Housing Bonds

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Administering Agency: U.S. Department of the Treasury

Year program started: 1954

Number of households served: In 2013, 34,473 with Mortgage Revenue Bonds (MRBs); 10,096 with Mortgage Credit Certificates (MCCs); and 23,992 with multifamily bonds.

Population targeted: Low and moderate income home buyers and renters

See also: *Low Income Housing Tax Credits, HOME Investment Partnerships Program*

Housing bonds are used to finance low-interest mortgages for low and moderate income home buyers, as well as for the acquisition, construction, and rehabilitation of multifamily housing for low-income renters. Investors purchase housing bonds at low interest rates because the income from them is tax-free. The interest savings made possible by the tax exemption is passed on to home buyers and renters in reduced housing costs.

HISTORY

Private activity bonds (PABs) were established under the Tax Code of 1954. These bonds were known as Industrial Development Bonds until the Tax Reform Act of 1986 and other legislation changed their name.

PROGRAM SUMMARY

PABs, a category that includes housing bonds, are distinct from other tax-exempt bonds because they are issued for private activities as opposed to governmental activities. The private activities must fulfill public purposes, and each private activity bond issuer must hold public hearings to demonstrate such public purposes. PABs are tax-exempt for the purchaser and are issued by state and local governments to support the stated public purpose. Purchasers, or investors, of PABs can include individuals and corporations. In addition to housing, PABs can be issued for other public purposes that include student loans, infrastructure, and redevelopment activities.

State and local housing finance agencies (HFAs) have authority under the Internal Revenue Code to issue housing bonds to support affordable housing activities in their states. Issuing bonds is a way for HFAs to access private capital markets to help support affordable housing activities. HFAs sell the tax-exempt bonds to individual and corporate investors, who are willing to purchase bonds paying lower than market interest rates because of the bonds' tax-exempt status. This interest savings is passed on through private lenders to support housing purchase and development.

There are two main types of housing bonds: Mortgage Revenue Bonds (MRBs), which finance single-family home purchases for qualified low-income home buyers; and, multifamily housing bonds, which finance the acquisition, construction, and rehabilitation of multifamily developments for low-income renters.

Mortgage Revenue Bonds. Proceeds from MRBs finance below-market rate mortgages to support the purchase of single-family homes. By lowering the interest rate, MRBs make homeownership affordable for families who would not be able to qualify for a market rate loan. Congress limits MRB mortgages to first-time home buyers who earn no more than the greater of area or statewide median income in most areas, and up to 140 percent of the applicable median income in targeted areas. Families of three or more in non-targeted areas can earn up to 115 percent of the greater of area or statewide median income. Congress also limits the price of homes purchased with MRB mortgages to 90 percent of the average area purchase price in most areas and up to 110 percent of the average area purchase price in targeted areas.

HFAs also use their MRB authority to issue Mortgage Credit Certificates (MCCs), which provide a nonrefundable federal income tax credit for part of the mortgage interest qualified home buyers pay each year. The MCC program is a flexible subsidy source that can be adjusted depending on the incomes of different home buyers. It provides a relatively constant level of benefit to first-time home buyers regardless of the spread between market and MRB rates.

Interested borrowers should contact their state or local HFA for information on obtaining an MRB loan or MCC.

Multifamily Bonds. Multifamily bonds provide funding for affordable rental housing development that reaches income groups the market might not otherwise serve.

Multifamily housing bonds finance the acquisition, construction, or rehabilitation of affordable rental housing. Multifamily housing developments with bond financing must set aside at least 40% of their apartments for families with income of 60% of area median income (AMI) or less, or 20% for families with income of 50% of AMI or less. The income-restricted apartments financed by those bonds must remain affordable for at least 15 years.

States increasingly combine multifamily bonds with other resources, including Low Income Housing Tax Credits (LIHTC) and HOME Investment Partnerships (HOME) program funds, to serve even lower income families for longer periods of time than the law requires. Furthermore, many multifamily bonds finance special needs housing, such as housing for formerly homeless people, veterans housing, transitional housing, senior housing, assisted living housing, housing for persons with disabilities, workforce housing, housing for persons with AIDS, migrant worker housing, and rural housing.

ISSUE SUMMARY

In 2013, the most recent year for which data are available, state HFAs used MRBs to provide $4.7 billion to support the purchase of 34,473 homes nationwide. Some bond issuance was used to raise proceeds that were escrowed for use in future years, and to refund prior-year bonds. HFAs also issued 10,096 MCCs in 2013, more than double the amount issued in the previous year. States issued upwards of $4.4 billion in multifamily bonds in 2013 to finance more than 20,000 affordable rental homes.

Housing bonds have been an unqualified success in providing lower income Americans an opportunity they might not otherwise have to own a decent and affordable home and to access quality rental opportunities. Using MRBs, HFAs have made homeownership possible for more than 3 million low and moderate income families. They help another approximately 100,000 families buy their first homes with MRB mortgages in a typical year. In 2013, 82% of MRB borrowers earned less than AMI. The median MRB borrower income was $45,328, 89% of the national median income.

HFAs have also provided over 200,000 lower and moderate income homeowners critical tax relief through the MCC program. Seventy percent of all MCC borrowers in 2012 earned less than AMI.

HFAs have financed an additional 1 million affordable rental apartments with Multifamily Bonds. About 40% of all annual LIHTC rental home production includes Housing Bond financing. HFAs have used the LIHTC to produce almost 3 million rental homes for families earning 60% of AMI or less. They add another 100,000 LIHTC apartments every year.

FUNDING

By law, the annual state issuance of PABs, including MRBs and multifamily bonds, is capped by each state's population and indexed to inflation. The 2016 state cap is $100 per capita, with a per-state minimum of $302,875,000.

FORECAST

As Congress continues to consider comprehensive tax reform, the tax exemption for housing bonds, and all municipal bonds, may face its biggest threat since Congress last considered tax reform in 1986. Indeed, then-Ways and Means Committee Chairman Dave Camp (R-MI) proposed to eliminate the tax-exemption for private activity bonds in his 2014 tax reform proposal. Although it is unlikely that Congress will pass tax reform legislation this year, we expect it to continue to work on tax reform and make serious efforts to enact tax reform legislation as soon as 2017.

President Obama's FY17 Budget proposes legislation to allow states to convert up to 18% of their PAB volume cap received in a calendar year into LIHTC authority for that same year. The FY17 Budget also proposes to repeal the MRB program purchase price limit and refinancing restriction; create a new permanent American Fast Forward Bond program, which would be an optional alternative to traditional tax-exempt bonds; and to cap the value of itemized deductions and other tax preferences, including the income exclusion of interest on tax-exempt bonds, to 28 percent.

Eliminating or capping the tax exemption for municipal bonds would have a significant negative impact on municipal bond investment, directly increasing borrowing costs for HFAs and detracting from their ability to provide affordable housing opportunities to lower income people and Americans with special needs. It is estimated that the president's 28% deduction value cap proposal would cause issuers to pay yields of up to half a percent higher to continue attracting investors, resulting in an additional $10 billion annually in debt payments. The ultimate impact, however, would likely fall not on bond issuers and investors but on the bond programs' ultimate beneficiaries, including home buyers and renters, who would bear the cost of higher interest rates demanded by investors. Further, lower and middle income taxpayers could face increases in taxes if state and local governments are forced to increase revenue to cover higher borrowing costs.

WHAT TO SAY TO LEGISLATORS

Advocates should tell legislators to preserve the tax exemption for housing bonds and other municipal bonds, and to strengthen the housing bonds program with targeted improvements.

Advocates should ask legislators to express their support for the tax exemption for all municipal and private activity bonds, including housing bonds, directly to the leaders of the Senate Finance Committee or House Ways and Means Committee.

Advocates should speak with staff in their Members' offices responsible for housing or tax policy and deliver the message that support is needed for housing bonds in any tax reform or deficit reduction proposal.

Specifically, lawmakers should:

- Preserve the tax exemption for municipal and housing bonds.
- Maintain and strengthen the MCC program.
- Allow states to convert PAB authority into Housing Credit authority.
- Repeal the housing bonds purchase price limit and refinancing restriction and increase the MRB home improvement loan limit by an amount at least adequate to reflect the rise in construction costs since it was first established, and index it for construction cost inflation annually thereafter.

FOR MORE INFORMATION

National Council of State Housing Agencies, 202-624-7710, www.ncsha.org ■