELL. I would. Thank you very much, Mr. Chairman.

It does give me great pleasure to welcome Ms. Lunner here. She has done an outstanding job as director of the Maine State Housing Authority. She has been a good friend of mine for many years. And I just wanted to say that in addition to all her other qualities, her middle name is Mitchell.

[Laughter.]

Senator MITCHELL. So we welcome Ms. Lunner and all of the rest of you here, and we look forward to your testimony.

Senator ROTH. Ladies and gentlemen, before we get into your testimony, I do have some material that Senator Danforth would like to be incorporated as part of the record, and we will do so with no objection.

[Answers to questions not available at press time.]

Senator ROTH. I would again urge that each one of you summarize, if you can, your testimony. The hour is late, unfortunately. But we will include your full statement in the record as if read. Who wants to start off?

STATEMENT OF ROBERT S. MOYER, DIRECTOR, DELAWARE STATE HOUSING AUTHORITY, ON BEHALF OF THE COUNCIL OF STATE HOUSING AGENCIES, WASHINGTON, D.C.

Mr. MOYER. Mr. Chairman and members of the subcommittee, my name is Robert S. Moyer, and I am the director of the Delaware State Housing Authority. I speak to you today as a representative of the Council of State Housing Agencies.

The council represents the State housing agencies in 49 States, in the District of Columbia and the Commonwealth of Puerto Rico.

I would like to take this opportunity both for myself and the Council of State Housing Agencies to thank Senator Roth for his continued interest and support for State housing finance agencies. We very much appreciate the action that he and Senator Mitchell have taken in introducing S. 137, which calls for the continued use of tax-exempt financing for these programs.

We would also want here today to express our appreciation for the chairman, Chairman Packwood, for taking such prompt action on the bill by holding this hearing today.

Now, in addition to my testimony being presented in the record, I would like to request that the Council of State Housing Agencies response to the GAO report on mortgage revenue bonds be presented in the record also.

Senator ROTH. Without objection.

[The material follows:]

COUNCIL OF STATE HOUSING AGENCIES

May 12, 1983

COUNCIL OF STATE HOUSING AGENCIES
RESPONSE TO THE GENERAL ACCOUNTING OFFICE
STUDY "THE COSTS AND BENEFITS OF MORTGAGE
REVENUE BONDS: PRELIMINARY REPORT"

Thomas W. White, Executive Vice President

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Executive Summary
Council of State Housing Agencies
Response to the GAO Study
"The Cost and Benefits of Single-Family Mortgage Bonds:
Preliminary Report"

This analysis was prompted by the GAO report REED-145, April 28, 1983 entitled The Costs and Benefits of Single-Family Mortgages: Preliminary Report. This report was requested by the Chairman of the Senate Finance Committee in order to receive the preliminary findings of a study of mortgage bonds that had been self-initiated by GAO. Although we believe the objective of the study—to review the mortgage bond program in advance of the "sunset" hearings—was potentially useful, The report itself is often inaccurate, misleading and based on incomplete data. To supply a more reasoned, accurate and useful report on the issues associated with the "sunset", this report responds to GAO on an issue by issue basis.

GAO APPROACH

We have two general comments on the GAO's approach to the issues and their presentation:

- GAO chose to limit its investigation to bonds issued from December 1981 through July 1982, a period of record high interest rates. This unrepresentative period distorts the analysis for budget purposes and provides a misleading picture of program beneficiaries. Despite this flaw in its approach, GAO does not attempt to balance its work with a perspective from past years, nor is the role played by State housing agencies in providing capital in 1982 to a severely depressed housing industry put into context.

- GAO presents conclusions which are unsupported by the data. For example, GAO's Figure 1, which compares MRB and FHA homebuyer incomes—however obscurely—is stated to show that incomes in these groups are essentially similar. In fact, the FHA homebuyer has a median income of $10,000 above the State agency buyer and the comparison shows that MRBs have a far greater share of borrowers in the lower income levels.

NOTE ON FUTURE BUDGET PROJECTIONS

The issue of future tax expenditures for post sunset years must be clarified. GAO uses 1982 interest rate assumptions for its cost analyses. Because the estimates of the cost of bond programs are based on overall interest rates, 1982's high rates dramatically—and improperly—inflate the revenue impact of tax-exempt financing, regardless of the methodology used.

In attempting to project tax expenditures for future years, the Joint Committee on Taxation uses reasonable estimates of interest rates for those years. The following chart, based on economic assumptions used by the Joint Committee in projecting revenue losses shows estimates of the cost of tax-exempt financing programs in a more normal year. We believe this to be a more accurate portrayal of the range of costs under all methods, both on a gross and per unit basis.

MORTGAGE REVENUE BONDS:
PROJECTED COSTS[1]
1984

Estimating Method	Revenue Loss Per $1 Billion in MRBs	Cost Per Mortgage Per Year	Total Subsidy Cost Per Mortgage
GAO	$31.5 mil.	$1,568	$8,681
Joint Tax	$22.7 mil.	$1,057	$6,255
Kormendi/Nagle	$7.5 mil.	$349	$2,065

1/ The methodology and sources for the various tables contained in this Executive Summary are set forth in the body of this response.

I. COST/BENEFIT ANALYSIS

1. Cost of Tax-Exempt Financing

Beyond its misleading use of 1982 data, GAO overstates the costs of tax-exempt financing:

- The report estimates the cost of mortgage bond programs based on the traditional method used by the Joint Committee on Taxation. However, it fails to include, as does the Joint Committee, increased revenue resulting from lower tax deductions taken by homebuyers using this financing.
- GAO assumes only 87 percent of the funds raised by bonds will be used for mortgages. Since the 1980 Mortgage Subsidy Bond Tax Act, a 13 percent set-aside tends to be the maximum, with 7% the average.
- Most importantly, GAO fails to acknowledge alternative—and more realistic—explanations of how tax-exempt issues affect federal revenues, such as a University of Chicago (Kormendi/Nagle) model which bases its estimates of revenue loss on actual investor behavior patterns and produces cost estimates substantially below those GAO uses.

The following table summarizes alternatives to the GAO revenue loss estimates, based on 1982 interest rates:

REVENUE LOSS ESTIMATES
(1982 Base)

Method	Cost per $43,000 Mortgage	Cost Per $1 Billion of Bonds
GAO	$13,300	45 million
GAO (7% set-aside and Joint Committee offset)	$10,155	36.9 million

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Kormendi/Nagle	$5,699	19.3 million
Kormendi/Nagle (7% set-aside and offset)	$3,231	11.7 million

Thus, the GAO estimate exceeds other, more plausible estimates of the cost of tax-exempt financing by anywhere from 30 to 400 percent.

2. Benefits to Home Purchasers

As GAO overstates the cost of revenue bond financing, so does it understate the benefit to home purchasers. It does so by understating the conventional mortgage rates and overstating the tax exempt mortgage rates that existed in 1982.

The following table illustrates the costs and benefits of tax-exempt financing using more realistic assumptions:

COSTS AND BENEFITS OF TAX-EXEMPT FINANCING
(1982 Base)

Method	Cost/Unit	Savings to Purchaser
GAO	$13,300	$8,533
GAO (7% set-aside and offset)	$10,155	$8,533
Kormendi/Nagle	$5,699	$8,533
Kormendi/Nagle (7% set-aside and offset)	$3,231	$8,533

3. Cost of Alternative Programs - 1982

GAO compares bond programs with the cost of theoretical alternative homeownership subsidy programs. As with the estimates of the cost of MRBs, more realistic interest rate assumptions greatly change the projected cost of these alternatives:

ALTERNATIVE COST ESTIMATES
(1982 Base)

Program	Subsidy Per Mortgage: GAO Assumptions	Subsidy Per Mortgage: Alternative Assumptions
Mortgage Revenue Bonds	$13,300	$5,699
Taxable Bonds	$10,400	$8,835
Mortgage Grants	$3,400	$8,680
Tax Credits	$3,500	$9,112

4. Credit Market Effect of MRBs

GAO states that MRBs drive up the cost of other municipal bond issues. To support this claim, GAO uses figures that overstate the percentage of the market that MRBs held in 1982, which was about 10 percent, not 14 percent, of total issues, and less than 3 percent of total outstanding tax-exempt bonds. Moreover, the volume of MRB issues is capped, so that arguments based upon an expectation of unrestrained growth are no longer relevant.

The volume of tax-exempt bond issues is only one of many factors that affect municipal rates, as the market's 1978 - 1982 experience demonstrated. Other factors include the reduction in federal income taxes, the withdrawal of financial institutions from the market because of profitability problems, and competition from other credit users, including the federal government.

5. Policy Considerations

The GAO report focuses on monetary costs and benefits of tax exempt financing. In doing so, it neglects other benefits and advantages which cannot be so easily quantified:

- Local and state agencies can tailor programs to local needs.
- Mortgage bond programs provide a source of mortgage funds to rural and urban areas which are traditionally capital short. They also have been particularly helpful as a tool of urban revitalization and neighborhood improvement.
- Special programs such as home improvement loans are ignored by GAO.
- There is no mention of the importance of these State and local programs in the face of reduced Federal support for housing and for housing program administration.
- GAO ignores the role Congress and the Administration designated for MRBs in 1982 as a countercyclical support for the housing industry.

II. BENEFICIARIES OF REVENUE BOND PROGRAMS

The picture of mortgage bond beneficiaries presented by GAO is distorted, and its conclusions are unsupported by the data it presents or chooses not to present.

1. Use of 1982 Data Misleads

The use of 1982 data is misleading because of high interest rates. Agencies had to go beyond the predominantly lower income homebuyers than they had served in the past in order to keep programs running at a time when the housing market needed support. The following table puts the 1982 experience into historical perspective.

MRB HOMEBUYER INCOMES:
HISTORICAL PERSPECTIVE

Year	1978	1979	1980	1981	1982
MRB Borrower Median Income (State agencies)	14,725	15,441	17,794	18,068	23,243
National Median Income	17,640	19,587	21,023	22,388	24,200
MRB Borrower as % of National Median	83%	79%	85%	81%	96%

2. Even in 1982, the MRB Program Served the Lowest Segment of the Home Purchase Market

According to GAO, the incomes of the MRB homebuyers "were similar to those of buyers" under the FHA unsubsidized mortgage programs. The actual picture is quite different:

MRB AND FHA HOMEBUYER MEDIAN INCOMES: 1982

FHA 1982 Median Income	$33,166
MRB 1982 Median Income (state agencies)	$23,243
% Difference	43%

What is true for medians is equally true across the board. Fully 50 percent of revenue bond program homebuyers in 1982 had incomes of less than $25,000 compared with only 23 percent of FHA buyers. Only 15 percent of MRB buyers had incomes over $35,000, compared to 41 percent of FHA buyers.

GAO states the "typical mortgage revenue bond homebuyer in 1982" had an income "between $20,000 and $40,000." In fact, the typical buyer had income of less than $25,000 and, as GAO's own data indicates, 72 percent were below $30,000.

GAO states the program serves the "more affluent half of the families in their states." What this means is that during a period of unprecedented high interest rates, nearly half the MRB buyers had incomes below the median income. In fact 23 percent had incomes at or below the eligibility level for the Section 8 "deep subsidy" program.

3. Revenue Bond Program Beneficiaries Could Not Have Purchased Homes Without This Assistance

GAO asserts that "three quarters of buyers had incomes above $20,000" and would have bought in the absence of revenue bond assistance. No data is given to support this conclusion and if it were accurate, the housing industry would not have been paralyzed in 1982.

At the interest rates prevailing for most of the year, it would have taken an income of $38,000 to buy a median priced existing home ($67,800). Fewer than 10 percent of MRB buyers had incomes at this level. Even at 75 percent of the median priced existing home, fewer than 50 percent of MRB buyers had incomes sufficient to support a mortgage. Thus, the data supports the conclusion dictated by common sense and experience: the moderate income homebuyer served by MRBs would otherwise have been priced out of the market.

4. Further Income Restraints and Purchase Price Limits Are Unnecessary

The experience of 1982 shows clearly that flexibility at the state and local level was essential to the value of mortgage bond programs. Arbitrary income limits would have precluded a countercylical role for MRBs. Thus, experience validated the judgment of Congress in rejecting such limits.

GAO also contends that the purchase price ceiling does not limit, indeed, actually "encourages" participation of "upper income people." This ignores the actual results seen in 1982. GAO in its own sample found the average purchase price to be

$48,800—hardly luxury housing. Revenue bond programs helped finance modestly priced housing in 1982, just as they have over the past several years. It simply took more income in 1982 for homebuyers to be able to afford modestly priced housing.

MRB MEDIAN HOME SALES PRICES VS. NATIONAL MEDIAN

	1978	1979	1980	1981	1982
MRB Median Sales Price	$35,866	$37,515	$42,438	$43,233	$43,791
National Median Sales Price	$55,700	$62,900	$64,600	$68,900	$69,300
MRB Median as % of National	64%	59%	66%	63%	63%

5. Federal Policies and State Agency Practices Effectively Target Revenue Bond Benefits.

As GAO acknowledges, Congress intended revenue bonds to serve those households that could not afford to purchase homes without assistance. Despite record high interest rates and the worst housing depression since World War II, State and local bond programs served precisely this function in 1982. As economic conditions continue to improve, their ability to aid the lowest end of the spectrum of first-time homebuyers will grow and their record of achievement should improve even further.

PART I
COST/BENEFIT ANALYSIS

The GAO report attempts to assess the cost effectiveness of mortgage revenue bonds by estimating their cost to the government in terms of lost tax revenues. It then compares that loss, first, with estimates of the financial benefit provided to borrowers and, second, with projected costs of several hypothetical alternative means of providing comparable levels of assistance to first-time homebuyers.

As the following will demonstrate, GAO (1) used an inappropriate methodology to compute the costs of tax-exempt bonds and (2) chose a number of assumptions that were inaccurate, internally inconsistent or otherwise invalid in making its estimates of the benefits of revenue bond programs and the costs of its suggested alternatives. As a result of these faulty assumptions and calucations, the cost/benefit analysis presented in the GAO report cannot withstand serious scrutiny and should not be used by the Congress as a basis for decision making.

It must be emphasized from the outset that this discussion of the cost of homeownership subsidy programs is based on the extreme high interest rates of 1982. Under more normal economic conditions, even the most exaggerated estimates of the cost of tax-exempt financing programs fall dramatically, as shown in section 4 below.

1. Costs of Tax-Exempt Financing

GAO bases its cost estimates on the traditional tax expenditure methodology used by the Department of the Treasury and the Joint Committee on Taxation. This method of estimating Federal revenue losses assumes that an issue of tax exempt bonds "replaces" an equal volume of fully taxable instruments. The taxes lost are computed as those which otherwise would have been collected on the taxable securities.

GAO assumes a taxable security rate of approximately 15 percent* and a marginal tax bracket for security purchasers of 30 percent. Finally, GAO assumes that "only 87 percent of funds raised will be available to lend for home mortgages," thereby requiring $49,770 to be raised for each average mortgage of $43,300. Using these assumptions and methodology, GAO estimates a total revenue loss for the average tax-exempt mortgage in 1982 to be $13,300.

*Although the taxable instrument rate is not stated in the report, we derive 15 percent from GAO's calculations.

The GAO methodology and assumptions grossly overstate the actual costs of tax-exempt financing for first-time homebuyers. First, the GAO approach, while based on the method used by the Joint Committee on Taxation, varies from it in a critical respect: it fails to include the increased tax revenues that result from lower mortgage interest deductions taken by homebuyers using this financing. Thus, while GAO computes the revenue loss for its hypothetical 1982 mortgage as $13,300, the Joint Committee on Taxation would compute a revenue loss in the same year, for the same size mortgage, as approximately $11,013.*.

A second flaw in GAO's analysis is its assumption that no more than 87 percent of the funds raised will be used for mortgages. In fact, many issuers now use well over 90 percent of bond proceeds for home mortgages. Consequently, if GAO had assumed that 93 percent of bond proceeds went to homebuyers, costs under the GAO approach would drop to $12,397. By the Joint Committee method, costs would drop further to $10,155.

Implicit in GAO's estimates of the revenue cost of mortgage bonds is the use of the 30 percent tax bracket from which to calculate tax loss. Some may argue that this is too low, given the fact that those tax-exempt securities are largely purchased by high income investors. However, the goal is to estimate the taxes that these investors otherwise would have paid. Given the availability of alternative tax sheltered investments and the presence of financial institutions in the market, it seems that 30 percent may well be overstating the potential revenue collection.

Most importantly, the proper method of estimating revenue losses associated with tax-exempt financing is a matter of substantial disagreement among analysts. University of Chicago professors Roger Kormendi and Thomas Nagle, for example, argue that the traditional Treasury/Joint Committee approach is based upon an unrealistic view of investor behavior. Kormendi and Nagle offer their own estimates, based upon actual holding patterns revealed in Federal Reserve Borad data, which yield revenue loss estimates significantly below those which result from the Treasury/Joint Committee method.

By the Kormendi/Nagle method, assuming GAO's estimate of a 15 percent taxable bond rate and a 13 percent set-aside of bond proceeds, the total revenue loss from 1982's average mortgage would amount to $5,699. Correcting GAO's assumptions further to incorporate only a 7 percent set-aside (93 percent of funds loaned) and to take account of the Joint Committee offset for reduced homeowner interest deductions, the revenue loss per average mortgage is reduced further to $3,231.

*Calculations for this and all subsequent estimates using alternative methodologies or assumptions are shown in the Appendix.

The following table summarizes the more accurate alternatives to the GAO revenue loss estimates:

REVENUE LOSS ESTIMATES
(1982 base)

Methodology	Cost per Mortgage of $43,300	Revenue Loss per $1 Billion of Mortgage Bonds
GAO	$13,300	$45 million
GAO, with offset (7% set-aside)	$10,155	$36.8 million
Kormendi/Nagle (7% set-aside; no offset)	$5,699	$19.35 million
Kormendi/Nagle (7% set-aside; with offset)	$3,231	$11.7 million

Thus, the GAO overstates revenue losses per mortgage by anywhere from 30 percent to 400 percent.

GAO further exaggerates the cost of tax-exempt financing by including the gratuitous assertion that the "actual cost per targeted household" could be four times the cost estimated in the report. This statement is based on GAO's assumption that since three out of four purchasers under revenue bond programs in 1982 had incomes above $20,000, they could have purchased homes without assistance. As is explored in detail later on, this assertion defies both common sense and actual experience in 1982 and is simply unworthy of serious consideration.

2. Benefits to Home Purchasers

As GAO overstates the costs of revenue bond financing, so does it understate the benefit to home purchasers. GAO's estimate of benefits is based upon the assumption that tax-exempt financing provided homebuyers "with an average interest rate reduction of about two percentage points" in 1982. Based on the assumed 13.75 percent tax-exempt mortgage rate, we believe that GAO would compute the average benefit to a home purchaser as $4,904.

The GAO assumptions are directly contrary to experience and consequently understate the benefit to homebuyers. While GAO assumes a tax-exempt mortgage rate of 13.75 percent, state housing finance agencies actually provided mortgage funds at an average rate of 12.32 percent in 1982. Using this figure and taking into account discount points, we can estimate that the average tax-exempt mortgage cost a homebuyer 12.5% in 1982.

This tax-exempt mortgage rate should be contrasted with a market mortgage rate of approximately 16 percent. The 16 percent figure can be reached in a variety of ways.

These include:

- The substantial majority of FHA mortgages were made at rates ranging from 15 percent to 16.5 percent. Assuming 4 to 6 points on the mortgage, an average interest cost of 16 percent seems appropriate.

- GAO's own estimate of a mortgage rate under taxable bonds is 16.18 percent.

- While rates fluctuated widely, fixed-rate, 30-year conventional mortgages tended to cost between 15 and 17 percent for most of the year. The 16 percent estimate seems conservative for the first three quarters of 1982.

Based on a spread of 3.5 percent between taxable and tax-exempt rates, the benefit the homebuyer of GAO's average mortgage in 1982 would be computed as $8,533.

Rates reported by the Federal Home Loan Bank Board support the use of a 3.5 percentage point spread between mortgage bond and market rates. For 1982, the FHLBB shows an average effective interest rate of 16.7 percent for 90 percent, conventional mortgages (16.6 percent for 80 percent loans). A 3.5 percentage point spread would put tax-exempt rates at 13.2 percent.

The following table illustrates the costs and benefits of tax-exempt financing to purchasers using the rectified numbers discussed above:

COSTS AND BENEFITS OF TAX-EXEMPT FINANCING
(1982 base)

Method	Cost/Unit	Savings to Purchaser
GAO	$13,300	$8,533
GAO, with offset (7% set-aside)	$10,155	$8,533
Kormendi/Nagle	$5,699	$8,533
Kormendi/Nagle (7% set-aside, with offset)	$3,231	$8,533

3. Cost of Alternative Programs

GAO supplements its analysis of the costs and benefits of revenue bond programs with an exploration of possible alternative means of providing comparable benefits. Here, too, the GAO analysis suffers from a series of incorrect assumptions and inappropriate methodologies. Before considering these alternative approaches, therefore, it is necessary to review GAO's assumptions and make such corrections as are needed.

- As noted above, GAO assumes a rate on mortgages financed with tax-exempt bonds as 13.75 percent. This rate should be projected at 12.5 percent.

- GAO assumes that taxable mortgage funds for use in a Mortgage Grant or Tax Credit program could have been obtained at a rate of 15.18 percent although the report also assumes that MRB loans at 13.75 percent provided an average two percentage point subsidy from market rates). Implicit in this assumption is the expectation that such funds would be raised through federally insured mortgages and federally guaranteed securities. Yet, as noted above, effective interest rates on these mortgages were closer to 16 percent in 1982.

- GAO assumes that the mortgage interest rate on tax-exempt mortgage revenue bonds averaged 12.5 percent in 1982. But the weighted average of state housing finance agency single-family bond issues in 1982 was about 12 percent. (The spread between bond and mortgage rates was reduced by large state contributions).

- The GAO estimates include no projection of administrative costs for the alternative programs. This omission further prejudices the analysis against tax-exempt bond programs, since these programs pay their own administrative expenses. In the following estimates, therefore, a modest projection of the administrative costs of non-bond financed programs is included.

- Unchanged from GAO's assumptions are (a) an average mortgage amount of $43,300; (b) 30-year, fixed-rate loans; (c) the 12-year prepayment assumption; and (d) a 13 percent discount rate for present value computations.

a. Taxable bond option

GAO's first alternative proposes that taxable bonds be issued by the same agencies which would otherwise issue tax-exempt bonds. The federal government would then pay an interest reduction subsidy to the issuer "so that its borrowing costs (are) equivalent to those incurred with tax-exempt securities."* GAO estimates the cost of such a program at $10,400 per unit. This cost is derived, according to GAO, by multiplying the bond principal amount by the difference between taxable and tax-exempt interest rates for each of the 12 years in which mortgages are outstanding.**

Using the corrected assumptions set forth above, we have computed the cost of the taxable bond option at $8,835 per unit. Note that this estimate assumes that 87 percent of the bond proceeds will be loaned for mortgages. If the 93 percent assumption is used, the proper subsidy cost would be $8,267 per unit.

b. Mortgage grant option

Under GAO's second option, the federal government would pay an up-front cash discount to mortgage lenders to provide the desired reduction in homebuyers' mortgage interest rates. GAO projects the cost of this cash grant at $3,400 per average unit, based upon the amount needed to reduce the payments on a 15.18 percent loan to the level required at a 13.75 percent interest rate. If these assumptions are corrected as explained above, the cost of the mortgage grant program rises to $8,533 per unit,

*Such a program is authorized by Section 802(c)(2) of the Housing and Community Development Act of 1974.

**We have not been able to duplicate the GAO calculation for this option, and believe there may have been an error in computation.

representing the capitalized value of reducing payments on a 16 percent mortgage to those on a 12.5 percent loan.

An estimate of administrative costs must be added to projections for the mortgage grant and tax credit programs. While any such estimate must necessarily be highly conjectural, we have attempted to provide one based upon HUD's staff costs in administering the Section 235 program. HUD estimates that 100,000 units of Section 235 housing require a total of 458 staff years of personnel time in the first year that a unit receives subsidy. It further estimates that those 100,000 units require 17 staff years annually in subsequent years. Considering only the first year costs, and assuming (as HUD does) a cost of $32,000 per staff year, first year administrative costs amount to $147 per Section 235 unit. If the Mortgage Grant option has the same administrtive costs as the Section 235 program, the total cost should be increased by $147 per unit to $8,680.

c. Tax credit option

GAO's last approach would use an annual tax credit to reduce the effective interest rate on the loan. Essentially similar to HUD's Section 235 program, this option would substitute a tax credit to the homebuyer for the "interest reduction payment" that would go to the lender under Section 235. GAO estimates the cost of this approach at $3,500 per unit, using the assumption of a taxable mortgage rate of 15.18 percent and a tax-exempt rate of 13.75 percent. As with the previous estimate, if we correct these assumptions on interest rates to 16 percent and 12.5 percent, the program cost amounts to $8,965. Adding an administrative cost of $147 per unit to the foregoing produces a total program cost for the Tax Credit option of at least $9,112.

The following table summarizes the comparative costs of tax-exempt bond financing and the various options posed by GAO:

ALTERNATIVE COST ESTIMATES
(1982 BASE)

Program	Subsidy per mortgage: GAO assumptions	Subsidy per mortgage: alternative assumptions
Mortgage revenue bonds	$13,300	$5,699
Taxable bonds	$10,400	$8,835
Mortgage grants	$ 3,400	$8,680
Tax credits	$ 3,500	$9,112

4. Effect of Changed Assumptions

As this report has demonstrated, estimates of the cost of alternative homeownership subsidy programs will vary greatly with the interest rate assumptions used. Estimates of the cost of mortgage revenue bond subsidies will depend greatly on the overall level of interest rates, while the three alternative will depend more on the differential between subsidized and unsubsidized rates. Consequently, limiting the analysis to one high interest rate year will necessarily bias the results against tax-exempt financing programs.

In calculating the cost of mortgage bond programs, GAO has assumed a taxable bond rate of 15 percent. But in a lower interest environment—say 13 percent—the estimated cost per subsidy for MRBs drops almost $2,000, to $11,486. At 10 percent, GAO's estimate falls to $8,835.

The cost of the proposed alternatives to tax-exempt financing depends on the spread between subsidized and unsubsidized mortgages. Taking GAO's least cost alternative as an example, we have shown that the mortgage grant program carries a per mortgage subsidy cost of $8,533 (not including administrative costs) when market rates are 16 percent and MRB loan rates are 12.5 percent. Narrowing that spread to 13.25 and 16 percent, the per unit subsidy falls to $6,733. With a larger spread- say 12.5 and 16.7— the subsidy increases to $10,272.

From this comparison of estimates across interest rate assumptions, it becomes clear that this kind of analysis will have dramatically different outcomes in different years. To illustrate, the table below compares cost estimates using GAO interest rate assumptions along with assumptions recently used by the Joint Committee on Taxation in projecting a cost for MRBs in 1984:

REVENUE LOSS ESTIMATES: 1982 vs. 1984

	Cost per mortgage: MRBs	Cost per mortgage: Mortgage Grants
GAO method - 1982 1/	$13,300	$3,500
Joint Committee method - 1982 1/	$11,013	n/a
GAO method - 1984 2/	$ 9,279	$8,042
Joint Committee method - 1984 2/	$ 6,686	n/a

1/ GAO interest rate assumptions, includes no offset.

2/ Based on interest rate assumptions used by Joint Committee on Taxation in recent revenue loss estimates for FY 84 - 88: for 1984, 10.5 percent taxable bond rate, 12 percent conventional mortgage rates and MRB mortgage rate of 70 percent of taxable bond rate plus 1.125 percent (8.475).

In short, had GAO undertaken its study in 1984, the results of its cost analysis would have looked considerably different.

5. Credit Market Effects

In addition to the dollar cost of a mortgage bond subsidy, GAO also claims that these financing programs impose a cost on the municipal bond market by driving up interest rates. They base this charge on the view that an increase in the volume of tax exempts will have a significant effect on interest rates relative to the taxable bond market.

Much of the concern about the credit market effects of MRBs stems from the rapid increase in the volume of these bonds experienced in the late 1970s. The proliferation of housing bonds gave rise to the fear that these issues would grow to overwhelm the market. But in fact, MRBs make up only a small portion of the total tax-exempt market. In 1982, MRBs totaled approximately $8 billion, which represents only about 10.5 percent of total long-term tax-exempt debt issued in that year—not 14 percent, as reported by GAO. The total was less than 2% of the total municipal bonds outstanding.

Furthermore, the Mortgage Subsidy Bond Tax Act of 1980 capped annual MRB activity on a state-by-state basis. As a result, total yearly volume cannot exceed approxiamtely $14 billion nationwide. Whatever the effect that volume has on tax-exempt interest rates, it must be remembered that housing bonds make up only a limited portion of that market.

As evidence of credit market effects, GAO cites a 1979 study by George Peterson and Brian Cooper of the Urban Institute, Tax Exempt Financing of Housing. The Peterson estimate rests on the assumption that increases in tax-exempt volume must be purchased by taxpayers in successively lower marginal tax brackets. Since the exemption is of less value to these taxpayers, tax-exempt rates must rise to attract the new bondholders, or so the argument goes.

University of Chicago professors Roger Kormendi and Thomas Nagle again provide an alternative view, based on a much broader perspective of capital markets. They reason that, because the bulk of new tax-exempt issues are purchased by high braacket investors, the increase in interest rates required to attract purchasers is much lower than that estimated by Mr. Peterson.

The evidence supports the claim that volume is not the controlling factor in determining tax-exempt interest rates relative to the taxable market. The table below shows how, from 1972 to 1982, the spread between tax-exempt and taxable interest rtes moved up and down relatively independent of changes in volume:

RATIO OF TAX-EXEMPT TO TAXABLE INTEREST RATES1/
(1972 - 1982)

	Long-Term Municipal Volume2/	AAA Municipal Bonds	AAA Corporate Bonds	Ratio Municipals to Corporates
1972	$23.7 b.	5.27%	7.21%	.731
1973	$23.8 b.	5.18%	7.44%	.696
1974	$23.6 b.	6.09%	8.57%	.711
1975	$30.7 b.	6.89%	8.83%	.780
1976	$35.4 b.	6.49%	8.43%	.770
1977	$46.7 b.	5.56%	8.02%	.693
1978	$48.2 b.	5.90%	8.73%	.676
1979	$43.3 b.	6.39%	9.63%	.663
1980	$48.4 b.	8.51%	11.94%	.713
1981	$47.7 b.	10.43%	14.17%	.736
1982	$77.3 b.	10.88%	13.79%	.789

1/ Source: Board of Governors Federal Reserve System
2/ Source: Public Securities Association

Volume is only one of many factors that affects interest rates. Equally as important are changes in the demand for tax-exempt securities, such as (1) the reduction in federal income tax rates in the 1981 tax act, which narrows the market for tax-exempts; (2) the withdrawal of financial institutions from the market because of profitability problems; and (3) competition from other demanders of credit—most notably the federal government.

These factors, which affect the demand for tax-exempt securities, appear to have had a greater impact on interest rates in recent years than has the volume of new issues. Thus, the implication that restricting the use of tax-exempt financing for housing—which is already limited in volume—will dramatically affect interest rates is an unfounded conclusion.

6. Policy Considerations

The General Accounting Office analysis focuses on the monetary costs and benefits of tax-exempt financing. In doing so it neglects to consider a range of benefits and advantages of this type of financing which cannot easily be quantified. Similarly it ignores, indeed refuses even to consider, the range of practical and policy objections that might be lodged against the various options that it poses.

A primary advantage of revenue bond financing is that it operates through independent, largely self-supporting state and local agencies which can develop and implement programs tailored to the particular needs of their areas. For example, the New Jersey Mortgage Finance Agency targets its homeownership program as a revitalization tool for the state's urban centers, while the Wyoming Community Development Authority uses its program to serve areas affected by energy-related development. In many states, outreach by the state agencies is the primary source of mortgage capital for areas underserved by private financial institutions, particularly rural areas.

Similarly, housing finance agency programs can be targeted to local development objectives and to specific groups with difficulty in meeting their housing needs. As the federal presence in the delivery and support of housing diminishes, it is all the more important for independent, self-supporting state and local agencies to be able to fill the gap.

The GAO report also excludes from consideration home improvement and rehabilitation loan programs run by tax-exempt bond issuing agencies. While these activities do not directly affect the cost/benefit analysis with regard to home purchase assistance, they re-emphasize the flexibility and responsiveness of housing finance agencies.

What is most ironic about the GAO analysis, is that it willfully ignores the role which the Congress expressly intended for tax-exempt home purchase finance programs in 1982 — to serve as countercyclical support for a devastated housing industry. By raising home purchase price limits and easing the first-time homebuyer requirement in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Congress relied explicitly upon the capacity of the housing finance agencies to bridge an unprecedented "affordability gap" with tax-exempt financing. Further, housing bond programs provided fixed-rate, level-payment mortgage financing at a time when such mortgages were extremely hard to find.

While state and local agencies successfully served the Congressionally-established objective of providing support to the housing industry in 1982, at the same time they maintained their focus on the moderate income, first-time homebuyer. GAO's own data on the beneficiaries of revenue bond programs in 1982 illustrates this point, as shown in Part II of this response.

PART II

BENEFICIARIES OF REVENUE BOND PROGRAMS

As with its work on cost effectiveness, GAO's analysis of the beneficiaries of revenue bond programs is both flawed and misleading. However, unlike the previous case, in which incorrect assumptions produced faulty data, GAO's conclusions with regard to homebuyers under tax-exempt programs are simply unsupported by the data which it presents or chooses not to present. Thus, GAO finds that "most subsidized home loans were not made to low and moderate income households in need of assistance, but rather to those who probably could have purchased homes without assistance." In fact, as the following analysis will demonstrate, state housing finance agencies did a remarkable job of targeting assistance to low and moderate income homebuyers who would have been priced out of the 1982 market without such help.

1. Use of 1982 Data Misleads

GAO draws its beneficiary data exclusively from 1982, a year in which tax-exempt interest rates averaged over 12 percent—a level which had not been reached even in the conventional or FHA market, prior to 1980. As a result of these high interest rates, state agencies had to reach beyond the predominantly lower income homebuyers they had served in the past. At the same time, the even higher rates in the conventional market greatly expanded the pool of borrowers in need of assistance.

In the face of these conditions, state agencies were forced to choose between serving higher income borrowers or shutting down operations. As public agencies, they chose to maintain the flow of affordable mortgage capital to homebuyers. They were encouraged to do so by both the Administration, which provided regulatory relief, and by the Congress in its TEFRA amendments to the Mortgage Subsidy Bond Tax Act of 1980.

The following table puts the 1982 experience into historical perspective. It compares the median income of borrowers under state agency programs with the national median. Note that in years prior to 1982, median borrower incomes did not exceed 85 percent of the national median. In 1982, however, borrower median incomes had to increase by nearly 30 percent and rise to 96 percent of the national median income simply in order to keep up with the unprecedented interest rates that prevailed. As interest rates return to more normal levels, state agencies will be able to shed their countercyclical role and focus once again on the lower income households which are their primary concern.

MRB HOMEBUYER INCOMES: HISTORICAL PERSPECTIVE

	Borrower Median Income(1)	National Median Income(2)	Borrower Median as % Of National Median Income
1978	$14,725	$17,640	83%
1979	$15,411	$19,587	79%
1980	$17,794	$21,023	85%
1981	$18,068	$11,388	81%
1982	$23,243	$24,200	96%

1/ Source: Council of State Housing Agencies membership survey; 24 states reporting.

2/ Source: Department of Housing and Urban Development (derived from Bureau of Census data).

2. Even in 1982, Revenue Bond Programs Served the Lowest Segment of the Home Purchase Market.

GAO states that the incomes of homebuyers under revenue bond programs "were similar to those of buyers" under the FHA unsubsidized mortgage insurance programs. The actual data for 1982, however, presents quite a different picutre.

According to HUD, the median family income of the FHA unsubsidized homebuyer in 1982 was $35,556 in new homes and $32,938 in existing homes, for a weighted average of $33,166. The median income of borrowers in state housing agency programs during the same year, based on a sample of 24 states, was $23,243. In other words, the median FHA homebuyer had an income some $10,000 or 43 percent higher than the median revenue bond homebuyer. GAO does not present its findings in this form.

What is true for the median incomes of bond program and FHA buyers, is equally true across the board. The following table, illustrates the distibution of mortgage revenue bond (MRB) program and FHA homebuyers by category.

COMPARISON OF MRB AND HFA HOMEBUYER INCOMES
(1982)

	MRB	FHA
less than $15,000	10%	2%
$15,000 - 25,000	40%	21%
$25,000 - 35,000 ($35,999 for FHA)	35%	36%
$35,000 - 40,000 (36,000 - 39,999 for FHA)	14%	11%
$40,000 - 44,999		11%
$45,000 - 54,999		19%
$55,000 - 75,000	1%	
over $75,000	3	
Number of Loans	20,471	27,158

Source: MRB homebuyer incomes from Table 5 of GAO report; FHA homebuyer incomes from annual report of FHA insurance programs for 1982.

The foregoing table illustrates that fully 50 percent of revenue bond program homebuyers — in 1982 — had incomes of $25,000 or less; only 23 percent of FHA buyers had incomes below this level. Further, only 15 percent of revenue bond program buyers had incomes over $35,000, compared to 41 percent of FHA buyers. Given the dramatic drop in interest rates during the last quarter of 1982, which enabled lower income buyers to enter the FHA program, the inclusion of loans made during this period in the FHA distribution tends to understate the difference in borrower incomes.*

Beyond the FHA/revenue bond home purchaser comparison, GAO simply misrepresents the data with regard to incomes of bond program participants. Thus, GAO states that "the typical mortgage revenue bond homebuyer in 1982" had an income "between $20,000 and $40,000." In fact, the "typical" revenue bond homebuyer had an income below $25,000 and, as GAO's own data indicates, 72 percent of these buyers had incomes below $30,000.

A similar distortion is contained in GAO's statement that "53 percent of the subsidized borrowers were among the more affluent half of the families in their States." What this statement means, of course, is that in a period of unprecedented high interest rates, nearly half the revenue bond program homebuyers had incomes below the area median income and, as GAO points out later, 64 percent of buyers had incomes below 115 percent of median. Finally, GAO's data indicates that 23 percent of homebuyers receiving bond financed loans had incomes at or below 80 percent of the state median income, the level of eligibility for Section 8 "deep subsidy" housing assistance.

In any year, the performance of state agencies as described by GAO would be most commendable for their success in reaching the lower segment of the homebuying public. Under the conditions which prevailed in 1982, this achievement is nothing short of remarkable.

3. Revenue Bond Program Beneficiaries Could Not Have Purchased Homes Without This Assistance.

GAO asserts that "three quarters of (bond program) buyers had incomes above $20,000 and could likely have purchased homes anyway," i.e. without revenue bond assistance. No data is offered in support of this novel proposition, and any reasonable analysis leads to quite a different conclusion.

The median sales price of existing homes in 1982 was $67,800 ($69,300 for new homes). At the interest rates of 15.5 percent or higher, which prevailed for most of

*Two additional, perhaps offsetting, factors may be considered with regard to the FHA/MRB comparison. First, a substantial number of FHA insured loans may have been made through revenue bond programs, most likely those loans at the lower end of the FHA distribution. GAO dismisses this fact with a brief statement but no data. On the other hand, GAO asserts that the presence of previous homeowners in the FHA sample, compared to the revenue bond program's first time homebuyers, may drive up incomes for the FHA buyers. It is equally plausible, however, that because previous homeowners have accumulated equity for larger down payments, they can purchase a particular house at a lower income level than a comparable first time homebuyer who can not make an equivalent down payment.

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1982, an income of more than $38,000 would be required to purchase such a house.* Fewer than 10 percent of revenue bond homebuyers had incomes at this level.

Of course, affordability problems would be eased for families willing to buy homes priced below the median. However, 1982's high interest rates made even modestly priced homes unaffordable to the kind of buyer served by the revenue bond programs. Thus, a home priced at $50,850—75 percent of the median sales price for existing homes in 1982—would require a homebuyer income of over $28,999 at an interest rate of 15.5%** Far fewer than 50 percent of revenue bond program homebuyers had incomes at this level.

"How much home" could the average revenue bond program homebuyer have afforded in 1982 without a bond financed mortgage? At a 15.5 percent interest rate, a household with an income of $23,243 could afford a home costing $41,200. According to the National Association of Realtors data for June 1982, only 15% of homes sold nationwide cost $40,000 or less. In the West, only 3.4 percent of homes sold in this range and in the South, the most active home building section of the country, only 13.3 percent of homes would have been affordable to the typical revenue bond homebuyer if he or she had been unable to obtain tax-exempt financing. The following table explores the relationship among affordability, revenue bond program beneficiaries, incomes and home sale prices in greater detail.

HOUSING AFFORDABILITY AND AVAILABILITY (1982)

Income	"Affordable" Home at 15.5% FHA Rate(1)	% of Homes w/in Price Range(2)	"Affordable" Home at 12.0% MRB Rate(1)	% of Homes w/in Price Range(2)
$15,000	$26,600	Below 6%	$33,700	Below 11%
$20,000	$35,500	Below 12%	$45,000	21%
$23,246 (MRB MEDIAN)	$41,200	16%	$52,300	30%
$25,000	$44,300	21%	$56,200	33%
$30,000	$53,200	31%	$67,500 (MEDIAN EXISTING HOME)	48%
$38,000	$67,400 (MEDIAN EXISTING HOME)	48%		

1/ Assumes 30 year, level payment mortgage; 25% ratio between principal and interest payment and gross income.

2/ NAR data for June 1982, interpolated within $10,000-price intervals.

*Assumes 90% mortgage, 30-year term, 25% of income allocated to principal and interest payments. While some lenders used higher payment to income ratios in 1982, these normally included taxes and insurance in the payment and a "net" rather than a "gross" measure of income.

**Same assumptions in the previous example.

In summary, analysis of the available data supports the conclusion dictated by both common sense and experience: the moderate income homebuyers served by revenue bond programs would otherwise have been priced entirely out of 1982's housing market by high interest rates and sales prices.

4. Further Income Restraints and Purchase Price Limits Are Unnecessary

GAO asserts that Federal home purchase price ceilings and state or locally set income limits "have been ineffective" in targeting revenue bond mortgages to low and moderate income households. Thus, GAO states that "income ceilings allowed" and "purchase price ceilings encouraged" use of the program "by middle- and upper-income households." Here, again, GAO ignores both the substantial affordability problems faced by issuers under 1982's interest rates and the remarkable degree of targeting to below median households that was actually achieved.

With regard to income limits, GAO acknowledges that all but two state agencies and two local jurisdictions established income ceilings for home purchasers. GAO was evidently concerned, however, that the majority of the ceilings were "in the $30,000 to $40,000 range and only "a few set income requirements below $20,000 for a portion of the bond funds."

Under the interest rate and purchase price conditions which prevailed in 1982, state and local issuers had to make their programs available to a somewhat higher income group if they were going to continue to operate. Particularly in the view of the need for a broad range of potential homebuyers and eligible homes within the scope of any bond issue, an arbitrary income limit would simply have prevented issuers fromplaying the countercyclical role which Congress and the Administration allotted to them in 1982.

In 1980, Congress specifically rejected rigid national income limits for the revenue bond program precisely because such limits were meaningless, even destructive, if established without regard to interest rates and to local market conditions. Thus, in 1979, with conventional interest rates around 10 percent and tax-exempt rates between 7 and 8%, Congress contemplated an income cap of 115 percent of median. Under those conditions, such a cap would have permitted the great majority of state programs to continue to operate. However, in 1982, with interest rates more than 50 percent higher than those in 1979, a 115 percent of median income limit would have shut down many, if not most, programs. Although, as GAO points out, only one-third of homes purchased under the revenue bond programs actually went to households above 115 percent of median, the ability to market to this group undoubtedly played a major role in enabling issuers to sell bonds and achieve satisfactory interest rate levels.

Had an income limit been set at the 80 percent of median level, which GAO appears to believe to be desirable and which has been the income limit in the deep subsidy Section 8 program, it is virtually certain that no bond programs could have functioned in 1982, at least without substantial additional federal or state subsidy.

Further, GAO's analysis of income limits ignores the actual targeting to lower income households that was achieved in 1982. As was explored above in detail, the median revenue bond program homebuyer had an income below the national median and approximately $10,000 below that of the median FHA homebuyer — the lowest income unsubsidized buyer in the housing market. It is plainly unreasonable to suggest that a higher degree of targeting could have or should have been achieved under 1982's conditions.

GAO further contends that the purchase price ceilings did not limit, indeed actually "encouraged", participation by "upper income people." As evidence it offers analysis showing that "buyers would have needed annual incomes of at least $30,000 and $25,000 respectively to purchase new and existing homes" at the average ceilings which existing in 1982. This analysis, of course, re-emphasizes the significance of 1982's interest rates. Homes selling at the average price in an area were simply beyond the reach of the median income homebuyer, even at tax-exempt interest rates. Nonetheless, in order to permit issuers to serve a countercyclical role, Congress increased purchase price ceilings in mid-1982.

As with income limits, the discussion of purchase price ceilings ignores the actual results obtained in 1982. GAO found the average purchase price of mortgage revenue bond financed houses in its sample to be $48,800, hardly luxury priced housing. National Association of Realtors data shows that only 25 percent of the homes sold in the United States in June 1982 would have fallen within this price range. Only 10 percent of the homes financed by state agencies in 1982 had a sales price over $60,000 — a price still well below the national average.

Revenue bond programs financed modestly priced housing in 1982, they have over the past several years. The following table illustrates that fact:

MRB HOME SALES PRICES: HISTORICAL PERSPECTIVE

	MRB Median Sales Price(1)	National Median Sales Price(2)	MRB Median as % of National
1978	$45,866	$55,700	64%
1979	$37,515	$62,900	59%
1980	$42,438	$64,600	66%
1981	$43,233	$68,900	63%
1982	$43,791	$69,300	63%

1/ Source: Council of State Housing Agencies membership survey; 24 states reporting.
2/ Source: Department of Housing and Urban Development (derived from Bureau of the Census data).

Thus, there is no evidence to support the claim that purchase price limits "encouraged" the participation of higher income households in revenue bond programs. Rather, it simply took more income in 1982 for homebuyers to be able to afford modestly priced housing.

5. Federal Policies and State Agency Practices Effectively Target Revenue Bond Benefits.

As GAO acknowledges, Congress intended the revenue bond program to serve those households that could not afford to purchase homes without assistance. GAO's misrepresentation of its data cannot disguise the fact that—despite record high interest rates and the worst housing depression since World War II state and local bond programs served precisely this function in 1982. As economic conditions continue to improve, their ability to aid the lowest end of the spectrum of first-time homebuyers will grow and their record of achievement should improve even further.

APPENDIX

TAX-EXEMPT MORTGAGE REVENUE BONDS: COST

1. Alternative assumption: offset for lower mortgage interest tax deduction

cost	=	bond principal	x	taxable bond interest rate	x	marginal tax bracket of investors		
	=	$1 bil	x	.15	x	.30		
	=	$45 mil						
offset	=	bond principal	x	% lendable	x	difference between MRB & market mortgage rates	x	tax bracket of homebuyer
	=	$1 bil	x	.87	x	(.16 - .125)	x	.25
	=	$7,612,500						

net cost per $1 bil / number of loans originated	=	$37,387,500 / 20,092	=	$1,861 per mortgage per year
SUBSIDY COST PER MORTGAGE			=	$11,013

2. Alternative assumption: 93 percent of bond proceeds originated as mortgages

cost per $1 bil / number of loans originated	=	$45 mil / 21,478	=	$2,095 per mortgage per year
SUBSIDY COST PER MORTGAGE			=	$12,397

3. Alternative assumptions: 93 percent lendable proceeds and offset for lower mortgage interest deductions

offset	=	bond principal	x	% lendable (93%)	x	difference between MRB and market rates	x	tax bracket of homebuyer
offset	=	$8,137,500						

net cost per $1 bil / number of loans originated	=	$36,862,500 / 21,478	=	$1,716 per mortgage per year
SUBSIDY COST PER MORTGAGE			=	$10,155

4. Alternative assumption: subsidy cost per mortgage based on Kormendi/Nagle revenue loss estimate

cost per $1 bil / number of loans originated	=	$19.35 mil[1] / 20,092	=	$963 per mortgage per year

SUBSIDY COST PER MORTGAGE	=	$5,699

5. Alternative assumptions: Kormendi/Nagle revenue loss estimate, 93 percent lendable proceeds, and offset for lower tax deduction

Kormendi/Nagle estimted cost per $1 billion	=	$19.35 mil
Offset per $1 billion	=	$7,812,500

net cost per $1 billion / number of loans originated	=	$11,737,500 / 21,478	=	$546 per mortgage per year

SUBSIDY COST PER MORTGAGE	=	$3,231

1/Based on 10 percent taxable bond rates, the Kormendi/Nagle analysis yields an estimate of $13 million per billion (43 percent of the standard estimate); at 14 percent, Kormendi/Nagle estimate a loss of $18 million (again, 43 percent of the standard estimate). For the purpose of analysis at 15 percent, we have assumed the Kormendi/Nagle estimate at 43 percent of $45 million—or $19.35 million.

TAX EXEMPT MORTGAGE REVENUE BONDS: BENEFITS

1. <u>Alternative assumptions: 16 percent market mortgage rate and 12.5 percent tax-exempt mortgage rate</u>

Monthly payment on 30-year, $43,300 mortgage at 16 percent	=	$582
Monthly payment on 30-year, $43,300 mortgage at 12.5 percent	=	$462
Annual savings on reduced rate mortgage	=	$1,442
AVERAGE SUBSIDY VALUE	=	$8,533

TAXABLE BOND OPTION

1. Alternative assumptions: 15 percent taxable bond rate and 12 percent tax-exempt bond rate

cost	=	bond principal	x	taxable bond rate	-	tax-exempt bond rate
	=	\$1 bil	x	(.15	-	.12)
	=	\$30 mil				

cost per \$1 bil / number of loans originated	=	\$30 mil / 20,092	=	\$1,493 per mortgage per year
SUBSIDY COST PER MORTGAGE			=	\$8,835

2. Alternative assumptions: 15 percent taxable bond rate, 12 percent tax-exempt bond rate, and 93 percent lendable proceeds.

cost per \$1 bil / number of loans originated	=	\$30 mil / 21,478	=	\$1,397
SUBSIDY COST PER MORTGAGE			=	\$8,267

MORTGAGE GRANTS

1. Alternative assumptions: 16 percent market mortgage rate and 12.5 percent tax-exempt mortgage rate.

Monthly payment on 30-year, $43,300 mortgage at 16 percent	=	$582
Monthly payment of 30-year, $43,300 mortgage at 12.5 percent	=	$462
Annual savings on reduced rate mortgage	=	$1,442
SUBSIDY COST PER MORTGAGE (Does not include administrative costs)	=	$8,533

TAX CREDITS

1. Alternative assumptions: 16 percent market mortgage rate and 12.5 percent tax-exempt mortgage rate

cost	=	mortgage amount	x	market mortgage rate	-	tax-exempt mortgage rate
	=	$43,400	x	(.16	-	.125)
	=	$1,515 per mortgage per year				

SUBSIDY COST PER MORTGAGE = $8,965
(Does not include administrative costs)

Mr. MOYER. Thank you.

I would like to give the subcommittee just a brief overview of the role that we play in providing opportunities for low- and moderate-income housing, but I think it is more important perhaps to hear from my colleague, Sharon Lunner, who is executive director, as you just heard, of the Maine State Housing Authority, and Mr. Greg Smith, the administrator of the Oregon Housing Division, who will discuss very briefly again the benefits and the costs that are associated with the single family mortgage purchase program that we operate. And then finally, Mr. Arthur White, who is chairman of the Connecticut Housing Finance Agency, is going to discuss the role that the boards of these agencies play in setting policy.

But each year there is an increase in the number of would-be single family home buyers who are absolutely frustrated in their search for even the most modest dwelling by steadily rising interest rates and soaring costs.

Now, at the same time, the number of families in this country who are trying to enter the homeownership market is growing. And we have been trying as State agencies, and we will continue to contribute as we can to filling the needs of these first-time home buyers.

I do believe, too, Senator Mitchell, that when we talk about the definitions of low, what dc we mean by low income, moderate income, middle income? People have their own definitions. And without a common one, everything tends to get all mixed up.

When we talk about median incomes, we are talking about young people right out of high school or just out of college. Maybe they want to be policemen or firemen or schoolteachers, and the beginning salaries are so low in those jobs and it takes two. So when we take the median income as $23,000 or $18,000, we are talking about two young people getting a job, each of them, maybe one of them at $9,000 and another one at $10,000, and trying to buy a home, which, as Senator Roth said, is the dream of every American from the time he is a little child. These are the people we are trying to help.

This is what we have done in Delaware with this program. Our agency, as Senator Roth pointed out, has done I guess somewhere on the order of 4,000 since 1979. Local issuing agencies have added another 5,000. But let me tell you we just made a market study very recently to see whether or not it was important to have this program continue. And we estimate in our State that there are about 6,000 young people who want their own homes who cannot afford it with today's high-interest costs and today's high-construction costs.

And I quite agree with the members of this previous panel who said that there will always be a point at which you can help young people get their first home with a program like this. And I hope that you will enact this measure, and we really appreciate your help.

[The prepared statement of Robert Moyer follows:]

PREPARED STATEMENT OF

ROBERT S. MOYER

DIRECTOR

DELAWARE STATE HOUSING AUTHORITY

BEFORE THE

UNITED STATES SENATE

SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

MAY 13, 1983

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, MY NAME IS ROBERT S. MOYER AND I AM THE DIRECTOR THE DELWARE STATE HOUSING AUTHORITY. I SPEAK TO YOU TODAY AS A REPRESENTATIVE OF THE COUNCIL OF STATE HOUSING AGENCIES. THE COUNCIL REPRESENTS STATE HOUSING FINANCE AGENCIES IN 49 STATES, THE DISTRICT OF COLUMBIA, AND THE COMMONWEALTH OF PUERTO RICO. AFFILIATE MEMBERS OF THE COUNCIL INCLUDE BUILDERS, INVESTMENT BANKERS, DEVELOPERS AND OTHERS INVOLVED WITH STATE HOUSING FINANCING AGENCIES.

I WOULD LIKE TO TAKE THIS OPPORTUNITY, BOTH FOR MYSELF AND THE COUNCIL OF STATE HOUSING AGENCIES, TO THANK SENATOR ROTH FOR HIS CONTINUED INTEREST IN AND SUPPORT FOR STATE HOUSING FINANCE AGENCIES. WE APPRECIATE THE ACTION HE AND SENATOR MITCHELL HAVE TAKEN IN INTRODUCING S. 137, WHICH CALLS FOR THE CONTINUED USE OF TAX EXEMPT SINGLE FAMILY MORTGAGE REVENUE BONDS. WE WOULD ALSO LIKE TO EXPRESS OUR APPRECIATION TO CHAIRMAN PACKWOOD FOR TAKING PROMPT ACTION ON THE BILL BY HOLDING THIS HEARING TODAY. IN ADDITION TO MY

TESTIMONY BEING PRESENTED IN THE RECORD, I WOULD REQUEST THAT THE COUNCIL OF STATE HOUSING AGENCIES RESPONSE TO THE GAO REPORT ON MORTGAGE REVENUE BONDS BE PRESENTED IN THE RECORD ALSO.

I WOULD LIKE TO BEGIN BY GIVING THE SUBCOMMITTEE MEMBERS AN OVERVIEW OF STATE HOUSING FINANCE AGENCIES AND THE ROLE WE PLAY IN PROVIDING HOUSING OPPORTUNITIES FOR LOW AND MODERATE INCOME FAMILIES, FIRST-TIME HOMEBUYERS AND OTHER GROUPS WHICH ARE AT A DISADVANTAGE IN TODAY'S HOUSING MARKET. MY COLLEAGUES, SHARON LUNNER, EXECUTIVE DIRECTOR OF THE MAINE STATE HOUSING AUTHORITY, AND GREGG SMITH, ADMINISTRATOR OF THE OREGON HOUSING DIVISION, WILL DISCUSS THE BENEFITS AND COSTS ASSOCIATED WITH SINGLE FAMILY MORTGAGE PURCHASE PROGRAMS. FINALLY, ART WHITE, CHAIRMAN OF THE CONNECTICUT HOUSING FINANCE AUTHORITY, WILL DISCUSS THE BOARD OF DIRECTORS' ROLE IN SETTING AGENCY POLICIES.

EACH YEAR THERE IS AN INCREASE IN THE NUMBER OF WOULD-BE SINGLE FAMILY HOMEBUYERS WHO ARE FRUSTRATED IN THEIR SEARCH FOR EVEN THE MOST MODEST DWELLING BY STEADILY RISING INTEREST RATES AND SOARING CONSTRUCTION COSTS. AT THE SAME TIME, THE NUMBER OF FAMILIES TRYING TO ENTER THE HOMEOWNERSHIP MARKET IS GROWING. IN FACT, POPULATION EXPERTS ANTICIPATE AN UNPRECEDENTED LEVEL OF HOUSING DEMAND DURING THE 1980'S FROM THE MATURING BABY BOOM GENERATION.

STATE HOUSING FINANCE AGENCIES HAVE BEEN AND WILL CONTINUE TO BE A MAJOR CONTRIBUTOR IN FILLING SINGLE FAMILY AND MULTIFAMILY NEEDS. STATE AGENCIES ARE UNIQUE IN THAT THEY ARE NEITHER A PURELY PUBLIC AGENCY NOR PART OF THE PRIVATE SECTOR. THEY ARE, RATHER, A LINK BETWEEN THE TWO, DRAWING UPON THE RESOURCES OF THE PRIVATE MORTGAGE LENDING INDUSTRY AND PRIVATE DEVELOPERS WHILE AT THE SAME TIME,

EMPLOYING AVAILABLE PUBLIC FUNDS TO HELP CREATE LOW INCOME HOUSING.

NO TWO HOUSING FINANCE AGENCIES ARE IDENTICAL. SOME EMPHASIZE HOMEOWNERSHIP PROGRAMS, OTHERS CONCENTRATE ON RENTAL PROGRAMS, MOST HAVE BOTH. MANY HAVE ONE-OF-A-KIND PROGRAMS TARGETED TO SPLCIALIZED NEEDS.

IT IS PRECISELY THIS VARIETY THAT MAKES STATE AGENCIES SO EFFECTIVE. PROGRAMS THAT MIGHT BE APPROPRIATE FOR DELAWARE MIGHT NOT HAVE MUCH RELEVANCE IN OREGON AND VIS VERSA. THE STATE HOUSING AGENCY, WITH ITS LOCAL FOCUS AND EXPERTISE, IS FAR BETTER SITUATED TO EVALUATE LOCAL NEEDS THAN A FEDERAL AGENCY MAKING NATIONAL POLICY IN WASHINGTON.

OF COURSE, STATE HOUSING FINANCE AGENCIES HAVE A NUMBER OF FEATURES IN COMMON. ALL WERE CREATED BY STATE LEGISLATION AND CHARGED WITH THE RESPONSIBILITY OF HELPING INDIVIDUALS AND FAMILIES OF LOW AND MODERATE INCOME TO FIND SAFE, SANITARY, AND ADEQUATE SHELTER. THEY ACCOMPLISH THIS GOAL IN A VARIETY OF WAYS. AGENCIES ISSUE TAX-EXEMPT BONDS TO MAKE LOANS AVAILABLE FOR THE PURCHASE OF SINGLE FAMILY HOMES. AGENCIES ALSO SELL BONDS TO MAKE LOANS TO NON-PROFIT AND LIMITED PROFIT DEVELOPERS FOR THE CONSTRUCTION AND REHABILITATION OF RENTAL HOUSING. MANY AGENCIES WORK WITH THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. THE MAJOR FEDERAL HOUSING PROGRAMS OF THE 1970'S ALL DEPENDED HEAVILY ON STATE HOUSING FINANCE AGENCIES FOR THE LOCAL EXPERTISE TO TURN FEDERAL DOLLARS INTO DECENT, WELL MANAGED, LOW AND MODERATE INCOME HOUSING. INDEED, CONGRESS IN 1974 SPECIFICALLY ENCOURAGED THE ESTABLISHMENT AND GROWTH OF STATE AGENCIES.

TO DATE, STATE HOUSING FINANCE AGENCIES HAVE FINANCED OVER 400,000

MULTIFAMILY UNITS AND PROVIDED BELOW MARKET RATE MORTGAGE LOANS FOR NEARLY HALF A MILLION HOMEOWNERSHIP UNITS. STATE AND LOCAL HFA TOGETHER HAVE PROVIDED WELL OVER $1 BILLION IN LOW INTEREST RATE LOANS FOR HOME IMPROVEMENTS AND ENERGY CONSERVATION.

IN MY STATE ALONE, AS OF MARCH 3, THIS YEAR, OVER 4,080 HOUSEHOLDS HAVE PURCHASED THEIR HOMES THROUGH THE DELAWARE STATE HOUSING AUTHORITY. WHEN WE ADD IN THE LENDING ACTIVITY OF OUR LOCAL ISSUERS, OVER 9,000 DELAWARE FAMILIES HAVE BEEN ABLE TO BUY HOMES. THESE 9,000 FAMILIES REPRESENT OVER 7% OF DELAWARE'S SINGLE FAMILY HOMEOWNERS. OVERALL, <u>ONE OUT OF EVERY 14</u> FAMILIES IN DELAWARE HAS A MORTGAGE THAT WAS FUNDED BY A TAX EXEMPT BOND ISSUE.

WE ARE HERE TODAY TO FOCUS PARTICULARLY ON THE BENEFITS OF STATE HOUSING FINANCE AGENCIES' SINGLE FAMILY HOME PURCHASE PROGRAMS. IT IS THE USE OF SINGLE FAMILY TAX EXEMPT MORTGAGE REVENUE BONDS, WHICH MAKE THESE PROGRAMS POSSIBLE, THAT IS THREATENED BY THE SUNSET LANGUAGE CONTAINED IN THE MORTGAGE SUBSIDY BOND TAX ACT.

STATE HOUSING FINANCE AGENCIES' HOME PURCHASE PROGRAMS ARE FINANCED THROUGH THE SALE OF BONDS IN THE TAX EXEMPT MUNICIPAL MARKET. BECAUSE INTEREST EARNED ON THESE BONDS IS EXEMPT FROM TAXATION, ISSUERS ARE ABLE TO OFFER MORTGAGE INTEREST RATES WELL BELOW CONVENTIONAL MARKET LEVELS. ONCE BONDS HAVE BEEN SOLD, PRIVATE LENDING INSTITUTIONS PARTICIPATE IN THE PROGRAMS BY ORIGINATING AND SERVICING LOANS FOR THE AGENCIES.

FEDERAL LAW TARGETS ALL MORTGAGE REVENUE BOND PROGRAMS. SECTION 103A OF THE INTERNAL REVENUE CODE STIPULATES THAT 90 PERCENT OF THE MORTGAGES ORIGINATED FROM A GIVEN BOND ISSUE MUST GO TO FIRST TIME HOMEBUYERS. IT ALSO SETS A PURCHASE PRICE LIMIT ON MORTGAGE BOND

FINANCED HOMES OF 110 PERCENT OF THE AREA MEDIAN PURCHASE PRICE AND 120 PERCENT IN TARGETED AREAS. THE LAW STIPULATES THAT 20 PERCENT OF THE BOND CAPITAL MUST BE SET ASIDE TO PROMOTE HOUSING DEVELOPMENT IN TARGETED AREAS, ESSENTIALLY LOW INCOME AREAS AND DESIGNATED AREAS OF CHRONIC ECONOMIC DISTRESS.

FEDERAL RESTRICTIONS DO NOT PROVIDE THE ONLY TARGETING OF THESE PROGRAMS. MOST STATE AND LOCAL HOUSING AGENCIES IMPOSE ADDITIONAL ELIGIBILITY REQUIREMENTS FOR THEIR OWNERSHIP PROGRAM. VIRTUALLY ALL STATE AGENCIES PLACE SOME LIMIT ON THE INCOME OF BORROWERS UNDER THEIR PROGRAMS. THE INTEREST RATE SUBSIDY IS NOT THE ONLY FORM OF ASSISTANCE PROVIDED BY TAX EXEMPT HOMEOWNERSHIP PROGRAMS. FOR INSTANCE, STATE HOUSING FINANCE AGENCIES MAY PROVIDE A SOURCE OF MORTGAGE CREDIT WHERE NONE WAS PREVIOUSLY AVAILALBLE, AS IN RURAL AREAS OR CENTRAL CITIES. LOW DOWN PAYMENT REQUIREMENTS ALSO PROVIDE A MUCH NEEDED FORM OF ASSISTANCE TO FIRST TIME HOMEBUYERS. FORTY-TWO OF THE 49 STATES WITH ACTIVE PROGRAMS IN 1982 OFFERED LOANS WITH FIVE PERCENT MINIMUM DOWN-PAYMENT REQUIREMENTS.

IN ADDITION, MANY STATE HOUSING FINANCE AGENCIES HAVE USED MORTGAGE REVENUE BONDS TO MEET A VARIETY OF SPECIAL HOUSING NEEDS. AMONG SOME OF THE PROGRAMS BEING OFFERED ARE HOME IMPROVEMENT LOANS, MOBILE HOME LOANS, PASSIVE SOLAR DEMONSTRATIONS, ENERGY CONSERVATION LOANS, HOUSING FOR THE DISABLED, OFF RESERVATION INDIAN HOUSING AND VIETNAM ERA VETERANS DOWNPAYMENT ASSISTANCE.

STATE HOUSING FINANCE AGENCIES HAVE BEEN VERY SUCCESSFUL AT PROVIDING HOMEOWNERSHIP OPPORTUNITIES FOR MODERATE INCOME HOUSEHOLDS. THEY HAVE SUCCESSFULLY CHANNELED PRIVATE CAPITAL TO SERVE THE LONG ACCEPTED PUBLIC PURPOSE OF PROMOTING HOMEOWNERSHIP. TODAY, HOWEVER, A DARK CLOUD HOVERS OVER STATE HOUSING FINANCE AGENCIES AND THE HUNDREDS OF THOUSANDS OF HOUSEHOLDS THAT NEED THEIR SERVICES. IF CONGRESS DOES NOT TAKE FAVORABLE ACTION TO STRIKE THE SUNSET PROVISION IN SECTION 103A OF THE INTERNAL REVENUE CODE, THE HOMEOWNERSHIP PROGRAMS OF ALL HOUSING FINANCE AGENCIES WILL END AND THE DREAM OF HOMEOWNERSHIP FOR HUNDREDS OF THOUSANDS OF ASPIRING HOMEBUYERS WILL FADE. WE URGE YOU TO ADOPT S. 137, THE HOUSING FINANCE OPPORTUNITY ACT.

Senator ROTH. Thank you, Mr. Moyer.
Ms. Lunner.

STATEMENT OF SHARON LUNNER, EXECUTIVE DIRECTOR AND CHAIRPERSON, MAINE STATE HOUSING AUTHORITY

Ms. LUNNER. Mr. Chairman and members of the subcommittee, my name is Sharon Lunner. I am executive director and chairman of the Maine State Housing Authority. And on behalf of the authority and the thousands of people that we assist would like to thank Senator Mitchell for joining with Senator Roth to be the lead cosponsor of S. 137.

Maine has a strong tradition of homeownership, and I know that his sponsorship of S. 137 is predicated on his desire not only to insure the continued availability of an important working tool to maintain that tradition in Maine, but also to help preserve its availability throughout the country.

Homeownership has long been a central element of the American dream. Since the Great Depression it has been an explicit Federal policy to promote and expand homeownership opportunities for all families. This policy has been enormously successful, making ours the best-housed Nation on Earth with two-thirds of families living in their own homes.

Now, however, this dream is threatened. Over the past 5 years we have been on an interest rate escalator. Even now in a period of relatively lower rates, FHA's 11½-percent rate plus points is at least a third higher than the average postdepression experience.

These high rates, combined with the high cost of housing, have priced homeownership beyond the means of millions of moderate- and middle-income families. This is occurring at the very moment when demographic trends indicate that the demand for homeownership housing should be at the highest level in our history. The baby boom generation is now trying to buy their first homes, and they are discovering that high-interest rates have placed those homes beyond their reach.

We can see from the purposes that Congress intended for the bond programs in the 1980 act and the 1982 amendments that these objectives include assisting those that otherwise could not afford to buy a home consistent with their means, generally first-time home buyers; allowing eligibility standards to reflect local needs; and to respond to local conditions affecting costs, terms and interest rates; and providing special incentives to help in areas of chronic economic distress.

Under this soundly designed and flexible system, in periods of high-interest rates the number of families eligible for assistance will grow. In high-cost areas the cost of homes purchased will reflect the local costs. In other words, there is an ebb and flow in the program that reflects the reality of the market.

Who has been served by mortgage revenue bonds? We have some charts which will reflect these numbers. From 1978 through 1981 median borrower incomes under revenue bond programs ranged from $14,700 to $18,000. These median borrowers represent from 79 to 85 percent of the national median income—in other words, moderate-income home buyers.

What kinds of homes did they purchase? Again, as the chart reflects, from 1978 through 1981 the median home bought through a mortgage revenue bond program grew in price from $35,800 to $43,000, ranging between 60 and 66 percent of the national median sales price—in other words, modestly priced housing.

Even in 1982, which is the only year considered in the recent GAO report, a year in which unprecedented interest rates drove all but the most affluent buyers from the conventional market, revenue bond program purchasers had a median income of $23,200, 96 percent of the national median. This was $10,000 below the median FHA buyer.

There are some suggestions in a recent GAO report that the home buyers we served could have purchased homes without the revenue bond assistance. I respectfully submit to you that this assertion is not true. As another chart which we have which graphically shows in 1982 of all the mortgage revenue bond home buyers, only 10 percent could have afforded a median priced conventionally financed home.

In Maine where our law states that we serve only those people that cannot afford conventional market rate, market interest rate and loan terms, our average acquisition cost in 1982 was $38,900, while our average loan was for $34,700. The average income for our borrowers was $23,000. When in February 1983 we were able to lower our interest rate to 10 percent and extend the term to 30 years, we reduced the maximum eligible income to $24,000.

The mortgage revenue bond program has provided many benefits other than direct homeownership. They have leveraged funds such as State funds and have proved to be the only available vehicle to provide affordable home improvement loans.

I urge your support of the repeal.

Thank you.

[The prepared statement of Ms. Sharon Lunner follows:]

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PREPARED STATEMENT OF

SHARON LUNNER

EXECUTIVE DIRECTOR AND CHAIRPERSON

MAINE STATE HOUSING AUTHORITY

BEFORE THE

UNITED STATES SENATE

SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

MAY 13, 1983

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, MY NAME IS SHARON LUNNER. I AM THE EXECUTIVE DIRECTOR AND CHAIRPERSON OF THE MAINE STATE HOUSING AUTHORITY. ON BEHALF OF THE AUTHORITY AND THE THOUSANDS OF PEOPLE WE ASSIST, I WOULD LIKE TO THANK SENATOR MITCHELL FROM MY HOME STATE FOR JOINING WITH SENATOR ROTH TO BE THE LEAD CO-SPONSOR OF S. 137. MAINE HAS A STRONG TRADITION OF HOMEOWNERSHIP AND THROUGH MY DISCUSSIONS WITH SENATOR MITCHELL, I KNOW THAT HIS SPONSORSHIP OF S. 137 IS PREDICATED ON HIS DESIRE NOT ONLY TO ASSURE THE CONTINUED AVAILABILITY OF AN IMPORTANT WORKING TOOL TO MAINTAIN THAT TRADITION IN MAINE, BUT ALSO TO HELP PRESERVE ITS AVAILABILITY THROUGHOUT THE COUNTRY.

I WILL ADDRESS FOUR ISSUES IN MY TESTIMONY TODAY: WHY THERE IS A NEED FOR HOME PURCHASE ASSISTANCE THROUGH MORTGAGE REVENUE BONDS; WHO SHOULD BE SERVED BY REVENUE BOND PROGRAMS; WHO HAS ALREADY BENEFITED FROM THESE PROGRAMS; AND WHAT BENEFITS THEY PROVIDE

BEYOND MAKING MORTGAGE FUNDS AVAILABLE AT AFFORDABLE INTEREST RATES.

HOMEOWNERSHIP HAS LONG BEEN A CENTRAL ELEMENT OF THE AMERICAN DREAM. SINCE THE GREAT DEPRESSION, IT HAS BEEN AN EXPLICIT FEDERAL POLICY TO PROMOTE AND EXPAND HOMEOWNERSHIP OPPORTUNITIES FOR ALL FAMILIES. AND THIS POLICY HAS BEEN ENORMOUSLY SUCCESSFUL, MAKING OURS THE BEST HOUSED NATION ON EARTH WITH TWO-THIRDS OF FAMILIES LIVING IN THEIR OWN HOMES.

NOW, HOWEVER, THIS DREAM IS THREATENED. OVER THE PAST 5 YEARS WE HAVE BEEN ON AN INTEREST RATE ESCALATOR. EVEN NOW, IN A PERIOD OF RELATIVELY LOWER RATES, FHA'S 11-1/2% RATE, PLUS DISCOUNT POINTS, IS AT LEAST A THIRD HIGHER THAN THE AVERAGE POST-DEPRESSION EXPERIENCE.

THESE HIGH RATES, COMBINED WITH THE HIGH COST OF HOUSING, HAVE PRICED HOMEOWNERSHIP BEYOND THE MEANS OF MILLIONS OF MODERATE AND MIDDLE INCOME FAMILIES.

THIS IS OCCURRING AT THE VERY MOMENT WHEN DEMOGRAPHIC TRENDS INDICATE THAT DEMAND FOR OWNERSHIP HOUSING SHOULD BE AT THE HIGHEST LEVEL IN OUR HISTORY. THE "BABY BOOM" GENERATION ARE NOW TRYING TO BUY THEIR FIRST HOMES — AND THEY ARE DISCOVERING THAT HIGH INTEREST RATES HAVE PLACED THOSE HOMES BEYOND REACH.

ANTICIPATING THIS PROBLEM, CONGRESS DIRECTED IN 1980 THAT MORTGAGE REVENUE BONDS BE USED IN RESPONSE. THE MORTGAGE SUBSIDY BOND TAX ACT OF 1980 REFLECTED CONGRESS' DETERMINATION THAT THE PROGRAM SHOULD BE DIRECTED TO FIRST TIME HOMEBUYERS WHO HAD NOT BEEN FORTUNATE ENOUGH TO ACQUIRE HOMES EARLIER, WHEN INTEREST RATES WERE LOW. CONGRESS FURTHER DIRECTED THAT THE BONDS BE USED TO AID AREAS OF CHRONIC ECONOMIC DISTRESS.

AT THE SAME TIME CONGRESS DECIDED TO "SUNSET" THE HOMEOWNERSHIP PROVISION IN THE HOPE THAT DECLINING INTEREST RATES WOULD SOLVE THE AFFORDABILITY PROBLEMS FACED BY HOMEBUYERS IN 1979 AND 1980. UNFORTUNATELY, INTEREST RATES DID NOT DECLINE, AND TODAY THE RATES OF 1979 AND 1980 LOOK LIKE THE "GOOD OLD DAYS." IT IS, THEREFORE, ESSENTIAL THAT CONGRESS ELIMINATE THE SUNSET IF TODAY'S YOUNG FAMILIES ARE GOING TO HAVE THE SAME HOMEOWNERSHIP OPPORTUNITIES THAT THEIR PARENTS AND OLDER BROTHERS AND SISTERS DID.

THUS, WE CAN SEE THE PURPOSES CONGRESS INTENDED BOND PROGRAMS TO SERVE AS EXPRESSED IN THE 1980 ACT, AND IN 1982 AMENDMENTS ALLOWING GREATER USE OF THE PROGRAM IN TIMES OF CRISIS CAUSED BY HIGH INTEREST RATES. THESE OBJECTIVES INCLUDE:

- ASSISTING THOSE THAT OTHERWISE COULD NOT AFFORD TO BUY A HOME CONSISTENT WITH THEIR MEANS, GENERALLY FIRST TIME HOMEBUYERS.

- ALLOWING ELIGIBILITY STANDARDS TO REFLECT LOCAL NEEDS AND TO RESPOND TO LOCAL CONDITIONS AFFECTING COSTS, TERM AND INTEREST RATES. THIS WAS TO BE ACCOMPLISHED THROUGH THE USE OF AREA PURCHASE PRICE LIMITS AND ENCOURAGEMENT OF LOCAL INCOME LIMITS.

- PROVIDING FOR SPECIAL INCENTIVES TO HELP IN AREAS OF CHRONIC ECONOMIC DISTRESS SUCH AS THROUGH THE WAIVING OF FIRST TIME HOMEBUYER RESTRICTIONS AND THE PROVISION OF INCREASED PURCHASE PRICE LIMITS IN TARGETED AREAS

UNDER THIS SOUNDLY DESIGNED, FLEXIBLE SYSTEM, IN PERIODS OF HIGH INTEREST RATES, THE NUMBER OF FAMILIES ELIGIBLE FOR ASSISTANCE WILL GROW. IN HIGH COST AREAS, THE COST OF HOMES PURCHASED WILL REFLECT THE LOCAL COSTS. IN OTHER WORDS, THERE IS AN EBB AND FLOW IN THE PROGRAM THAT REFLECTS THE REALITY OF THE MARKET.

WHO HAS BEEN SERVED BY REVENUE BOND PROGRAMS? HAVE THEY MET CONGRESS' INTENT TO HELP FIRST TIME HOMEBUYERS WHO WOULD OTHERWISE BE PRICED OUT OF THE MARKET TO ACQUIRE MODESTLY PRICED HOUSING? THE ANSWER IS CLEARLY THAT THEY HAVE.

FROM 1978 THROUGH 1981, MEDIAN BORROWER INCOMES UNDER REVENUE BOND PROGRAMS RANGED FROM $14,725 TO $18,068. THESE MEDIAN BORROWERS REPRESENTED FROM 79% TO 85% OF THE NATIONAL MEDIAN INCOME, IN OTHER WORDS, MODERATE INCOME HOMEBUYERS.

WHAT KINDS OF HOMES DID THEY PURCHASE? FROM 1978 THROUGH 1981, THE MEDIAN HOME BOUGHT THROUGH A REVENUE BOND PROGRAM GREW IN PRICE FROM $35,866 TO $43,233, RANGING BETWEEN 60% AND 66% OF THE NATIONAL MEDIAN SALES PRICE. IN OTHER WORDS, MODESTLY PRICED HOUSING.

EVEN IN 1982, WHICH IS THE ONLY YEAR CONSIDERED IN THE RECENT GAO REPORT, A YEAR IN WHICH UNPRECEDENTED INTEREST RATES DROVE ALL BUT THE MOST AFFLUENT BUYERS FROM THE CONVENTIONAL MARKET, REVENUE BOND PROGRAM PURCHASERS HAD A MEDIAN INCOME OF $23,246 - 96% OF THE NATIONAL MEDIAN. THIS WAS $10,000 BELOW THE MEDIAN FHA BUYER - NORMALLY THE LOWEST SEGMENT OF THE UNSUBSIDIZED MARKET.

AND THIS MEDIAN REVENUE BOND PROGRAM PARTICIPANT PURCHASED A HOME COSTING, ON THE AVERAGE, $43,791, OR 63% OF THE NATIONAL MEDIAN.

THERE IS SOME SUGGESTION IN A RECENT GAO REPORT THAT THE

HOMEBUYERS WE SERVED IN 1982 COULD HAVE PURCHASED HOMES WITHOUT REVENUE BOND ASSISTANCE. I RESPECTFULLY SUBMIT TO YOU THAT THIS ASSERTION IS PURE NONSENSE. OUR MEDIAN $23,000 FIRST-TIME HOMEBUYER COULD HAVE AFFORDED, AT THE VERY MOST, A $40,000 HOUSE AT 1982'S CONVENTIONAL INTEREST RATES. THIS REPRESENTS NO MORE THAN 16% OF THE HOUSES ON THE MARKET IN THAT YEAR AND AVAILABLE IN VERY FEW AREAS. MORE THAN 70% OF OUR BUYERS HAD TOTAL HOUSEHOLD INCOMES BELOW $30,000 - NOT ENOUGH TO BUY A HOME PRICED AT $54,000 AND $13,000 BELOW THE NATIONAL MEDIAN SALES PRICE IN 1982. WITHOUT REVENUE BOND PROGRAMS, THESE HOUSEHOLDS WOULD HAVE BEEN KEPT OUT OF THE MARKET.

THUS, I WOULD ASSERT TO YOU THAT, GIVEN THE CONDITIONS IN 1982, REVENUE BOND PROGRAMS DID A REMARKABLY GOOD JOB IN HELPING MODERATE INCOME FAMILIES BUY MODESTLY PRICED HOMES.

IN MAINE, WHERE OUR LAW STATES THAT WE SERVE ONLY THOSE PEOPLE WHO CANNOT AFFORD CONVENTIONAL MARKET RATE AND TERM LOANS, OUR AVERAGE ACQUISITION COST IN 1982 WAS $38,900, WHILE OUR AVERAGE LOAN WAS FOR $34,700. THE AVERAGE INCOME FOR OUR BORROWERS WAS $23,300. WHEN, IN FEBRUARY OF 1983 WE WERE ABLE TO LOWER OUR INTEREST RATES TO 10% AND EXTEND THE TERM TO 30 YEARS, WE REDUCED THE MAXIMUM ELIGIBLE INCOME TO $24,000.

I REITERATE THAT THE MAJORITY OF BORRWERS WOULD NOT HAVE BEEN SERVED IN 1982 WITHOUT THE PROGRAM. IF THEY COULD HAVE BEEN, THE INDUSTRY WOULD NOT HAVE BEEN IN THE DISASTER IT WAS, AND CONGRESS AND THE PRESIDENT WOULD NOT HAVE ENCOURAGED THE USE OF THE PROGRAM BY ENACTING PROGRAM AMENDMENTS.

NOW, IMPROVING ECONOMIC CONDITIONS WILL ENABLE STATE AGENCIES THROUGHOUT THE COUNTRY TO TARGET EVEN LOWER INCOME GROUPS—AS WE

HAVE ALREADY DONE IN MAINE. THE FLEXIBILITY OF THESE PROGRAMS, THUS, PERMITS US QUICKLY TO SHED THE ROLE OF COUNTERCYCLICAL SUPPORT, WHICH YOU ASSIGNED US LAST YEAR, AND RETURN TO OUR PRIMARY JOB OF SERVING THOSE PRICED OUT OF THE NORMAL HOUSING MARKET.

BUT LOWER INTEREST RATES ARE NOT THE ONLY BENEFIT MRBS PROVIDE. NO COST/BENEFIT STUDY COULD BE COMPLETE BY LOOKING AT INTEREST RATES ALONE. OTHER BENEFITS INCLUDE:

- THE MRB PROGRAM HAS LEVERAGED OTHER FUNDS SUCH AS CDBG GRANTS TO DISTRESSED CITIES.

- STATE AND LOCAL FUNDS HAVE BEEN PROVIDED FOR USE WITH THE PROGRAMS. STATES CONTRIBUTED 150 MILLION DOLLARS IN 1982 ALONE.

- THE ONLY AFFORDABLE HOME IMPROVEMENT LOANS FOR LOWER INCOME HOMEOWNERS ARE MADE AVAILABLE THROUGH MRB PROGRAMS.

- OFTEN CAPITAL POOR AREAS, URBAN AND RURAL, HAVE FOUND THEIR MOST RELIABLE SOURCE OF MORTGAGE FUNDS IN THE MRB PROGRAM.

INDICATIVE OF MAINE'S COMMITMENT TO THE USE OF MRBS IN ACHIEVING THESE GOALS WAS ACTION TAKEN BY THE 110TH SESSION OF THE MAINE LEGISLATURE IN 1982. FOR THE FIRST TIME SINCE THE AUTHORITY'S CREATION IN 1969, THE LEGISLATURE APPROPRIATED FUNDS FROM THE STATE'S GENERAL FUND FOR THE SUPPORT OF AUTHORITY PROGRAMS. IN RELATION TO MRBS AND

THE CHANGES BROUGHT ABOUT BY THE 1980 LEGISLATION, THAT $4.25 MILLION APPROPRIATION STATED SPECIFICALLY THAT THE STATE FUNDS COULD BE USED TO HELP DEFRAY COSTS ASSOCIATED WITH THE SALE OF AUTHORITY BONDS. THROUGH THAT ACTION, TWO-THIRDS OF THE MAINE LEGISLATURE CLEARLY WENT ON RECORD IN SUPPORT OF MRBS, A PROVEN, WORKABLE TOOL, TO PROVIDE DESPERATELY NEEDED, AFFORDABLE, MORTGAGE CAPITAL FOR MAINE'S WORKING FAMILIES.

IN SUMMARY, MR. CHAIRMAN, THE MRB PROGRAM ADVANCES THE NATIONAL OBJECTIVE OF HOMEOWNERSHIP, SERVES THOSE WHO NEED IT MOST, AND WARRANTS THE CONTINUED SUPPORT OF CONGRESS. IT HAS INDEED MET YOUR EXPECTATIONS, AND HAS DONE SO IN A PARTNERSHIP WITH STATE AND LOCAL GOVERNMENT. I RESPECTFULLY URGE YOU TO ENACT S. 137.

Senator ROTH. Thank you very much.
Mr. Smith.

STATEMENT OF M. GREGG SMITH, ADMINISTRATOR, OREGON HOUSING DIVISION

Mr. SMITH. Senator, my name is M. Gregg Smith. I am administrator of the State of Oregon's Housing Division.

Our agency finances single family homes, apartments, and we operate a number of innovative programs. We have heard today some Federal officials attack mortgage finance programs as costly and inefficient; and my first reaction to these attacks is costly and inefficient compared to what? Compared to Federal programs that allegedly exist? Let us focus on what mortgage bond programs really cost.

Some economists, such as Dr. Norman Ture, former Under Secretary of the Treasury, argue that tax-exempt mortgage bonds are a form of savings and cost little or nothing because they actually increase net savings in the country. There are some analysts who advocate a static model, but even among these people there is substantial disagreement on cost.

The staff of the Joint Committee on Taxation simply argues that a tax-exempt security displaces a taxable security of equal amount and the tax losses computed as a tax that would have been paid on the taxable security.

Prof. Roger Kormendi and Tom Nagle, who were mentioned earlier in the day, at the University of Chicago dispute this particular approach. They assert that investor behavior is not consistent with the assumptions embodied in the Joint Tax Committee model.

They point out that the Federal Reserve data about actual asset holding patterns demonstrates that investors shift among investments for a variety of reasons not always predicated upon pure after-tax yield considerations; that they project the revenue losses under mortgage bond programs at only a third of the amount estimated by the Joint Committee staff.

The recent GAO preliminary report on——

Senator ROTH. That was the Federal Reserve?

Mr. SMITH. Federal Reserve data, yes.

The recent GAO preliminary report on mortgage bonds muddies the water even further. First, GAO ignores the revenue feedback effect of reduced homeowner deductions, tax deductions which the Joint Committee staff uses, thus incorrectly inflating its cost estimates by 20 to 30 percent.

In addition, GAO places its cost estimates on the taxable interest rates which existed in the early half of 1982. This raises the overall estimate of revenue lost to nearly twice the amount that the Joint Committee staff uses.

Finally, GAO includes an incorrect assumption about the percent of bond proceeds that are actually loaned to home buyers, thereby further inflating costs.

GAO projects the lifetime cost of the average bond-financed mortgage in 1982 at $13,300. If this number is corrected to conform with the Joint Committee staff approach, the theoretical loss drops to $10,155. Under the Kormendi-Nagle method, the actual loss would drop to $3,231.

Correcting all of these figures to reflect the interest rates which the Joint Committee staff projects for the next 5 years, we see a further drop in estimated cost. And we have a chart on this.

Thus, the actual Joint Committee staff estimate revenue loss per average GAO mortgage amount would be $6,255. Under the Kormendi-Nagle approach the loss drops to $2,065. And I want to point out that these are theoretical estimates, but there is disagreement on what the theoretical estimate of tax loss is.

As the GAO report inflates the alleged program cost of these programs, it also understates the benefits to home buyers by using an incorrect low spread of 2 percent between taxable and tax-exempt obligations. If a more accurate spread of 3.5 percent is used, the average 1982 home buyer under mortgage bond programs would have saved $8,533 because of tax exemption.

Remember, this compares with a revenue loss of $10,155 under the Joint Committee approach, $3,231 under Kormendi-Nagle. Remember also that these two figures are simply estimates.

If the GAO's assumptions are corrected to reflect actual market conditions which existed throughout 1982 or the more normal conditions existing today, the costs of various alternatives to housing subsidies is roughly equivalent. Indeed, if the Kormendi-Nagle approach is used, revenue bonds are by far the cheapest way to assist first-time homebuyers.

One final question must be considered, and that is whether comparable assistance could be provided to first-time home buyers in less costly fashion than under bond programs. Is anyone seriously considering that the Federal Government is going to launch some new ownership program? Does anyone seriously maintain that Washington can design a program that is better than the programs you have heard about today?

I believe that you will answer "no" to these questions the same way I do. I request that you allow the continued operation of these very successful programs.

I very much appreciate the opportunity to talk to you today, and particularly Senator Packwood, and urge your support of S. 137.

Thank you.

[The prepared statement of M. Gregg Smith follows:]

PREPARED STATEMENT OF

M. GREGG SMITH

ADMINISTRATOR

OREGON HOUSING DIVISION

BEFORE THE

UNITED STATES SENATE

SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

MAY 13, 1983

MR. CHAIRMAN, MY NAME IS GREGG SMITH. I AM THE ADMINISTRATOR OF THE STATE OF OREGON'S HOUSING DIVISION. OUR AGENCY FINANCES SINGLE FAMILY HOMES, RENTAL APARTMENTS AND OPERATES A NUMBER OF OTHER INNOVATIVE PROGRAMS. A SEVEN MEMBER HOUSING COUNCIL APPOINTED BY THE GOVERNOR APPROVES ALL OUR LARGER LOANS AND OUR AGENCY RULES. WE ARE ENTIRELY SELF-SUPPORTING.

I AM HERE TO EXPRESS SUPPORT FOR S. 137, THE BILL TO PRESERVE THE AVAILABILITY OF LOW PRICED MORTGAGE FUNDS FOR FIRST-TIME HOMEBUYERS. IT IS A PARTICULAR PRIVILEGE TO APPEAR BEFORE YOUR SUBCOMMITTEE, MR. CHAIRMAN FOR I HAVE LONG APPRECIATED YOUR CONCERN FOR OUR ABILITY TO MEET THE HOUSING NEEDS OF THE PEOPLE OF OREGON. WE ARE GRATEFUL FOR YOUR COSPONSORSHIP OF S. 137 AND YOUR LEADERSHIP IN CHAIRING THIS HEARING.

I AM ONE OF THE LONGEST SERVING ADMINISTRATORS OF A STATE HOUSING AGENCY IN THE COUNTRY. I MENTION THIS ONLY BECAUSE IT IS FROM THIS PERSPECTIVE OF DEALING WITH A RANGE OF FEDERAL HOUSING AND TAX

PROGRAMS OVER TWELVE YEARS THAT I WOULD LIKE TO ADDRESS SOME OF THE ARGUMENTS WHICH HAVE BEEN ADVANCED AGAINST MORTGAGE REVENUE BOND PROGRAMS. A CASE IN POINT WOULD BE THOSE RAISED IN A RECENT GENERAL ACCOUNTING OFFICE REPORT.

FOR YEARS I HAVE HEARD FEDERAL OFFICIALS ATTACK STATE HOUSING FINANCE PROGRAMS AS COSTLY AND INEFFICIENT. MY FIRST REACTION IS "COSTLY COMPARED TO WHAT?" TO OTHER FEDERAL HOUSING PROGRAMS? I SUGGEST TO YOU THAT THOSE PROGRAMS, WHILE OFTEN EFFECTIVE, HAVE BEEN QUITE EXPENSIVE.

"COSTLY COMPARED TO OTHER TAX INCENTIVES?" I DOUBT IT. THERE IS NO MORE TIGHTLY CONTROLLED, CAREFULLY CAPPED TAX BENEFIT IN THE INTERNAL REVENUE CODE THAN THE EXEMPTION OF INTEREST ON MORTGAGE REVENUE BONDS.

BUT WHAT DO MORTGAGE BOND PROGRAMS COST? SOME ECONOMISTS, SUCH AS DR. NORMAN TURE, FORMER UNDERSECRETARY OF THE TREASURY, ARGUE THAT TAX EXEMPT MORTGAGE BONDS ARE A FORM OF SAVINGS AND COST LITTLE OR NOTHING BECAUSE THEY INCREASE NET SAVINGS IN THE COUNTRY. AS THIS INCREASED SAVINGS BASE IS USED TO FINANCE PRODUCTION, IT CREATES JOBS AND THEREBY INCREASES FEDERAL, STATE AND LOCAL REVENUES TO REPLACE THOSE LOST THROUGH THE TAX EXEMPTION.

EVEN AMONG THOSE ANALYSTS WHO ADVOCATE THE STATIC MODEL FOR ESTIMATING THE COST OF MORTGAGE BONDS—AS OPPOSED TO THE DYNAMIC MODEL SUGGESTED BY DR. TURE—THERE IS SUBSTANTIAL DISAGREEMENT. IN ONE APPROACH, THE STAFF OF THE JOINT COMMITTEE ON TAXATION SIMPLY ASSUMES THAT A TAX-EXEMPT SECURITY DISPLACES A TAXABLE SECURITY OF EQUAL AMOUNT. THE TAX LOSS IS COMPUTED AS THE TAX THAT WOULD HAVE BEEN PAID ON THE TAXABLE SECURITY - OFFSET TO SOME EXTENT, IN THE CASE

OF MORTGAGE BONDS, BY THE LOWER INTEREST DEDUCTIONS AVAILABLE TO THE BOND PROGRAM HOMEBUYER. WHILE THE JOINT COMMITTEE STAFF ACKNOWLEDGE THAT MOST INVESTORS SIMPLY SHIFT FROM ONE TAX-PREFERRED INVESTMENT TO ANOTHER, THEY ASSERT THAT THIS SHIFTING "TRICKLES DOWN" THROUGH THE MARKET UNTIL THE MARGINAL INVESTOR SHIFTS TO THE HYPOTHETICAL TAXABLE INVESTMENT.

PROFESSORS ROGER KORMENDI AND TOM NAGLE OF THE UNIVERSITY OF CHICAGO DISPUTE THIS "TRICKLE DOWN" THEORY. THEY ASSERT THAT INVESTOR BEHAVIOR IS NOT CONSISTENT WITH THE ASSUMPTIONS EMBODIED IN THE JOINT COMMITTEE MODEL. THEY POINT OUT THAT FEDERAL RESERVE DATA ABOUT ACTUAL ASSET HOLDING PATTERNS DEMONSTRATES THAT INVESTORS SHIFT AMONG INVESTMENT FOR A VARIETY OF REASONS, NOT ALWAYS PREDICATED ON PURE AFTER-TAX-YIELD CONSIDERATIONS. THUS, KORMENDI AND NAGLE PROJECT REVENUE LOSSES UNDER MORTGAGE BOND PROGRAMS AT ONLY ONE-THIRD OF THE AMOUNT ESTIMATED BY THE JOINT COMMITTEE STAFF.

I WOULD LIKE TO INSERT IN THE RECORD AT THIS POINT A TABLE ILLUSTRATING THIS RELATIONSHIP.

Mortgage Revenue Bonds: Revenue Loss Estimates
FY 1984 - 1988

	1984	1985	1986	1987	1988	TOTAL
Joint Committee	$59 M	$222 M	$421 M	$616 M	$814 M	$2,159 B
Kormendi (approx.)	$15 M	$69 M	$149 M	$233 M	$324 M	$790 M
Kormendi Estimate as % of Joint Committee	25%	31%	35%	38%	40%	37%

THE RECENT GAO REPORT MUDDIES THE WATER EVEN FURTHER. FIRST, GAO IGNORES THE "REVENUE FEEDBACK" EFFECT OF REDUCED HOMEOWNER DEDUCTIONS WHICH THE JOINT COMMITTEE STAFF USES, THUS INCORRECTLY

INFLATING ITS COST ESTIMATES BY 20% TO 30%.

IN ADDITION, GAO BASES ITS COST ESTIMATES ON THE TAXABLE INTEREST RATES WHICH EXISTED IN 1982. THIS RAISES THE OVERALL ESTIMATE OF REVENUE LOSS TO NEARLY TWICE THE AMOUNT THAT THE JOINT COMMITTEE STAFF WOULD PROJECT.

FINALLY, GAO INCLUDES AN INCORRECT ASSUMPTION ABOUT THE PERCENT OF BOND ISSUE PROCEEDS THAT ARE ACTUALY LOANED TO HOMEBUYERS, THEREBY INFLATING COSTS FURTHER.

GAO PROJECTS THE LIFETIME COST OF THE AVERAGE TAX-EXEMPT MORTGAGE IN 1982 TO HAVE BEEN $13,300. AS THE COUNCIL OF STATE HOUSING AGENCIES' (CSHA) RESPONSE TO GAO WHICH WAS OFFERED TO THE RECORD EARLIER TODAY, DEMONSTRATES IN DETAIL, IF THIS NUMBER IS CORRECTED TO CONFORM TO THE STANDARD JOINT COMMITTEE STAFF APPROACH, IT DROPS TO $10,155. UNDER THE KORMENDI-NAGLE METHOD, TOTAL REVENUE LOSSES PER AVERAGE MORTGAGE LOAN IN 1982 WILL BE $3,231.

CORRECTING THESE FIGURES TO REFLECT THE INTEREST RATES WHICH THE JOINT COMMITTEE STAFF PROJECTS FOR THE NEXT FIVE YEARS, WE SEE A FURTHER DROP IN ESTIMATED PER UNIT COSTS. THUS, THE ACTUAL JOINT COMMITTEE STAFF ESTIMATE OF REVENUE LOSS PER AVERAGE GAO MORTGAGE AMOUNT WOULD BE $8,255. UNDER THE KORMENDI-NAGLE APPROACH, THIS LOSS DROPS TO $2,065.

IF FORCED TO CONCEDE THE COST EFFICIENCY OF MORTGAGE BOND PROGRAMS, OPPONENTS RETREAT TO THE ARGUMENT THAT MORTGAGE BONDS ADVERSELY AFFECT THE ENTIRE MUNICIPAL SECURITIES MARKET. THIS PROPOSITION, HOWEVER, CANNOT SURVIVE SERIOUS ANALYSIS. THE VOLUME OF MORTGAGE BONDS IS TIGHTLY CONTROLLED BY THE 1980 ACT, AND THE VOLUME IN ANY ONE YEAR IS UNLIKELY TO EXCEED 2% OF THE TOTAL OUTSTANDING TAX-

EXEMPT SECURITIES. VOLUME OF THIS MAGNITUDE IS NOT SUFFICIENT TO HAVE A DISCERNIBLE IMPACT ON INTEREST RATES IN A $400 BILLION MARKET.

COST, OF COURSE, IS ONLY ONE SIDE OF THE ISSUE. THE OTHER SIDE IS THE BENEFIT PRODUCED BY MORTGAGE BOND PROGRAMS. AS THE GAO REPORT INFLATES PROGRAM COSTS, SO DOES IT UNDERSTATE BENEFITS TO HOMEBUYERS BY USING AN INCORRECTLY LOW SPREAD OF 2% BETWEEN TAXABLE AND TAX EXEMPT MORTGAGE RATES IN 1982. IF A MORE ACCURATE SPREAD OF 3.5% IS USED, THE AVERAGE 1982 HOMEBUYER UNDER MORTGAGE BOND PROGRAMS WILL HAVE SAVED $8,533 BECAUSE OF THE TAX-EXEMPTION. THIS COMPARES WITH A REVENUE LOSS OF $10,155 UNDER THE JOINT COMMITTEE STAFF APPROACH OR $3,231 UNDER THE KORMENDI-NAGLE METHOD. REMEMBER, THESE ARE COMPARISONS THAT HELD TRUE FOR 1982 AND ARE NOT ADJUSTED DOWNWARD TO REFLECT LOWER INTEREST RATES.

OF COURSE, AS ANOTHER WITNESSES' TESTIMONY HAS POINTED OUT, THE REAL BENEFITS OF TAX-EXEMPT FINANCING FOR HOMEOWNERSHIP ARE THAT IT PERMITS FAMILIES TO PURCHASE THEIR FIRST HOMES, PROMOTES NEIGHBORHOOD REDEVELOPMENT AND HELPS TO REVIVE A MORIBUND HOUSING MARKET.

ONE FINAL QUESTION MUST BE CONSIDERED, AND THAT IS WHETHER COMPARABLE ASSISTANCE COULD BE PROVIDED TO FIRST-TIME HOMEBUYERS IN A LESS COSTLY FASHION THAN UNDER MORTGAGE BOND PROGRAMS. THE COUNCIL OF STATE HOUSING AGENCIES' RESPONSE TO GAO DEMONSTRATES IN DETAIL THAT IF GAO'S ASSUMPTIONS ARE CORRECTED TO REFLECT THE ACTUAL MARKET CONDITIONS WHICH EXISTED IN 1982 OR THE MORE NORMAL CONDITIONS EXISTING TODAY, THE COSTS OF VARIOUS ALTERNATIVE APPROACHES TO HOUSING SUBSIDIES ARE ROUGHLY EQUIVALENT. INDEED, IF THE KORMENDI-NAGLE ANALYSIS IS CORRECT, REVENUE BONDS ARE BY FAR THE CHEAPEST WAY TO ASSIST FIRST-TIME HOMEBUYERS.

I WOULD LIKE TO INSERT IN THE RECORD, AT THIS POINT, A TABLE WHICH ILLUSTRATES THE VARIOUS COST ESTIMATES PROPOSED BY GAO AND CORRECTED BY CSHA.

Program	Subsidy per mortgage: GAO assumptions	Subsidy per mortgage: alternative assumptions
Mortgage revenue bonds	$13,300	$5,699
Taxable bonds	$10,400	$8,835
Mortgage grants	$ 3,400	$8,680
Tax credits	$ 3,500	$9,112

BUT ASIDE FROM COST, I WOULD POSE SEVERAL QUESTIONS FOR YOU, OR MORE PROPERLY, FOR GAO:

IS ANYONE TODAY SERIOUSLY CONSIDERING A NEW FEDERAL SPENDING PROGRAM FOR HOMEOWNERSHIP?

DOES ANYONE TODAY SERIOUSLY MAINTAIN THAT WASHINGTON CAN DESIGN HOUSING PROGRAMS TO MEET LOCAL NEEDS AND LOCAL CONDITIONS MORE EFFECTIVELY THAN CAN A STATE OR LOCAL AGENCY?

CAN ANYONE SERIOUSLY ASSERT THAT THE INDEPENDENT, SELF-SUPPORTING ACTIVITIES OF EXPERIENCED STATE HOUSING AGENCIES OUGHT TO BE TERMINATED IN FAVOR OF AN EXPANDED ROLE FOR THE FEDERAL GOVERNMENT?

I SUSPECT YOU WILL ANSWER "NO" TO THESE QUESTIONS, AS THE PEOPLE IN OREGON AND THE 49 OTHER STATES THAT PERMIT TAX-EXEMPT FINANCING FOR HOME OWNERSHIP HAVE — "NO" TO ANOTHER WASHINGTON-DIRECTED, FEDERAL SPENDING PROGRAM—AND THAT YOU WILL PROVIDE CONTINUED SUPPORT FOR THE PROGRAMS OF STATE AND LOCAL HOUSING FINANCE AGENCIES.

I APPRECIATE YOUR COURTESY IN HEARING ME OUT AND URGE YOUR PROMPT ACTION ON S. 137.

Senator ROTH. Mr. Heltzer.

STATEMENT OF JAMES R. HELTZER, EXECUTIVE DIRECTOR, MINNEAPOLIS COMMUNITY DEVELOPMENT AGENCY, MINNEAPOLIS, MINN., ACCOMPANIED BY JAY JENSEN, DIRECTOR OF FINANCIAL SERVICES

Mr. HELTZER. Thank you.

Mr. Chairman, members of the subcommittee, my name is Jim Heltzer. I am the executive director of the Minneapolis Community Development Agency. I appreciate the opportunity to appear before you today to speak in favor of S. 137 relating to housing revenue bonds.

My testimony today will be from the perspective of local government, and more specifically, the experience Minneapolis has encountered in our efforts to upgrade and add to our housing stock, and the role that these mortgage revenue bonds have played in this effort.

Minneapolis' housing efforts began in 1939 when Mayor Hubert H. Humphrey created our agency, the Minneapolis Housing Authority, at that time. Since that time, the agency has created and currently manages approximately 6,900 public housing units. In addition, over 6,600 units of other subsidized rental housing units have been produced.

During the 1960's and 1970's, tens of millions of Federal dollars came to Minneapolis to assist us in rehabilitating and recreating housing in several of our worst neighborhoods, the worst neighborhoods with regard to housing problems. Moreover, millions of Federal dollars were loaned at 3 percent interest or granted to homeowners to rehabilitate their properties.

In the last several years we have expanded our housing efforts even though there have been less Federal dollars available. This housing effort has been coordinated through the development of a comprehensive municipal plan.

We have in Minneapolis, I believe, used the existing housing revenue bond program to create innovative housing programs that have been tailored to meet specific problems in housing for Minneapolis and our specific housing goals.

We started the recent group of programs back in 1974 with a local rehabilitation program. We sold $10 million of Federal obligation bonds at that time. We managed to get about $81½ million from local loan sources to match with that. Two thousand loans were originated. The average income of the person obtaining those loans was $18,488.

In 1977, we sold mortgage revenue bonds. It was our first effort at that. Single family loans were involved here. There were 94 loans originated. An average income of the people using the program then was under $17,000.

In 1979 there were three additional single-family programs using housing revenue bonds. One thousand seven hundred and thirteen mortgages resulted. The average income for these people was under $17,000. Ninety-one percent of the people who used those programs, the 1977 and 1979 programs, were people who had previously been renters.

Then in 1981, the city of Minneapolis and the city of St. Paul joined together with the private McKnight Foundation to develop the Minneapolis-St. Paul family housing program. This program utilized $120 million of housing revenue bonds. It utilized private funds from the McKnight Foundation. It also utilized moneys from labor union and municipal pension funds. The result was 1,800 units of housing. There were 2,000 construction jobs created as a result of this. The average income of the person using this program and benefiting from the sale of those bonds was approximately 84 percent of the median income for the metropolitan area.

The profile of the average person using the program was a person about 31 years old. Thirty percent of the people who used the program were female heads of household. Over 10 percent of the users of the program were minority individuals.

We have had a number of other innovative programs that we have utilized, and that is in the record that we prepared for the Clerk. Use of local, Federal, State, and private moneys, plus local creativity in developing effective programs has so far made it possible for us to push back the cancerous growth of poor housing, on the one hand, while giving low- or moderate-income families an opportunity to own a decent home in a decent neighborhood.

In block after block we have accomplished this in this city. We urge you not to take away this flexible and extremely useful tool for us because we need it in order to help our people.

Thank you very much.

[The prepared statement of James Heltzer follows:]

MINNEAPOLIS COMMUNITY DEVELOPMENT AGENCY

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JAMES R. HELTZER, EXECUTIVE DIRECTOR PHONE 612-348-2611

EQUAL EMPLOYMENT OPPORTUNITY

EQUAL HOUSING OPPORTUNITY

Testimony
of
James R. Heltzer
Minneapolis Community Development Agency
Before the Senate Subcommittee on Taxation and Debt Management
May 13, 1983

Mr. Chairman, Members of the Subcommittee. I am Jim Heltzer -- Executive Director of the Minneapolis Community Development Agency.

I appreciate the opportunity to appear before you today to speak in favor of S. 137, relating to housing revenue bonds. My testimony today will be from the perspective of local government. More specifically, the experience Minneapolis has encountered in an effort to upgrade and add to its housing stock, and the role housing revenue bonds has played in this effort.

Minneapolis' housing efforts began in 1939 when Mayor Hubert H. Humphrey created the Minneapolis Housing and Redevelopment Authority (MHRA). Since then the MCDA has created and currently manages approximately 5900 public housing units. In addition, over 6600 units of other subsidized rental housing units have been produced. In the 1960's and early 1970's, tens of millions of federal dollars were spent through the Urban Renewal, Model Cities and Neighborhood Development Program to rehabilitate and recreate housing in several of Minneapolis' neighborhoods. Moreover, millions of federal dollars were loaned at three percent interest or granted to homeowners to rehabilitate their properties.

In the last several years, Minneapolis has expanded its housing efforts even though less federal dollars are available. This housing effort has been coordinated with the development of a Comprehensive Municipal Plan. The Comprehensive Plan details the interrelationship of all municipal activities from public works to parks to housing. Housing is a major chapter of this Plan. Like any prudent corporation.

COMMISSIONERS STEPHEN H. KEEFE CHAIRMAN BARBARA ALLIVATO D. ELIZABETH ANDERSON LEONARD C. BIENIAS EDWARD DIRKSWAGER MICHELE G. FOSTER RICHARD D. HALL RICHARD H. JEFFERSON STANLEY J. MURZYN RICHARD D. SCHNEIDER LYALL A. SCHWARZKOPF

Minneapolis has not only tried to coordinate its various activities through this Comprehensive Plan, but has tried to direct its resources to achieve prescribed goals by 1990.

The Housing Chapter of the Comprehensive Plan relies upon the resources of the Department of Housing and Urban Development and the Minnesota Housing Finance Agency in conjunction with local resources to achieve the 1990 goals. A major piece of the state and local resources is the utilization of housing revenue bonds to provide affordable rehabilitation loans and home mortgages. As with any comprehensive, interrelated effort, all of the major components must be utilized to assure any chance of meeting a prescribed goal. Such is the case with housing revenue bonds. Minneapolis will not meet its 1990 goals if a major tool, housing revenue bonds, is not utilized.

Minneapolis has created several innovative housing finance programs. In 1974 Minneapolis created one of the first local rehabilitation loan programs with the sale of four General Obligation Bonds totalling $10 million dollars. The $10 million dollars of City funds were matched by $8,500,000 of local lending monies. This local rehabilitation loan program created 2000 loans averaging $7,750 with interest rates between four and eight percent. The average income was $18,488. In 1977, Minneapolis became the first local issuer of single family housing revenue bonds. This program assisted 94 people who had an average adjusted income of under $17,000. In the next year and one half, Minneapolis had three additional programs which provided an additional 1713 mortgages for people whose average income was under $17,000. Another interesting feature of these first four homeownership programs was that 91% of the home buyers were previously renters and the average single family homes cost less than $40,000. In 1981 Minneapolis joined together with the City of Saint Paul to create a $120 million single family mortgage program that created 1800 housing units in both cities. This program has also created almost 2000 construction jobs in both cities over the last year and one half. To date, approximately two thirds of the mortgages have been closed. Demographic statistics show that the average income is 84% of the metropolitan median income. The average home buyer's age is 31 years old and over 30% of the home buyers are female head of households and over 10% of the borrowers being minority people. In addition to the two cities working together, this program also has a commitment of several million dollars from the McKnight Foundation, as well as several million dollars of construction loans from Minnesota labor union and municipal pension funds.

Since the enactment of the Mortgage Subsidy Bond Tax Act of 1980, Minneapolis has created two new housing finance programs to further energy conservation and substantial rehabilitation. The first of these innovative programs was the Energy Bank Program, which is now in its second phase.

The purpose of the Energy Bank Program is to provide up to $5,000 loans to single family homes to do energy conservation improvements that would pay for themselve within a ten year period. The innovative feature of this program is that the loans are serviced and originated by local gas utilities at no charge to the borrowers or the City. The first program began with a housing revenue bond of $2,750,000, privately placed by the Minneapolis Community Development Agency staff. Phase II consisted of a bond sale last year of $6,300,000. To date, approximately 1600 loans have been made to homeowners under this program. Early indications estimate that these homeowners receiving the energy bank loans will see a significant savings off their monthly heating bill. The attached report by Iric Nathanson, Energy Finance Coordinator, describes the Energy Bank Program in greater detail and how the Program complies with the Mortgage Subsidy Bond Tax Act of 1980.

The second innovative program is a substantial rehabilitation loan program entitled Project Renovate. Project Renovate was capitalized with a $4,800,000 housing revenue bond and $880,000 of Urban Development Action Grant monies. The Program will provide loans of from $15,000 to $50,000 to finance major renovation of one-to-four unit owner-occupied housing. Approximately half of the loan funds will be available to finance the rehabilitation of urban homestead properties which are limited to people whose income is less than 80 percent of area median income. The remaining funds will be available on a first-come, first-serve basis to eligible applicants throughout the City. As part of their renovation work, borrowers will be required to bring their property into compliance with City energy conservation standards. Loan funds will be available, on a limited basis, to refinance existing contract-for-deeds when such refinancing is necessary to facilitate rehabilitation. In such cases, the loan limit will be increased from $50,000 to $60,000. Of the total $4.8 million bond issue, $900,000 will be available for refinancing. The MCDA contributed $250,000 to pay a portion of the interest due on the revenue bonds during the first four years of the Program. This interest payment will enable the Agency to reduce the interest paid by the borrower on a graduated basis. During the first year of the 15 year loan amortization period, the interest rate will be 9.5%. This rate will increase to 10% in the second year, 11% in the third year and 12% in the fourth year. During the remaining years of the amortization period, the rate will be 1% in excess of the bond rate.

These two innovative Programs are helping Minneapolis maintain its current housing stock in good condition as well as making it more energy efficient. The cornerstone of these programs is the ability to customize a housing revenue bond in conjunction with local resources to meet a specific local need. This ability to create customized housing programs is very important to Minneapolis, and other cities as well. No series of federal housing programs is going to be able to meet all the housing needs of cities - each with its own type and severity of housing problems. Federal housing programs do meet many local housing needs, but there are always some housing needs that are not met. To let the ability of cities to utilize an important housing tool, housing revenue bonds, expire would directly cause some of the local housing needs to go unmet. The last thing cities need is to loose one of the few housing tools that can be specifically designed to help needs that would otherwise go wanting and add to the already excessive urban deterioration.

Based upon Minneapolis' need to create customized housing programs to meet unmet local housing needs through the prudent use of housing revenue bonds and other resources, Minneapolis has formally gone on record strongly supporting Senate Bill 137.

Once again, Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today.

Senator ROTH. Thank you, Mr. Heltzer.

Next we have Mr. White.

STATEMENT OF ARTHUR WHITE, CHAIRMAN, CONNECTICUT HOUSING FINANCE AUTHORITY, ON BEHALF OF THE NATIONAL CONFERENCE OF HOUSING FINANCE CHAIRMEN

Mr. WHITE. My name is Arthur White. I have three sources of my testimony. One is I am the chairman of the Connecticut Housing Finance Authority and have been for 7 years. Two, I was elected last year the chairman of the National Conference of Housing Finance Chairmen, and I have had the opportunity to go around the country and meet with my brethren who are in housing finance leadership. And three, I am a partner and vice chairman of Yankelovich, Skelly and White, a firm that is engaged, and I have been personally for over 30 years, in measuring public opinion in this country.

From those three sources, and without repeating many of the things that have been said, which I think are quite clear and factual and solid in terms of the achievements of these programs, including our own in Connecticut, I would like to skip to just a few summary points.

One, I think it is important—and as I sit here this morning, I am frankly pleased to hear questions being raised about this program, because I think that you, without arrogating to myself to tell you how to do your job, but I think the budget problem that this country has is extraordinarily critical.

I am spending time with Mr. Peterson's group, a group organized by other business people who are trying as desperately as we can in a way I have never seen bipartisan concern on that subject. So we have to look at the things we believe in. I believe in this program, but I believe it should be challenged, reviewed, examined in every way we can.

Second point: This is a success. This program is an extraordinary success for these reasons, I think. First, it does help low- or middle-income families. There is no way—and Senator Mitchell, you can ask those questions about the terms being used, but there is no question about the help to low- and middle-income families. And, you know, we will pour on you more statistics and evidence of that than you will ever need.

I listened to Dr. Rivlin, who I have a lot of respect for, but, you know, it is clear. This program does that. And I say this from the perspective of having spent—before I became head of the Housing Finance Authority I headed a public housing authority, I headed a housing site agency, I headed a planning agency in cities. And in the work we do we did a study for your Congress some 14 years ago assessing the community action program in 37 states and in 53 communities. I know low income and middle income from high income and affluent and more affluent, various aspects of the income stream. And I submit to you there is no question about this program helping low or middle income, particularly when you look at the multifamily aspects.

In Connecticut, for example, we have over 50 developments for low- and middle-income families, multifamily rental projects that only help mostly low income families, and also the rehab programs, as everybody has pointed out.

The flexibility of this program is extraordinary. We have in Connecticut an urban area mortgage program where we want to attract people back to the middle of Bridgeport, Conn., for example. We want to attract them back to New Haven, et cetera. This is the only kind of program that can do that.

The opposition says the cost is greater than direct subsidies. It may be, but you know and you have said that we are not going to enact direct subsidies. Also, when we had section 235 in Connecticut it did not work. The banks did not want to work with it. They work with us and they work with us well. Our board includes two bankers, our State officials. It is the most—I am on a number of private corporate boards and on public nonprofit. The board we have running this operation is the best.

And we have the oversight of legislative people, the auditors of the State; we have our bonds that we have to sell. These programs are working. They are standing the test.

One other thing: they have also stabilized the whole picture. I mean we have gone in my 7 years through periods where our money has been more or less attractive. This program has been the only money available in several of these periods.

I would like to say finally as a personal thing I hope you will continue this and will support Senate 137. I hope we will continue to work to improve this program. I think we can. I certainly will be happy to come at any time toward that end.

Third, our whole congressional delegation is supportive of essentially S. 137 because they know our program works, as I have seen recognizing by your State people.

And finally, I want to say this: that my satisfaction in this program—I do not sell real estate. I do not build homes. I am not in the finance business. I do it as a public service. It is important to me. This has been the most satisfactory and the easiest in a way effort, because we have marvelous staffs, too.

I think one of the great things of this program is that it has attracted men and women of extraordinary stature who could all get paid more by just crossing over to the banks or the various people they work with. So we have a tremendous national resource that we should be proud of, and I hope we will extend it and even improve it.

Thank you.

[The prepared statement of Arthur White follows:]

PREPARED STATEMENT OF

ARTHUR H. WHITE

CHAIRMAN, CONNECTICUT HOUSING FINANCE AUTHORITY

BEFORE THE

UNITED STATES SENATE

SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

MAY 13, 1983

MR CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, MY NAME IS ARTHUR H. WHITE AND I AM THE CHAIRMAN OF THE CONNECTICUT HOUSING FINANCE AUTHORITY. I HAVE BEEN CHAIRMAN FOR 7 YEARS, AND A MEMBER OF THE AGENCY BOARD FOR 8 YEARS.

IN PRIVATE LIFE I AM A PARTNER IN THE FIRM OF YANKELOVICH, SKELLY, AND WHITE, A MARKET AND SOCIAL RESEARCH CONSULTING FIRM. I MENTION THIS NOT ONLY BECAUSE I AM PROUD OF MY ASSOCIATION WITH THIS FIRM, BUT, AS I WILL UNDERLINE LATER, MOST HOUSING FINANCE AGENCIES HAVE BOARDS REPRESENTING THE CITIZENS OF THEIR STATE.

THE CONNECTICUT AUTHORITY WAS AN EARLY AGENCY, AUTHORIZED IN 1969, AND AS OF JULY 1, 1981, OUR TOTAL HOUSING INVESTMENT WAS ABOUT $1.3 BILLION. THE AGENCY HAS 76 STAFF MEMBERS AND A 10 MEMBER BOARD OF COMMISSIONERS. THROUGH 1981, THE AGENCY HAD FINANCED ABOUT 7,000 RENTAL UNITS INCLUDING OVER 500 DEEP SUBSIDY SECTION 8 UNITS, AND SOME 30,000 SINGLE FAMILY MORTGAGES.

I AM CHAIRMAN OF A COMMISSION THAT INCLUDES THE STATE TREASURER, BANKING COMMISSIONER, HOUSING COMMISSIONER, AND SECRETARY OF POLICY

AND MANAGEMENT, AS WELL AS 6 ADDITIONAL MEMBERS APPOINTED BY THE GOVERNOR.

MY EXPERIENCE, AND THAT OF MY FELLOW COMMISSIONERS, IS THAT TAX EXEMPT FINANCING IS AN EFFICIENT AND EFFECTIVE WAY TO FINANCE HOUSING FOR THOSE WHO CANNOT OTHERWISE AFFORD DECENT RENTAL UNITS, OR AFFORD TO PURCHASE HOMES. WHY DO I, AS A PRIVATE CITIZEN, BELIEVE SO STRONGLY IN THE VALUE OF TAX-EXEMPT FINANCING? BECAUSE I HAVE SEEN IT WORK. I HAVE SEEN THE CONNECTICUT AGENCY GROW OVER THE PAST 14 YEARS TO INCREASE ITS EXPERTISE, ITS ABILITY TO RESPOND QUICKLY AND EFFECTIVELY TO LOCAL NEEDS.

WE HEAR A LOT ABOUT THE "NEW FEDERALISM." WHETHER "NEW" OR "OLD," STATE HOUSING AGENCIES REPRESENT FEDERALISM AT ITS BEST. THE FEDERAL GOVERNMENT ESTABLISHES A NATIONAL POLICY OF CREDIT SUPPORT FOR HOUSING, AND STATE LEGISLATURES PROVIDE, AND STATE AGENCIES OPERATE, THE TOOLS THAT IMPLEMENT THIS POLICY I FRANKLY BELIEVE, MR. CHAIRMAN, THAT WE FROM STATE HOUSING AGENCIES OUGHT TO BE COMING TO CONGRESS TO DISCUSS WITH YOU HOW TO ENHANCE AND EXPAND OUR ABILITY TO RESPOND TO LOCAL NEEDS AND CONDITIONS, RATHER THAN COMING TO PLEAD FOR OUR CONTINUED EXISTENCE.

HFAS ARE MOST RESPONSIVE TO LOCAL NEEDS BECAUSE THEY ARE HELD ACCOUNTABLE FOR THEIR ACTIONS. STATE HFAS AND MOST LOCAL AGENCIES HAVE THREE LEVELS OF ACCOUNTABILITY. FIRST, THERE IS SERIOUS LEGISLATIVE OVERSIGHT. STATE LEGISLATURES ESTABLISH THE PRIORITIES AND RESTRICTIONS GOVERNING STATE AGENCY OPERATIONS. INCOME LIMITS ARE GENERALLY REQUIRED. AGENCIES ARE OFTEN SUBEJCT TO STATE MUNICIPAL FINANCE COMMISSION REVIEW, AND ALWAYS ARE SUBJECT TO LEGISLATIVE COMMITTEE REVIEW AND LEGISLATIVE AUDITS.

SECOND, THE AGENCIES' MANAGEMENT IS SUBJECT TO BOARD OVERSIGHT. OUR BOARD HAS 10 ACTIVE, CONCERNED MEMBERS. IT IS A COMMON PATTERN TO HAVE THE STATE TREASURER ON THE BOARD. SOME STATES HAVE THE ATTORNEY GENERAL. A FEW EVEN HAVE THE GOVERNOR. THE PRIVATE APPOINTEES MOST OFTEN REPRESENT COMPETING INTERESTS. FOR EXAMPLE, MANY STATES HAVE BANKING REPRESENTATIVES WHO ARE VERY CONCERNED THAT THE STATE AGENCY NOT UNDULY COMPETE WTH PRIVATE MORTGAGE FINANCING.

LAST, BUT NOT LEAST THERE IS MARKET DISCIPLINE. STATE HOUSING FINANCE AGENCIES AND THE MAJOR LOCAL HFAS ARE NOT OVERNIGHT MONEY MANUFACTURING OPERATIONS. WE ARE HERE TO STAY AND PLAN TO FINANCE HOUSING IN FUTURE YEARS. WE MUST MEET THE TEST OF THE NATIONAL FINANCIAL MARKETS.

THUS YOU CAN SEE THAT STATE AND LOCAL AGENCIES DO NOT OPERATE IN ISOLATION. THEIR DECISIONS AS TO PUBLIC POLICY ARE OFTEN HOTLY CONTESTED. PUBLIC PURPOSE IS MAINTAINED AND PROTECTED BY THIS PROCESS.

I ALSO POINT OUT ANOTHER BENEFIT OF MAINTAINING STATE AND LOCAL PROGRAMS. WE AT THE LOCAL LEVEL HAVE BECOME INTERESTED IN TOTAL HOUSING PROGRAMS. STATE AND LOCAL GOVERNMENT ARE FINANCING RENTAL LOANS, REHABILITATION LOANS, AND ARE USING THESE PROGRAMS TO REACH URBAN AND RURAL AREAS NOT HERETOFORE ADEQUATELY SERVED. WE HAVE COMBINED STATE AND FEDERAL FUNDS IN CREATIVE WAYS SUCH AS PROVIDING LOANS FOR HANDICAPPED HOUSING.

THIS GROWTH IS A CRITICAL PART OF THE DEVELOPING FEDERALISM TO WHICH I REFERRED EARLIER. HOWEVER, THIS GROWTH CANNOT CONTINUE AND WE CANNOT CONTINUE TO ACCEPT NEW RESPONSIBILITIES IF OUR BASIC

FINANCING TOOL IS ELIMINATED AND REPLACED BY FEDERALLY ADMINISTERED PROGRAMS. WITHOUT SOME INDEPENDENT SOURCE OF FINANCING AND SUPPORT, WE WILL BE UNABLE TO MAINTAIN OURSELVES AS VIABLE INDEPENDENT AGENCIES.

IN CONCLUSION, MR. CHAIRMAN, I FIRMLY STATE THAT THE NEED FOR THE MRB PROGRAM CONTINUES. ITS FUTURE MAY VARY FROM NEW CONSTRUCTION, TO THE REHABILITATION OF OUR CITIES, TO PROVIDING FOR AFFORDABLE LOW INTEREST RATE HOME IMPROVEMENT LOANS TO LOW INCOME HOMEOWNERS, TO WHATEVER OTHER OBJECTIVES MAY BE SET AT THE LOCAL LEVEL. BUT THE NEED IS THERE MORE THAN EVER.

IT'S TRUE THAT INTEREST RATES HAVE FALLEN, BUT RATES ARE STILL FAR HIGHER THAN THE HISTORICAL LEVELS FOR MORTGAGES, AND THEY WILL REMAIN HIGHER THAN IS TRADITIONAL IN A DEREGULATED MARKET. WE AT THE STATE AND LOCAL LEVEL NEED THE TOOL OF TAX-EXEMPT FINANCING TO MEET THE RECOGNIZED NEEDS OF OUR CITIZENS.

MRBS PROVIDE A MEANS TO SERVE THOSE NEEDS WHICH IS:

- O ALREADY IN PLACE.
- O EFFECTIVELY CONTROLLED AT THE FEDERAL, STATE, AND LOCAL LEVEL.
- O BALANCED BETWEEN PUBLIC PRIORITIES AND PRIVATE MARKET DISCIPLINE.

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO APPEAR HERE TODAY. I BELIEVE YOU SHOULD MOVE QUICKLY ON S. 137.

Senator ROTH. Thank you, Mr. White.
Ms. Feldman.

STATEMENT OF BARBARA F. FELDMAN, DEPUTY DIRECTOR, STATE OF NEW YORK MORTGAGE AGENCY, NEW YORK, N.Y.

Ms. FELDMAN. My name is Barbara Feldman. I am the deputy director of the State of New York Mortgage Agency, better known by its trade name of SONYMA.

I am speaking here on behalf of Wallace Ford, our executive director and chief executive officer. Due to a death in the family he is unable to deliver these remarks himself.

Since its establishment in 1970 as a public benefit corporation, the State of New York Mortgage Agency has played a significant role in stabilizing and increasing the supply of funds in the private banking system for residential mortgage loans.

During the past 12 years the agency has issued approximately $1.2 billion in tax-exempt revenue bonds, providing financing for an estimated 30,000 new mortgage loans. In the attempt to make residential mortgages a more attractive investment for the private banking system, the State legislature established SONYMA as a secondary mortgage market within the State. SONYMA's operation was also aimed at reducing the volatility in the availability of mortgage credit and thereby provide stability to the housing and construction industries.

Prior to the enactment of the Mortgage Subsidy Bond Tax Act of 1980, SONYMA's mortgage purchase program provided a secondary market for mortgages exclusive of the current targeting and first-time home ownership requirements. During this 10-year period, SONYMA issued $645 million in tax-exempt bonds.

The agency's response to the statutory changes of the Mortgage Subsidy Bond Tax Act has been both aggressive and responsible. Notably, SONYMA became the first agency to issue bonds under the act and became a model for many other States.

More significantly, it has been responsive to the overwhelming housing needs of the State by exercising its initiative and authority in helping to provide financing for many households which otherwise would not have been able to purchase homes at conventional rates. For example, the November 1981 and July 1982 bond issues enabled SONYMA to provide 14 percent mortgages when the rates were as high as 17 percent. At the same time, the agency has made available a large number of high loan-to-value ratio mortgages which enabled many households to purchase homes with low downpayments.

In 1970 few housing economists could have accurately predicted the developments in the housing market during the next 12 years. By 1980 the median household income in New York State was $19,844, an increase of 87 percent from the median income of $10,617 in 1970. During the same period, the median purchase price of a home increased at a substantially higher rate; 1970 census data show that the median asking price for a vacant for sale home was $19,600. However, 1980 data reflects a median asking price of $46,000 for the same type of structure—a dramatic increase of price of $26,500 or 135 percent.

In 1970 almost 50 percent of all American families could afford a median priced single family home, but in 1980 only 15 percent could afford a median-priced home. During that same period of time interest rates for home mortgages increased from about 8 percent in 1970 to 70 percent in 1981.

The affordability of housing has had the most dramatic impact on the first-time home buyer. While the proportion of the population in the first-time home buyer category nationwide has risen, fewer homes, 13.5 percent of all homes sold, were sold to them in 1981, as compared to 1977 when 36 percent of all homes were sold to first-time home buyers.

The shortage of mortgage financing in traditional lending channels has been one of the primary reasons for the decline in starts and sales. While deregulation of banking institutions has served to increase the funds available to banks that could be used for mortgage lending, these institutions are still not providing adequate long-term fixed rate financing.

In spite of the influx of funds into New York State banks this year, there has been on increase in mortgage activity over the comparable period of last year. The lenders' reluctance to issue new mortgage loans is most clearly supported by statistics on the sale of existing housing in New York State. Although interest rates started dropping by the end of 1982, the sales of existing homes did not increase very much in 1982, and no change yet appears in the first quarter of 1983. In 1981, 120,700 existing homes were sold in New York State with a slight increase to 120,900 in 1982.

The State of New York Mortgage Agency has a firm commitment to insure that homeownership opportunities continue to exist for those households that cannot afford to purchase at market interest rates.

Furthermore, the redevelopment and the rehabilitation of large urban areas such as New York City and Buffalo depend to a great extent on the leveraging of private and public funds which the Mortgage Subsidy Bond Tax Act can afford.

SONYMA looks forward to participating in innovative housing efforts. Projects such as those being sponsored by the New York City Partnership and the South Bronx Development Corporation at Charlotte Street, and the East Brooklyn Church's Nehemiah Plan, all in inner city neighborhoods, will require below-market rates to make these projects viable.

The State of New York Mortgage Agency's goal is to inspire and encourage and facilitate financial institutions and private developers to invest throughout the State, making New York State a more desirable place to live.

Our ability to fully meet this goal is contingent upon the passage of S. 137. I encourage your support of this legislation, not only for the social and economic health of New York State, but for the country as a whole.

Thank you.

[The prepared statement of Ms. Barbara Feldman follows:]

SONYMA STATE OF NEW YORK MORTGAGE AGENCY

MAY 13, 1983

TESTIMONY OF
WALLACE L. FORD II
EXECUTIVE DIRECTOR/CHIEF EXECUTIVE OFFICER
STATE OF NEW YORK MORTGAGE AGENCY
BEFORE THE
UNITED STATES SENATE
SENATE FINANCE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

MR. CHAIRMAN AND DISTINGUISHED SENATORS, GOOD MORNING,

MY NAME IS BARBARA FELDMAN. I AM DEPUTY DIRECTOR OF THE STATE OF NEW YORK MORTGAGE AGENCY BETTER KNOWN BY ITS TRADE NAME OF SONYMA. I AM SPEAKING HERE ON BEHALF OF WALLACE L. FORD, EXECUTIVE DIRECTOR AND CHIEF EXECUTIVE OFFICER OF SONYMA. DUE TO A DEATH IN THE FAMILY, MR. FORD IS UNABLE TO DELIVER THESE REMARKS HIMSELF.

SINCE ITS ESTABLISHMENT IN 1970 AS A PUBLIC BENEFIT CORPORATION, THE STATE OF NEW YORK MORTGAGE AGENCY HAS PLAYED A SIGNIFICANT ROLE IN STABILIZING AND INCREASING THE SUPPLY OF FUNDS IN THE PRIVATE BANKING SYSTEM FOR RESIDENTIAL MORTGAGE LOANS. DURING THE PAST 12 YEARS, THE AGENCY HAS ISSUED APPROXIMATELY $1.2 BILLION IN TAX-EXEMPT REVENUE BONDS, PROVIDING FINANCING FOR AN ESTIMATED 30,000 NEW RESIDENTIAL LOANS. IN AN ATTEMPT TO MAKE RESIDENTIAL MORTGAGES A MORE ATTRACTIVE INVESTMENT FOR THE PRIVATE BANKING SYSTEM, THE STATE LEGISLATURE ESTABLISHED SONYMA AS A SECONDARY MORTGAGE MARKET WITHIN THE STATE. SONYMA'S OPERATION WAS ALSO AIMED AT REDUCING THE VOLATILITY IN THE AVAILABILITY OF MORTGAGE CREDIT AND THEREBY PROVIDE STABILITY TO THE HOUSING AND CONSTRUCTION INDUSTRIES.

260 Madison Avenue New York, New York 10016 (212) 340-4200

PRIOR TO THE ENACTMENT OF THE MORTGAGE SUBSIDY BOND TAX ACT IN 1980, SONYMA'S MORTGAGE PURCHASE PROGRAM PROVIDED A SECONDARY MARKET FOR MORTGAGES EXCLUSIVE OF THE CURRENT TARGETING AND FIRST-TIME HOMEOWNERSHIP REQUIREMENTS. DURING THIS 10-YEAR PERIOD, SONYMA ISSUED $645,000,000 IN TAX-EXEMPT BONDS.

THE AGENCY'S RESPONSE TO THE STATUTORY CHANGES OF THE MORTGAGE SUBSIDY BOND TAX ACT HAS BEEN BOTH AGGRESSIVE AND RESPONSIBLE. NOTABLY, SONYMA BECAME THE FIRST AGENCY TO ISSUE BONDS UNDER THE ACT AND BECAME A MODEL FOR MANY OTHER STATES. MORE SIGNIFICANTLY, IT HAS BEEN RESPONSIVE TO THE OVERWHELMING HOUSING NEEDS OF THE STATE BY EXERCISING ITS INITIATIVE AND AUTHORITY IN HELPING TO PROVIDE FINANCING FOR MANY HOUSEHOLDS WHICH OTHERWISE WOULD NOT HAVE BEEN ABLE TO PURCHASE HOMES AT CONVENTIONAL RATES. FOR EXAMPLE, THE NOVEMBER 1981 AND JULY 1982 BOND ISSUES ENABLED SONYMA TO PROVIDE 14% MORTGAGES WHEN THE RATES WERE AS HIGH AS 17%. AT THE SAME TIME, THE AGENCY HAS MADE AVAILABLE A LARGE NUMBER OF HIGH LOAN TO VALUE RATIO MORTGAGES WHICH ENABLED MANY HOUSEHOLDS TO PURCHASE HOMES WITH LOW DOWNPAYMENTS.

IN 1970, FEW HOUSING ECONOMISTS COULD HAVE ACCURATELY PREDICTED THE DEVELOPMENTS IN THE HOUSING MARKET DURING THE NEXT 12 YEARS.

BY 1980, THE MEDIAN HOUSEHOLD INCOME IN NEW YORK STATE WAS $19,844, AN INCREASE OF 87% FROM THE MEDIAN INCOME OF $10,617 IN 1970. DURING THE SAME PERIOD, THE MEDIAN PURCHASE PRICE OF A HOME INCREASED AT A SUBSTANTIALLY HIGHER RATE. 1970 CENSUS DATA SHOWED THAT THE MEDIAN "ASKING PRICE" FOR A VACANT "FOR SALE" HOME AT THAT TIME WAS $19,600; HOWEVER, 1980 DATA REFLECTS A MEDIAN "ASKING PRICE" OF $46,000 FOR THE SAME TYPE OF STRUCTURE—A DRAMATIC INCREASE IN PRICE OF $26,500 or 135%.

IN 1970, ALMOST 50% OF ALL AMERICAN FAMILIES COULD AFFORD A MEDIAN PRICED SINGLE FAMILY HOME, BUT IN 1980, ONLY 15% COULD AFFORD A MEDIAN PRICED HOME. DURING THAT SAME PERIOD OF TIME, INTEREST RATES FOR HOME MORTGAGES INCREASED FROM APPROXIMATELY 8% in 1970 TO OVER 17% BY 1981.

THE AFFORDABILITY OF HOUSING HAS HAD THE MOST DRAMATIC IMPACT ON THE FIRST-TIME HOMEBUYER. WHILE THE PROPORTION OF THE POPULATION IN THE FIRST-TIME HOMEBUYER CATEGORY NATIONWIDE HAS RISEN, FEWER HOMES, 13.5%, OF ALL HOMES SOLD, WERE SOLD TO THEM IN 1981 AS COMPARED TO 1977 WHEN 36% OF ALL HOMES WERE SOLD TO FIRST-TIME HOMEBUYERS.

HOUSING STARTS WERE LOWER IN 1980 AND 1981 THAN IN ANY OTHER YEAR SINCE 1959 WHEN OUR STATE'S DIVISION OF HOUSING AND COMMUNITY RENEWAL BEGAN RECORDING THE NUMBER OF PERMITS ISSUED. OVER THE PAST 20 YEARS, HOUSING STARTS IN NEW YORK STATE HAVE AVERAGED 75,000 PER YEAR WHILE HOUSING STARTS IN 1981 TOTALED ONLY 29,800. MOREOVER, DURING THE FIRST NINE MONTHS OF 1982, ONLY 21,300 PERMITS WERE ISSUED REFLECTING FEWER STARTS ON A MONTHLY BASIS THAN WERE REPORTED IN 1981.

THE SHORTAGE OF MORTGAGE FINANCING IN TRADITIONAL LENDING CHANNELS HAS BEEN ONE OF THE PRIMARY REASONS FOR THE DECLINE IN HOUSING STARTS AND HOME SALES. WHILE DEREGULATION OF BANKING INSTITUTIONS HAS SERVED TO INCREASE THE FUNDS AVAILABLE TO BANKS THAT COULD BE USED FOR MORTGAGE LENDING, THESE INSTITUTIONS ARE STILL NOT PROVIDING ADEQUATE LONG-TERM FIXED RATE FINANCING. IN SPITE OF THE INFLUX OF FUNDS INTO NEW YORK STATE BANKS THIS YEAR, THERE HAS BEEN NO INCREASE IN MORTGAGE ACTIVITY OVER THE COMPARABLE PERIOD OF LAST YEAR. THE LENDER'S RELUCTANCE TO ISSUE NEW MORTGAGE LOANS IS MOST CLEARLY SUPPORTED BY STATISTICS ON THE SALE OF

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EXISTING HOUSING IN NEW YORK STATE. ALTHOUGH INTEREST RATES STARTED DROPPING AT THE END OF 1982, THE SALES OF EXISTING HOMES DID NOT INCREASE VERY MUCH IN 1982 AND NO CHANGE YET APPEARS IN THE FIRST QUARTER OF 1983. IN 1981, 120,700 EXISTING HOMES WERE SOLD IN NEW YORK STATE WITH A SLIGHT INCREASE TO 120,900 IN 1982.

THE STATE OF NEW YORK MORTGAGE AGENCY HAS A FIRM COMMITMENT TO ENSURE THAT HOMEOWNERSHIP OPPORTUNITIES CONTINUE TO EXIST FOR THOSE HOUSEHOLDS THAT CANNOT AFFORD TO PURCHASE AT MARKET INTEREST RATES. FURTHERMORE, THE REDEVELOPMENT AND THE REHABILITATION OF LARGE URBAN AREAS SUCH AS NEW YORK CITY AND BUFFALO DEPEND TO A GREAT EXTENT ON THE LEVERAGING OF PRIVATE AND PUBLIC FUNDS WHICH THE MORTGAGE SUBSIDY BOND TAX ACT AFFORDS. SONYMA LOOKS FORWARD TO PARTICIPATING IN INNOVATIVE HOUSING EFFORTS. PROJECTS, SUCH AS THOSE BEING SPONSORED BY THE NEW YORK CITY PARTNERSHIP AND THE SOUTH BRONX DEVELOPMENT CORPORATION AT CHARLOTTE STREET AND THE EAST BROOKLYN CHURCHES NEHEMIAH PLAN, IN INNER CITY NEIGHBORHOODS REQUIRE BELOW MARKET INTEREST RATE FUNDS TO MAKE THESE PROJECTS VIABLE.

THE BENEFITS OF HOMEOWNERSHIP TO NEW YORK STATE ARE CRUCIAL TO THE STABILITY AND CONTINUOUS REDEVELOPMENT OF NEIGHBORHOODS IN MAJOR CITIES AS WELL AS DEVELOPMENT IN RURAL AREAS. "THE HOUSING FINANCE OPPORTUNITIES ACT OF 1983" WILL ENABLE THE STATE TO CONTINUE TO PROVIDE AFFORDABLE HOMEOWNERSHIP OPPORTUNITIES FOR MANY OF ITS CITIZENS.

THE STATE OF NEW YORK MORTGAGE AGENCY'S GOAL IS TO INSPIRE, ENCOURAGE AND FACILITATE FINANCIAL INSTITUTIONS AND PRIVATE DEVELOPERS TO INVEST THROUGHOUT THE STATE, MAKING NEW YORK STATE A MORE DESIREABLE PLACE TO LIVE. OUR ABILITY TO FULLY MEET THIS GOAL IS CONTINGENT UPON PASSAGE OF THE "HOUSING FINANCE OPPORTUNITIES ACT OF 1983". I ENCOURAGE YOUR SUPPORT OF THIS LEGISLATION NOT ONLY FOR THE SOCIAL AND ECONOMIC HEALTH OF NEW YORK STATE, BUT FOR THE COUNTRY AS A WHOLE.

Senator ROTH. Thank you, Mrs. Feldman.
Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

I have no questions of the panel. I think they have covered the material very well. I commend them all for their statement. I just want to say that I think the hearing today has demonstrated truly broad support for the mortgage revenue bond program, ranging from the States to the cities to the agencies represented in these panels; and I think have demonstrated clearly that there remains in our society an enormous need that is unfulfilled and that must be addressed in some fashion. And I regard it as truly specious and irrelevant for anyone to suggest that this program is inadequate, as indeed most human actions are, without suggesting some constructive alternative.

It is not enough for persons of responsibility in our society to acknowledge a serious problem and then to limit themselves to criticism of the efforts of others to deal with that problem without offering some alternative method.

I think as Mr. Smith said very precisely and accurately, there is no one seriously suggesting the adoption of the alternatives that were measured in the analysis of this program. It was in effect measuring this program against some abstract ideal which is simply not going to be realized.

Mr. White correctly said that this is a program devised by humans and subject to human failures. It ought to be severely scrutinized, as it has been, as it will be, but I think nothing here today has shaken the determination of those of us who believe in the program, believe in what it is doing, and to continue it as soon and as fairly and effectively as we can.

So I thank you all very much for your statements, and I hope very much that we will be acting on this in the near future under Senator Roth's leadership and guidance.

Thank you, Senator Roth.

Senator ROTH. Thank you, Senator Mitchell. I appreciate your being here today for these hearings. I confess I am responsible for pushing, because I think it is important that we act at the earliest possible date on this legislation.

Like Senator Mitchell, I am not going to propound any questions, because I think you ladies and gentlemen have answered our questions and answered them well.

Senator Mitchell has already pointed out that there is a need, and I think this program is fulfilling that need as well as it can under current circumstances. We will be interested in any suggestions or recommendations you may have as to how to improve it, or if there are alternatives that are better, we would be happy to consider them as well.

But I think, Mr. White, what you said we have found to be true, Mr. Moyer, in Delaware. We have brought in through this program a remarkably good group of people. The program is working. There has been a minimum of problems, of scandal which has too often unfortunately been characteristic of other programs.

I was interested in your comments about cost, Mr. Smith. One of my concerns here is that because somebody in the government lays out a figure, we tend to accept that as accurate when in fact the presumptions upon which they are based are often very controversial and not generally understood.

I will be frank with you: I do not understand them. As a matter of fact, I was hoping you would go on a little more, and I thought maybe we would end up making money rather than losing money.

But, in any event, it does seem to me that this program has answered not only a need but has given flexibility to the people back home to target the program to meet the very special needs.

I am one who has great confidence in our officials back home. I think we have able people there, as we have here. The success of this program I think bears witness to that. I can just assure each one of you that working together with Senator Mitchell and others we hope to push this program.

Thank you very much.

The committee is in recess.

[Whereupon, at 1 p.m., the subcommittee was recessed, subject to the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

TESTIMONY OF SENATOR PETE V. DOMENICI
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
MAY 13, 1983

Pete V. Domenici

Chairman Packwood and distinguished members of the Subcommittee, I thank you for the opportunity to testify before the Subcommittee as you review the single-family mortgage revenue bond program.

I have introduced legislation, S. 733, that would extend the tax-exemption for single-family mortgage revenue bonds for seven years, until the end of 1990. I would like to tell you briefly how important I think this program is and why I think the Congress should extend it. I also would like to indicate why I think we should extend the program for a limited period of time, rather than indefinitely, and to comment on a number of issues pertaining to the program.

The mortgage revenue bond program is one of the most important Federal programs that addresses the issue of housing affordability today. The program's role has been vital to the housing industry, and the home buying public. Inflation raised the price of houses and high interest rates increased the monthly payments to the point where many low and moderate income families could not qualify for a home mortgage.

Although mortgage rates have come down significantly, affordability remains a serious problem. At current mortgage rates of about 13 percent, a family needs an income of $32,900 to make the monthly housing payments on a median-priced home costing $70,000. Less than one-third of American families have incomes that high. The affordability gap widens when interest rates increase making even more young, American families unable to qualify for a home of their own.

The "baby boom" generation will be in the prime homebuying ages of 25 to 45 during the 1980's. One and one-half million prospective first-time homebuyers will be entering the marketplace each year during the 1980's. The demand for mortgage originations during 1983 has been estimated at $150 billion - not including refinancing. The need for the remainder of the decade has been estimated by FNMA at approximately $1.6 trillion. I do not see how Congress could justify letting this tremendous demand go unmet.

This administration has made encouraging progress. Inflation is under control and interest rates are dropping. However, there is still a vital need for mortgage revenue bonds. Deregulation of the financial institutions has raised questions of how the mortgage credit needs, especially for low-and moderate-housing, will be met in the 1980's.

I like this program's approach because it is based on New Federalism principles. It allows every State to respond to its particular housing demands. I think this is an excellent way to address housing needs.

One of the virtues of the program is flexibility. Each state's program is different because each is tailored to meet the housing needs of its citizens and to respond to its capital availability and secondary market access.

In addition, the Mortgage Revenue Bond authorization allows the states to modify their Housing Finance Agency's charters to meet changing situations and to respond to local problems. A recent example in my State comes to mind. Many financial institutions in New Mexico have low-interest bearing mortgages which are adversly affecting their liquidity. They wanted to sell these mortgages, but couldn't sell them to FNMA or FredieMAC because they didn't conform to the federal guidelines. The financial institutions needed an intermediary to package and sell these mortgage backed securities to private investors. The flexibility of this mortgage revenue bond program allowed the legislature to meet this need. The legislature granted additional powers to the New Mexico Mortgage Finance Authority to act as a secondary market facility for these passthrough mortgage backed securities. Once the mortgages are sold, the lending institutions can take the proceeds, make more mortgages, and serve more homebuyers. This is a good example of how this federally authorized program can be customized to meet the local housing needs.

The single-family mortgage revenue bond program has reduced the cost of homeownership for first-time homebuyers. Since the passage of the Mortgage Subsidy Bond Tax Act of 1980, state and local governments have issued approximately $10 billion in mortgage revenue bonds. Proceeds from the sale of the bonds have been used to finance the purchase of nearly 200,000 newly constructed and existing homes. The interest rates charged on mortgage loans provided under the program have been about 2-3 percent lower on average than the conventional mortgage rates available during that period.

In my own State of New Mexico, the program has provided mortgages for close to 12,000 home buyers since the New Mexico Housing Authority was created in 1975. The Finance Authority in New Mexico is completely self-sufficient in that no tax monies are appropriated to sustain its operations. Since the authority's establishment, eight bond issues have been sold, totaling over one-half billion dollars. Of this amount, roughly $400 million has gone to deserving homeowners to finance approximately 12,000 mortgages at interest rates of 7.5 to 12.12 percent. Banks, savings and loans and mortgage bankers throughout the State have participated by disbursing the authroity's funds through their branches.

The average income for families receiving a mortgage under the New Mexico program is $23,582 and the average purchase price for existing homes is $42,391 and $48,916 for new homes. The program has provided 3,298 new jobs in my State since 52% of the loans have been for new construction. In addition, the program has generated $25,541,733 in tax revenues based on figures provided by the Mortgage Finance Authority in New Mexico.

Today the financial markets in this country are in a state of transition. This is particularly true of the mortgage market. I. this uncertain environment, I believe it is essential that we continue to assist homebuyers that would be priced out of the homebuying market without assistance. The problem of affordability continues to be a serious one for many American families, particularly first-time homebuyers, and the federal government must address it.

The bill I have introduced, S. 733, is quite similar to the legislation put forward by Senator Roth. Both measures would extend the tax-exempt status of single-family mortgage revenue bonds beyond the end of this year. My bill would do so for seven years, until 1990. I have several reasons for advocating a temporary, rather than an indefinite, extension of the program.

The first is simply that I believe that it is good public policy to require the Congress to review all federal programs periodically. Keeping a sunset on mortgage revenue bonds will enable us to evaluate the program after additional experience and make changes in it if any are necessary.

The second reason for a limited extension is the fact that we do not know the outcome of the revolution now occuring in our country's mortgage finance system. I feel that because the secondary market is undergoing a major change, and because there are some questions as to the efficiency and targetting capability of this program, that we should continue to look for ways to improve its efficiency or to find more efficient alternates or supplements.

Deregulation of interest rates and the secondary market is also a consideration. As traditional intermediaries such as thrifts and banks experience higher average costs and shorter average maturities on their retail deposits because of interest rate deregulation, long-term mortgage lending may seem less and less attractive as an outlet for those funds. This factor will reouire secondary market investors to play an increasingly greater role in mortgage finance if affordable capital is to remain available for housing.

The question that will be addressed is what can and must be done to restructure the secondary market to assure that it plays this role as efficiently and effecitvely as possible.

I hope that in the next few years the private sector will be able to attract pension funds and other investors who have not invested much money in mortgages in the past to put a much larger percentage of their assets into housing. The Administration will soon propose tax legislation as part of the "Trust for Investments in Mortgages" or TIMs initiative that will allow the private sector to issue flexible mortgage-backed securities to attract these new investors.

This kind of innovation could very well help lower mortgage rates and lessen the housing affordability problem, without any federal subsidy. Given the rapid changes occuring in the mortgage market and the uncertain impact of developments such as TIMs, I think we should be cautious about how long we extend the mortgage revenue bond program.

I believe that extension proposed in my bill balances the need to enable mortgage revenue bond issuers to operate effective programs with the need to review the program in the not too distant future.

On a related matter, let me add that I support the President's proposal, embodied in S. 1061, to limit the tax exemption for bonds which are guaranteed by the federal government. This would not take anything away from congressionally enacted support for housing, but would correct an abuse which arose last fall when the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation issued letter rulings which extended federal guarantees for certificates of deposit issued to state housing authorities in return for the proceeds of the sale of mortgage revenue bonds. These funds are in turn lent to developers who receive a double benefit of both tax exemption and the federal guarantee.

This double dip was never intended by the Congress, and it undermines the effectiveness of mortgage revenue bonds generally by encouraging bond buyers to opt for bonds with the federal guarantee. This raises the interest rate required to attract buyers for other mortgage revenue bonds and reduces the overall effectiveness of the program. S. 1061 simply would restore the program as originally intended by Congress by denying tax exemption if a federal guarantee is claimed.

In conclusion, let me say again that the single-family mortgage revenue program has proven to be an effective way of making housing more affordable, particularly for first-time homebuyers. The support for the homeownership provided by the program should be continued.

JAMES A. MC CLURE, IDAHO, CHAIRMAN
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D. MICHAEL HARVEY, CHIEF COUNSEL FOR THE MINORITY

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

June 14, 1983

Senator Bob Packwood
Chairman of the Subcommittee on
Taxation and Debt Management
United States Senate
Washington, D.C. 20510

Dear Bob:

I have enclosed a copy of a letter I recently received from Mr. Bob Kucab, Executive Director of the Idaho Housing Association. Mr. Kucab has responded to many of the allegation that the General Accounting Office made in their recent audit of single family mortgage revenue bonds. I would appreciate it if you would include his letter as a part of the record for the hearing your subcommittee recently held on this subject.

I appreciate your concern in advance.

Sincerely,

Jim McClure

James A. McClure
United States Senator

McC:jck
Enclosure

Idaho Housing Agency

760 WEST MYRTLE • BOISE, IDAHO 83702
TELEPHONE (208) 336-0161

May 26, 1983

The Honorable James A. McClure
United States Senator
Room 3121, Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator McClure:

I would like to take this opportunity to thank you and your staff for the courtesy extended to me during my trip to Washington for the hearing on Senate Bill 137.

After attending the hearing before the Senate Finance Subcommittee on Taxation and Debt Management and hearing the testimony presented by the U.S. General Accounting Office (GAO) and thoroughly reading their Report, "The Costs and Benefits of Single-Family Mortgage Revenue Bonds", I feel there are several misstatements in the report that must be addressed.

The report alledges that ". . .the public purpose objective of subsidizing low-moderate-income households is not generally achieved and that the purchase price and income limits have been ineffective in targeting benefits."

In Idaho this statement is, quite simply, totally inaccurate. The household income of families participating in IHA's Single Family Mortgage Program (SFMP) have incomes 71% of the average household income for the State. Further, the purchase price of homes mortgaged under our program are 28% below the average purchase price of homes purchased in Idaho.

The report further states that homebuyers purchasing homes through a Mortgage Revenue Bond (MRB) program could have been served by the private market and that this fact negates the positive economic impact of MRB programs. This is also inaccurate of the MRB programs in Idaho. The programs operated by the Agency have had interest rates 2-4 1/2% below the conventional market interst rate.

Eighty four percent (84%) of the families participating in our program could not have purchased their homes at the conventional interest rate.

IHA

For the HRB programs operated in Idaho it is accurate to say that:

- Those served by the program are in the low and low-moderate income range, averaging less than $20,000 per year in annual income.

- Homes purchased through the program are in the low to moderate purchase price range, averaging less than $41,000.

- The economic impact generated from the program is genuine because the market served would not have been otherwise served.

I have enclosed some supporting data for your review. If you have any questions concerning this data, please feel free to contact me.

As always, I appreciate the support and interest you have in adequate, affordable housing for the citizens of Idaho.

Sincerely,

A R Kucab

A. Robert Kucab
Executive Director

ARK:krh
Enclosures

7-3006.4

COMPARISON IHA BORROWERS -- IDAHO AVERAGES
1978 - 1982

Year	Average Idaho Household Income	Income of IHA Borrower	IHA Borrower Income as % of Idaho Average	Average Sale Price in Idaho	Average Sale Price - IHA Borrower	% Below Idaho Average Sale Price	Interest Rate Conventional Market	IHA Interest Rate	% Below Conventional Rate
1978	$ 19,642	$ 14,500	74%	$ 49,000	$ 35,600	27%	9.8%	7.2%	2.6%
1979	$ 20,613	$ 14,500	70%	$ 52,800	$ 38,200	27%	11.3%	7.7%	3.6%
1980	$ 22,708	$ 16,500	71%	$ 54,500	$ 39,300	28%	13.1%	8.7%	4.4%
1981	$ 25,023	$ 16,500	64%	$ 60,300	$ 43,400	28%	15.2%	11.2%	4.0%
1982	$ 25,435	$ 19,100	75%	$ 65,200	$ 46,700	29%	[illegible]	13.0%	1.9%
			71%		$ 40,640	28%			

7-3006.4

STATEMENT

OF

THE AMERICAN BANKERS ASSOCIATION

ON S. 1061

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

COMMITTEE ON FINANCE

UNITED STATES SENATE

May 26, 1983

The American Bankers Association is pleased to provide this statement regarding S. 1061, a bill which would deny tax exemption to bonds if proceeds are invested in federally insured deposits. Our Association consists of approximately 90% of the more than 14,000 full service banks in the U.S.

In several recent issues of tax-exempt Industrial Development Revenue Bonds (IRBs), the issuing authority has deposited the bond proceeds in a bank or savings and loan account insured by the FDIC or FSLIC to be loaned to the user by the depository institution. In the typical arrangement, the issuer transfers the proceeds to a trustee for the bondholders and the trustee deposits the funds in FDIC or FSLIC insured certificates of deposit (CDs). The depository institution agrees to make the deposited funds available to private users for stated tax-exempt purposes. Interest and principal on the bonds are repaid from payments on the CDs. The repayment of the bonds is secured by the CD. Because the proceeds of the bonds are used ultimately for exempt purposes, the bonds qualify as tax-exempt obligations under present law. Because the trustee for the bondholder holds a CD in an insured institution the amount of each bondholder's holding is insured to the extent of $100,000 for each depository institution.

Our Association opposes this use of federal insurance to, in essence, transform a tax-exempt issue into one which is insured by the depository insurance of the United States government, therefore, we support S. 1061, including its effective date of April 15, 1983. We feel that this is an inappropriate use of the depository insurance funds and certainly was not the purpose for which they were created.

A tax-exempt federally guaranteed bond, which may be perceived as superior in the market and in direct competition with those obligations issued directly by the Federal government, may well increase the borrowing costs of Federal, state and local governments. As the current cost of funding the debt exceeds $100 million annually, we would have strong reservations about any scheme which would exacerbate that figure.

Even though many savings and loans and some commercial banks have gained sizeable deposits as a result of this "loan to lender" program, it is the opinion of our Association that this legislation is in the best interest of the country and that the April 15, 1983 effective date must be maintained.

STATEMENT IN OPPOSITION TO SENATE BILL S. 1061 PRESENTED BY ALABAMA COMMISSIONER OF AGRICULTURE AND INDUSTRIES ALBERT MCDONALD, SUBMITTED AS A WRITTEN STATEMENT TO THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT HEARING

To the Senate Finance Subcommittee on Taxation and Debt Management, Honorable Bob Packwood, Chairman:

Mr. Chairman, the undersigned as Commissioner of Agriculture and Industries of the State of Alabama, on behalf of the citizens of Alabama and especially its farmers and farm related workers, wishes to go on record before your Committee as being opposed in every way to Senate Bill S. 1061, which apparently attempts to deny tax exempt treatment to certain bonds that, in part, use FDIC insurance in connection with the issuance of the funds. The reasons for the opposition follow:

At the offset, this Committee does not have to be told that the farmers throughout the Nation today, due to high interest rates and low prices for the products produced on the farm, are in serious trouble.

One of the few ways that individual states can help these farmers is to make money available to them at an interest rate that does not eat up their profit; and in fact many states, to include Alabama, have attempted to do this. This is generally accomplished by having some state agency or public corporation, as in Alabama, issue tax exempt bonds whereas the bond proceeds can only be used by farmers in furtherance of farming.

To be able to obtain monies that can be loaned to farmers at lower rates than they can obtain from commercial banks, the bonds have to be sold as tax exempt and be rated with a rating sufficiently high enough so the bonds can be sold at a low interest rate. If the bonds were not tax exempt and did not have some type of official guarantee, then they would be rated so high and sold at such a high rate of interest that it would be impossible to loan this money to farmers at any type of savings on interest.

One method recently devised is to have FDIC, in effect, do nothing more than what it already has an obligation to do. This involvement is to have the bond purchaser only purchase up to $100,000 in bonds. The bond issuing and lending authority then purchase certificates of deposits from the lending banks. They in turn are obligated to extend to a qualified farmer the monies that are used to purchase the C.D. at this low interest rate for farm purposes.

As is readily obvious, the role of FDIC in this matter is only to insure that if the lending bank folds, then FDIC would be obligated, as it already is, to guarantee any certificates of deposit up to $100,000. There is no more drain upon the U.S. Treasurer from this procedure than if it didn't exist. Certificates of deposit are by law today protected by FDIC up to $100,000.

Alabama and several other states have today used the above described method to get low interest money into the hands of farmers for farm related activities. If S. 1061 passes and is signed into law, then another avenue which attempts to keep America's farmers from either leaving the farm or going bankrupt will be closed.

It is not known how much more America's farmers can endure before the entire Nation and its population feels this impact, but it is not believed that we need to find out. Therefore, the attempt which Alabama and many other states are using to get low interest money into the hands of farmers, which creates no drain upon the U. S. Treasure should not be struck down by the passage of S. 1061.

Due to the above I, speaking on behalf of the Alabama Agricultural Development Authority, and the entire population of Alabama, and especially its farmers, urge your Committee not to take favorable action on S. 1061.

Respectfully Submitted,

Albert McDonald

Albert McDonald, Commissioner of
Agriculture and Industries and
Chairman, Alabama Agricultural
Development Authority

**SUBMITTED STATEMENT OF THE
AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS
TO THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE FINANCE COMMITTEE ON S. 137 and S. 1061
MORTGAGE SUBSIDY BONDS AND FEDERAL GUARANTEES OF TAX-EXEMPT BOND INVESTMENTS**

May 25, 1983

S. 137 would make permanent the authority for the issuance of tax-exempt, single-family mortgage revenue bonds by states or local governments. Such authority is scheduled to expire at the end of 1983.

It has generally been a long-standing policy of the AFL-CIO to oppose the expansion of tax-exempt financing of all types. Such financing benefits primarily higher income taxpayers who are in higher marginal income tax brackets. It causes a loss of federal revenue, which increases federal debt and interest payments by the federal government that contributes to an increase in total budgetary expenditures. It also causes interest rates on other securities to be raised in the competition for funds. Consequently, the rates on other mortgages and loans are higher than they otherwise would have been, and there is a drag on economic activity.

The AFL-CIO did not oppose the enactment of the present authority in 1981 in order to help meet the large and increasing unmet need for homes. The high rates of interest then being charged on mortgages financed with loan funds on which the interest was taxable made housing unaffordable for almost all families. The AFL-CIO did not, at that time, oppose the authority for the issuance of tax-exempt revenue bonds to finance homes for two years.

At this time, after three years of depressed housing production, there is need to catch up with the unmet demand for homes, even with somewhat lower interest rates in the 12 to 13 percent range that prevails now. The great majority of families, especially those of moderate income, however, still cannot afford to buy a home. For that reason, the AFL-CIO recommends the extension of the authority for an additional two years to expire at the end of 1985.

S. 1061 is aimed at preventing an abuse of tax-exemption through issuance of industrial development bonds. If the proceeds of such bonds are deposited in financial institutions, the interest on the funds thus deposited generally is not exempt from income tax. However, if the bond proceeds are to be used for certain tax-exempt purposes, the interest paid on the deposit by the financial institution may be tax exempt. One of the exempt purposes is for acquisition, construction, or improvement of land or depreciable property, if the amount of the bond issue, together with certain related capital expenditures, does not exceed $10 million over a 6-year period.

There has arisen a process whereby the proceeds of such a tax-exempt bond issue are used to purchase federally insured certificates of deposit from depository institutions who agree that the funds will be used to make housing mortgage loans. Each bondholder's bonds thus are indirectly insured for up to $100,000. The interest from the bonds remains tax exempt while the certificates of deposits serve as security for repayment of the bonds. The holder of such bonds, therefore, in effect, has federally insured bonds while, at the same time, receiving tax-exempt interest. Consequently, such bonds provide an investment with a tax-exempt yield, while the principal is being insured by the full faith and credit of the United States behind it in the form of the insured certificate of deposit.

The after-tax yield to the investor is significantly greater than on a taxable bond that would be issued by the U.S. Treasury. The tax-exempt bonds that are in effect federally insured, therefore, can compete favorably with Treasury issues. It logically causes the Treasury to have to pay higher rates of interest on its debt obligations. The higher after-tax yield will also cause other security obligations to carry higher interest rates than would otherwise be necessary. Such higher interest rates are a distinct disadvantage to the government of the United States and to the U. S. economy. The practice should be prohibited; and for that purpose, the AFL-CIO endorses S. 1061 and urges its enactment.

THE STATE OF NEVADA
EXECUTIVE CHAMBER
Carson City, Nevada 89710

RICHARD H. BRYAN
Governor

TELEPHONE
(702) 885-5670

May 11, 1983

STATEMENT OF THE HONORABLE RICHARD H. BRYAN, GOVERNOR OF NEVADA, TO THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE

Mr. Chairman and members of the Committee:

I strongly urge that S.137 and its companion bill H.R. 1176, (the Housing Finance Opportunity Act of 1983) be passed into law. As the Governor of Nevada my comments will focus upon certain policy perceptions concerning the continuation of mortgage revenue bond financings as this Act would provide.

The continuation of mortgage revenue bond financing provides a clear public benefit on two fronts. First, bond issues of this nature alleviate a shortage of owner-occupied housing which eligible families may purchase and, second, these bond programs increase housing production, which serves as a mechanism of job formation. An often unrecognized tertiary benefit of mortgage revenue bond financing is the addition of new tax revenues through expanding real property rolls and actual increases in wealth and income created by added housing production.

In 1975, the Legislature of Nevada recognized that there was, and would continue to be a shortage of safe, decent, and sanitary housing that private enterprise could not provide by itself. The people of Nevada, acting through their representatives, determined that a true public benefit would be served by establishing a Housing Division in the State Department of Commerce to issue tax exempt mortgage bonds in order to obtain below market interest rates for assisting low and moderate income families acquire affordable residential housing.

The Housing Division has taken its creation as a serious responsibility and has conscientiously undertaken to issue mortgage revenue bonds for public purposes within its statutory authorization. The State of Nevada is proud of the Housing Division and its efforts to benefit only those low to moderate income families who could not otherwise obtain financing for residential housing from private capital sources.

The Division sets program guidelines for sales prices and eligible family incomes based entirely on data supplied by the U.S. Department of the Treasury and the U. S. Department of

Housing and Urban Development. Sales price limits are set below the safe harbor limitations issued by the Internal Revenue Service. In the case of new construction, the limits are $6,600 below IRS guidelines. Existing residential sales prices are $8,400 below IRS levels. Income guidelines are set for families ranging in size from one person to five or more. The Division sets gross annual maximum allowable incomes for its single family programs on a statewide basis based upon 120% of HUD median income. The relationships among family size categories is based upon section 8 relationships. The gross allowable incomes include IRA and KEOGH accounts in the calculation of eligibilty.

The actual sales price limits represented by the Division's loan portfolio for the years 1978-1982 are below the established IRS guidelines. Thirty percent of the purchase prices in the Division's files are between $40,000-$49,999, while 43 percent are in the $50,000-$59,999 range. None of the loans carry purchase prices at or near the safe harbor limits.

Historically, the Division has thoroughly underwritten the eligibility of borrowers for each of its programs. The statutory purpose of serving only those families who cannot compete in the private sector mortgage market is the guiding principle. Since 1978 the Division has financed over 3,900 loans. 80 percent of these loans are below the HUD median income level. Considering the loan portfolio held by the Division for the years 1978-1982 inclusive, 47 percent of the Division's borrowers had family incomes between $15,000-$19,999. Borrowers with family incomes between $20,000-$24,999 represent 30 percent of the loan portfolio. Only 20 percent of the Division's borrowers approached the gross maximum allowable income level.

The greatest percentage of Division borrowers, therefore, had incomes well below the allowed levels. As the data suggests, Nevada is firmly committed to encouraging and supporting single-family residential housing opportunities for low and moderate income families.

There exists a continuing need for mortgage revenue bond financing in the State of Nevada. Nevada's housing problems have been created by its enormous population growth since 1970. The population growth of Nevada continues at a pace which is five times faster than that of the nation. Nevada grew by 63 to 64 percent from 1970 to 1980 while the nation's population grew by 7 percent. This rapid growth in population, coupled with a shortage of privately owned land and high building costs, have placed single family home ownership beyond the reach of most of Nevada's moderate income families.

Population estimates and projections for Nevada reflect a high potential demand for housing production. The table below reports the current population and near term estimates predicated upon recent trends.

POPULATION ESTIMATES

Area	1982	1985	1987	1990
Las Vegas	515,021	573,397	639,416	752,965
Reno	208,321	237,268	264,586	311,572
Rural	129,180	171,951	198,439	233,680
Total	886,543	988,616	1,102,441	1,298,217

At 2.63 persons per household, (the statewide estimate from the 1980 census) new housing unit requirements total nearly 38,900 in 1985, almost 43,300 in 1987, and some 74,500 in 1990. Nevadans, by nearly a 3 to 1 margin have always chosen the owner-occupied market to the rental, if the opportunity was available. This opportunity must be preserved.

Data available to the Division for the last quarter of 1983 suggests that the housing affordability profile for the Las Vegas area in relation to household incomes exhibits a significant void in the ranges supplied by the Housing Division as a result of the Division's mortgage bond programs. Specifically, the $40,000-$65,000 per unit range.

Demand for single-family housing units remains high, (about 5,000 units) even in light of the recent period of slow growth in the regional economy. An absorption rate of about 1,000 units per year is a likely reflection of this demand. However, because of the void in sales prices noted above, and the cost of money, absorption is below what demand would suggest. New construction appears to float, for the most part, in the $77,000-$95,000 per unit range. The Housing Division's programs will, if allowed to continue, drive the price downward as a function of providing a guaranteed takeout loan for this segment of the market.

In the Reno market, the shortage of affordable housing opportunities remains critical. During 1982 less than 500 new units were authorized. A comparison of income ranges with available housing indicates that the greatest void in the Reno housing market is at levels which would be priced for family incomes at or near $25,000 per year. These eligible families are the Division's target. The continuation of the Division's single-family programs will, again, influence this problem by creating a "guaranteed" market for the construction of housing at prices at or below $75,000 per unit.

Nevada has always been an importer of capital. A principal purpose of the Division's bond programs is to provide a source of mortgage money which cannot be supplied by the private sector. In the Housing Division's single family programs, lending institutions apply for a reservation of mortgage funds. The amounts requested presumably indicate the shortage of funds which the private sector cannot supply or is unwilling to supply to meet the needs of low to moderate income families. Allocation requests received from lending institutions for mortgage funds were \$234 million in 1978, \$150 million in 1979, more than \$17[illegible] million in 1980 and exceeding \$75 million in 1982.

The Nevada Housing Finance Law requires that prior to the issuance of any bonds for the purpose of financing single or multifamily housing, the Administrator must find that:

> Private enterprise and investment have been unable, without assistance, to provide an adequate supply of decent, safe and sanitary housing in such housing market area at rentals or prices which persons or families of low and moderate income can afford or to provide sufficient mortgage financing for residential housing for occupancy by such persons or families.

This goal is also reflected in the Housing Division's single family program documents. The Housing Division will purchase only those loans which are made to persons who would not otherwise qualify for conventional loans. Each lending institution must represent and warrant that each mortgage loan is in addition to and not in substitution for, residential loans which it otherwise would have made in the State of Nevada.

Allocation requests from the private lenders, savings and loan associations, banks and mortgage bankers are an important element in the determination of what portion of the State's housing capital they must rely on the Housing Division to fulfill. When capital is no longer necessary, lenders will not request funds from the Division and no mortgage revenue bonds will be issued by the Housing Division.

Analysis by the Nevada Housing Division is also conducted to determine the amount of capital and ratios in the market. A Division survey of lending institutions in the state indicated that the typical savings & loan association loan with government guaranteed mortgage insurance generally requires 5% down and bears interest at 12% plus 3 points. The typical conventional savings and loan association loan is 12.78% with 3 points. The qualifying housing expense to income ratio is 25% PMI to 28% and the qualifying overall living expense to income ratio is 35 to 38%.

Due to the popularity of money market deposit accounts, savings and loans and mutual saving banks had more new deposits last December ($16.6 billion total, or a $199.6 billion annual rate) than in all of 1981. After their authorization in the last two weeks of December, these deposits rose by $38.8 billion at savings and loans and $9.3 billion at mutual saving banks. (About $31-32 billion came from other deposits at these thrifts, and some came from money market mutual funds, which declined by $20 billion in the last three weeks of December.)

Both the money market deposit accounts and the super NOW accounts, authorized in January, are continuing to grow rapidly, although the latter are not as popular as the former is, it would appear that there will be no probelm with availability of funds at thrifts to finance mortgage lending this year.

The real issue, however, is what these new accounts will do to the cost of funds, and thus to the mortgage interest rates that thrifts are likely to charge. The cost of funds at savings and loans in the first half of last year (latest available data) was 11.5%. The rates paid on the new accounts vary, but seem to be in the 8-10% range. These higher rates will probably drop somewhat as competition settles down, assuming of course that the structure of money market rates does not change dramatically. Therefore, it would appear as though the average cost of funds will decline sufficiently to allow for mortgage rates to hold around 13% in the conventional market. Government guaranteed loans will, naturally, remain below 13%. But not at levels the state can provide.

The historically typical Housing Division borrower has a loan of $45,000 with a loan to value ratio no less than 95%. His or her housing expense to income ratio is typically in excess of 35%. While it is likely that the price of shelter in todays market will be above the $45,000 level, it is also likely that in today's market the typical Division borrower will have little acess to mortgage money outside of the Division. Thus, private enterprise is unable to supply mortgage loans at interest rates and on terms that eligible families, under Division policy and state mandate, can meet.

It remains, therefore, critically important that states be allowed to maintain their position in the mortgage market. In this way, both lower cost housing production and lower cost money may be encouraged and provided.

Mortgage revenue bonds provide public benefits not just from the provision of affordability for low and moderate income families in the market, but from the expansion of the construction industry, the increase of real property tax rates, and the importation of capital. Each of these secondary and tertiary benefits provide an economic multiplier which must be considered in any cost-effectiveness agreement and not simply ignored in the face of an alleged federal revenue loss. The expansion of investment and productivity resultant from activity generated by housing revenue bonds creates additional tax revenues. Further, when considering the nature of the investor in tax-exempt financings it may be concluded that the absence of mortgage revenue bonds will generate demand for other forms of tax-exempt securities or, at least, a new form of tax-shelter to offset the necessitated investment in taxable securities. The arguments reflecting upon the cost-effectiveness of mortgage revenue bonds will be further quantified in companion testimony from the Council of State Housing Agencies, of which the Housing Division is a member.

As a member of the Nevada Legislature I sponsored the Nevada Housing Finance Law which created the Housing Division. I believed then, and I still believe that single-family housing must continue to be a major component of the housing stock of Nevada. As a state policy I do not believe that low to moderate - income families should always be tenants rather than owners of modest homes. The development of affordable single-family housing for these families must be encouraged.

Government at all levels, and the private sector as well, have an obligation to promote forms and processes of housing financing, that enhances access to housing for all families, including the poor and minorities. The opportunities this country has provided for citizens to move up socially and economically have been based in large part on an adequate housing supply. When the housing supply is restricted, especially housing affordable to those of low and moderate incomes; social, economic, and geographic mobility is limited. Not only are moves to better neighborhoods more difficult, but people cannot find homes near suitable job opportunities, thus compounding the barriers to mobility.

The Housing Division has stressed adherence to its statutory mandate of providing housing for Nevada's low to moderate income families. The continuance of the Housing Division's ability to provide this housing opportunity and to further the state's housing goals in general is the end to which I am submitting this statement. Accordingly, I respectfully request favorable consideration of S.137.

Respectfully submitted,

RICHARD H. BRYAN
Governor

STATE OF NEVADA
OFFICE OF THE ATTORNEY GENERAL
CAPITOL COMPLEX
CARSON CITY 89710

BRIAN McKAY
ATTORNEY GENERAL

WILLIAM E. ISAEFF
CHIEF DEPUTY ATTORNEY GENERAL

STATEMENT OF BRIAN McKAY

ATTORNEY GENERAL, STATE OF NEVADA

I am strongly in favor of S.137, and its companion bill in the House of Representatives, H.R. 1176. S.137 is now in hearings before this Senate Finance Subcommittee on Taxation and Debt Management. The bill seeks to cure one of the most onerous defects in the so-called "Mortgage Subsidy bond Tax Act of 1980" (Public Law 96-499), (hereinafter referred to as the "Act"). As a result of the Act, the internal revenue code now states in 26 U.S.C. 103A(c)(1)(B) that the interest earned on state and local mortgage revenue bonds issued for the purpose of financing owner-occupied residences will not be exempt from income taxation under the internal revenue code if such bonds are issued after December 31, 1983. Without such tax exemption, the State's cost of money will be too close to the prevailing private sector mortgage interest rates for the State to provide loans to persons of low and moderate income.

As chief legal advisor to the State of Nevada, my comments will focus on the legal implications of the Act in general and the above referenced section in particular. I am

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advised that other State officials will address the serious policy and political questions raised by the repudiation of the new federalism that the Act represents.

The United States Constitution grants the federal government the "Power to lay and collect Taxes...(and) To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers" in Article I Section 8. This seemingly unlimited power is restricted in part by the Tenth Amendment to the Constitution which states "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people".

In interpretating these constitutional provisions, the Supreme Court has developed the doctrine of intergovernmental immunity. In Weston v. City Council (1829) the Supreme Court struck down a city personal property tax on federal obligations, reasoning that it was a tax on "an operation essential to the important objectives for which the government was created...it is a burden on the operations of government". Weston v. City Council, 2 Peters (27 U.S.) 449 at 467-469 (1829). This immunity was reciprocally applied to state securities in the case of Mercantile Bank v. New York (1887). Pollock v. Farmers' Loan and Trust Company, 157 U.S. 429 (1895) made it clear that this reciprocal immunity extended to the interest income earned on state securities. In the Pollock case the Court examined the income tax law which Congress enacted in 1894. That law subjected the income derived from state, county and municipal securities to federal income taxation. The Supreme Court held at page 451 that "the authorities fully sustain the proposition that Congress cannot tax the borrowing powers of the States or their municipalities; for clearly if the right to tax existed, it would place the borrowing power of the States completely at the mercy of a majority in Congress, (citations omitted)". The Court's decision in Pollock was unanimous on the point that state and municipal bonds were exempt from federal taxation.

In apparent response to the Pollock decision, the 16th Amendment was adopted. The sweeping language of the 16th Amendment could be read so that it would eliminate not only the apportionment requirement of the Pollock decision but also that part of Pollock, and prior cases relied on therein, which stated that state and municipal borrowing was immune from federal taxation. Rather than chance rejection of the amendment, Congress made it clear that such was not the case. c.f. 45 Cong. Rec. 61st Cong. 2d Sess. Part 3, Pages 2539-2540; Part 2 Pages 1694-1698; and Part 3 Pages 2245-2247. That the purpose of the 16th Amendment was to overrule the apportionment ruling but not the immunity ruling in Pollock was affirmed by the Supreme Court in the case of Evans v. Gore (1920). The Congressional promise of 1910 thus became the law in unequivocal terms in 1920; the securities of states and their municipalities remained as immune from federal taxation after the adoption of the 16th Amendment as they had been after adoption of the original Constitution.

The Pollock holding was again reaffirmed in a case questioning the constitutionality of a tax on the gains derived from trading in municipals, Willcuts v. Bunn (1931). The opinion states at Pages 224 and 225 of 282 U.S.:

> The well-established principal is involved that a tax upon the instrumentalities of the States is forbidden by the Federal Constitution, the exemption resting upon necessary implication in order to effectively maintain our dual system of government...And a tax upon the obligations of a State or of its political subdivisions falls within the constitutional prohibition as a tax upon the exercise of the borrowing power of the State.

In the recent case of Massachusetts v. United States, 435 U.S. 444 at 454 (1978), after a lengthy review of the intergovernmental immunity doctrine, the Court, at page 459, succinctly concluded that "the purpose of the implied constitutional restriction on the national taxing power is...to protect the States from undue interference with their traditional governmental functions". In another recent case the Court had occasion to comment on the vitality of the intergovernmental tax immunity doctrine, albeit in a non-tax case, in its widely quoted opinion in National League of Cities v. Usery, 426 U.S. 833 (1976). The Court stated:

> This Court has never doubted that there are limits upon the power of Congress to override state sovereignty, even when exercising its otherwise plenary powers to tax or to regulate commerce which are conferred by Art. I of the Constitution. (at 842).

> The (Tenth) Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system...(at 843).

The Court continued at page 847, that the vice of the federal statute there being examined was that "quite apart from the substantial costs imposed on the States and their political subdivisions, the Act displaces state policies regarding the manner in which they will structure delivery of these governmental services which their citizens require". The Court repeated at pages 851 and 852 that the vice of the federal statute being examined was that it would "impermissibly interfere with the integral governmental functions of (the states)", concluding that under our Constitution the federal government may not "wield its power in a fashion that would impair the States' ability to function effectively in a federal system".

State housing finance programs using mortgage revenue bonds to assist low and moderate income persons to obtain housing they would otherwise be unable to afford have been found to serve a valid public purpose by many state supreme courts. Such a decision of the Iowa Supreme Court in the case of John R. Grubb, Inc., v. Iowa Housing Finance Authority in 1977 contains a lengthy description of similar State Supreme Court decisions in Alaska in 1966, Illinois in 1948, Maine in 1971, Massachusetts in 1969, Minnesota in 1973, New Jersey in 1970, Rhode Island in 1973, Vermont in 1970, West Virginia in 1969, and Wisconsin in 1973.

In 1975, when adopting our Housing Finance Law, the Nevada Legislature made specific findings, including that:

> There exists a serious shortage of decent, safe and sanitary housing in this State available to persons and families of low and moderate income...This condition is conducive to disease, crime,

environmental decline and poverty, impairs the economic value of large areas, which are characterized by depreciated value, impaired investments, reduced capacity to pay taxes, and lack of new development to meet the needs of area residents, and is a menace to the health, safety, morals and welfare of the citizens of this state...It is difficult and uneconomic for individual owners independently to remedy this condition...The ordinary operations of private enterprise have not in the past corrected these conditions...It is necessary to create a housing division in the department of commerce to encourage the investment of private capital and stimulate the financing of housing through the use of public financing to provide mortgage loans and to make loans to and purchase mortgage loans from mortgage lenders. All the the(se) purposes...are public purposes and uses for which public moneys may be borrowed, expended, advanced, loaned or granted. Nevada Revised Statute 319.020.

The Nevada Housing Finance Law, in section 319.060, limits the class of persons eligible for assistance to those persons who have insufficient income to compete successfully in the private unassisted housing market.

I firmly believe that it is the right of the State of Nevada to analyze its housing conditions and to determine which class or classes of residential housing may be in need of assistance. At the time the Nevada Housing Finance Law was enacted it was firmly believed, and continues to be, that it is within the traditional role of state government to designate the promotion of single-family home ownership by persons of low to moderate incomes as a valid public purpose.

To the extent the Act limits the class of persons of low and moderate income the State may assist, it may well prove to be an unconstitutional restriction of a traditional state governmental function. The December 31, 1983 sunset provision, however, presents a much clearer case. If sunset occurs, i.e. if S.137 does not pass, States will not even be able to serve the low to moderate income home buyers targeted for such assistance by the Act. At least to the extent of such targeted home buyers the Act is an express acknowledgement that a State housing finance program like Nevada's is an appropriate governmental function since Nevada's housing assistance program is limited to the targeted class. It is therefore hard to imagine how the sunset provision could withstand a constitutional challenge in light of the case law described above.

To summarize, I urge you to give favorable consideration to S.137, so that the Mortgage Subsidy Bond Act of 1980 can continue to serve the purpose for which it was intended. Should you fail to give favorable consideration to S.137, I am confident that we will be able to successfully challenge the objectionable sunset provision of the Act on constitutional grounds. However, in recognition of legal reality and fiscal responsibility, I would hope that your positive action would make it unnecessary to litigate.

Thank you for this opportunity to state my support for S.137.

Respectfully submitted,

Brian McKay

BRIAN McKAY
Attorney General

COLORADO AGRICULTURAL DEVELOPMENT AUTHORITY

1525 Sherman Street

Denver, Colorado 80203

May 19, 1983
83-152

Roderick A. DeArment, Chief Counsel
Committee on Finance
Room SD-221 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. DeArment:

I am writing for the Colorado Agricultural Development Authority concerning S. 1061 which is presently being considered by the Senate Finance Committee. It is our understanding that this bill would remove tax exempt status from bonds that are guaranteed by the Federal Deposit Insurance Corporation (FDIC).

The ability to issue tax exempt bonds with FDIC backing has been very important to Colorado's farmers and ranchers. Low commodity prices and high production costs have proven to be disastrous for many agricultural producers. The low interest rate program which the State of Colorado was able to put in place, because of the FDIC backing of our bonds, has been one of the few bright spots in agriculture within the state. With this program we have helped more than 100 farmers and ranchers to buy farm equipment, breeding livestock and farm land. Without this program these farmers would be even further in debt and our state's farm economy in still worse shape.

Our nation's farm economy is going to need help to get back on its feet. The FDIC backing of tax exempt bonds for agricultural purposes is a very positive step in accomplishing this. If the low interest farm loan programs which have been created because of FDIC support have to be dismantled because of Congressional action, this will be viewed as one more slap in the face to America's farmers and ranchers. For these reasons we strongly urge that no action be taken to remove FDIC support for tax exempt bonds used for agricultural purposes.

Sincerely,

Jim Rubingh

Jim Rubingh, Secretary
Colorado Agricultural Development Authority

JR:bcw

cc: Colorado Congressional Delegation

HEARING: S. 137--Housing Finance Opportunity Act of 1983--May 13, 1983
Senate Finance Subcommittee on Taxation and Debt Management

Mr. Chairman and Members of Senate Subcommittee on Taxation and Debt Management:

This testimony is submitted for the record by State Senator Wilber G. Smith and State Representative Paul Garavel in our capacity as Co-Chairmen of the Planning and Development Committee (Committee) of the Connecticut General Assembly.

It is appropriate that we submit joint testimony in our shared responsibility as the Committee has oversight responsibility for the programs and activities of the Connecticut Housing Finance Authority (Authority). The Authority is a political sub-division of the State of Connecticut with major responsibility for the issuance of mortgage revenue bonds, the continued issuance of which beyond December 31, 1983 is the purpose of S. 137--Housing Finance Opportunity Act of 1983.

In our capacity as Co-Chairmen of this Committee we herewith register our unqualified support for S. 137. This support is shared by our colleagues in the Connecticut General Assembly, as verified by the attached Senate Joint Resolution No. 50 entitled RESOLUTION MEMORIALIZING THE MEMBERS OF THE CONNECTICUT CONGRESSIONAL DELEGATION TO SUPPORT THE HOUSING FINANCE OPPORTUNITY ACT OF 1983 adopted by both the Connecticut Senate and House of Representatives. Our support is based on the record of performance achieved by the Authority in providing below-market mortgage interest rates to low and moderate income households via the issuance of mortgage revenue bonds.

As of December 31, 1982, the Authority has provided an aggregate original mortgage financing in the amount of $1,023,933,663 to finance a total of 28,891 single family loans located in 157 out of a total of 169 towns in Connecticut. A total of 24,287 loans or 84.1 percent of the total have been made to first time homebuyers. The average annual family income of the loan recipients is $19,269, the average family size is three persons, and the average age is 31 years. The average purchase price of an Authority-financed home is $41,207, with an average loan amount of $35,441.

The statistical record of performance by the Authority testifies to the benefits of mortgage revenue bonds in assisting low to moderate income households in Connecticut to achieve the American dream of homeownership.

There are additional benefits. In 1976 the Connecticut General Assembly authorized the Authority to make home mortgage loans without regard to income in nine urban areas. The Authority establishes income limits by family size and location for all other towns in the State. This statutorily required provision was made in recognition of the need to restore and to preserve neighborhoods in these urban areas and to stabilize their economic base. The Authority, by regulation, took action to prevent potential abuse by requiring letters of refusal from at least two mortgage lenders that such loans could not be made by such lenders.

This "targeting program" that was initiated well in advance of the targeting provisions under the Mortgage Subsidy Bond Tax Act of 1980 has contributed to a total of 12,426 loans (43 percent of the total loans) made in these State statutorily designated urban areas.

The proceeds from mortgage revenue bonds issued by the Authority have also proven to be an economic stimulus for the homebuilding industry, as well as a source of additional revenue for federal, state and local governments. It has been conservatively estimated that newly constructed homes financed by the Authority, expressed in 1982 dollars, has generated an additional 4,638 jobs, $19,866,200 in federal taxes, $6,616,700 in state taxes, and $12,711,100 in local revenue. The majority of these newly-constructed home loans were made since 1977 during a time when new construction of single family homes reached record low levels in Connecticut.

The Authority has also been innovative in designing and adapting new mortgage financing instruments to meet the financial needs of first-time homebuyers. In 1982 it introduced and continues to apply a growing equity mortgage program. Accelerated amortization is achieved by applying a fixed rate mortgage, presently 10-5/8%, with monthly payments modestly increased by 70¢ per original $1,000 of principal, beginning on January 1, 1986 and every two years thereafter. All such payment increases are applied to the outstanding principal so that the loan is fully paid in less that 17 years.

This is the record of the Authority's performance in applying mortgage revenue bonds to the homeownership needs of low to moderate income households in Connecticut. In discharging our responsibility as Co-Chairmen of the Committee, we have concluded that it is an impressive record. We share this record of sustained performance with the Senate Subcommittee on Taxation and Debt Management with confidence that it will reach the same conclusion.

Therefore, we urge the Subcommittee to take favorable action on S. 137--Housing Finance Opportunity Act of 1983.

Attachment: Senate Joint Resolution No. 50

File No. 342

Senate Joint Resolution No. 50

State of Connecticut

SENATE

Senate, April 14, 1983. The Committee on Planning & Development reported through Senator Smith of the 2nd District, Chairman of the Committee on the part of the Senate, that the joint resolution ought to be adopted.

RESOLUTION MEMORIALIZING THE MEMBERS OF THE CONNECTICUT CONGRESSIONAL DELEGATION TO SUPPORT THE HOUSING FINANCE OPPORTUNITY ACT OF 1983.

Resolved by this Assembly:

WHEREAS, The Connecticut housing finance authority has enabled thousands of low and moderate income families and persons to purchase or rent decent, safe and sanitary housing in the state of Connecticut; and

WHEREAS, state housing finance authorities throughout the nation have demonstrated a willingness and capability to provide lower cost financing of housing for low and moderate income families and persons; and

WHEREAS, the Connecticut housing finance authority, as well as other state housing finance authorities are being thwarted in their legislatively directed purpose of financing low and moderate income housing primarily due to the excessive restrictions imposed by the Mortgage Subsidy Bond Tax Act of 1980, as modified by the Tax Equity and Fiscal Responsibility Act of 1982; and

WHEREAS, the federal administration has stated that it will continue to reduce its efforts to provide low and moderate income housing and simultaneously transfer responsibility for low and moderate income housing to the states.

NOW, THEREFORE, BE IT RESOLVED by the general assembly that the congressional delegation from the state of Connecticut is hereby respectfully requested to support the Housing Finance Opportunity Act of 1983 (S-137, H-1176) which would eliminate the "sunset" provision requiring all state housing finance authorities to terminate tax-exempt bonding to provide funds for single family mortgages at lower interest rates than are available in the conventional market.

Committee Vote: Yea 7 Nay 1

FISCAL IMPACT STATEMENT

STATE FISCAL IMPACT None

MUNICIPAL FISCAL IMPACT None

STATE AGENCY(S) AFFECTED Connecticut Housing Finance Authority

EXPLANATION OF ESTIMATES:

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America 1983 JUN 20 PM 4:17

James M. Wooten
President
(202) 861-6500

June 17, 1983

Honorable Bob Packwood
Chairman
Subcommittee on Taxation and Debt
Management
Committee on Finance
U.S. Senate
Washington, D.C. 20505

Dear Mr. Chairman:

This letter is submitted in connection with the hearings on tax-exempt revenue bonds held by the Subcommittee on May 13, 1983. MBA wishes to comment upon the exemption from Federal income tax for interest paid on revenue bonds for housing and we respectfully request that this letter be included in the hearing record, if that is still possible. Section 103A of the Internal Revenue Code provides that this exemption for such bonds will expire on December 31, 1983. MBA favors amending the law to continue the exemption, provided the proceeds from the sale of revenue bonds for housing are targetted toward the disadvantaged, that is, low-income families, the elderly, and the handicapped. MBA also believes that all revenue bond programs should allow participation by all types of mortgage originators and servicers.

The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership is comprised of mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios.

Mortgage bankers have participated extensively in homeownership programs financed with the proceeds of tax-exempt revenue bonds. When properly administered and properly targetted, revenue bond programs can provide homebuyers with needed financing and mortgage lenders with a new source of business opportunities, without infringing upon markets that can be served without government subsidy.

MBA opposed the use of municipal tax exempt revenue bonds to fund home ownership when such bonds mushroomed in 1978. The rapid proliferation of these bonds for home mortgages allowed the substitution of public funds for private funds in the marketplace. In addition, they were an inefficient way to deliver governmental help even to those in our society who could not be served adequately by private lenders. Others, too, saw the danger of the apparently limitless use of home mortgage revenue bonds, and in the Mortgage Subsidy Bond Tax Act of 1980, (Subtitle A of the Revenue Adjustments Act of 1980, Title XI of the Omnibus Reconciliation Act of 1980. PL 96-499), Congress provided that the tax-free status of such bonds would expire at the end of 1983.

The Mortgage Subsidy Bond Tax Act of 1980 not only established an expiration date in the future; it imposed other restrictions to be effective until that expiration date. A statewide ceiling was set on the volume of bond issuances; a one percent arbitrage limit was imposed; only first-time homebuyers could be financed, and, the maximum purchase price that could be paid using tax-exempt financing was set at 90 percent of average for the area (110 percent in areas of special need). The practical result of these interim restrictions was to prevent the issuance of tax-exempt revenue bonds for housing almost immediately, long before the established December 31, 1983 expiration date.

Recognizing that the restrictions imposed in 1980 were too tight, Congress included provisions in the Tax Equity and Fiscal Responsibility Act (TEFRA) (PL 97-248) to ease the limits. The arbitrage limit was increased to 1.25 percent; the first-time homebuyer rule was given a 10 percent safety exclusion; and the sales price limits were raised from 90 percent to 110 percent of average acquisition cost for the area (120 percent in targetted areas).

The experience of bond issuance under these restrictions indicates that revenue bonds for housing can be used successfully with limits. The limits established by the 1980 Act, as modified by TEFRA, may need further tuning to achieve the proper balance between high volume and targetted benefits, but the recent history of the bonds indicates that their use can be controlled and their implicit Federal subsidy can be directed to those who cannot be adequately served by the private market.

Reflecting this recent history, MBA no longer opposes categorically the issuance of home mortgage revenue bonds. Rather, on May 17, 1983, the Board of Governors adopted a revised statement of policy on the subject of tax exempt bonds for housing, as follows:

> "MBA supports using municipal tax-exempt bond issues to provide funds for home mortgages, provided such issues are targetted toward meeting the needs of the disadvantaged, that is, the low-income, the elderly, and the handicapped. Further, such programs should be simplified and strict standards applied to make them less costly to homeowners and easier to work with for all participants. Moreover, if used, such programs should only be available to housing finance agencies which allow all types of originators and servicers to participate in all their programs."

Therefore, MBA supports enactment of S 144, The Housing Financing Opportunity Act of 1983, introduced by Senator William V. Roth, Jr. and many co-sponsors. This legislative measure simply would delete the tax exemption expiration date from the Internal Revenue Code by restating Section 103A(b) without the expiration clause. It would not ratify or otherwise endorse the current purchase price ceilings, nor preclude subsequent fine tuning to target the proceeds from revenue bonds toward encouraging homeownership by the disadvantaged, that is, people with relatively low income, or who are elderly or handicapped.

Preliminary findings of a study being conducted by the General Accounting Office (GAO) raise a question whether revenue bonds for housing are currently restricted so as adequately to target the proceeds to disadvantaged persons. In its April 18, 1983 report

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to the Chairman of the Senate Finance Committee, "The Costs and Benefits of Single-Family Mortgage Revenue Bonds: Preliminary Report," the GAO found "that most subsidized home loans were not made to low-and moderate-income households in need of assistance, but rather to those who probably could have purchased homes without assistance." (page 3). Whether the final report will reach the same conclusion remains to be seen, of course, but, if the study does result in evidence that the Federal tax exemption is being used widely for people who would be excluded from direct Federal subsidy programs, a careful adjustment of the Federal law should be made.

In reviewing the final results of the GAO study, observers should be aware that it was conducted on activity occurring during 1981 and 1982—a period of record increases in home mortgage interest rates and market distortions brought about by these increases, as well as the high rates actually reached. Because of the rapid increase in the price of financing, the private market was accessible only to a few. Now that home mortgage interest rates have dropped to more normal levels, the private market is again serving moderate-income homebuyers and a more normal economic environment exists. Whether the states generally will exercise restraint and offer tax-exempt revenue bond assistance only to those disadvantaged people who cannot be served by the private market may not be answered by the study results alone.

MBA appreciates the opportunity to express its views, and would be pleased to furnish any additional information that may be needed.

Sincerely,

James M. Wooten

James M. Wooten
President

JMW/aml

NAHRO
Serving the Nation's Housing and Community Development Needs

May 24, 1983

Senator Robert Packwood
Chairman
Subcommittee on Taxation and Debt Management
Committee on Finance
United States Senate
221 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Packwood:

The National Association of Housing and Redvelopment Officials (NAHRO) would like to offer comments in support of S. 137, which would make the issuance of Single-Family Mortgage Revenue Bonds permanent. NAHRO has worked with a coalition of Public Interest Groups led by the Council of State Housing Agencies and endorses their testimony and anaylsis of the recently conducted GAO study of the use of Mortgage Revenue Bonds. Homeownership is a dream of many Americans. Mortgage Revenue Bond programs exist to serve those who otherwise cannot buy a home or make necessary repairs. The goal of these programs is to provide assistance to those who find themselves priced out of the market. Specifically, single family housing bond programs serve the long standing goal of expanding homeownership opportunities for American families. State and local housing finance agencies have compiled an impressive record serving the need for assistance to homebuyers and owners, these same agencies have, since the early 1970's, provided below market rate loans to roughly 700,000 households.

The program involves all levels of governmant and a wide array of private sector enterprises. The discipline of the private sector has resulted in efficiently run programs that have negligible default rates. Because they are operated at the state and local level, Mortgage Revenue Bond programs can be tailored to meet local needs and housing market conditions. As a result, Mortgage Revenue Bonds have provided the basis for the development of a strong state and local role in housing.

National Association of Housing and Redevelopment Officials
2600 Virginia Avenue, Northwest Suite 404 Washington, D C 20037 (202) 333-2020

In light of the surtailment of federal programs to provide funding for housing assistance, it seems inconsistent to ring the death knell on this mechanism that gives localities the ability to address the housing needs of its low inclome and first time home-buyers. In conclusion, NAHRO hopes that you favorably report out S. 137.

Sincerely,

Richard Y. Nelson, Jr.
Deputy Executive Director

STATEMENT OF THE

PUBLIC SECURITIES ASSOCIATION

BEFORE THE SUBCOMMITTEE ON TAXATION

AND DEBT MANAGEMENT

OF THE UNITED STATES

SENATE COMMITTEE ON FINANCE

May 13, 1983
Washington, D.C

Statement of the Public Securities Association

The Public Securities Association is pleased to submit this statement in support of the Housing Finance Opportunity Act (S. 137), a bill that will eliminate the sunset provision for Mortgage Revenue Bonds. Identical legislation has also been introduced in the House of Representatives (H.R. 1176) and is receiving significant and broad bi-partisan support.

We wish to point out at the outset that without enactment of this legislation, the authority of state and local governments to issue tax-exempt bonds to finance single family mortgages for low and moderate income Americans will expire on December 31, 1983. This legislation would simply permit state and local governments to finance their own housing finance program.

PSA is the national trade association which represents brokers, dealers, and dealer banks active in the municipal securities market, the U.S. Government and federal agencies market, and the mortgage-backed securities market. Currently, there are nearly 300 member firms whose offices are located in all 50 states. Last year, our members participated in over 95 percent of the dollar volume of new issues of state and local government securities. These same firms also account for the vast majority of secondary market trading activity in municipal securities. Our membership participates in the full range of dealer activities, including small firms dealing in special assessment issues and local financings, multi-million dollar investment banking powers, full service national wire houses, major money market center, and regional dealer banks.

First, and most importantly, we urge the Congress to expeditiously and independently address the issues relating to the continued use of tax-exempt mortgage revenue bonds. This legislation should be reviewed on its own merits, and judged only in terms of whether it has satisfied the original intent and purposes of the Congress when it adopted the Mortgage Subsidy Bond Tax Act of 1980 and the amendments thereto adopted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

Congress should not allow this legislation to become embroiled in a quid pro quo debate concerning steps to reduce or control the size of the federal budget deficit. While we are quite concerned with the size of the deficit, we believe that the most prudent approach to our present economic situation is adherence to a comprehensive economic development plan whose primary focus should be reducing the rate of growth of federal spending, stable monetary growth, stimulating savings and investment, and elimination of unnecessary and burdensome federal regulation.

Moreover, PSA believes that the Congress should adopt this legislation promptly, in order to avoid any unnecessary surge in volume which would occur as a natural consequence of the December 31, 1983, deadline. It is logical to assume that the present uncertainty surrounding the future ability of state and local governments to make use of this valuable form of housing finance is having an unsettling effect on the market and causing many issuers to alter their timetables to finance issues while they still qualify for tax-exemption.

In 1980, when the Mortgage Subsidy Bond Tax Act was enacted, it was the intention of Congress to target the use of tax-exempt financing for housing. Consequently, tax-exempt mortgage financing was, among other restrictions, limited to first-time homeowners, home purchase price limitations were instituted to assure that the bonds were used for low and moderate income housing, and a distressed area criterion was designed to facilitate neighborhood renewal. Congress further limited the use of mortgage revenue bonds in 1982 by the adoption of TEFRA. The four most significant amendments in TEFRA affecting the use of mortgage revenue bonds included a provision that 80 percent of lendable proceeds be made available to first-time home purchasers, an increase in the purchase price limitation to 110 percent (120 percent in a targeted area) of the average area home purchase price, an adjustment in the arbitrage limitations, and an amendment to the reserve liquidation requirements.

After completing the original process of targeting the use of this financing vehicle in 1980, and adjusting it again in 1982, we believe it advisable to afford this legislation an opportunity to work in an unencumbered and stable environment. This will permit all participants in the tax-exempt housing market, as well as Congress, to adequately evaluate the effectiveness of the existing legislation.

The use of tax-exempt obligations to construct low income housing has permitted state and local governments to minimize the cost of financing homeownership. This result concurs with the finding of the President's Commission on Housing that affordability of housing is the chief difficulty facing low income renters. Further, the reflow generated by these programs has been beneficial to local economies and tax revenues of all levels of government. Increased construction has resulted in new employment opportunities and increased activity by suppliers of the construction industry. This increased economic activity has resulted in tax revenues which otherwise would not have been generated on the state and local level.

The Council of State Housing Agencies estimates that every 1 billion dollars in mortgage revenue bonds will result in financing for about 9,250 newly constructed single family homes, plus a comparable number of existing homes. They further estimate that this new construction generates almost 12,000 jobs and nearly $100 million in tax revenues, including about $85 million in federal tax revenues. In 1982, it is estimated that 80,000 jobs were created as a by-product of mortgage bond financing.

It is also worth noting that, as interest rates fall along the entire maturity spectrum and conditions in the housing market improve generally, mortgage revenue bonds, because of their built-in criteria, will tend to provide greater benefits and assistance to families on the lower levels of the income scale. These are the type of families who would otherwise not be able to afford homeownership.

CONCLUSION

PSA urges Congress to adopt S. 137 promptly in order that state and local governments will be able to continue to provide needed housing opportunities for our country's low and moderate income homebuying public. Further, we reiterate our position that Congress should independently evaluate the benefits of mortgage revenue bonds separate from any review of other tax legislation.

A. Dalton Smith Jr.
Attorney at Law

5010 DUNCANS SUITE 100
HOUSTON, TEXAS 77096
BUSINESS PHONE (713) 526-4587 OR (713) 526-6792

1983 MAY 11 AM 11:51

May 10, 1983

The Honorable Bob Packwood
173 Russell Senate Office Building
Washington, D.C. 20510

Re: H.R. 1635 & S. 1061

Dear Senator Packwood:

Two Bills, H.R. 1635 by Representative Pickle and S. 1061 by Senator Dole, have been introduced in this session of Congress concerning tax exempt industrial revenue bonds and the FSLIC and/or FDIC insurance of deposits.

It is my understanding that you, as a member of the Senate Finance Committee, are presently serving on the Taxation and Debt Management Subcommittee of the Senate Finance Committee to which S. 1061 has been referred and upon which a hearing is scheduled this week.

As you are aware, the original legislation which created the Industrial Revenue Bonds and allowed for the FSLIC/FDIC insurance pass through, was created to provide additional low and moderate income housing during a period of time when interest rates were extremely high and little, if any, construction was being done. The Building Industry, in partnership with the Savings and Loan Industry mainly, was able to utilize this program to develop a good number of multi-family dwelling units for those of low and moderate incomes. This construction took place during the past twelve (12) months, which was a period of extremely high unemployment and in historical terms continues to be a period of extremely high unemployment.

Although interest rates are somewhat lower, on a historical prospective, interest rates are still near historical highs. It is also projected by most economists that although interest rates are continuing a downward movement at this time, this trend could be reversed by the end of this summer, which could result in the higher interest rates that we had experienced over the past year or two. I presently serve as the Chairman of the Multi-Family Council of the Greater Houston Builders Association, which council along with the Board of Directors of the Greater Houston Builders Association voted unanimously to oppose H.R. 1635 which set a termination of the FSLIC/FDIC tax exempt revenue bonds and made other adjustments to the capital recovery periods for properties using I.R.B.'s.

Actually, savings and loans and banks take in deposits and the FSLIC and FDIC insure those deposits no more than the authorized $100,000 per account that applies to all other deposits in banks and savings and loans. This program has benefited the alining savings and loan industry resulting in increased deposits during a period where they were losing deposits, and additional income to bolster their dropping net worths.

With so many plusses for so many segments of our economy, it is incomprehensible that this program would be terminated. I know the opponents of the program have argued the possible loss of tax revenues, but I am certain that the taxes generated from the safe of goods, profits on construction, and taxes on wages generated by this program, would far out weigh any possible loss of treasury revenue dollars. Added to that, would be a reduction of the amount of unemployment benefits and other welfare related costs that would be incurred if those persons were not employed as they had been through the use of these tax exempt industrial revenue bonds.

I would also like to point out that the the Multi-Family Council of the National Association of Home Builders has voted unanimously to oppose H.R. 1635.

I hope that we can continue to count on your help for housing and lower unemployment in our country.

Very truly yours,

A Dalton Smith, Jr

A. Dalton Smith, Jr.

lmj

ADS:lmj

USL

UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE

1709 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. 20006 / TEL. (202) 637-8900

PHIL GASTEYER
Vice President and Legislative Counsel

May 27, 1983

Mr. Roderick A. DeArment
Chief Counsel
Committee on Finance
Room SD-221
Washington, D. C. 20510

Dear Mr. DeArment:

The U.S. League of Savings Institutions is pleased to comment on S. 137, the Housing Finance Opportunity Act of 1983, as it relates to the elimination of the sunset provision for tax exempt mortgage revenue bonds. We will also comment briefly on a related bill, S. 1061, regarding the treatment of tax-exempt bonds secured by federally-insured certificates of deposit.

Mr. Chairman, the U.S. League of Savings Institutions believes that tax-exempt mortgage revenue bonds may well have a place in the housing finance system, but that the unrestricted use of such bonds is deleterious to overall health and vitality of homeownership in America.

The popularity of mortgage revenue bonds in recent years is indicative of the need for housing in this country and the strong desire for homeownership. Yet at the same time, the unrestricted use of mortgage revenue bonds obscures some of the deeper problems afflicting the housing delivery system and thereby delays progress in effecting the necessary reforms.

In elaborating on this point, our comments will address four main areas which relate directly and indirectly to these deeper problems. On the basis of these comments, we will then offer suggestions regarding means of restricting the issuance of mortgage revenue bonds for the Subcommittee's consideration.

Mortgage Revenue Bonds and Affordability: The housing sector is now recovering from its worst recession in the postwar period. The primary reasons for this deep recession was the inability of large numbers of home buyers to afford the monthly mortgage payments on new and existing homes offered for sale.

Although three elements interact to determine affordability--income, mortgage interest rate, and home price--it has become traditional to associate affordability problems with "high" interest rates. Mortgage revenue bonds seek to alleviate these problems by providing mortgage financing at lower, tax-exempt rates.

Incomes and home prices are just as important in determining affordability as interest rates, but unrestricted mortgage revenue bond financing does little, if anything, to deal with these aspects of affordability.

State and local governments do, however, have within their power the ability to reduce the regulatory costs of housing construction--permit processing, zoning, codes and standards. The Joint Venture for Affordable Housing, under the auspices of the Department of Housing and Urban Development has made great strides in reducing such costs in collaboration with some state and local government agencies. The Department of Housing and Urban Development, of course, must rely on the voluntary participation of state and local governments to carry this program forward.

As one among several ways of restricting the issuance of mortgage revenue bonds, the Subcommittee might therefore wish to consider making their issuance conditional upon participation in the Joint Venture for Affordable Housing. Such a condition should have the effect of assuring that state and local governments were taking affirmative action to reduce the regulatory costs of construction and home prices in their jurisdictions before resorting to the issuance of mortgage revenue bonds.

Mortgage Revenue Bonds and Employment: Advocates of mortgage revenue bonds frequently note that they serve to stimulate employment in the construction industry and thereby in the community at large. There is clearly merit to this argument--to the extent that mortgage revenue bond financing induces new construction that would not have occured otherwise and to the extent that the funds so raised are used to finance new construction rather than the purchase of existing homes.

Thus, the Subcommittee might wish to consider restricting the use of the proceeds of mortgage revenue bonds to the financing of new housing units.

Mortgage Revenue Bonds and Federal Deficits: The current projections of the budget deficits of the federal government are a significant cause for concern. These deficits threaten higher borrowing costs for the entire economy in the months ahead. Slower economic growth rates, smaller increases in family income and employment, and fewer housing starts and sales are the inevitable consequences of higher interest rates.

Although arguments can be made on both sides of the question of the tax efficiency of mortgage revenue bonds, a recent study of the General Accounting Office contends that mortgage revenue bonds are ineffective in generating net additional housing starts and that mortgage revenue bonds are the most expensive (to the Treasury) of several mortgage subsidy programs analyzed. If this analysis is correct, the income and employment effect benefits attributed to mortgage revenue bonds are negated, but the tax expenditures cost to the Treasury remains.

Under these circumstances, home buyers in general and the housing sector as a whole would be less well off than if no mortgage revenue bonds were issued.

Other aspects of the inefficiency of mortgage revenue bonds were presented by the U.S. League to the Senate Subcommittee on Housing and Urban Affairs in its testimony of June 12, 1979.

Mortgage Revenue Bonds and the Housing Finance System: For a variety of reasons, not the least of which is the general deregulation of the financial sector, the housing finance system must move in the direction of adjustable rate mortgage lending. Even more than the administrative pricing of FHA/VA fixed-rate mortgage loans, mortgage revenue bonds retard progress in this direction by offering subsidized, below-market interest rates on long-term fixed-rate mortgages.

Adjustable rate mortgages can and must be offered at interest rates below those available for fixed-rate loans to compensate the borrower for sharing the interest rate risk with the lender. The presence of below-market fixed-rate mortgages funded by mortgage revenue bonds thwarts the effort to introduce adjustable rate mortgages.

For similar reasons, the U.S. League supports S. 1061, as it applies to tax-exempt bonds. In the interests of extending access of the housing finance system to the capital market and of introducing longer-term (e.g. five-year) adjustable rate loans, the U.S. League urges the Subcommittee to exercise great care to assure that the provisions of S. 1061 not be extended to taxable bonds.

The U.S. League thanks the Subcommittee for the opportunity to comment on these two items of pending legislation.

Sincerely,

Phil Gasteyer

Phil Gasteyer
Legislative Counsel

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