[JOINT COMMITTEE PRINT]

TAX-EXEMPT BONDS FOR MULTIFAMILY RESIDENTIAL RENTAL PROPERTY

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

ON JUNE 21, 1985

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

JUNE 17, 1985

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1985

48-539 O

JCS-19-85

CONTENTS

INTRODUCTION

The Subcommittee on Oversight of the Committee on Ways and Means has scheduled a hearing on June 21, 1985, regarding the use of tax-exempt industrial development bonds (IDBs) to finance multifamily residential rental property. Specifically, the Subcommittee intends to focus on the effectiveness and adequacy of the present-law set-aside rules targeting use of housing units financed with these IDBs to low- and moderate-income families. This pamphlet,[1] prepared in connection with the hearing, provides descriptions of present law and legislative background, issues related to the present-law provisions governing issuance of these bonds, and revenue analysis.

On August 8, 1984, the Joint Committee on Taxation requested the General Accounting Office to study the use of tax-exempt bonds for multifamily residential rental property. GAO will report its findings at the Subcommittee hearing. The Joint Committee's letter to GAO is reproduced as an appendix to this pamphlet.

---

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Tax-Exempt Bonds for Multifamily Residential Rental Property* (JCS-19-85), June 17, 1985.

I. SUMMARY

Interest on State and local government obligations generally is exempt from Federal income tax (Code sec. 103). This rule permits State and local governments to issue tax-exempt obligations to finance traditional public projects and services and permits private nonprofit organizations (described in sec. 501(c)(3)) to benefit from tax-exempt financing. State and local governments further are permitted to provide tax-exempt financing for certain private activities (e.g., by means of industrial development bonds, student loan bonds, and mortgage subsidy bonds).

Industrial development bonds (IDBs) are bonds that are issued for use in a trade or business of a nonexempt person, and the payment of which is to be derived from, or is secured by, money or property used in a trade or business. Interest on IDBs is tax-exempt only when the IDBs are issued to finance certain specified activities. One of the activities for which tax-exempt IDBs may be issued is to finance projects for multifamily residential rental property. At least 20 percent (15 percent in targeted areas) of the housing units in a project financed with tax-exempt IDBs must be held for occupancy by individuals of low -or moderate-income. The Code defines low -or moderate-income by reference to criteria used in the Housing Act of 1937, with the exception that the appropriate percentage of median gross income qualifying as low or moderate is 80 percent.

In the Deficit Reduction Act of 1984, Congress imposed new restrictions on IDBs. Among these restrictions are State volume limitations, additional arbitrage restrictions, a prohibition on Federal guarantees of tax-exempt bonds, and expansion of the requirement that cost recovery deductions for bond-financed property be determined using the straight-line method over ACRS periods. Exceptions were provided in the 1984 Act to exempt IDBs for multifamily residential rental property from most of the new restrictions enacted in 1984, including the restrictions cited as examples in the preceding sentence.

II. DESCRIPTION OF PRESENT LAW

A. Overview

State and local government obligations

Interest on State and local government obligations generally is exempt from Federal income tax (Code sec. 103). Under this rule, State and local governments may issue tax-exempt bonds to finance public projects or services, including facilities such as schools, roads, and water and sewer facilities. Additionally, State and local governments may provide tax-exempt financing for use by tax-exempt charitable, religious, scientific, or educational organizations (described in sec. 501(c)(3)) and may provide such financing for certain private activities (e.g., by means of industrial development bonds, student loan bonds, and mortgage subsidy bonds).

Industrial development bonds

Industrial development bonds (IDBs) are obligations issued as part of an issue all or a major portion of the proceeds of which are to be used in a 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. A nonexempt person is defined to mean all persons other than State or local governments or tax-exempt charitable, religious, scientific, or educational organizations (as described in sec. 501(c)(3)). Interest on IDBs is tax-exempt only if the bonds are issued for certain specified purposes.

One of the exceptions pursuant to which interest on IDBs is tax-exempt is where the proceeds of the bonds are used to finance certain exempt activities. Under this exempt activity exception, interest on IDBs is tax-exempt if the bonds are used to finance the following activities: (1) projects for multifamily residential rental property;[2] (2) sports facilities; (3) convention or trade show facilities; (4) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to these facilities; (5) sewage or 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 hydro-electric generating facilities; or (9) local district heating or cooling facilities. In addition, interest on IDBs used to acquire or develop land as a site for an industrial park is exempt from tax.

Present law also permits tax-exemption for interest on small-issue IDBs, the proceeds of which are used for the acquisition, con-

[2] Residential property that consists of fewer than five units, one unit of which is occupied by the owner of the units, is not eligible for tax-exempt IDB financing, but that property instead is treated as owner-occupied housing eligible for qualified mortgage bond financing (sec. 103A).

struction, or improvement of certain land or depreciable property (the small-issue exception). This exception applies to issues of $1 million or less without regard to related capital expenditures. Alternatively, the amount of the issue, together with certain related capital expenditures over a six-year period, may not exceed $10 million. If an urban development action (UDAG) grant has been made with respect to a facility, up to $20 million of capital expenditures may be made. The small-issue exception expires generally after December 31, 1986; small-issue IDBs to finance manufacturing facilities may be issued under the exception for an additional two years, through 1988.

B. IDBs for Multifamily Residential Rental Property

Projects for residential rental property may be financed with tax-exempt IDBs only pursuant to the exempt activity exception, discussed above (sec. 103(b)(4)(A)).[3] Multifamily residential rental projects financed with tax-exempt IDBs must remain as rental housing for the longer of the term of the IDBs or a qualified project period,[4] and a set-aside requirement for low- and moderate-income tenants also must be satisfied continuously during the qualified project period. Additionally, a multifamily residential rental project must consist of housing units that are used on other than a transient basis and that are available for occupancy by the general public, subject to the set-aside requirement.

Required set-aside for low- or moderate-income tenants

At least 20 percent of the housing units in a residential rental project must be set aside for tenants with low -or moderate-incomes. In the case of projects located in certain targeted areas, this requirement is reduced to 15 percent. The determination of individuals of low- or moderate-income is made by reference to the rules established under section 8 of the Housing Act of 1937 (the 1937 Act) for determinations of lower-income families, except that the percentage of family median gross income that qualifies as low or moderate is 80 percent.

Present Treasury Department regulations do not provide specifically that adjustments for family size are to be made in the applicable percentage of median gross income to be used under the Code restrictions. Adjustments for family size are made, however, under section 8 of the 1937 Act. Under the 1937 Act, the applicable percentages of median gross income qualifying as low or moderate are 80 percent for a family of 4; 72 percent for a family of 3; 64 percent for a family of 2; and 56 percent for single persons.

The set-aside requirement must be satisfied continuously during the qualified project period, defined above (i.e., 20 percent of the

---

[3] Bonds issued under section 11b of the United States Housing Act of 1937 that are IDBs must satisfy all Internal Revenue Code requirements applicable to IDBs for multifamily residential rental property. All references in this pamphlet to these IDBs include section 11b bonds that also are IDBs. (*See*, II. D., below.)

[4] The term qualified project period means the period beginning on the first date on which at least 10 percent of the units in the project are first occupied (or the date on which the IDBs are issued) and ending on the later of the date; (1) that is 10 years after the date on which at least 50 percent of the units are first occupied; (2) that is a specified number of days after the date on which any of the units in the project is first occupied; or (3) on which any assistance provided to the project under section 8 of the Housing Act of 1937 terminates.

housing units must continue to be occupied by qualifying low -or moderate-income tenants). If a tenant qualifies as having a low -or moderate-income when he or she moves into an apartment, however, that tenant continues to be treated as a low -or moderate-income tenant throughout the period the apartment is occupied, regardless of subsequent increases in the tenant's income.

For purposes of the special set-aside requirement for targeted area projects, the term targeted area means (1) a census tract in which 70 percent or more of the families have incomes that are 80 percent or less of the applicable statewide median family income, or (2) an area of chronic economic distress as determined under statutory criteria (sec. 103A(k)(3)).

Definition of project and housing unit

A residential rental project includes a building containing rental housing units and any functionally related and subordinate facilities. A project may include multiple buildings having similarly constructed housing units provided the buildings are located on the same tract of land. Such buildings may be treated as a single project, however, only if the buildings are owned by the same person for Federal tax purposes and if the buildings are financed pursuant to a common plan of financing.

Facilities that may be treated as functionally related or subordinate include such tenant amenities as swimming pools, other recreational facilities, and parking areas. Additionally, trash disposal facilities and common heating and cooling plants are included as are housing units occupied by resident managers or maintenance personnel (Treas. Reg. sec. 1.103-8(b)(4)(iii)).

As stated above, multifamily residential rental property is eligible for tax-exempt financing only if the housing units are used on other than a transient basis. Treasury Department regulations implement this requirement by defining the term housing unit as a unit "containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation" (Treas. Reg. sec. 1.103-8(b)(8)). Hotels, dormitories, hospitals, nursing homes, and trailer parks are not qualified residential rental property (Treas. Reg. sec. 1.103-8(b)(4)(i)(*b*)).

Penalty for failure to comply with set-aside and rental use requirements

Failure to comply with the set-aside and rental use requirements at any time during the qualified project period (discussed above) results in the interest on the bonds becoming taxable, retroactive to the date of issue. If noncompliance with the requirements is corrected within 60 days after it reasonably should have been discovered, the tax-exempt status of the interest on the bonds is not affected.

C. Application of Other IDB Restrictions to Bonds for Multifamily Residential Rental Property

Bonds that are issued to finance multifamily residential rental property must satisfy most of the Code restrictions that apply to other types of IDBs. For example, bonds issued for this purpose must be in registered form, must satisfy prescribed public approval and information reporting requirements, and may not be advance refunded. In the case of a number of Code restrictions, however, special exceptions are provided for these bonds.

State volume limitations

The aggregate volume of tax-exempt private activity bonds issued in a State for any year may not exceed the greater of $150 per capita or $200 million (sec. 103(n)). Private activity bonds include most IDBs and student loan bonds. IDBs for governmentally owned airports, docks, wharves, mass commuting facilities, and convention and trade show facilities are not subject to these volume limitations. Additionally, bonds to finance multifamily residential rental property, even though the projects are privately owned and operated, are not subject to the State volume limitations.

Arbitrage restrictions

Interest on bonds is not tax exempt if the bonds are arbitrage bonds (sec. 103(c)). Bonds are arbitrage bonds if the proceeds are reasonably expected to be used to acquire securities producing a yield that is materially higher than that of the bonds or to replace funds used to acquire such securities. This restriction applies to all types of tax-exempt bonds.

IDBs other than IDBs to finance multifamily residential rental projects are subject to two additional arbitrage restrictions. First, the amount of bond proceeds that may be invested at a yield greater than that of the bonds may not exceed 150 percent of annual debt service. Second, subject to certain exceptions, arbitrage earned on investments that are not acquired to carry out the purpose of the borrowing must be paid to the Federal Government at five-year intervals, with any remaining balance being paid 30 days after the bonds are retired.

Prohibition on Federal guarantees of tax-exempt bonds

In general, if payment of bonds is directly or indirectly guaranteed (in whole or in part) by the Federal Government, interest on the bonds is not tax exempt (sec. 103(h)). Subject to exceptions for certain Federal guarantee programs in existence when it was enacted, this prohibition applies both to IDBs and to most other types of tax-exempt bonds. A special exception is provided, however, allowing bonds for multifamily residential rental projects and mortgage subsidy bonds to benefit from Federal guarantees, other than guarantees arising by means of Federal deposit insurance (e.g., FDIC or FSLIC insurance).

Restriction on cost recovery deductions

In general, cost recovery deductions for all property that is financed with tax-exempt bonds must be determined using the straight-line method over prescribed ACRS periods. Other property is entitled to deductions determined using a 150-percent (175 percent for real property) declining balance method in the initial recovery years.[5] The only type of property financed with tax-exempt IDBs that remains eligible for full ACRS deductions is multifamily residential rental property.

D. Section 11b of the Housing Act of 1937

Section 11b of the 1937 Act provides that interest on bonds issued pursuant to that Act is tax-exempt. Bonds issued pursuant to the 1937 Act are used to finance private housing projects as well as to finance public projects. In the case of private housing projects constructed pursuant to the 1937 Act, the bonds may be IDBs, but historically their tax exemption was treated as derived from the 1937 Act rather than from the Internal Revenue Code.

In 1982, Congress provided that the tax exemption for section 11b bonds is derived from the Code rather than the 1937 Act.[6] The Deficit Reduction Act of 1984[7] further provided that these bonds must satisfy Code requirements applicable to similar bonds issued under the Code, effective for all bonds issued after June 18, 1984. Pursuant to the 1984 Act, therefore, section 11b bonds that are IDBs must satisfy all Code requirements applicable to IDBs for multifamily residential rental projects.

---

[5] Under present law, the cost of real property generally is recovered over an 18-year recovery period. Certain low-income housing is permitted a 15-year recovery period and a 200-percent declining balance method (rather than 175 percent). The eligibility requirements for this type of low-income housing are stricter than those for determining eligibility for tax-exempt financing (secs. 168(c)(4) and 1250(a)(1)(B)).

[6] Sec. 547(a) of the Surface Transportation Assistance Act of 1982 (P.L. 97-424).

[7] P.L. 98-369.

III. OVERVIEW OF RECENT LEGISLATIVE DEVELOPMENTS

Before 1968, interest on State and local government bonds was exempt from Federal income tax regardless of the manner in which the proceeds of the bonds were used. In 1968, in response to the rapidly expanding issuance of industrial development bonds (IDBs) Congress restricted the use of tax-exempt IDBs to certain specified exempt activities (with an exception for qualifying small issues of IDBs). One of the exempt activities for which tax-exempt IDBs could continue to be issued was residential property units. This provision did not distinguish between multifamily rental housing and single-family, owner-occupied residences, although tax-exempt bonds generally were not issued for single-family residences until the 1970s. In the case of rental housing, tax exemption was permitted under the 1968 legislation regardless of whether the housing units were leased to low-, moderate-, or high-income individuals.

A. IDBs for Multifamily Residential Rental Property and Mortgage Subsidy Bonds

Mortgage Subsidy Bond Tax Act of 1980

In 1980, responding primarily to increased issues of State and local bonds for single-family, owner-occupied housing ("mortgage subsidy bonds"), Congress passed the Mortgage Subsidy Bond Tax Act of 1980 (the 1980 Act),[8] which imposed restrictions on both single-family and multifamily housing bonds. The 1980 Act provided that IDBs for multifamily residential rental property would be tax-exempt only if 20 percent or more of the housing units in the project were occupied by low -or moderate-income individuals. (This percentage is reduced to 15 percent for "targeted area" projects located in certain lower-income census tracts or areas of chronic economic distress.) The 1980 Act further provided that the low -or moderate-income set-aside requirement was to be applied in a manner consistent with the Leased Housing Program under section 8 of the Housing Act of 1937 (the 1937 Act), i.e., individuals and families were generally to be considered low -or moderate-income if their adjusted family income did not exceed 80 percent of area median income as determined by the Department of Housing and Urban Development.

With respect to mortgage subsidy bonds, the 1980 Act imposed Statewide volume ceilings and various other limitations. These additional limitations included purchase price restrictions, targeting rules, special arbitrage rebate requirements, and a general requirement that bond proceeds be made available only to first-time homebuyers (except in targeted areas). The 1980 Act provided that the

[8] Title XI of the Omnibus Reconciliation Act of 1980 (P.L. 96-499).

tax exemption for mortgage subsidy bonds meeting these requirements (i.e., for qualified mortgage bonds) would expire, effective with respect to bonds issued after December 31, 1983.[9]

Tax Equity and Fiscal Responsibility Act of 1982

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) made two adjustments to the rules regarding IDBs for multifamily residential rental property.[10] First, TEFRA provided that, while the set-aside requirement for low -or moderate-income tenants would continue to be defined by reference to the requirements under section 8 of the 1937 Act, the percentage of family median gross income that qualified as low or moderate would be 80 percent, regardless of subsequent changes to that percentage that might be made under the 1937 Act. Second, TEFRA changed a prior-law rule that the set-aside requirement had to be satisfied for 20 years from the date of issuance of any bond to require satisfaction of that requirement throughout a qualified project period, discussed in II. B., above.

In addition to these amendments to the restrictions on IDBs for multifamily residential rental property, TEFRA required generally that the cost of IDB-financed property be recovered using the straight-line method over the applicable ACRS periods in lieu of the otherwise prescribed accelerated method. An exception was provided permitting full ACRS cost recovery for four types of IDB-financed property, including multifamily residential rental property.

Deficit Reduction Act of 1984

The Deficit Reduction Act of 1984 (the 1984 Act) imposed statewide volume limitations on most IDBs and student loan bonds (private activity bonds). Pursuant to the 1984 Act, the face amount of private activity bonds that may be issued by a State during any year is limited to the greater of (1) $150 for each resident of the State or (2) $200 million. IDBs to finance projects for multifamily residential rental property are exempted from these volume limitations. (Bonds issued to finance airports and certain other facilities also are exempt from the volume limitations, but only where the facilities are owned by, or on behalf of, a governmental unit.) The 1984 Act included several additional restrictions for private activity bonds; projects for multifamily residential rental property were exempted from many of these restrictions.[11]

---

[9] Under the 1980 Act, all tax-exempt bonds for single-family, owner-occupied residences had to meet the requirements applicable to qualified mortgage bonds or, alternatively, qualified veterans' mortgage bonds. Qualified veterans' mortgage bonds are general obligation bonds used to finance loans to veterans. Under the 1980 Act, veterans' mortgage bonds were exempted from the volume and most other limitations applicable to qualified mortgage bonds.

[10] TEFRA also liberalized certain of the mortgage subsidy bond restrictions adopted in 1980.

[11] In conjunction with its private activity bond restrictions, the 1984 Act extended the tax exemption for qualified mortgage bonds for single-family, owner-occupied housing through December 31, 1987. Issuers of these bonds also were subjected to new reporting and policy statement requirements, intended, in part, to determine the extent to which the bond proceeds are made available to lower-income families. The 1984 Act also established additional restrictions providing an eventual phase-out of qualified veterans' mortgage bonds.

B. Section 11b of the Housing Act of 1937

The tax status of bonds issued under section 11b of the 1937 Act also was modified by recent legislation. This legislation requires issuers of these bonds to satisfy appropriate requirements of the Internal Revenue Code. Section 11b bonds issued before June 19, 1984, are not subject to these Code requirements. (*See*, II. D., above.)

IV. ISSUES

A. Efficiency of Tax-Exempt Bonds as a Housing Subsidy

Three major Federal Government programs operate indirectly to subsidize low- and moderate-income families in multifamily housing developments: (1) Federal mortgage insurance, (2) accelerated cost recovery methods and periods for tax purposes, and (3) tax-exempt financing. The combination of these incentives attempts to realize this housing goal by more than doubling the investor's after-tax rate of return.

The subsidy from tax-exempt bonds for multifamily residential rental property reduces the interest rate that the developer pays on the borrowed funds used to finance the property, thereby increasing estimated after-tax profits. The lower-cost financing, in combination with the two other subsidies, also reduces other after-tax costs the developer must incur to undertake a multifamily housing project.

Proponents of tax-exempt financing suggest that this type of financing should be retained for multifamily residential rental projects because Federal spending reductions (both enacted and proposed) have included reductions in direct Federal housing assistance programs. The proponents suggest that reducing or eliminating direct subsidies would reduce part of the developer's after-tax rate of return and would make the interest rate subsidy much more significant. Also, the proponents suggest that low- and moderate-income families, especially those that are above average in size, may not be able to find other adequate housing.

Opponents of this type of tax-exempt financing suggest that the tax-exempt interest subsidy does not benefit true low- and moderate-income households in terms of reduced rents, but rather translates into benefits to bond investors, higher profits for developers, and fees for other persons involved in issuance of the bonds. Additionally, these persons point out that both the 1984 Treasury Department tax reform proposal and the President's current proposal recommend repeal of tax-exemption for all nongovernmental bonds. Similarly, H.R. 800 (Mr. Gephardt) and H.R. 2222 (Mr. Kemp) would repeal the tax exemption for IDBs.

B. Targeting to Intended Beneficiaries

Present law permits tax-exempt IDB financing for residential rental property only if a specified percentage of the housing units are occupied by families of low- or moderate-income. In addition to this general targeting to individuals, present law also targets the subsidy to areas of economic need. This area targeting is accomplished by relaxing the restrictions otherwise applicable to these bonds when the property financed with the bonds is located in such an area.

Proponents of stricter targeting criteria suggest that by targeting tax-exempt financing to beneficiaries with lower income levels, Congress and local authorities would increase the probability that the subsidy actually will accomplish its intended purpose. The proponents suggest that private sector housing available for low- or moderate-income families and located in the most economically needy neighborhoods generally is old, run-down, and poorly maintained. Additionally, these persons suggest that the quality of the neighborhoods and the low rents that the residents can afford to pay inhibit profit-motivated investors from extensive maintenance and investment expenditures. To the extent that Federal subsidies are targeted effectively to low -or moderate-income families, proponents of targeting suggest that the quality of housing available to these groups will improve.

Opponents of stricter Federal targeting criteria suggest that such requirements compound the economic problems of providing adequate housing for low- and moderate-income families, because the greater the proportion of low-income families, the greater the need for financial subsidies for the developers. The opponents state that tax-exempt financing alone cannot provide a sufficiently deep subsidy in the poorest neighborhoods; this results in a mixed-income project that may subsidize more nonqualified families than families that qualify on income criteria. These persons suggest that direct subsidies in the form of rent supplements may be targeted to the beneficiaries most in need of assistance with more certainty.

C. Efforts to Monitor Compliance with the Set-Aside and Other Requirements

The requirements that a minimum percentage of the housing units in a residential rental project be set aside for low- or moderate-income tenants and that the project remain as rental property must be satisfied for a statutorily prescribed period. While the requirements must be satisfied continuously, no periodic review of compliance or regular reports are required. Some people argue that regular reviews of compliance with the Code requirements by owners of residential rental projects should be conducted, either by local housing agencies, by IRS, or by both.

Proponents of regular reviews suggest that the Federal subsidy provided by tax-exempt financing should not be permitted unless the beneficiaries comply with the conditions placed on that subsidy. Some of these proponents suggest further that the IRS is the appropriate party to conduct such reviews, as it is the only party without an interest in continuing the tax-exemption.

Opponents of regular reviews and Federal reporting requirements suggest that requiring periodic reviews of compliance would impose an unwarranted burden on the resources of State and local agencies, probably in the form of additional required reports to IRS, when no substantial noncompliance has been documented. Some opponents suggest further that even the present-law requirement that projects continuously comply with certain requirements is inappropriate because the current penalty for noncompliance, loss of tax-exemption for the bond interest, affects bond investors rather than project owners, whose responsibility it is to ensure compliance.

D. Efficiency of Tax-Exempt Bonds in Encouraging New Housing as Opposed to Churning of Existing Housing

Tax-exempt bonds may be issued to finance a new multifamily residential rental project. Bonds also may be issued to finance the purchase of an existing project by a new owner, subject to a minimum rehabilitation requirement.[12] Questions have arisen whether issuance of additional tax-exempt financing should be allowed with respect to a qualified residential rental project after the initial development and construction of the project (i.e., for churning).

Proponents of restrictions on tax-exempt financing for existing projects suggest that tax-exempt bonds should be issued only for new multifamily residential rental property because adequate housing otherwise would not be provided for low- and moderate-income families. These persons suggest that refinancing the same project to realize tax advantages associated with a change in ownership does not promote any increase in available housing stock.

Opponents of limiting this form of financing to new housing suggest that churning should be treated as any ordinary business practice. They state that it is not unusual, for example, for a business to be resold, even for tax purposes, with only taxable financing being used. These persons point out that churning may even be desirable, if it is accompanied by rehabilitation that substantially improves the quality of the existing housing. While the extent of the required rehabilitation may be debated, these persons suggest that unless tax-exempt financing is allowed in such cases, existing housing may be allowed to deteriorate further, thereby resulting in expanded areas of economic blight.

[12] Present law requires rehabilitation expenditures equal to 15 percent of the lesser of (1) the cost of the project or (2) the amount of tax-exempt bonds when tax-exempt bonds are used to acquire existing property.

V. REVENUE ANALYSIS

Size and composition of the tax-exempt bond market

Table 1 shows the growth in the volume of the tax-exempt bond market, by selected function, from 1975 to 1983. The table shows that the total volume of tax-exempt obligations increased by more than three-fold from $30.5 billion in 1975 to $93.3 billion in 1983. The volume of bonds identified for private activities (including tax-exempt IDBs, student loan bonds, mortgage subsidy bonds, and bonds for use by tax-exempt private hospitals and universities) increased by more than six-fold, from $8.9 billion in 1975 to $57.1 billion in 1983. During this same period, the volume of tax-exempt bonds for multifamily residential rental property increased almost six-fold, from $0.9 billion in 1975 to $5.3 billion in 1983. As a percentage of total tax-exempt bonds issued, bonds to finance multifamily residential rental property increased from 3 percent in 1975 to 6 percent in 1983.

Table 1.—Volume of Tax-Exempt Bonds Issued, By Type

[In billions of dollars; calendar years]

Type of bond	1975	1976	1977	1978	1979	1980	1981	1982	1983
All tax-exempt bonds	30.5	35.0	46.9	49.1	48.4	54.5	55.1	84.9	93.3
Private activity bonds	8.9	11.4	17.4	19.7	28.1	32.5	30.9	49.6	57.1
Multifamily residential rental property bonds	0.9	1.4	2.9	2.5	2.7	2.2	1.1	5.1	5.3

Revenue effect

Table 2 indicates the estimated revenue loss from private activity tax-exempt bonds during the next five fiscal years. The total revenue loss from all types of private activity bonds during this five-year period is estimated at $68.5 billion. The total revenue loss from bonds to finance multifamily residential rental property during this five-year period is estimated at $7.2 billion.

Table 2.—Estimated Revenue Loss For Private Activity Tax-Exempt Bonds Under Present Law, Fiscal Years 1986–90

[In billions of dollars]

Type of bond	1986	1987	1988	1989	1990	1986–90
Total private activity bonds	11.0	12.4	13.9	15.1	16.1	68.5
Multifamily residential rental property bonds	1.0	1.2	1.4	1.7	1.9	7.2

Revenue effects of tax-exempt bonds traditionally have been expressed as the revenue foregone on a year-by-year basis as a result of the issuance of the bonds. However, tax-exempt bonds typically are outstanding for a number of years, and consequently, the issuance of tax-exempt bonds during a year results in revenue losses over a number of years. Since tax-exempt bonds result in tax expenditures over a number of years, it is helpful to express the revenue effect of these obligations in terms of the total value of future revenue losses. Table 3 indicates projected future revenue losses from bonds forecast to be issued in calendar years 1986 through 1990 to finance multifamily residential rental property. For example, the $7.6 billion of such bonds forecast to be issued in calendar year 1986 is estimated to result in total future revenue losses of $3.1 billion, with a present value of $2.1 billion. The authority to issue these bonds during the years 1986 through 1990 is, therefore, economically equivalent to annual authorizations totalling $20.2 billion.

Table 3.—Various Measures of Total Revenue Loss From IDBs for Multifamily Residential Rental Property Forecast To Be Issued in Calendar Years 1986–90

[In billions of dollars]

	1986	1987	1988	1989	1990
Dollar amount of estimated multifamily residential rental property bonds issued	7.6	8.4	10.2	11.3	13.4
Revenue loss:					
Total revenue loss attributable to bonds issued in given year	3.1	3.6	4.3	4.4	4.8
Present value (in year of issuance) of total	2.1	2.4	2.9	3.0	3.2

APPENDIX

JOINT COMMITTEE ON TAXATION,
Washington, DC, August 8, 1984.

Hon. CHARLES A. BOWSHER,
Comptroller General of the United States,
U.S. General Accounting Office, Washington, DC.

DEAR MR. BOWSHER: The Joint Committee on Taxation, pursuant to section 6103(f)(4)(A) of the Internal Revenue Code of 1954, as amended, requests the General Accounting Office to conduct a study of the use of tax-exempt bonds to finance multifamily rental housing. Section 103(b)(4)(A) of the Code generally exempts from Federal income tax the interest on industrial development bonds to finance such housing if 20 percent or more of the units financed with the bond proceeds are reserved for occupancy by low- and moderate-income individuals. Interest on bonds issued by public housing agencies to finance low-income housing projects is exempt by virtue of sections 103(a) and (m) of the Code and section 11(b) of the U.S. Housing Act of 1937.

Your work should be designed to help Congress decide whether tax-exempt bonds are an efficient method for making more or better housing available to low- and moderate-income individuals. We recognize that a study of this nature is a large and complex undertaking; therefore, after your staff has developed preliminary information, we would like to meet with them to reach agreement on issues warranting further study and to determine whether these issues should be developed as part of an overall study or as a series of studies. Among the questions on which you should focus your initial efforts are the following:

—Who benefits, and by how much, from the tax-exemption provided for interest paid on these bonds?

—To what extent are these bonds being used to finance new housing units as opposed to units undergoing a change of ownership, and when previously occupied units are financed, to what extent does renovation occur in conjunction with the change of ownership?

—What role does the tax-exemption for interest on these bonds play in decisions to "churn" rental housing projects for low- and moderate-income individuals?

—How large are the costs imposed on various parties, including the Federal Government, States, and local governments, by the issuance of tax-exempt bonds for this purpose?

—Are adequate efforts being made to monitor compliance with the requirement that specified numbers of units be reserved for low- and moderate-income individuals and with other requirements for tax-exemption imposed by the Code?

Your initial work also should examine the effect of this tax-exemption on the housing market. This facet of your work should be directed to determine whether and how much additional housing is being built in response to these tax incentives. You also should analyze the effects of this increase in the stock of housing on local housing markets and who benefits from the increase. Additionally, we would like you to describe the physical characteristics of some of the projects that have been built with the proceeds of tax-exempt bonds. Are the rental units that are reserved for low- and moderate-income individuals different from the other units in the project? Do these occupants enjoy equal access to such amenities as swimming pools and recreation halls? Are the housing units financed with tax-exempt bond proceeds generally well-maintained over their economic life, or are they permitted to deteriorate with relatively little maintenance being performed?

We expect that your designated representatives will have access to all IRS files, records, and returns necessary to conduct this study for the Joint Committee. Because of possible interest of other Congressional committees in this subject, we anticipate that you may be asked to brief other committees on the progress of your work. We do not object to such briefings; however, we would like to be notified in advance as to the nature and time of all such briefings and be given an opportunity to attend. (Of course, these discussions could not involve any disclosure of tax returns or return information.)

Sincerely,

DAVID H. BROCKWAY,
Chief of Staff.

○