[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 1598 (THE FIRST TIME HOMEBUYER ASSISTANCE ACT OF 1983)

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FINANCE

ON SEPTEMBER 13, 1983

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on September 13, 1983, on S. 1598 ("The First Time Homebuyer Assistance Act of 1983"), introduced by Senators Dole, Long, Domenici, Bradley, Wallop, Tower, and Heinz. The bill relates to the authority of State and local governments to issue qualified mortgage credit certificates.

The first part of the pamphlet is a summary of the bill. This is followed by a more detailed description of the bill, including present law, issues, explanation of provisions, and effective date.

I. SUMMARY

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

The bill (S. 1598) would allow State and local governments to elect, for any year, to exchange all or part of their qualified mortgage bond authority for authority to issue qualified mortgage credit certificates (MCCs). MCCs would entitle homeowners to refundable credits not exceeding 50 percent (but not less than 10 percent) of mortgage interest on qualifying principal residences. The credits would be subject to the existing eligibility requirements for qualified mortgage bonds.

The total amount of MCCs distributable by a State or local government would be equal to 14.35 percent of the amount of exchanged mortgage subsidy bond authority. For States and localities which issued less than their full authorized volume of mortgage subsidy bonds in 1983, the authority to issue MCCs would be phased in over a 5-year period.

Under the bill, MCCs could be distributed only following the announcement by the State or local government, at least 90 days before distribution, of a proposed plan of distribution.

The bill does not extend the authority to issue qualified mortgage bonds, although it assumes some such extension.

II. DESCRIPTION OF THE BILL

A. Present Law

Overview

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

Qualified veterans' mortgage bonds

Qualified veterans' mortgage bonds are general obligation bonds, the proceeds of which are used to finance mortgage loans to veterans. Unlike qualified mortgage bonds, the tax-exemption for veterans' bonds does not expire after December 31, 1983.

Qualified mortgage bonds

Qualified mortgage bonds must satisfy numerous requirements, discussed below. In addition, interest on these bonds is tax-exempt only if the bonds are issued before January 1, 1984.[2]

Volume limitations

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

Limitation to single-family, owner-occupied residences

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

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

[2] S. 137 (introduced by Senators Roth, Mitchell, Durenberger, Danforth, Packwood, Wallop, and others) would make permanent the tax exemption presently provided for qualified mortgage bonds. A hearing on this bill was held by the Senate Committee on Finance on May 13, 1983. (For a description of S. 137, see Joint Committee staff pamphlet, "Description of Tax Bills (S. 137 and S. 1061) Relating to Mortgage Subsidy Bonds and Federal Guarantee of Tax-Exempt Bond Investments," JCS-12-83, May 12, 1983.

H.R. 2973, as approved by the Senate on June 16, 1983, would likewise have made permanent the present law tax exemption for qualified mortgage bonds. However, that provision was subsequently deleted in conference (P.L. 98-67).

ed that each residence will become the principal residence of the mortgagor within a reasonable time after the financing is provided. Generally, the term single-family residence includes 2-, 3-, and 4-family residences if (1) the units in the residence were first occupied at least 5 years before the mortgage is executed and (2) one unit in the residence is occupied by the owner of the units.

General limitation to new mortgages

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

Certain mortgage assumptions permitted

Loans financed by qualified mortgage bond proceeds may be assumed if the residence satisfies the location and principal residence requirements, discussed above, and the assuming mortgagor satisfies the 3-year and purchase price requirements, discussed below.

Limitation on advance refunding

Qualified mortgage bonds may not be advance refunded.

Targeting requirement

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

3-year requirement

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

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

Purchase price requirement

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

Arbitrage requirements

In order for an issue to be a qualified mortgage issue, the issue is required to meet certain limitations regarding arbitrage as to both mortgage loans and nonmortgage investments. The effective rate of interest on mortgages provided under an issue of qualified mortgage bonds (determined on a composite basis) may not exceed the yield on the issue by more than 1.125 percentage points. The 1980 Act also imposes restrictions on the arbitrage permitted to be earned on nonmortgage investments and requires that any arbitrage on nonmortgage investments must be paid or credited to the mortgagors or paid to the Federal Government.

B. Issues

The principal issue is whether State and local goverments should be entitled to exchange all or part of their qualified mortgage bond authority for authority to issue mortgage credit certificates. Related issues include:

First, what is the relative efficiency and effectiveness of mortgage credit certificates and mortgage subsidy bonds as a means of providing a subsidy to first time homebuyers?

Second, which type of program (mortgage credit certificates or mortgage subsidy bonds) is better suited to the purpose of targeting the available subsidy to those individuals who are most in need of assistance?

C. Explanation of Provisions

Overview

The bill would allow State and local governments to elect, for any calendar year beginning after 1983,[4] to exchange all or part of their qualified mortgage bond authority for authority to issue qualified mortgage credit certificates (MCCs). MCCs would entitle taxpayers to refundable Federal income tax credits for not more than 50 percent (but not less than 10 percent) of interest on indebtedness incurred to finance the acquisition (or qualified rehabilitation or improvement) of qualified principal residences. The credits would be subject to the existing eligibility requirements for qualified mortgage bonds. For States and localities which issued less than their statutory maximum of qualified mortgage bonds during calendar year 1983, authority to issue MCCs would be phased in over a 5-year period.

[4] Under present law, the authority to issue qualified mortgage bonds will expire on December 31, 1983 (see Part A, Present Law, above). Thus, in order for the MCC program to take effect, Congress would have to extend the availability of qualified mortgage bonds beyond the 1983 sunset.

Qualified mortgage credit certificates (MCCs)

Qualified mortgage credit certificates (MCCs) would take the form of certificates issued to qualifying homebuyers. Each certificate would specify (1) the principal amount of indebtedness the interest on which qualified for the credit and (2) the applicable percentage of the credit. The applicable percentage could not exceed 50 percent, but could not be less than 10 percent, of interest on the qualifying indebtedness. (The actual amount of the credit in any year would depend upon the mortgage interest rate.) The certificate would entitle the taxpayer to a credit against his or her Federal income taxes for a taxable year during which the taxpayer used the residence as his or her principal residence during that taxable year.

MCCs would be refundable to the taxpayer (i.e., credit amounts in excess of any Federal income taxes would be refunded to the taxpayer). However, when a taxpayer received an MCC, the taxpayer's deduction for interest on the qualifying mortgage (sec. 163(a)) would be reduced by the amount of the credit. For example, a taxpayer receiving a 50-percent credit, and making $1,000 of interest payments in a given year, would receive a $500 credit and a deduction for the remaining $500 of interest payments.

Under the bill, MCCs would not be available for property financed with mortgage subsidy bonds. Additionally, loans between related parties would not qualify for the credit.

Criteria for eligibility

MCCs would be subject to the existing eligibility requirements applicable to qualified mortgage bonds. Thus, MCCs would generally (1) be limited to interest on mortgage loans for single-family owner occupied residences (as defined under the qualified mortgage bond provisions) located within the jurisdiction of the issuing authority, (2) be available only for new mortgages (with allowances for qualified rehabilitation and improvement loans and for certain mortgage assumptions), and (3) be available to finance the acquisition of residences the acquisition cost of which does not exceed 110 percent (120 percent in targeted areas) of the average area purchase price applicable to the residence. Additionally, 90 percent of MCCs distributed under each MCC program[5] would be required to be made available only to mortgagors who did not have a present ownership interest in a principal residence at any time during the 3-year period ending on the date the mortgage is granted (with exceptions for qualified rehabilitation and home improvement loans and residences located in targeted areas). Finally, at least 20 percent of the aggregate amount of MCCs issued under each program would be required to be made available for financing in targeted areas for a period of at least one year.

Under the bill, MCCs could be issued for debt incurred to refinance a principal residence if the refinancing takes the place of an existing mortgage for which a certificate has already been issued and does not extend the term or increase the principal amount of the original mortgage.

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[5] A State or locality could have more than one MCC program in each year (subject to the aggregate volume limitations on MCCs).

As in the case of qualified mortgage bonds, a State or locality would be free to establish more stringent criteria for participation in an MCC program.

Volume limitations

General limits

Under the bill, the aggregate annual amount of MCCs distributable by a State or locality could not exceed 14.35 percent of the volume of qualified mortgage bond authority exchanged by the State or locality. For example, a State which was entitled to issue $200 million of qualified mortgage bonds, and which elected to surrender $100 million of bond authority, could distribute an aggregate amount of MCCs not exceeding $14.35 million.

The aggregate annual amount of MCCs issued by a State or locality would be determined by multiplying (1) the principal amount of each MCC certificate issued by the State or locality by (2) the applicable percentage for each certificate, and adding the products. For example, a State with $14.35 million of MCC authority could distribute credits for 14.35 percent of the interest payments on mortgages having an aggregate principal amount of $100 million (thereby approximating the benefits provided by $100 million of mortgage subsidy bonds). However, the State could also issue any other mix of higher or lower percentage credits in an aggregate amount not exceeding $14.35 million (subject to the 10 -and 50-percent requirements and the targeting and purchase price requirements applicable to mortgage subsidy bonds).

Phase-in of MCC authority

States or localities which issued qualified mortgage bonds in amounts less than their maximum legal authority during calendar year 1983, would be subject to a 5-year phase-in of authority to issue MCCs. For each of these years, the amount of qualified mortgage bond authority which a State or locality could exchange for authority to issue MCCs would be limited to the volume of qualified mortgage bonds it actually issued in 1983, increased for each year by 25 percent of the remaining difference between the 1983 volume and the statutory amount. For example, a State which had authority to issue $200 million of qualified mortgage bonds in 1983, but actually issued only $100 million, would be entitled to exchange $125 million of authority in 1984 ($100 million plus 25 percent of the remaining statutory authority), $144 million in 1985 ($125 million plus 25 percent of authority remaining in 1984), $158 million in 1986, $167 million in 1987, $175 million in 1988, and the full $200 million in 1989.[6]

Where a State or locality issued both qualified mortgage bonds and MCCs, the phase-in would apply to the total amount of bonds and credits which it could issue. Thus, in the example above, the State (if it elected to issue MCCs) could use or exchange a total of $144 million of qualified mortgage bond authority in 1985. The

[6] The phase-in rule would apply regardless of the amount of authority actually exercised by a State or locality in any intervening year. Thus, in the example, the State could exchange $144 million of bond authority in 1985 for authority to issue MCCs regardless of the actual volume of its 1984 issues.

hase-in would not apply if the State elected to issue only mortgage bonds.

Public reporting requirement

Under the bill, State or local housing agencies could issue MCCs only after making generally available, at least 90 days prior to distribution, a proposed plan of distribution of the credits. The proposed plan would set forth the eligibility requirements to receive MCC certificates and the methods by which the certificates would be issued.

E. Effective Date

The bill would apply to interest paid or accrued after December 31, 1983, on mortgages executed after December 31, 1983.

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