

101244
24998

BY THE U.S. GENERAL ACCOUNTING OFFICE

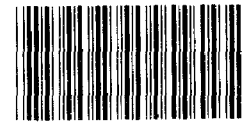
**Report To The Chairman
Committee On Finance
United States Senate**

**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.



121244

121244
525438

GAO/RCED-83-145
APRIL 18, 1983

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".



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. Home-buyer 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).

- - - -

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.

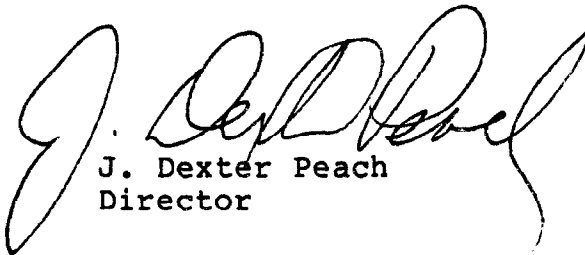
We did not obtain official agency comments on this preliminary report. However, we discussed our results informally with HUD and Treasury officials as well as several recognized private sector authorities and made changes where appropriate. Our final report will include additional information on bond program beneficiaries and a more comprehensive cost analysis, including sensitivity analysis. The final report will also include an

B-211508

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

C O N T E N T S

	Page
APPENDIX	
I	Objective, Scope and Methodology 1
	Work performed on MRB beneficiaries and program targeting mechanisms 1
	Work performed on MRB cost-effectiveness 2
II	High cost--Marginal Effectiveness 3
	Cost of alternatives 3
	Many MRB loans substitute for loans that would have been made without the subsidy 7
	Mortgage revenue bonds adversely affect the cost of other tax-exempt borrowing 9
III	Majority of Assisted Households Were Middle- and Upper-Income 11
	The intended beneficiaries 11
	Annual income of MRB borrowers 12
	MRB borrower incomes as compared to State income levels 14
	Many MRB homebuyers exceeded income ceilings considered by the Congress in 1980 15
IV	Income and Purchase Price Ceilings Have Been Ineffective 20
	Income ceilings allowed participation by middle- and upper-income households 20
	Purchase price ceilings encouraged participation by middle- and upper-income households 21
V	Letter dated March 24, 1983, from the Chairman, Senate Committee on Finance 23

ABBREVIATIONS

CBO	Congressional Budget Office
FHA	Federal Housing Administration
GAO	General Accounting Office
GNMA	Government National Mortgage Association
HUD	Department of Housing and Urban Development
MRB	Mortgage Revenue Bonds
OMB	Office of Management and Budget

TABLES

		Page
1	Comparison of Treasury costs to subsidize a mortgage in 1982	5
2	Higher proportion of money was made available to higher income people based on a six-State analysis	14
3	The majority of borrowers in 40 jurisdictions exceeded State median income	15
4	Many homebuyers exceeded income guidelines considered in 1980	15
5	Income distribution of MRB homebuyers in 40 jurisdictions, by bond-issuing authority	16
6	Income distribution of MRB homebuyers in 40 jurisdictions, by percent of State family median income, by bond-issuing authority	18
7	Most jurisdictions have income ceilings above \$30,000	21
8	Incomes required to buy the maximum-priced house allowed by Federal regulations through August 1982	22

FIGURES

1	Comparison of MRB and FHA homebuyer income	9
2	Distribution of MRB homebuyers incomes	13

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

<u>Alternative</u>	<u>Subsidy cost per mortgage</u>	<u>Subsidy Cost for 200,000 mortgages (billions)</u>
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-aside 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 report¹ 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

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

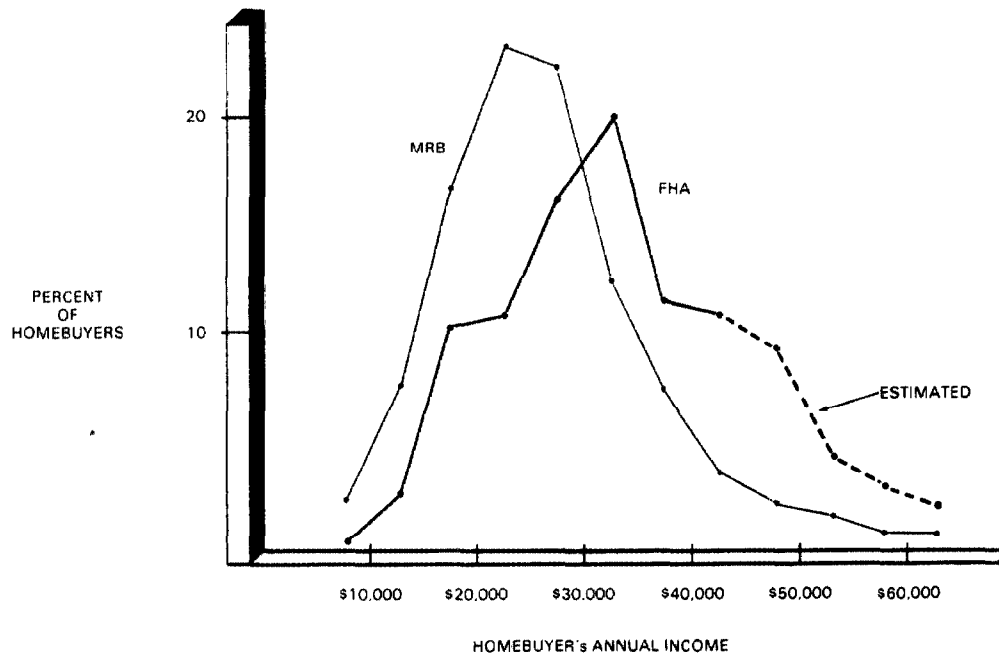
mortgages were financed by MRBs, few additional housing starts would result, but the Treasury would lose \$175 million per year for the term of the bonds, due to the bondholder's tax-exempt earnings.

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 likely 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 OTHER 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.

MAJORITY OF ASSISTED HOUSEHOLDSWERE 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 Committee 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

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 areas² 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.

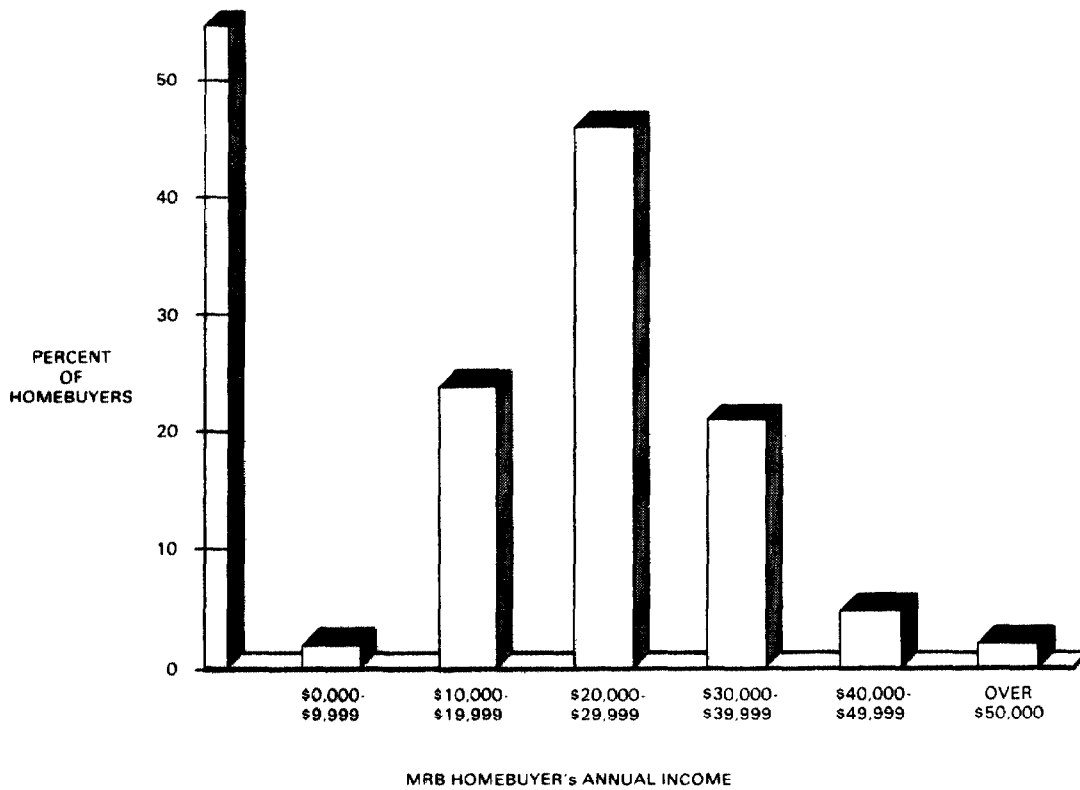
The conference report of November 26, 1980, on mortgage subsidy bonds, deleted the Federal income limits of the House bill so that State and local governments could have sufficient flexibility to design programs for their particular needs. The conferees believed that purchase price ceilings and first-time 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).

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

<u>Income (Thousands)</u>	<u>Percent of all loans made</u>	<u>Percent of all funds lent</u>	<u>Weighted average mortgage amount</u>
\$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	<u>74,832</u>
Average for 6,666 loans in 6 States			<u>\$48,377</u>

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

<u>Percent of State family median income</u>	<u>Percent of homebuyers</u>		
	<u>State bonds</u>	<u>Local bonds</u>	<u>Total</u>
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	<u>3</u>	<u>2</u>	<u>4</u>
Total	<u>100</u>	<u>100</u>	<u>100</u>

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

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

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							
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	0-15	15-25	25-35	35-55	55-75	Over 75	Total
Jurisdiction							
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	<u>1,974</u>	<u>8,160</u>	<u>7,252</u>	<u>2,872</u>	<u>198</u>	<u>15</u>	<u>20,471</u>
Percent of participants	10	40	35	14	1	0	100

Table 6

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

Percent of State median income Jurisdiction	Number of Participants						Total
	0-50	50-80	80-100	100-120	120-200	200 and over	
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							
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	0-50	50-80	80-100	100-120	120-200	200 and over	Total
Jurisdiction							
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	<u>670</u>	<u>4,168</u>	<u>4,954</u>	<u>4,326</u>	<u>5,663</u>	<u>690</u>	<u>20,471</u>
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 jurisdictions) 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 7Most Jurisdictions Have Income
Ceilings Above \$30,000 (note a)

<u>Income range (Thousands)</u>	<u>Number of States with ceiling in income range</u>	<u>Number of localities with ceiling in income range</u>
\$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	<u>3</u>	<u>2</u>
Total	<u>47</u>	<u>13</u>

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

<u>Ceiling</u>	<u>Required incomes</u>		<u>Price ceiling</u>	
	<u>New</u>	<u>Existing</u>	<u>New</u>	<u>Existing</u>
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.

ROBERT J. DOLE, KANS., CHAIRMAN

BOB PACHWOOD, OREG.
 WILLIAM V. ROTH, JR., DEL.
 JOHN C. DANFORTH, MO.
 JOHN M. CHAFFEE, R.I.
 JOHN HEINE, PA.
 MALCOLM WALLOP, WYO.
 DAVID DURENBERGER, MINN.
 WILLIAM L. ARMSTRONG, COLO.
 STEVEN D. SYMMS, IDAHO
 CHARLES E. GRASSLEY, IOWA

RUSSELL B. LONG, LA.
 LLOYD BENTSEN, TEX.
 SPARK M. MATSUMAGA, HAWAII
 DANIEL PATRICK MOYNIHAN, N.Y.
 MAX BAUCUS, MONT.
 DAVID L. BOREN, OKLA.
 BILL BRADLEY, N.J.
 GEORGE J. MITCHELL, MAINE
 DAVID PRYOR, ARK.

United States Senate

COMMITTEE ON FINANCE
 WASHINGTON, D.C. 20510

ROBERT E. LIGHTHIZER, CHIEF COUNSEL
 MICHAEL STERN, MINORITY STAFF DIRECTOR

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

23

(382751)

24948

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE



THIRD CLASS