S. HRG. 100-1002

EXPIRING TAX PROVISIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

MARCH 28, 1988

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

91-401 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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MONDAY, MARCH 28, 1988

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

The hearing was convened, pursuant to notice, at 9:38 a.m. in Room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Present: Senators Baucus, Mitchell, Riegle, Packwood, Danforth, and Chafee.

[The prepared statement of Senator Chafee and a background paper by the Joint Committee on Taxation appear in the appendix.]

[The press release announcing the hearing follows:]

[Press Release No. H-10, February 23, 1988]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARING ON EXPIRING TAX PROVISIONS

WASHINGTON, DC.—Senator Max Baucus (D., Montana), Chairman of the Senate Finance Subcommittee on Taxation and Debt Management, announced Tuesday that the Subcommittee will hold a hearing on expiring tax provisions.

The hearing is scheduled for *Monday, March 28, 1988 at 9:30 a.m.* in Room SD-215 of the Dirksen Senate Office Building.

"Congress occasionally enacts tax provisions on a temporary basis to allow time for further review and study," Senator Baucus said. "This hearing gives us an opportunity to review some of those provisions which have expired recently or will expire this year."

Expiring provisions which may be addressed at the hearing include the exempt treatment of mortgage revenue bonds and the Targeted Jobs Tax Credit. The hearing will not address the R&D tax credit or the allocation of domestic research expenses which were the subject of a hearing on April 3, 1987.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. The hearing will come to order. The subcommittee today will hear testimony on five provisions of the Code that either already have expired or will expire this year. Some of the provisions have been in the Code longer than ten years.

In the past, Congress extended these provisions because they were found to encourage worthwhile objectives.

Two such provisions are the Mortgage Revenue Bonds and Mortgage Credit Certificates. They are intended to make housing more affordable for first-time home buyers. Legislation to extend MRBs and MCCs through 1992 has been introduced by Senator Riegle and ten other members of the full committee.

Another provision is the Targeted Jobs Tax Credit. This credit was designed to encourage businesses to hire economically disadvantaged youth and Vietnam era veterans as well as members of other targeted groups. Senator Heinz has introduced legislation to make the credit permanent.

He also is sponsoring legislation, along with Senators Moynihan, Durenberger, and Boren, to reinstate the exclusion for employer-provided group legal services.

The subcommittee also will hear testimony on two other expiring provisions. The first concerns rules enacted in 1981 for financially troubled thrifts. The second is the tax credit for business investment in geothermal, solar, and ocean thermal property.

Some of these provisions have been in the Code for a while. They serve different constituents with diverse interests, and each provision was intended to achieve a laudible goal; but the value of these provisions is only one issue before the committee.

In deciding whether to extend these provisions, we must determine whether they are efficient. We must decide if they are a economical means of providing assistance to home buyers, the unemployed, or troubled thrifts. We also must consider costs, which means we are here to determine whether we can afford to extend these provisions and how to pay for them. We must determine whether the desired activity that these provisions are intended to accomplish would if these provisions were not in the Code.

I note that Senator Riegle, a sponsor of one of the expiring provisions, is here. Senator Riegle, do you have a statement?

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MI

Senator RIEGLE. Thank you, Mr. Chairman. Thank you for your kind mention of S. 1522 which I am sponsoring and which now has very broad cosponsorship. That legislation would extend the Mortgage Revenue Bond program through 1992.

As we know, that program is said to expire at the end of this year. Mortgage Revenue Bonds are very important in helping low and moderate income individuals to become first time home buyers. I am happy to say that the legislation to extend the Mortgage Revenue Bond program now has broad and very bipartisan support in both the House and the Senate.

The Senate bill, as of this morning, has 61 cosponsors, 13 of whom are members of this committee. The companion House bill, H.R. 2640, now has 277 cosponsors, 20 of whom are members of the Ways and Means Committee. In addition, the broad sponsorship outside the Congress includes such organizations as the National Association of Home Builders, the National Association of Realtors, and the Council of State Housing Agencies, and others.

The problem that we are facing is that the American dream of home ownership is becoming more and more difficult for many people to achieve. In fact, the nation's home ownership rate is at now its lowest level in 15 years. So, we are sliding backward in terms of percentage of Americans who can afford to own their own homes.

This decline has been taking place at a time when members of the baby boom generation, as we call it, are in the prime home buying age. There have been a number of studies done that point this problem up one by the Joint Center for Housing Studies of Harvard. We have that report, and it is worth looking at in terms of documenting the scale of this problem.

I think it is very important that we extend the sunset date on the Mortgage Revenue Bond program. These bonds allow State and local housing finance agencies to make mortgage loans a below market interest rates for first time home buyers who need assistance. The record shows that these programs have been a resounding success nationwide.

Since they began in the 1970s, MRBs—as they are called—have been used to finance the purchase now of over 900,000 homes. In addition, States may exchange that authority for Mortgage Credit Certificates, which entitle eligible first time home buyers to a credit against Federal income taxes.

In my home State of Michigan, the Michigan State Housing Development Authority has shown that there are additional benefits to MRBs. These include the financing of home improvement loans, which many small localities in Michigan blend with community development block grants. In this way, we have added nearly 5,500 home owners with average incomes of $7,500 a year to be able to afford repairs to their homes.

Other indirect benefits common to these programs around the country include the many jobs that have been added in construction and related trades. I think as incomes fail to keep pace with inflation in the housing markets, that many potential first time home buyers are going to be denied their chance of achieving the dream of starting up the home ownership ladder.

I think we all know how important that is. We all strive for it in our own personal circumstances. And I think one of the useful things we can do here is to extend this program so that this opportunity is spread in such a way as to reach the maximum number of people in the country.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator. Our first witness is Senator Pete Domenici. Is Senator Domenici here? (No response)

Senator BAUCUS. Our next witness is the Honorable Michael Bilirakis, United States Representative from the State of Florida. Congressman, we are very happy to have you here. Why don't you proceed.

STATEMENT OF HON. MICHAEL BILIRAKIS, A U.S. REPRESENTATIVE FROM FL

Congressman BILIRAKIS. Thank you and good morning. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you this morning to discuss the Targeted Jobs Tax Credit Program.

First, let me start out by saying that I wholeheartedly support the reauthorization of this program. I believe that the Congress should thoroughly study the program, keep what is working, and revise what is not. The groups that are presently targeted do need help, and I feel it is far better to give them a working experience than a handout.

However, Mr. Chairman, there is a group of people out there who are as needy, and I believe even more needy in most cases, as those presently covered under TJTC; and they are the displaced homemakers. Displaced homemakers are primarily women who have been full-time homemakers for a number of years, but who have lost their source of economic support due to divorce, separation, abandonment, or the death or disability of a spouse.

I am not talking about women, Mr. Chairman whose husbands have died and left them well off, or women who receive substantial alimony or child support payments. We are talking about poor women who have been out of the work force and cannot find decent jobs, either because of a lack of job skills or a employer's unwillingness to hire them because they haven't worked in years or perhaps never worked outside of the home.

They are struggling to make ends meet without unemployment insurance without health insurance in many cases, and without jobs. These are not only elderly women that I am talking about, even though prime working years are usually considered to be up to age 64 but women who may be in their late twenties, thirties, or forties.

They may have a number of children or none at all However, the basic fact is that they need to eat, have housing, medical care etcetera, all of which they could pay for if they had a decent paying job.

The statistics on displaced homemakers are truly shocking. The displaced homemakers network here in Washington, which represents local programs serving displaced homemakers nationwide, in one of its studies indicates that women and children suffer a 73 percent decline in their standard of living the first year after a divorce, while men experience a 42 percent rise.

I believe we can all appreciate the inequity of this situation, and it is obvious who the victims are.

A 1985 Congressional Office of Technology Assessment study further confirms that many displaced homemakers are living at or near poverty levels. Nearly half had family incomes below $10,000. Most of those displaced homemakers under age 35 are living with children and most of them are poor.

The question is obvious, Mr. Chairman. How can we expect children who are brought up in a poverty-ridden single-parent home to reach their full potential?

A network status report on displaced homemakers and single parents in the United States also states that there are 11.4 million displaced homemakers in the United States. Two-thirds of all displaced homemakers are widows, and 30 percent are divorced or separated. Nearly half have completed high school, including 18 percent who have obtained some education beyond high school.

Any woman who has succeeded in running a home, budgeting, and possibly caring for children has skills that will fit very nicely in a working environment outside of the home.

In 1983, as well as the past two Congresses, in an effort to give displaced homemakers an opportunity for meaningful employment and job dignity, I have introduced legislation which would amend the Internal Revenue Code to allow employers a tax credit for hiring displaced homemakers.

Basically, this legislation would establish displaced homemakers as a targeted group under the Targeted Jobs Tax Credit Program. My bill is intended to be an encouragement for employers to hire those who have been out of the work force because of family obligations.

The problems of displaced homemakers, Mr. Chairman, are significant and truly very costly to society. It only stands to reason that in these deficit-ridden times, we need productive people who are contributors to the coffers, not recipients of assistance.

An investment in helping these women obtain job skills, self-confidence, and a paid position can only enhance their lives and the lives of their children, not to mention the savings to the taxpayers.

These women do not have high-paid, slick lobbyists acting as their advocates. They fall between the cracks—and I might add that this gentleman has a pretty high conservative fiscal rating—and often end up as victims once again.

They want to work, and they need help to reach this goal. We as elected officials are in a position to see that their needs and the needs of their children are addressed. I believe passage of my bill, calling for an expansion of the TJTC Program, will do much to address the needs of these hidden poor. This is an issue of compassion, good fiscal sense, and progressive thinking.

Mr. Chairman, I urge you and the other members of this subcommittee to move forward in reauthorizing the TJTC Program and expanding it to include a displaced homemakers target group. As our elders have taught us, "If you give a person a fish, you feed him for a day. If you teach a person to fish, you feed him—and I might add, his family—for a lifetime." And I believe that my legislation will accomplish this.

Also, Mr. Chairman, I would request that the testimony prepared by the FACE Learning Center in Largo, Florida be inserted in the record. The FACE Center assists displaced homemakers toward achieving personal stability and economic self-sufficiency. It provides services in the areas of preemployment training, setting and achieving realistic career goals educational planning and promotion of nontraditional employment opportunities.

The FACE Program maintains a job bank and, if a displaced homemaker is lucky enough to find a job, FACE is there to help them after the fact with self-esteem counseling sessions and financial and family advice. We are extremely proud of the good work that FACE is doing in my congressional district, and I believe you will find their testimony interesting.

I would also like to insert for the record, sir, the distribution of the displaced homemakers in the country by State. As you will notice, Mr. Chairman, there are 33,826 displaced homemakers in Montana; 445,685 in the State of Michigan, Senator Riegle; and in my own State of Florida, there are 596,918. Thank you, Mr. Chairman, for providing me with this opportunity to testify on the TJTC and the need for my legislation.

Senator BAUCUS. Thank you, Congressman. And without objection the matters you requested will be placed in the record.

[The prepared statement of Congressman Bilirakis and the FACE Program report appear in the appendix.]

Senator BAUCUS. Do you have any estimate as to how much the TJTC will be expanded with the inclusion of the displaced homemakers? How many more employees would qualify?

Congressman BILIRAKIS. No, no. I don't have that estimate. As you know of course, the cost of the program is very minimal insofar as administrative costs are concerned, as is true generally with TJTC; but the costs would be, of course, the direct immediate loss to the revenue as a result of the tax credit.

My argument has been quite frankly even against the Administration. A hearing was held in the last session over in the other body, and my argument with the Administration is that certainly there would be some sort of a loss on an immediate basis, but overall it would be a tremendous gain to the Government.

Senator BAUCUS. You raise the old question of dynamic versus static analysis, and neither of them work very well. It is just a problem we face around here, and I see that the Senator from New Mexico is smiling; and he knows more about that than anyone else. Thank you very much, Congressman.

Congressman BILIRAKIS. Thank you, Senator.

Senator BAUCUS. Senator Domenici?

STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATOR FROM NEW MEXICO

Senator DOMENICI. Mr. Chairman and members of the committee. First, I apologize for being a few minutes late. I hope I did not detain you, and I greatly appreciate your permitting me to testify with reference to the Targeted Jobs Tax Credit.

I thought, Mr. Chairman, that along with some general statements, I would like to share with you—since both you and I come from relatively small States, without huge industrial bases—with the success of this program in a small State like mine. And then, I will tell you why I think we ought to make this program permanent.

In my State, about a million and a half people, rather diverse from agriculture to high tech to mining and mineral extraction—that you are well aware of—in 1984, 3,766 people were placed in jobs as a result of the Targeted Jobs Tax Credit. In 1985, again while our small business people became accustomed to it, it worked even better, 4,121.

In 1987, over 5,000 requests were made for certification under the Targeted Jobs Tax Credit.

Now, having said that, it seems to me that in our country we are very concerned about certain of our groups of citizens who are having a very difficult time working into the mainstream of American jobs and American opportunity.

And this Targeted Jobs Tax Credit, while it is simple, is a very effective program; and what it really does is it works both for employers and employees because employers are given an incentive, as I view it, to take a chance, that is, take a chance on a member of one of these targeted groups regardless of the associated higher training costs and potential employment risks.

Without this incentive, it seems to me that the employers would not make the effort to help these disadvantaged individuals; and as a matter of fact, unless business was very different across this land than it is in your State and mine, there would be no reason for them to take a risk with the kinds of individuals that we are asking them to employ.

What we are doing here is saying for the economically disadvantaged young people, between 18 and 24, sometimes many of these are referred to as our "street kids" or they are young people who are recovering from drug addiction or the like; we are asking an employer to take a chance, and we are asking these young people to come back and join us and become part of mainstream America in jobs.

It is a perfect marriage because what we do is we permit the employer, through the Tax Code, to take a tax credit and thus take a risk, to look out there and say, well, it is worthwhile that we do this from the business standpoint. And what they are finding is that it is also worthwhile from the standpoint of the response that they are getting.

Disadvantaged Vietnam era veterans are given a preference. Disadvantaged young people who need summer employment are given a preference. And then, some convicts who have been released and have been cleared in all respects, obviously, find it difficult to get a job; they are given this advantage also.

Any way you look at it, this is a plus/plus bill. It is plus for the employers, small and large, but predominantly small business people in this country; and clearly, it is a plus for those who are responding to the call of the leadership in this country—local, State-wide and national—that the best way to cure the disadvantages that fester their lives is to try working, try to get a job, try to get trained.

So, I think it is time that we make this a permanent part of our tax structure. It is not going to work as well as it should, Mr. Chairman, unless we make it more permanent and not from year to year turn it off and on and wait until the last minute to send the message to our agencies and heroes that are in charge of unemployment and trying to be the matchmaker.

It is not going to work for our small business people unless they know it is around, year to year, month to month; and I urge that we make it a permanent part of our tax structure. We built it into the permanent tax reform package. It was there; it was expected to be continued, and I hope we will do that.

Mr. Chairman, on Mortgage Revenue Bonds, rather than talk to the committee about it as it applies to the housing need in this country, let me just ask if you would make my statement a part of the record. Clearly, we need a mix of incentives with reference to housing; and for those who would like the Government to do more on the housing side, I submit that even if we could do that and even if we do that, we are going to need various approaches, and the Mortgage Revenue Bond approach has been a very good instrument.

It has brought the States and local governments into the housing business, into the area of trying to match up those, particularly first home buyers, with a program that is more apt to be able to meet their needs in the early productive years of their lives. And yet, it is not a major Federal housing program.

So, I urge that we solve the problem that exists there, even within the cap that we have established for interest on municipal bonds and the like. I thank you very much for giving me a bit of your time. I have nothing further to add.

I would ask that my statement on both these issues be made a part of the record.

Senator BAUCUS. Without objection, it will be included.

[The prepared statement of Senator Domenici appears in the appendix.]

Senator BAUCUS. Both those provisions, Senator, are quite popular with this committee. The Mortgage Revenue Bond bill inparticular is sponsored by 13 members of this committee; and the Targeted Jobs Tax Credit, has enjoyed widespread support as well.

I want to thank you very much for your valuable contribution. Thank you, Senator.

Senator DOMENICI. Thank you, Mr. Chairman.

Senator BAUCUS. Our next witness is Mr. Dana Trier, Acting Tax Legislative Counsel for the Department of the Treasury.

STATEMENT OF DANA L. TRIER, ACTING TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. TRIER. Thank you, Mr. Chairman. There are a wide variety of provisions that are expiring or have expired last year. Looking at the testimony that is scheduled today, it appears that five of them will be testified on today; and I would like to confine my remarks with respect to the Treasury Department's position to those five. I would refer to our written testimony for information on our position with respect to the other provisions.

The first that I would like to address are the various provisions relating to so-called energy credits, which are investment credits which are given for investment in alternative energy projects relating to biomass, geothermal, or solar energy sources.

The Administration is in opposition to the extension of these credits really for one fundamental reason. We believe that this sort of discrimination in favor of one type of investment is not justified in this particular case. At the same time, the Administration strongly supports through other efforts continued attention to research and development with respect to those areas. As addressed in our written testimony, the budget has certain revenue proposals with respect to that.

But as far as the energy credits go themselves, we are against extension of them.

The second provision I would like to address is the prepaid legal services, Section 120, the provision under which certain prepaid legal services either the benefits or the contributions are excluded from the income of the employee whereas they would otherwise, in some circumstances, be subject to taxation.

Again, the Administration opposes the extension of this program while understanding that legal services for the middle class or lower class people are an important consideration. We have on fundamental reason for opposing it, and that is that there is simply not a good justification for in fact turning something that would not otherwise be deductible into an effect a deductible payment.

These legal services programs primarily cover things like wills, divorces, and things of that nature, in which most employees who are not covered by such a program would have to take taxable compensation and pay for these services without getting a deduction.

The percentage of employees, or that group of employees that are covered by prepaid legal services, under Section 120, are to the contrary really subject to an exemption in those cases; and we do not believe that exemption is justified, particularly since these programs when viewed from the point of view of the nation at large, cover only a very small group of people proportionally.

That sort of discrimination, we do not believe, is justified in this case.

We also are some skeptical as to whether other means can't be used to gain middle class access to legal services, and we note that there is a variety of programs and mass legal services programs that really have brought that type of service to the middle class in a greater amount.

The third provision which is the provision that Senator Domenici already discussed earlier this morning, is the Targeted Jobs Tax Credit. Again we applaud the goal of the Targeted Jobs Tax Credit, which is to increase the employment of disadvantaged groups in our society; and that is a goal that we all have to share.

But in this case, we are again not in favor of extension of the credit. There are essentially two reasons that we are not in favor of the credit, but I think they both relate to the same general concept; and that is that the credit as a tax expenditure can only be justified if, in fact, it really has a major incentive effect and really does increase employment by the targeted groups.

There are two reasons we are skeptical of that. The first is that, if you look at the statistics, the very large majority for the year 1981—which is referred to in our testimony—the percentage is 92 percent; the great majority of people in the targeted groups that are employed by businesses are not, for some reason or another, subject to the Targeted Jobs Tax Credit, which leads us to some skepticism as to whether on the margin this is really performing an important role.

Second, even in those cases where there has been a Targeted Jobs Tax Credit given so that you could say that the employment of a given person is in some sense attributable to the Targeted Jobs Tax Credit, we are skeptical as to whether in fact that same person isn't just replacing another person in the same disadvantaged class that would have otherwise been employed.

So, in general, we are against the Targeted Jobs Tax Credit while, again, recognizing that through training programs and other efforts of the Federal Government, this is an all-important goal.

The fourth matter which I would like to address is Mortgage Revenue Bonds, which as you said is a widely supported provision within the Senate Finance Committee and indeed outside of it.

Again, although we think that housing and making housing more accessible is a worthwhile goal, we do not believe that the Mortgage Revenue Bond provisions should be extended. Again in this case, the fundamental question is whether this is a worthwhile tax expenditure on the part of the Federal Government, and we are at this point quite skeptical that it is; and there are really two fundamental reasons for that.

The first is that Mortgage Revenue Bonds are attempting to implement the goals of the program through tax exempt financing. Tax exempt financing, however, has been found to be a very inefficient means by which the Federal Government can serve policy goals. There are essentially two reasons for that. One is that a large proportion of the benefit, that is of the tax exemption, goes to the buyer of the bonds rather than filtering directly through the person who it is intended to aid, in this case the home buyers; and second, by having the Mortgage Revenue Bonds adding to the quantity of tax exempt financing generally, there is a definite tendency to increase the interest rates on tax exempt finance generally, which will really decrease the advantage to municipal governments and others who have other types of purely public program that do not benefit particular private groups.

The second general reason that we oppose extension of the bonds, which is not a reason that the Treasury Department itself has thoroughly explored, is our skepticism that on the margin this really increases the availability of housing to a wide group of people. Based on the GAO report and other studies on this, it would appear that a good portion of those people who indirectly benefit from the Mortgage Revenue Bonds would have been able to purchase housing in any event.

And so long as that is true, the case for the tax expenditure of the scope of Mortgage Revenue Bonds is, in our minds, limited.

The final set of provisions, which is a much more complicated set of provisions, and about which you will hear apparently later this morning, are those provisions relating to the thrifts—certain expiring complicated corporate tax expiring provisions that particularly benefit thrifts—and which are intended to facilitate FSLIC arranging takeovers of ailing thrifts.

There are really three different types of such provisions. One, under Section 597 of the Internal Revenue Code, is a provision which is simply intended to permit assistance payments by FSLIC to these thrifts without the payments being subject to income under any of several alternative theories.

The second is a set of provisions which is intended to facilitate tax-free reorganizations under which an acquirer would acquire an ailing thrift as arranged by FSLIC. And a third set of provisions is the provisions which facilitate the acquirer of these ailing thrifts, which thrifts have generated large net operating loss carried forward to facilitate them being able to take advantage of these thrifts.

Both of the latter two provisions are intended in essence to facilitate buying by the buyers for these ailing thrifts and to thereby encourage the injection of new money and stability into the ailing thrifts.

Again, this is the type of provision that in general we would oppose. We generally do not think that it is wise as a matter of tax policy to subsidize particular sectors of the economy or to inject a nonneutrality into economic decisions.

But in this case we have understood, and we have understood even before the 1986 Act, as evidence in our position in 1985, that this is in fact a troubled industry; these provisions are provisions that merit a look-see and a transition period at least during which we analyze further whether these provisions are sound tax policy.

And for that reason, if it were determined by Congress or others that it was appropriate to extend these provisions through 1991, the Treasury Department would not oppose the extension.

Thank you very much. If there are any questions, I would be pleased to take them from you.

Senator BAUCUS. Thank you, Mr. Trier.

[The prepared statement of Mr. Trier appears in the appendix.]

Senator BAUCUS. I have a somewhat technical question. As you know, the expiring thrift provisions apply only to thrifts. The FDIC suggests that the same provisions that apply to thrifts should also apply to banks. Does the administration have a view on that proposal?

Mr. TRIER. Obviously, the same thought has occurred to us, particularly as the banking industry, as opposed to the thrift industry, has developed some problems. At this point, we do not have an Administration view on that point.

I would be pleased to get to you with one if you would like us to consider it thoroughly. My own expectation, based on our discussions over the last week as we have prepared for this testimony is that it would probably be true that we would also not oppose such a provision if it were deemed appropriate to extend the thrift type of treatment to FDIC governed banking institutions.

Senator BAUCUS. Thank you. Senator Danforth?

OPENING STATEMENT OF HON. JOHN C. DANFORTH, A U.S. SENATOR FROM MISSOURI

Senator DANFORTH. Thank you, Mr. Chairman. With respect to the Mortgage Revenue Bonds, do you think that it is becoming clear that the 1986 Tax Act went too far in that it is having a deleterious effect on construction and on housing in this country?

Mr. TRIER. It certainly is not clear to me that that is true. I think the 1986 Act with respect to the tax exempt financing provisions generally, some of which obviously pertain to housing, and with respect to other Code provisions, certainly took a lot of the tax juice out of investment in this type of activity.

It is not clear to me, though, at all—and I don't believe it certainly is the view of the Administration—that it went too far itself because of a bad situation with respect to housing investment. As a matter of fact, I don't think you can find that much evidence that that is true, and I think we would continue to believe that in our tax system, we are better off with provisions that, although they assist from time to time certain sectors of the economy, do not do it as extremely as was done prior to 1986.

I think the other point, which you really have to keep in mind when you analyze something like this, is whether in fact part of the doldrums is simply reaction to having overbuilt under the tax benefit system which we had prior to 1986.

Senator DANFORTH. Is there any ongoing analysis within the Administration as to the effect of the 1986 Tax Act on housing?

Mr. TRIER. I think, segment by segment, each one of the provisions that had an effect on housing under the 1986 Act, Senator, are considered and considered in some depth. But I am not aware of a comprehensive study. I could get back to you with that, if you wish.

Senator DANFORTH. Clearly, it is not that good a deal now to get into housing construction as it used to be. Right?

Mr. TRIER. There are not nearly as man different tax benefits that are available for getting into housing construction. In my prior reincarnations, I certainly worked on a lot of transactions which tended to benefit or did end up benefiting housing transactions.

But I think it is one thing to say that there are not as many provisions which make it a good deal to get into housing and another thing to say that that is a harmful thing. I think one of the things that we are perhaps seeing in different sectors of the economy is, in fact, so many of this tax-oriented transactions in which housing and other real estate transactions were promoted heavily really may have led to an overbuilding; and what you have now is a reaction setting in.

Senator DANFORTH. Do you think that this is possibly just the natural decline after a glut?

Mr. TRIER. I think that in some cases it is, but I wouldn't purport to say that I have a comprehensive knowledge, nor does the Treasury Department have a comprehensive knowledge. I think that, after all, the legislation was just passed in 1986; as in all these questions, we have a variety of things going on at the same time with respect to the economy.

We have a variety of tax things going on at the same time. We have lower tax rates. We still have encouragement of housing in very significant respects, for example the interest deduction in home mortgage loans, etcetera.

And I think that really the jury should still be out on whether in fact the tax aspects of the 1986 Act detrimentally affected housing or whether it would be appropriate to go back more to the type of system that we had in the past.

Senator DANFORTH. I can only say that a number of people in my State who pay a lot of attention to the problems of housing and the availability of housing feel that the 1986 Tax Act had a very significant effect on housing. My hope would be that the Administration would at least look at that, rather than locking itself into a past decision.

You know, one thing that is I guess very hard for all of us in Government is to ever admit that we made any mistakes. We say, well, we have come to a kind of philosophical conclusion, and it makes sense.

As you stated in your testimony a few minutes ago, the idea of neutrality is the philosophical issue; it seems to make sense. On the other hand, if we see our cities decaying, if we see unavailability of housing, if we have people sleeping in backs of cars and in the streets, maybe we should take another look a the question of housing availability. My hope would be that Treasury, possibly in conjunction with the Department of Housing and Urban Development, might take a look at what is going on in the country after the 1986 Tax Act and ask itself whether the new look is called for.

I and other Senators have introduced a bill to bring the low income tax credit and rehab credit out from under the passive loss rules. That would seem to me to be a good idea. I would hope that, at the least, the Administration would look into this issue of low income housing in particular and ask itself whether we have overdone it in that 1986 Act.

Mr. TRIER. I think that point is fairly taken and we really should continue to look into it constantly. However, I would still reiterate that I do think that the basic premises of the 1986 Act and neutrality is a positive goal. And I would also say that, as part of this ongoing consideration of the impact of the Internal Revenue Code on housing or similar things, which we need to encourage, we should pay particular attention—before we just react and start introducing new legislation again—to that legislation or that type of provision whether it be a nontax provision or a tax provision, which has the most effect per revenue cost, which is I think a very important consideration for us at the Treasury Department and one of the reasons we do oppose the Mortgage Revenue Bond legislation.

We think that alternatives would be better.

Senator DANFORTH. Does the R&D credit lead the list of the Administration on otherwise expiring provisions which you would like to keep allowing?

Mr. TRIER. The R&D credit is, I think, the list of expiring provisions that we strongly support. The other would be the two percent floor for mutual funds, which I look at more as somewhat of a technical provision as opposed to one of these tax preferences.

Senator BAUCUS. Mr. Trier, the degree to which tax policy should tilt in one direction or another is an important issue. Some people suggest that this country should tilt a little more in favor of industrial production—whether it is manufactured products or services—and that perhaps that we have gone too far in support of housing.

This country has really only had two basic industrial policies. One has been housing and the other has been agriculture. I think that, as useful as it may be to consider Mortgage Revenue Bonds to stimulate the housing in this country, it is also vitally important that this country spend more time thinking about the other major sectors in our economy.

I am happy to hear that the R&D tax credit is basically the list of the Administration because Senator Danforth, too, is a strong proponent of the R&D tax credit. I tend to think that this country is going to have to spend a little more time thinking about items such as this to increase our productivity within the United States if our children's future real incomes are going to continue to rise not only at an absolute level, but also at a comparative level with other countries.

Mr. Trier, I have one other question that is somewhat technical. If the group legal services provision is not reinstated or made retroactive, what is the Treasury's recommendation as to how employers should treat the withheld income of their employees? Should that be withheld on a quarterly basis or on an annual basis as a fringe benefit?

Mr. TRIER. Senator, in all honesty, I haven't fully considered that issue. My reaction to it—and I would like to get back to you with full consideration of it—would be that I don't see the distinction between it and other types of compensation——

Senator BAUCUS. It would help a lot of employers to have an answer to that question, frankly.

Mr. TRIER. All right.

You are really talking about the transition issue and then afterward?

Senator BAUCUS. I am talking about the provision, even if it is extended but not made retroactive. How should employers treat the income they are now withholding from their employees? Thank you very much for your testimony.

Mr. TRIER. Thank you.

Senator BAUCUS. Next, we have a panel of witnesses consisting of Mr. Danny Wall, Chairman of the Federal Home Loan Bank Board; Mr. William Sideman, Chairman of the Federal Deposit Insurance Corporation; Mr. Rodney Shinkawa, Executive Vice President, First Federal Savings and Loan Association of America; and Dr. Carel Otte, President, Geothermal Division of Unocal Corporation, testifying on behalf of the Geothermal Resources Association.

Gentlemen, before you begin, I have a statement I would like to make concerning the submission of testimony by witnesses.

The hearing process is very important to this committee and to the Congress in determining how to react to proposals that various witnesses do and do not have. These expiring provisions are good examples of that. It is very important for this committee to have timely receipt of the prepared testimony and statements of witnesses so that this committee and the committee staff can review the statements.

When this committee sends notices of hearings, it always indicates the date and the time by which this committee would like to have the testimony. In this case, it was noon last Friday. I am very dismayed to report that, of the 12 witnesses before this committee, only one submitted his testimony on time. That was Mr. Jack Curran, who is testifying later.

No other witness submitted testimony on time. This committee has the discretion, therefore, of denying those witnesses from appearing before this committee if their testimony is not received on time. The chairman will not exercise that at this time on this day, but does serve notice that in the future, if witnesses do not provide this committee with testimony on time, then those witnesses may not be allowed to testify.

So, with that, we will begin with Mr. Wall.

STATEMENT OF M. DANNY WALL, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD, WASHINGTON, DC, ACCOMPANIED BY LAWRENCE J. WHITE, BOARD MEMBER, THE FEDERAL HOME LOAN BANK BOARD

Mr. WALL. Thank you, Mr. Chairman. I thank you for this opportunity to testify in behalf of the Federal Home Loan Bank Board and its constituent deposit insurance agency, the Federal Savings and Loan Insurance Corporation commonly referred to as FSLIC.

The Bank Board and the FSLIC are the principal Federal regulators, supervisors, and insurers of the nation's savings and loan associations and Federal savings banks. The expiring FSLIC tax provision should be extended. Since 1981, the tax law has contained a number of provisions—the FSLIC tax provisions, as they are referred to—that were enacted to help the FSLIC fulfill its statutory mandate of protecting the safety of almost a trillion dollars of deposits in savings institutions in thousands of institutions across the country.

Although the provisions are currently scheduled to expire at the end of 1988, there are good and compelling reasons for the Congress to extend them for an additional three years, until the end of 1991. We also support a request to apply similar treatment to the FDIC where they assist with troubled banks. I would like to call on my colleague, Larry White, a Board member, to continue our brief testimony.

Senator BAUCUS. Mr. White?

Mr. WHITE. Thank you, Chairman Wall. Mr. Chairman, since 1981 the tax law has contained a number of provisions that were enacted to help the Federal Savings and Loan Insurance Corporation fulfill its statutory mandate of protecting the safety of almost a trillion dollars.

And these provisions that concern us today are applicable to transactions supervised by the Federal Savings and Loan Insurance Corporation, the FSLIC, in which a financially troubled thrift institution is acquired by a healthy institution with financial assistance from the FSLIC that compensates the acquirer for assuming the troubled institution's liabilities and poor quality assets.

These transactions are typically the least costly and most effective way for the FSLIC to deal with troubled institutions in its caseload. By making each dollar of FSLIC assistance go farther, the extension of these provisions will allow the FSLIC to resolve a greater number of cases and to resolve them more quickly than it would if the provisions were allowed to expire.

The extension of these provisions until the end of 1991 is warranted for several reasons.

First, to a large degree, the provisions may constitute merely a helpful codification and clarification of the otherwise applicable law, rather than a significant departure from it.

This clarification is helpful, however, since tax uncertainties alone may increase the FSLIC's cost.

Second, to the extent that the provisions are more favorable than otherwise applicable law the tax benefits do not inure to the institutions involved in the transaction but instead inure to the FSLIC by reducing the direct cost of the transaction.

This, in turn, means that more institutions can be dealt with sooner, which reduces the overall cost of resolving cases.

Third, we believe that the revenue losses from an extension will be offset by corresponding reductions in direct FSLIC outlays, which means that the extension should not result in an increase in the Federal budget deficit.

We respectfully ask the subcommittee's permission to submit for the record our full ten-page statement. We also ask for permission to submit a technical submission detailing the specific tax provisions involved in our recommendation, together with comments on a number of appropriate technical corrections and refinements. Thank you, Mr. Chairman and members of the subcommittee.

We would be happy to respond to any questions the subcommittee may have.

[The prepared statement of Mr. Wall and the additional information appear in the appendix.]

Senator BAUCUS. Thank you, Mr. White. Mr. Cooke, I assume that you are substituting for your boss. Is that correct?

Mr. COOKE. Yes, sir.

Senator BAUCUS. All right. Why don't you begin?

STATEMENT OF DAVID C. COOKE, DEPUTY TO THE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC

Mr. COOKE. Thank you. Good morning, Mr. Chairman and members of the subcommittee. I appreciate this opportunity to testify today for Chairman Siedman of the FDIC. I ask that our full testimony be submitted for the record.

My appearance here today is for two purposes: first to urge an extension of the tax provisions governing the tax treatment of financial assistance transactions arranged by the FSLIC. Extending these tax provisions will help minimize the cost to the FSLIC insurance fund.

Second, the FDIC also recommends extensions to comparable transactions arranged by the FDIC. This will eliminate present confusion concerning the tax treatment of these transactions and permit the FDIC to more effectively perform its role in the financial system.

This can be done while producing a net positive impact on the budget due to the reduction in FDIC outlays. We are now facing the greatest challenge in the history of the FDIC. In 1987, 184 banks failed; and 19 more required assistance. In 1988, the outlook is much the same.

When a bank's failure is imminent, the FDIC must consider how it will discharge its obligations, as both the insurer of the bank's deposits and the likely receiver of the failed bank. There are generally three categories of alternatives available.

First, the FDIC can provide direct financial assistance to the failing bank. Second, the FDIC can arrange a direct payoff of insured depositors. Uninsured depositors are paid only to the extent funds are available from the liquidation of the bank's assets. A payoff is the least desirable and usually the most costly alternative.

The third and most prevalent alternative is a purchase and assumption transaction. Under this alternative, a health bank assumes all of the failed bank's deposit liabilities, including uninsured deposits and agrees to acquire some or all of the failed bank's assets.

The FDIC provides cash to make up the difference between the value of the assets and the liabilities assumed. These various transactions raise significant tax issues which could be resolved through tax revisions which now apply to FSLIC transactions which are scheduled to expire at year end.

The FDIC strongly supports legislation to either extend or make permanent those provisions for the FSLIC, but given the similarities in our roles as deposit insurers, and our record volume of bank failures, the FDIC urges also that these same provisions be made available to us.

This would eliminate the confusion relating to the tax treatment of FDIC assistance, and these provisions would reduce the cost of FDIC transactions, thereby helping to preserve the insurance fund.

The resulting increased use of assistance for purchase assumption transaction would enhance the stability of the banking system and help ensure adequate banking services to all communities.

We are very aware that cost is an important concern. Extending these provisions to the FDIC should have the net effect of reducing the deficit because the benefits largely would accrue to the deposit insurance fund. We estimate that yearly reductions in FDIC outlays could range between $435 and $870 million.

Moreover while the reduction in FDIC outlays would be recognized fully at the time of the transaction, any tax revenue cost would be stretched out over a number of years. In the final analysis, we believe the reduction in outlays may exceed whatever tax revenue cost is associated with these provisions.

Generally, there are three provisions being sought. The first specifically clarifies that assistance payments are not taxable income and will not be used to reduce the basis of the assets acquired by the recipient institution. The tax law in this area is unclear, and the transactions frequently are complicated.

Because these transactions often must be consummated quickly, parties to the transactions usually assume the worst case tax result, thus driving up the cost to the FDIC.

The second expiring provision provides that an FSLIC assistance transaction may qualify as a tax-free reorganization. This section represents a major benefit to the FSLIC in merging troubled thrift institutions with healthy thrifts, and would benefit the FDIC as well.

The third expiring provision makes it easier to preserve a failed thrift's net operating losses and thereby reduce the cost to the insurance fund. Again, the FDIC asks that this provision be extended and made applicable to similar transactions arranged by us.

Mr. Chairman, thank you for allowing me to testify on this issue, and we are available to provide whatever assistance you require in considering these proposals.

[The prepared statement of Mr. Cooke appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Cooke. Our next witness is Mr. Shinkawa.

STATEMENT OF RODNEY R. SHINKAWA, EXECUTIVE VICE PRESIDENT, FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF AMERICA, HONOLULU, HI; TESTIFYING ON BEHALF OF THE U.S. LEAGUE OF SAVINGS INSTITUTIONS

Mr. SHINKAWA. Mr. Chairman and members of the subcommittee, my name is Rodney Shinkawa. I am Executive Vice President of First Federal Savings and Loan Association of America of Honolulu, Hawaii, and appear today on behalf of the U.S. League of Savings Institutions.

The League urges your committee and the Congress to extend for three years, until December 31, 1991, the special tax rules which are critically important to the Federal Savings and Loan Insurance Corporation, the FSLIC.

These provisions, which are set to expire on December 31, enable FSLIC to attract merger partners for problem thrift institutions in the most cost-effective manner and conserve the strained resources of the FSLIC fund.

The rules permit tax-free reorganization treatment as certified by the FSLIC where a insolvent thrift is acquired. Second, where a thrift certified as troubled is acquired, carry forward of net operating losses are less likely to be limited.

Finally, where FSLIC contributes financial assistance as part of our supervisory case resolution, that assistance is not included in income.

As the committee is no doubt aware, there are tremendous and well-publicized demands today on the resources of both the FSLIC and the FDIC. The deposit insurance they provide is central to the public's confidence in our banking system.

Once again, in last year's banking bill, the Congress pledged the federal government's full faith and credit guarantee for federally insured deposits. One way or another, the deposit guarantee will be upheld, and these special FSLIC rules are a straight-forward mechanism already in place to assist toward that goal.

The revenue impact should not be a problem in considering whether or not to extend these provisions. When the FSLIC spends less to resolve a problem case because of the availability of these tax rules, Federal outlays and hence the budget deficit decreases. Any revenue pickup from allowing these provisions to expire is illusory since, without these rules, Federal outlays through the FSLIC will increase.

Finally, these tax provisions apply only to the FSLIC under existing law. It is apparent that regional economic conditions in the southwest and elsewhere are also putting great pressure on the Federal Deposit Insurance Corporation and the commercial and savings banks whose deposits it insures.

Therefore, we have no objection to broadening the special FSLIC provisions to apply to the FDIC as they are extended through 1991.

My prepared statement also addresses several related technical matters. Thank you very much for giving us the time to express our views. We will be happy to respond to your questions and to supply any other information we have for the record.

[The prepared statement of Mr. Shinkawa appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Shinkawa. Dr. Otte?

STATEMENT OF DR. CAREL OTTE, PRESIDENT, GEOTHERMAL DIVISION, UNOCAL CORPORATION; TESTIFYING ON BEHALF OF THE GEOTHERMAL RESOURCES ASSOCIATION, LOS ANGELES, CA

Dr. OTTE. Mr. Chairman, members of the subcommittee, my name is Carel Otte, and I am President of Unocal's Geothermal Division; and I thank you for the opportunity to testify. I appear today representing the Geothermal Resources Association. This is an association of primary U.S. geothermal producers and developers who are actively developing geothermal resources in the country.

Members of the GRA include small independent geothermal developers like Geothermal Resources International, Cal Energy, Oxbow Geothermal, as well as large integrated producers like Chevron, Unocal, and Freeport-McMoRan Resources.

Mr. Chairman, I would like to summarize my comments here and, at the same time, I would like to ask you whether I can introduce my complete statement for the record.

Senator BAUCUS. Without objection.

Dr. OTTE. If I may take you back a few years, in the early 1980s, there was a massive conservation taking place in energy development in the country, largely as the result of the price run-up of energy commodities because of the Iranian crisis. Because of that conservation, the market contracted; and subsequent to that, also the prices dropped. We are still in this turndown of oil and gas prices.

Because of this, many projects in the alternative energy field were delayed, many even were permanently cancelled. We feel that it is just a matter of time and additional energy shortages will be upon us again.

The supply of fossil energy in this country is declining rapidly. In 1986, we lost about 800,000 barrels of oil production a day; in 1987, it will be about the same or even more.

So, many studies forecast that additional energy shortages could be upon us again in the early 1990s. So, an incentive to diversify the energy base of this country is essential.

The development of renewables and alternatives is the fundamental underpinning of this total program. This is why the energy tax credits were passed in the first place in the early 1980s.

Now, what has happened? The previous energy tax credits were expiring at the end of 1985. This sequence of three years extension which is due to expire at the end of 1988, was really put into place as part of the Tax Reform Act of 1986; but in 1986, there was no credit available, and many of the projects were deferred, and some were even cancelled at that time.

Basically, we are asking that, in a combination of this extensive debate that took place on the TRA, as well as the turndown in the market, that an additional three-year extension be granted to the industry so that many of the projects currently in the pipeline can be completed. This will also complete the technology base, which is so fundamental to the future of development of these domestic alternative energy sources.

It is worthwhile doing because the energy base that exists is considered very large. Experts in the United States Geological Survey have made estimates of an extremely large energy base; and geothermal, as well as some of the other renewables, could make a significant contribution to the energy diversification of this country.

Basically, then, Mr. Chairman and gentlemen, this is what I ask of the committee to recommend to the full Senate Finance Committee, the extension of the energy tax credits for an additional three years.

I would like to take an opportunity to comment briefly on the statements made by the Administration witness, Mr. Trier. He said he is against extension, but they are granting R&D funds to the Department of Energy. I feel a little frustrated with that statement because it is the very fundamental policy of the Administration to only provide R&D for the long range and, therefore, only for the technology in the 21st century

What I am talking about are projects that are in the pipeline that should be completed in the next two years. Much of the energy research that is being developed is not of any direct use to us at the present time. Second, I take exception with the size of his budget. He was talking about $128 million. If that is the case, I don't know where it is going because the budget for geothermal is $16 million.

And finally I also take exception with the decrease in the revenue forecast that he has made. Thank you very much, Mr. Chairman.

Senator BAUCUS. Thank you, Dr. Otte. You just answered the questions I was going to ask you. (Laughter)

[The prepared statement of Dr. Otte appears in the appendix.]

Senator BAUCUS. I have a general question I would like to ask Mr. Cooke and Mr. Shinkawa. How important are these expiring provisions to the solvency of the thrifts? Would these mergers go through with or without these provisions? Wouldn't they go through, regardless?

Mr. SHINKAWA. I think the mergers will go through more expeditiously and efficiently if the provisions were extended to 1991. The acquiring association certainly looks to the carry-forwards and the net operating loss provisions in pricing out their package or in bidding for the associations.

We in particular have a couple of instances in which we have acquired failed institutions; and certainly, that was part of the mathematics in coming up with a computation of whether it would be a good deal for us to acquire the assets and liabilities of a failed association.

I think from FSLIC's point of view, the resources of the FSLIC would be certainly leveraged out further and that these provisions help again to provide a benefit to the acquiring association, to the extent of as much as 100 percent of the net operating loss carryforwards, for example.

Senator BAUCUS. If these provisions, though, do expire and they are not reauthorized, what alternative needs will FSLIC and S&Ls

pursue? For example, would you seek authority for additional assessments?

Mr. SHINKAWA. I think it would be more costly for the FSLIC to resolve their problem cases and less beneficial for the acquiring institutions in acquiring these troubled thrifts.

Senator BAUCUS. But what other mechanisms would you pursue? As I have already asked what about increased assessments?

Mr. SHINKAWA. That is a question that I think should be directed to the FSLIC. I really don't have a position on the matter.

Senator BAUCUS. All right. Mr. Wall?

Mr. WALL. Mr. Chairman, the Congress, of course, last year with the Competitive Equality Banking Act, put into place a structure for the recapitalization of the FSLIC insurance fund, with borrowing ceilings of $3.75 billion for each of the years as we move forward, and an overall borrowing authority of $10.8 billion.

Clearly, if these tax provisions are not extended, we will have to use more of the resources from the FSLIC fund in each of the steps that we take, be it a sale of an institution, be it a recapitalization of an institution, or be it an insurance pay-out of an institution.

We will have a greater cost so that the resources that we have will go a shorter distance. What alternatives would be available or would be pursued? It seems to me that the Congress put the question before themselves and the Administration, as will ensue after the election, that the new Administration and the next Congress will visit the question of how far will this $10.8 billion have gone as we move forward.

And as I say, if these tax provisions are not extended we will have had to use more resources for each of the steps that we take. Hence, the resources will not have gone as far as if these provisions had continued.

Senator BAUCUS. How much farther would you have to go into those other resources? That is the question I am trying to pin down.

Mr. WALL. In terms of a percentage?

Senator BAUCUS. Yes. Quantify it in some way if you could.

Mr. WALL. We are trying to quantify the budget impact, and we are looking forward to working with those who you and the Administration charge with making those analyses. We think that we can provide a theory—and a defendable and defensible theory—that the impact in the budget sense is minimal, significantly so.

On the other side, in terms of costs, perhaps as much as a third higher.

Senator BAUCUS. That is, a third into the other FSLIC resources?

Mr. WALL. Yes.

Senator BAUCUS. Is that your high or your low?

Mr. WALL. The seat of the pants.

Senator BAUCUS. The seat of the pants? All right. (Laughter)

Senator BAUCUS. All right. Senator Chafee?

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Thank you, Mr. Chairman. I have a statement that I would like to submit for the record in connection with the

Mortgage Revenue Bonds program with a couple of attachments thereto. I just want to stress how important I feel that the continuation of that program is.

I know that some of the prior witnesses dealt with this, not this panel.

Mr. Cooke, what you are asking is—as I understand it—that we extend to the FDIC the same tax advantages that come with a rescue mission under the FSLIC program. Is that correct?

Mr. COOKE. Yes, sir. That is correct.

Senator CHAFEE. Do you have any price tag on that? Has Treasury come up with any estimates of what that will cost us?

Mr. COOKE. As far as the revenue cost, no, although we would be glad to work with the revenue estimators. We do believe, though, that it would reduce our cash outlay by anywhere from $400 to $900 million a year; and that, in effect, would reduce the budget deficit since we are on budget.

The way we normally do our transactions is we put up cash immediately. W e sell the institution and provide cash up front. To the extent that we could get these tax benefits, we would provide that much less cash up front.

So, the only thing we really might have an estimate on at this time is just what it might mean to us in terms of outlays from the FDIC fund.

Senator CHAFEE. Mr. Wall, in your situation, by going to a continuation of the existing program, obviously we encounter revenue problems for the next fiscal year. Correct?

Mr. WALL. We are not so sure it is revenue problems. We think that there is, as I said, a very defensible analysis that can be made that demonstrates, together with the budget impact that Mr. Cooke has identified, we have the same effect. We are on budget as well.

We think we can help to identify the analysis as not a negative.

Senator CHAFEE. That would be a very happy conclusion if we could reach it. It doesn't seem that Treasury usually comes up with such joyous endings, though.

Mr. WALL. In the very simplest sense, to use one of the TV cliches, you could look at it—even if there is a negative—you could look at it as: Pay me now or pay me later.

Senator CHAFEE. I see. Absent this, and I know I am reviewing your testimony a little bit, but absent this inducement, you believe that the rescuing institutions would have a much reduced incentive?

Mr. WALL. Those that would propose to be partners with our——

Senator CHAFEE. They just wouldn't step in there; and, therefore, you folks would have to carry the whole ball?

Mr. WALL. Yes, we will have to carry proportionally more of the load and likely with fewer candidates on the other side of the table.

Senator CHAFEE. Could you give us a little prediction on how things are looking? Perhaps you and Mr. Shinkawa could both do that. Are we rounding the corner in this business?

Mr. WALL. Senator, it is interesting. As I was looking at the list of witnesses for this particular panel, I was wondering about the relationship of my fellow panelist to my right, but I sense a good deal more similarity of interest and concern than might have been apparent on the face. And that is energy.

The southwest, as we have identified and targeted, is where our problem institutions are focused. Increasingly, FDIC's problem institutions are seen as being in that part of the country as well. We are very much a factor of the energy as it relates to the rest of the economy in Texas, Oklahoma, New Mexico, Louisiana—the circle gets larger.

So, the extent to which we are rounding the corner in part relates to the question of energy and energy prices, and I will leave that prediction to others.

Senator CHAFEE. There is certainly not much encouragement in that field if you look at what has happened to oil prices in the past two weeks.

Mr. WALL. I was just going to say that, as we look at the subeconomies of real estate, to which we are more directly linked and connected as an industry, we see some indications in some of the microeconomies—Houston economy, the Dallas economy—that the economies have bottomed out; and in fact, there is some improvement occurring.

Senator CHAFEE. Mr. Shinkawa, representing your organization, how do you see it?

Mr. SHINKAWA. Certainly, in Hawaii we have turned the corner. Back in the early 1980s, we were faced with the deregulation issue and the squeeze on interest rates where we had a negative interest rate spread on our operations. Certainly, all of the institutions in Hawaii have turned the corner.

Senator CHAFEE. Boy, if we are in trouble in Hawaii——(Laughter)

Senator CHAFEE. Real estate-wise, that is. You haven't seen a decline in real estate prices in Hawaii, have you?

Mr. SHINKAWA. We have. We have in the early 1980s as much in the tourist-related areas; the resort-related areas as much as 50 percent.

Certainly, the economy has come back in Hawaii. Unemployment is down. Tourism is up. And the institutions have found their way through various methods of recapitalizing themselves.

Senator CHAFEE. You mean real estate prices were off 50 percent in Hawaii?

Mr. SHINKAWA. In certain resort areas, yes, they were in the early 1980s. The problem was not as great a magnitude as they are in the southwest, and the institutions in Hawaii have not invested heavily in that part of the country. So, this has helped us to bring our operations around then and become very profitable.

Senator CHAFEE. Thank you, Mr. Chairman.

Senator BAUCUS. Senator Mitchell?

Senator MITCHELL. Thank you, Mr. Chairman. I have no questions of this panel. I ask that, since I will have to leave shortly to go to another meeting, I be permitted to submit questions in writing to witnesses for their written responses.

Senator BAUCUS. Without objection.

Senator MITCHELL. Thank you.

[The questions appear in the appendix.]

Senator BAUCUS. Mr. Wall, does the Federal Home Loan Bank Board support the recommendation to include FDIC and the banks?

Mr. WALL. Yes, more than just for the matter of symmetry. It may not be realized by some that we, in fact, are the charterers of Federal savings banks, some of which are insured by FDIC. So, we have a cross-relationship as they have a cross-relationship with us in that some of our institutions—that is, some of their charter institutions—are insured by us.

Senator BAUCUS. Thank you all very much. We appreciate your testimony.

The next panel is Elizabeth Mitchell, Executive Director of the Maine State Housing Authority; Mr. Bernard Tetreault, Executive Director of the Housing Opportunities Commission of Montgomery County, Maryland; Mr. John H. Luke, Associate Director, Housing and Community Development, U.S. General Accounting Office; and Mr. Mark E. Tipton, Vice President and Secretary, National Association of Home Builders, Raleigh, North Carolina. Thank you all for coming. I think we will go down the list, beginning with Ms. Mitchell. I believe that Senator Mitchell would like to introduce you.

Senator MITCHELL. Thank you very much for permitting me to introduce Elizabeth Mitchell, the Executive Director of the Maine State Housing Authority. Although no relation, Ms. Mitchell is a good and long-time friend, and she is performing an outstanding service to the people of Maine in her capacity as Director of the State Housing Authority.

We have in our State fortunately an active, aggressive State program. We think it is one of the finest in the country, and we look forward to doing what we can at this level to make it possible for the State Housing Authority to continue its good work on behalf of the people of Maine.

So, I am pleased, Mr. Chairman, to present Ms. Mitchell to the committee.

Senator BAUCUS. Thank you.

Senator CHAFEE. Mr. Chairman, unfortunately, I have another commitment also; but if I could, I would just like to put in the record my full statement, and I would like to just touch on the GAO report briefly on the Mortgage Revenue Bonds.

I was disappointed in the conclusion and the results of that study and troubled by it. I understand that this study covered the Mortgage Revenue Bond program from November 1983 through June of 1987 and was, therefore, based on information, a majority of which came from a period before the program was targeted toward low income and first time home buyers.

We have documents from my own State, which I have included in the record here, one from the president of one of our major banks that stated that 74 percent of all Mortgage Revenue Bond applicants would not have been able to obtain mortgages through any of the other alternative sources available. So, the program has been an extreme success—a great success—in my State, and I just hope we will continue it.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator. Those statements will be put in the record.

Ms. Mitchell?

STATEMENT OF ELIZABETH H. MITCHELL, EXECUTIVE DIRECTOR, MAINE STATE HOUSING AUTHORITY; TESTIFYING ON BEHALF OF THE NATIONAL COUNCIL OF STATE HOUSING AGENCIES, AUGUSTA, ME

Ms. MITCHELL. Thank you, Senator Baucus. Good morning, Mr. Chairman and members of the committee. I would like to thank Senator Mitchell. I will be happy to claim relationship to him at any time. We certainly share a great commitment to affordable housing, and he has long been a friend of housing for low and moderate income Americans. We appreciate his commitment.

Senator Baucus, I bring you greetings from my colleague, Dick Kane from your home State of Montana; and we both commend you for your leadership in calling this hearing. I am Libby Mitchell, the Executive Director of the Maine State Housing Authority, and I am here before you today with a great responsibility.

I am speaking on behalf of all the other State housing finance agencies from the national council. I respectfully request that my complete testimony be entered for the record; but in the interest of time, I will try to abbreviate those remarks.

Over the past 14 years, ten years as a State representative in the State of Maine and now as the Director of the Maine State Housing Authority, I have seen the value of the Mortgage Revenue Bonds. As the only Federal subsidy directed solely to potential first time home buyers of low and moderate income, they must not sunset. There is only one accomplishment that could justify their elimination, and that is that the provisions of the American dream for all American citizens.

We are far from that reality. In fact, we are losing ground. The Harvard study on the state of the nation's housing, I commend to you for your reading. It shows that the relatively high levels of housing construction home sales, and remodeling expenditures have masked an ever increasing population of housing have-nots, and I suggest to you that the GAO report failed to unmask and deliver the real truth about those who are have and have-nots.

The experience in Maine parallels the study, particularly the decline of home ownership. In Maine, fishermen on the coast cannot afford to live on the coast any longer. Firemen and policemen have difficulty buying a home in the towns that they must protect.

Children cannot live in their own home towns; they cannot buy their own homes there because of an ever-spiraling cost of home ownership.

Today, it is the inability of families and individuals to buy their first home which indeed exacerbates the shortage of affordable rental housing. Mr. Chairman, in the State of Maine, there is a waiting list of 20,000 Maine citizens for assisted housing—rental housing. There are 20,000 assisted units in the State. That is the nature of the problem.

We are very proud of our work in Maine. Since 1972, we have issued over $500 million in tax exempt revenue bonds, and we have allowed over 16,000 Maine people to purchase their first home. The charts that we brought along show that our purchase prices always have been well below the Congressional mandated targeting. We have always had them, even before Congress told us to have purchase prices.

The income level shown by Maine people is certainly also well below that that Congress intended us to serve with this program. As a matter of fact, our State is so committed to the first time home buyer program that they enacted a real estate transfer tax; and we are able to use that fund to buy the rate down even further.

This year we had $12 million made available at six percent to families earning $20,000 or less, a combination of Mortgage Revenue Bond funding and our own State taxes; but as Government officials, I am asking you to look behind these statistics for a minute, and let's look at the people we are talking about.

In the past six months, we have served a woman working in a laundry; her husband is disabled. She has four children; her income is $13,800. Another borrower, a teacher, wife, child; income $18,900. Then there is a 38-year-old carpenter whose wife is a waitress, two children, income $22,300. Certainly not the Yuppie picture the GAO report would have us believe.

The report presents a very disturbing analysis to me, not because of just its findings, but for its distorted portrait. One of the most incredible things to me is the assertion, which was readily adopted by Treasury this morning, that the people in this program could be served in the conventional market.

To me, that has no resemblance to reality. As elected officials, you understand full well the consequences when you encroach on other people's turf. The bankers in Maine would be the first to close down the Maine State Housing Authority if I encroached on people who could get conventional loans. That is their turf.

The realtors tell me over and over again that we serve a niche between Farmers Home—very low income—and the conventional market. Without the interest rate favorability of an MRB, people wouldn't even qualify under the debt threshold.

There is one statement, however, that I will refer you to that I do agree with. In the GAO report. It is on page 19, and I quote:

"Because we selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified Mortgage Bond activity nationwide." I invite them to Maine.

We have major concerns over GAO's methodology. A very small subsample select and skewed to very high income areas. Further, the comparative baseline was not with the conventional market but a whole universe of assisted first time home buyers. And frankly their studies proved what we thought all along: if you really had a fair comparison.

The private lenders take on the least risky borrowers, FHA and VA the next level, and the MRB recipients the riskiest of all; and with that, I would like to say that in New England we are very proud. Our default rate is one percent or less.

The underwriting criteria is simplistic and theoretical. I defy anyone in here to go into a bank and get a loan for 28 percent of income if they are a marginal income person.

And finally, no post tax reform analysis of any meaningful value was undertaken. Again, Treasury this morning on another question said that the jury is still out; we don't know. So, why rush to make changes?

The assumption that moderate income households could, if they just waited, get a home—I am sorry, Senator.

I would like to say that incomes in Maine have increased only 186 percent, but purchase price of homes, 500 percent.

I would like to submit my full written testimony for the record and the more complete analysis of the National Council of State Housing Authorities.

Senator BAUCUS. Thank you very much. All that will be included. Mr. Tetreault?

[The prepared statement of Ms. Mitchell appears in the appendix.]

STATEMENT OF BERNARD L. TETREAULT, EXECUTIVE DIRECTOR, HOUSING OPPORTUNITIES COMMISSION OF MONTGOMERY COUNTY, AND PAST PRESIDENT, ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES, MONTGOMERY COUNTY, MD

Mr. TETREAULT. Thank you. Good morning, Mr. Chairman and members of the subcommittee. My name is Bernie Tetreault Executive Director of the Montgomery County, Maryland Housing Opportunities Commission, and also Past President of ALHFA, on whose behalf I speak this morning.

ALHFA is a nonprofit national association of professionals in the field of affordable housing; and from our letterhead, you see that they are from cities throughout the country, in both urban and rural counties.

We finance home ownership and rental housing opportunities for low and moderate income families. We support S. 1522's extension of the MRB Program, and urge that the GAO study be rejected. We conclude that there is a need for this type of program and urge its extension with a small modification.

ALHFA firmly believes that the MRB program is sound public policy and appropriately assists first time home buyers, whom more often the conventional market has left behind, in purchasing a home. ALHFA strongly supports S. 1522 and urges its prompt adoption by this subcommittee and the Congress.

Using the same data that GAO did in their report, it could have concluded that MRBs did in fact assist many first time low and moderate income families. The single family bond programs add significantly to new housing construction and the nation's overall affordable housing stock, providing increased home ownership opportunities.

Housing finance agencies administering single family programs, even before the 1986 Tax Act, had highly targeted programs in a manner that generally complied with the Act's new income and price restrictions.

Therefore these findings demonstrate that housing finance agencies have largely succeeded in achieving the very fundamental objectives of the program enunciated by the Congress, to encourage home ownership and to expand home ownership opportunities by expanding affordable housing stock.

GAO, however, does not reach these conclusions nor any others that reflect favorably on the MRB program. Its conclusions lead ALHFA to wonder whether GAO was given a conclusion and asked to justify it. We doubt very seriously that GAO could have qualified 67 percent of the assisted home buyers for conventional loans if it had considered the purchasers' net worth, income stability, employment history, housing expenses, credit ratings, etcetera, which are the usual conventional criteria.

It was only through Mortgage Revenue Bond programs, with below market mortgage rates, that made it possible for these families to own a home.

For that reason alone, but also several others in my full testimony, we believe that the GAO study should be rejected out of hand as biased and as a disservice to the Mortgage Revenue Bond program recipients, the agencies that administer it, and the 61 Senators who support it.

Regarding a need for the Mortgage Revenue Bond program, the Harvard study has been referred to; and I will not repeat it here. It is against the backdrop of that study that Congress must address continuation of this program.

A couple of examples; one, ours in Montgomery County, Maryland, and Pittsburgh, Pennsylvania. In Montgomery County, by providing this financing in the form of commitments of permanent financing to builders, HOC—our agency—provides for the construction of new, modest homes for first time home buyers. Because of the nature of our housing market in Montgomery County, affordable housing was built that absent this bond financing, would not have been built.

Since the program began in 1979, some 5,000 home buyers, like Mr. and Mrs. Graybill—I call your attention to—and Mrs. Able here have been assisted. Our program has been sharply targeted so that the average loan in our program during the nine years was $52,000 or 39 percent of the current average purchase price safe harbor limit.

So, we hit around 40 percent of what we could have gone to. The household income of home buyers over this time frame averaged $25,000, or 58 percent of the county's current median income of $44,000; and the average down payment by those assisted was 7.5 percent.

These families are typical of the blue collar workers and single female parents with children who have been helped by this program that a conventional program would not have been able to assist.

Another example is the home ownership and home improvement program in Pittsburgh, Pennsylvania. Through its bond financed home improvement loan program, the authority has helped 12,000 units to be rehabilitated.

One last comment. I know that Senator Moynihan is addressing the high cost and relatively low median income problem. The Association of Local Housing Finance Agencies support Senator Moynihan in his efforts to respond to this real problem presented by high cost areas.

I believe that ALHFA is correct in its support of the Mortgage Revenue Bond program and hope that you do also Thank you.

Senator BAUCUS. Thank you, Mr. Tetreault. Mr. Tipton?

[The prepared statement of Mr. Tetreault appears in the appendix.]

STATEMENT OF MARK E. TIPTON, VICE PRESIDENT AND SECRETARY, NATIONAL ASSOCIATION OF HOME BUILDERS, RALEIGH, NC

Mr. TIPTON. Good morning. Mr. Chairman and members of the subcommittee, my name is Mark Tipton. I am from Greenville North Carolina. I am also the Vice President and Secretary of the National Association of Home Builders, and my business, The Whistler Corporation, is involved in home building and land development in rural eastern North Carolina.

I am also a member of the Board of Directors of the North Carolina Finance Agency.

As a home builder and a businessman, I want to thank you for the opportunity to discuss Mortgage Revenue Bonds and Mortgage Credit Certificates. I am here to ask you for your support for Senate bill 1522, a bill that will extend the use of Mortgage Revenue Bonds and Mortgage Credit Certificates through December of 1992.

Ladies and gentlemen, a housing crisis is growing in this nation. The average American family can no longer afford the average American home. This problem can be described statistically, but I don't make my living from statistics.

I am a home builder, and I see the problem first hand every day. It is shocking to discover that two income families of teachers, nurses, clerical, and construction workers—the backbone of America—cannot afford to make the important step to home ownership.

Since 1980 the home ownership rate has dropped more than 10 percent, which is the first decline in 35 years. According to a recent Harvard University study, which has already been referred to, America is increasingly becoming a nation of housing haves and have-nots.

Young, hard-working families are not the only ones falling into the category of have-nots. Elderly couples are living in substandard conditions because the cost of financing home repairs would deprive them of other basic necessities.

And then, there is the latest housing problem: the plight of the homeless families, those who cannot afford any shelter with their limited resources.

Though not a final solution, Mortgage Revenue Bonds and Mortgage Credit Certificates are the only assistance provided through the Internal Revenue Code that is targeted to low and moderate income, first time home buyers. Since the 1970s, about one million Americans have bought a home using Mortgage Revenue Bond loans.

All of these homes were sold, financed, and in many cases built by a private businessman. In North Carolina, the average family receiving a Mortgage Revenue Bond loan has an income of less than $25,000. Mr. Chairman, in my State, these buyers are bus drivers, textile workers, teachers, secretaries, and probably a lot of government employees.

The North Carolina agency, like others nationwide, also helps the elderly home owners whose homes desperately need repairs. The average home improvement loan borrower in North Carolina is 62 years old, earns about $16,000, and borrows a little more than $10,000 for rehabilitation costs.

Where would these families find financing if Mortgage Revenue Bond programs were not available? These programs are available because Congress has already recognized the social and economic importance of home ownership.

Recently, the General Accounting Office issued a report that criticized some of the aspects of Mortgage Revenue Bond programs. One fault of the GAO report is that it overstates the cost of Mortgage Revenue Bonds by ignoring the economic value of the housing activity generated.

Mr. Chairman, if a builder constructs a home, that builder needs a carpenter, a roofer, an electrician; all of these employees pay Federal and State income taxes. Plus, the new home is subject to State and local property taxes.

The real estate industry and the home building industry, in particular, will generate more than enough in new revenue to pay for this program. The GAO report also criticizes the use of builder set-asides for Mortgage Revenue Bond issues. Plainly, the report misses the point on how and why home builders use Mortgage Revenue Bonds.

First of all, most Mortgage Revenue Bond loans for new construction are not made through direct builder set-asides but rather through participating lender institutions. A majority of States do not provide builder set-asides at all. Those that do use them selectively to respond to specific housing needs.

Second, certain areas need set-asides so builders have a stable source of mortgage money, encouraging the construction of affordable homes.

One more comment on the GAO report. It states that most Mortgage Revenue Bonds assisted buyers would have probably been served by the conventional market. I assume no representatives of the GAO visited Murpheysburg in North Carolina, a thriving community of 2,800 people, where home buyers earning less than $18,320 can now afford a home as a result of financing by the North Carolina Housing Finance Agency.

We are able to target assistance to lower income families by leveraging the lower Mortgage Revenue Bond interest rates with $1 million in State-generated funds The use of the Mortgage Revenue Bond is not a complete solution to our housing problem.

It is, however, an important part of the answer. On behalf of the National Association of Home Builders, I strongly urge the Congress to extend Mortgage Revenue Bonds and Mortgage Credit Certificates through December 1992 because, ladies and gentlemen, testimony today is not only about Mortgage Revenue Bonds. It is about housing our young families. It is about developing neighborhoods and creating neighbors.

The door to home ownership is locked for many people. I don't want us to be accused of hiding the key. Thank you very much.

Senator BAUCUS. Thank you, Mr. Tipton. Next is Mr. Luke.

Mr. LUKE. Is it my time, Mr. Chairman?

Senator BAUCUS. Your time. Your report has gotten a lot of attention here.

Mr. LUKE. It is probably the first I have been associated with that has been read so widely and so quickly and understood very adroitly. (Laughter)

[The prepared statement of Mr. Tipton appears in the appendix.]

STATEMENT OF JOHN H. LUKE, ASSOCIATE DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, ACCOMPANIED BY RICHARD L. COOPERSTEIN, ECONOMIST, U.S. GENERAL ACCOUNTING OFFICE, AND JAMES C. RATZENBERGER, EVALUATOR, U.S. GENERAL ACCOUNTING OFFICE

Mr. LUKE. Thank you, Mr. Chairman. Before I get started, I would like to recognize Mr. Jim Ratzenberger to my left, and Mr. Richard Cooperstein to my right. These two gentlemen, among others, were very instrumental in the conduct of this review.

We appreciate this opportunity to discuss whether to extend the issuance authority of qualified mortgage revenue bonds. As you are well aware by now, we just completed this study for the Joint Committee on Taxation of the home ownership opportunities afforded by this tax-exempt financing method.

My remarks today summarize our findings. I would like to submit my complete statement for the record along with the attachments, and I will try not to get through all of it, but the meat of it.

Senator BAUCUS. Without objection.

Mr. LUKE. I will preference my remarks by saying that our findings are not a criticism of housing agencies per se, but rather reflect the limited ability of bond financing to provide assistance to first time home buyers. That is, the tax exempt financing mechanism is limited to providing a small subsidy. Thus, qualified mortgage bonds cannot be expected to make more than a marginal difference in affordability, despite the best efforts of the housing agencies that issue them.

Further and not surprisingly, given the small subsidy provided, we found that financing below market mortgage loans through tax exempt borrowing does little to increase home ownership opportunities. The profile of those receiving assistance strongly suggests that most of these assisted home owners would have been likely to become home owners if bond assistance had not been available. Also, most of these assisted buyers could have probably qualified for the same or slightly smaller conventional loan at the same time they received a bond assisted mortgage.

Aside from having many buyers who do not need assistance, qualified mortgage bonds are inefficient. Home buyers on average receive only about 36 to 39 cents of benefits for every dollar in tax revenue foregone. Moreover, changes made by the Tax Reform Act of 1986 could further reduce these benefits. Given our findings, we question whether authority to issue these bonds should be extended.

During the conduct of our study, we contacted some 32 States and local housing finance agencies across the country. We asked each of them to provide computerized data on loans from January 1983 through June of 1987. Twenty-nine of the agencies supplied this information, giving us about 178,000 records. We also spent considerable time with 25 of the agencies to learn how they operate their programs. We are confident of our analysis for several reasons. First, we performed several analyses, all of which produced the same results. Second, our large sample probably represents about one-third of the loan activity during this period of time. Third, our work in the housing agency gave us the reality check for our computer analysis data. And finally, our results are consistent with the economic literature in the field.

As you know, qualified mortgage bond financing provides a fixed-rate loan at an interest rate below the market rate. Twenty-one of the twenty-five agencies we contacted said that they tried to achieve a 1.5 to 2.0 interest rate spread between bond assisted and unassisted loans. We found that these agencies achieved this spread about one-half of the time, with the median spread being about 1.4 percentage points.

To determine what this spread means in dollars and cents to the assisted buyer, we compared the payment under the assisted loan with payments in the prevailing conventional market. The median after-tax benefit was about $477.00 annually, or about $40.00 per month. A benefit of this size cannot be expected to make a material difference for any but the marginally unqualified buyer.

In fact, we calculated that in some high cost metropolitan areas, the reduced interest rate is often not enough to make housing affordable for low, and sometimes moderate income, buyers. Conversely, in more affordable areas, we calculated that many bond assisted buyers would not need the assistance to purchase the homes.

Given that qualified mortgage bonds provide only limited benefit, the results of our next two analyses are not surprising. First, we compared assisted buyers to other first time buyers in the country. For this comparison, we used 1983 HUD's American Housing Survey, which was the latest data available. The American Housing Survey includes the characteristics of first time buyers across the country and is valid for the nationwide emphasis, but not area-by-area comparisons. To make income and purchase price comparisons, we converted these variables to 1986 dollars.

We found that assisted buyers have characteristics that are strongly associated with home ownership. Although some differences exist between the two groups, both typically were White, married, and young, with median incomes around $26,000 for assisted buyers and $27,000 for all first time buyers. Assisted buyers are slightly younger than all first time buyers.

Second, we estimated how many of the assisted buyers could have probably qualified for the same size loan at the same time in the conventional rate. Allowing 28 percent for housing expenses, which is the standard test for mortgage affordability, we found that 56 percent of the assisted buyers could have probably purchased the same house at the same time without bond assistance using the fixed rate conventional mortgage. An additional 12 percent could have probably purchased the same house at the same time using the conventional adjustable rate mortgage.

Other assisted buyers may have been able to purchase a slightly less expensive house. We found that for those who could not have purchased the same house, 11 percent more probably could have purchased one with an adjustable rate mortgage that was about one to ten percent smaller than the mortgage they actually received.

We see no public purpose being served in assisting buyers who could purchase homes on their own without bond assistance on the conventional market.

For the sake of time, Mr. Chairman, I would just conclude, as you recognize and have heard so far this morning, there have been a number of questions raised about our methodology, particularly with respect to post-1986 Act data.

What we found is that 80 percent of those in our sample would have met the income eligibility requirement, and about 84 percent would have met the purchase price requirement in our sample. These data suggest that our profile would not have been markedly different after 1986, as it was before 1986.

For the sake of time, I will close now, Mr. Chairman. We would be prepared to respond to any questions that you may have at this time.

Senator BAUCUS. Thank you, Mr. Luke.

[The prepared statement of Mr. Luke appears in the appendix.]

Senator BAUCUS. I wonder whether Mr. Tetreault or Ms. Mitchell would agree with the efficiency arguments of GAO, apart from whether these purchasers would have purchased a home or not. I have forgotten the exact figure, but it is roughly 26 to maybe 30 cents on the dollar—the taxpayer's dollar—that goes to purchase these homes. The remainder—roughly 70 cents—goes to middlemen and bond holders and so forth.

Do you agree with that part of GAO's analysis? And if not, why?

Ms. MITCHELL. No, I do not agree with that part of the analysis because they put a very high burden on cost and not a very high analysis on benefits. That is not a specific yet, but I am getting into it.

I think also you have to look at the delivery of this program in terms of other alternatives you may one day consider. There is an efficient, effective network in place. This program is delivered by small local housing finance agencies through a network of existing local lenders and through a network of existing realtors.

So, I think that the money is targeted very specifically to the individual to allow them to get into the home.

And I think also in terms of the efficiency, if I may, Mr. Chairman, this Congress said that States were going to be limited in the amount of mortgage revenue bonds or public purpose bonds that they would be able to issue. Our States, because they are small, are under a $200 million cap.

And this Congress certainly was comm itted to letting the States use this source of financing to carry out all their needs from sewage construction to home builders purposes.

I think that is very important to note. We are simply saying that you have committed to us on that level. Let us on the local State level decide how much of that will be distributed to home ownership versus other State needs; and to me, it stays right with the command or the dictates of the Congress in terms of setting our own priorities.

Senator Baucus Mr. Tetreault?

Mr. TETREAULT. Just two quick additional points. One is what was referred to as what happens when people construct houses and the money circulates and you have the multiplier effect. The second is that, would this money—even a small percentage—come to housing if we had done away with Mortgage Revenue Bonds? And the answer is no; housing expenditures on the Federal level have reduced by 70 percent since 1980.

Senator BAUCUS. No, I am addressing the efficiency point.

Mr. TETREAULT. I understand your point, but the fact of the matter is that what we are up to is making available home ownership to people who otherwise couldn't. And I am saying that if you took this away, they would not.

Senator BAUCUS. But are there more efficient ways to accomplish the same result?

Mr. TETREAULT. I would be glad to take the money directly, but I would ask you to go get it—

Senator BAUCUS. Mr. Luke, could you respond please to Ms. Mitchell and Mr. Tetreault?

Mr. LUKE. Sure, Mr. Chairman. As I indicated in my statement, we calculated the benefits to be between 36 and 39 cents on the dollar for every tax dollar foregone. That would accrue to homeowners. That is one part of the equation, the one of inefficiency.

The other part of the equation is one of targeting. Now, with that 36 to 39 cents accruing to home owners, only one-third of those accruing the benefit are in need of the benefit. So, you have two thirds of those who accrue the benefit who are not in need of the benefit to buy the house at the time that they bought the house.

So, in addition to the inefficiency aspect of the mechanism itself, there is also a targeting question, so much so that you are foregoing approximately $8.00 for $1.00 of benefits that would accrue to home owners. Richard or Jim, do you have any comments on this?

Senator BAUCUS. Would you identify yourself, please?

Mr. COOPERSTEIN. My name is Richard Cooperstein; I work for the General Accounting Office. We used prevailing studies in the literature about the tax loss for tax-exempt bonds as well as information from the Treasury Department for the loss for the given volume of bonds that are issued.

We then compared that to the benefits that we found these home buyers receiving. We knew exactly when they bought their house and exactly at what interest rate and the size of the mortgage they received. We could then compare the mortgage that they had to pay with exactly what mortgage they would have to pay if they got a conventional fixed-rate loan.

And for our almost 200,000 observations over four and a half years, they were getting about $40.00 a month because, on average, they were only getting a 1.4 percentage point reduction in their interest rate. And this small benefit is inescapable given the structure of the program.

You have to float the bonds and induce bond holders to buy them, and you have the whole tax-exempt industry which must operate in order for the bonds to be floated.

We are not suggesting that they are doing this inefficiently in any way; but still, the money must flow in these other sectors before households directly receive the funds.

Some other housing subsidy that would go directly to the home buyers wouldn't involve these other transactions or other sectors. So, regardless of the validity of the question about how representative our home buyers were of all the assisted buyers or home buyers nationally—that isn't going to change the inherent structure of the program itself and how much of this money gets actually delivered to home buyers.

Senator BAUCUS. What about the comment, Ms. Mitchell and Mr. Tetreault, that only about $40.00 benefit is received?

Ms. MITCHELL. Could I share a specific example from the State of Maine, Senator?

Senator BAUCUS. Sure.

Ms. MITCHELL. My treasurer ran these numbers for me because we were very concerned about that statement. If that were the case we would be very concerned about the program, too.

Assuming that a median priced home of $77,000, assuming that you could get by with a five percent down payment—and ours are averaging more like nine because as you become less credit-worthy, you have to put up more cost—so that leaves you a mortgage of $73,000.

Our programs have been running two points—a difference in the conventional rate and our rate—and we have had to use State funds to make that happen because we are committed to it. So, in that case, they would save $110.00 in monthly payments. So, to meet this 28 percent standard, which they seem not to understand from the GAO, it would require an extra $390.00 a month in gross income, or $4,700.00 annually.

Incomes simply do not keep pace with housing costs in Maine at that rate. So, it is a substantial saving, and it makes the difference in home ownership.

Senator BAUCUS. Mr. Luke?

Mr. LUKE. Yes, Mr. Chairman. If you have my statement before you, page 13, Exhibit 2, I would just like to refer you to it for a moment.

Now, what that does is calculate the hypothetical situations—three as a matter of fact. Small mortgage, roughly $40,000; a mid-sized mortgage of $60,000; and a large mortgage at $80,000. What we did was calculate the after-tax conventional payment on each of those at different interest rates.

And recognizing that the Mortgage Revenue Bonds work off of a spread or a differential, if you will, between the conventional mortgage rate and what the bonds can be floated at, as we indicated, the median difference was about 1.4 percent.

If you notice, say, for the 1.5 percent figure and about 13 percent for the purchase price of the home of roughly around $40,000, you would see that approximately $39.00 would be saved or shaved off of $378.00 a month.

Senator BAUCUS. All right. Go ahead.

Mr. LUKE. I am done.

Senator BAUCUS. Ms. Mitchell claims the spread is much more on a higher priced house. You said the average was a 1.4 percent differential?

Mr. LUKE. Based on the 25 agencies that we asked, that was the spread that we noted. That doesn't mean that there may not be some larger differences in the country; but at those that we saw, there was roughly a 1.4 percent spread.

Senator BAUCUS. The problem here is trying to compare the specific with the general and also trying to determine how accurate the general is. Ms. Mitchell, could you tell me the degree to which you know and have evidence to the effect that your experience can be extrapolated to be the general experience in other States?

Do you have evidence that the Maine example is representative?

Ms. MITCHELL. I believe that we have evidence that we can submit to you which shows that that two points difference is often what gets you over the qualifying threshold.

Without that reduction in the mortgage rate, then your ratio of mortgage costs plus your overall debt ratio throws you out of the program.

I think it is important for you to know also, because it has become so difficult to get mortgage insurance on the private market, that we are often combining our programs with FHA and VA because that potential buyer who cannot be served in the conventional market needs all the benefit of the Federal insurance plus the lower interest rate.

So, it is this qualifying step which is very important that I think is being overlooked.

Senator Baucus Thank you. Senator Riegle?

Senator RIEGLE. Ms. Mitchell, I think, really makes a key point here; and that is that it is the ability to qualify, it is to get over that hurdle. I think that is really where the GAO has gone off the tracks here.

Let me just give you some data that you don't have in your report. That is, we have taken the median income data for Michigan participants in 1986, and the figure was $21,000. Now, in your study, you use as the median income a figure of $26,000. You know, that is about a 20 percent variation here. This is a huge variation.

Even the casualness with which you talk about $40.00 a month, we are talking about people whose incomes are not all that large. And when you talk about $40.00 a month of after-tax income—and that is an average—in fact, I can't even figure out precisely where you got the $40.00 a month because, as you say on page 19 of your study, and I quote your words:

"Because we selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified mortgage bond activity nationwide." Now, that is buried on page 19, but that is a pretty substantial qualification to the data.

But even if the number were right, if it is $40.00 a month—and we have witnesses at the table who indicate that it is in cases that you know of—not hypotheticals, but real cases, much higher than that—that to me seems to be a significant amount of money. It makes a significant difference and I am not hearing a very convincing argument when I see that the data here from GAO is as much off the data that we have on the aggregate in a State like Michigan. We are the eighth largest State; we are very active in this area.

I don't know what accounts for why your data is that far off. Can you give me any sense for why that is? Why would the figure be $21,000 in Michigan in 1986, and $26,000 in your study?

Mr. LUKE. First of all, Senator Riegle, in terms of the $21,000 versus the $26,000, I don't know how you derived the $21,000; but the $26,000, we adjusted to 1986 income. So, that may explain some of the difference.

Senator RIEGLE. Ours is 1986 data. This was given to us by the housing authorities in Michigan; it is the data that they have. So, we have a very substantial gap. I would like for you to talk with them about it and see if you can figure out why that is.

Let me refer to something that Mr. Tipton said as well; and that is that I think there is another level of economic argument here that we are not really getting to. We are sort of touching at it around the edges; and that is that home building and home ownership are two of the really high value added activities in our country.

When you think of all the things that we produce that are broadly consumed, the two most expensive things that we produce are homes and cars. Those are the two big ticket items for most people; and then when you come down from that, you get into home appliances and other things.

But far and away, the premier high-value added asset for an individual or a family in their lifetime (in the overwhelming number of cases) is the home. It is a home if they can afford to buy one, and followed by a car.

So, when we talk about the structure of the economy, when we talk about the multiplier effect as dollars are spent there and then trickle on through the stream of commerce and down through to everyone who helps build the house and so forth, you have also got the fact that in terms of just shear buildup of economic strength in the country, in terms of building a asset base for the country—I am talking now in private hands, individual hands; I am not talking about corporate ownership of assets; I am talking about individual ownership of assets—home ownership becomes far and away the central and dominating high value asset that is owned by individuals and all individuals in the aggregate.

And it is a tremendous part of the private wealth that we have in this country; it is represented in that area. That is one of the reasons that I have proposed that we allow the IRA to be changed so that first time home owners could use their buildup in the IRA to invest in a house, because it is a form of investment just like investing in stocks or Government bonds or something else that might be thought of as a long-term investment.

So, when we start looking at the question of how we take and build the base of private asset holdings—and you get all these other benefits, of course, with home ownership—we are talking about something there that is a very different part of our economy and has a strategic impact that is quite different from anything else.

I guess I get troubled when I see what I consider to be a relatively static analysis done here and where, even in the analysis, it says "Because we have selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified mortgage bond activity nationwide."

I mean, if you can't do a study that doesn't have to have that disclaimer, have you done the right study? I mean, these are not my words; those are your words.

Mr. LUKE. Yes, and we think so, Senator Riegle.

Senator RIEGLE. Now, wait a minute. Tell me why those words are there.

Mr. LUKE. What we did with respect to the judgmental sample was that we tried to get a good snapshot of the program in terms of size—large versus small—as well as programs throughout the country, geographical locations so to speak. That is why it was a sample that was judgmentally selected. So, we could get a pretty good snapshot of what was happening across the country.

There was just no way humanly possible for us to review as many of those individually as we had to, to do a statistical sample so to speak that we could assert within plus or minus two percent that represents the country.

The other point I would like to make with respect to the $26,000—

Senator RIEGLE. Now, wait a minute. Let me just stop you there because this is a very important point. Then, in the second part of your sentence in your report, where you say "We cannot assert that our findings are representative of qualified mortgage bond activity nationwide," if you are that confident, then why didn't you say instead that we can assert that our findings are representative?

Why wouldn't you have said in the positive what you are in effect doing now if that is what you meant? You didn't put it in the positive here; you put it in the negative.

Mr. LUKE. I can only respond, by definition, as a result of a judgmental sample, I mean the theory would not allow us to extrapolate across the universe in that context. Okay?

But the other point I want to make in terms of the difference between the $21,000 and the $26,000: keep in mind that we are looking at live records, live data, of 178,000 individuals. We didn't create those; those were there within the 25 agencies that we visited. Those data were taken from the files, analyzed, and we calculated the median income to be $26,000 adjusted to 1986 dollars.

There are two points I would really like to leave you with from our study. One is that if you look at the annual housing survey, you have a pretty good profile and a snapshot of what first time home buyers look like in terms of age, income, race. There is no question about that.

Second, if you look at who is being served in this program, we also know who is being served in this program in the context of age, race, median income, marriage status.

Those two populations look very similar. We did not identify anything in the assisted population——

Senator RIEGLE. Now, wait a minute. You testified before, and this is my time, so I want to raise some questions here; and if you need more time, we will give you more time later.

Why would you expect that the profiles would be different? I don't expect the profiles to be different. What you are doing is broadening the opportunity; you don't want the profiles to be different. You want to broaden the opportunity in a way where the profiles are roughly the same.

I find that to be good news, and I think that is what has happened. I mean, you have expert witnesses here who are telling you that Mortgage Revenue Bonds have broadened the amount of home ownership out there.

Mr. LUKE. Let me pick up on that point, Senator Riegle, and I don't disagree with you there. I think basically what we are saying is that, as a result of not seeing that profile any different, the question becomes: Are you assisting someone who could have bought anyway? That is the issue.

Senator RIEGLE. And I think the answer is no. You see, I appreciate the job you have, and I appreciate the care with which it has been done and the fact that I am being argumentative, you should not take personally.

Mr. LUKE. I don't, sir.

Senator RIEGLE. Because I appreciate the work that has been done here; but you folks are not in the housing business, and these folks are. And they do it every single day, and they are out there professionally trying to match people up, people with lower incomes with a chance to get into housing opportunity.

When folks come in—not just from my own State of Michigan—but here we have a witness from Maine coming in here who has been at this for a long period of time, and what she is telling me is that, if you have this program, you can manage to get home ownership into the reach of a lot more people of lower income. And if you don't have the program, then you can't reach them, and they are not going to have a chance to get into the game and own a home and build up an asset value over a lifetime.

When somebody who is in that business all the time tell me that you need the program to get the job done, and then I have a statistical survey which I find doesn't even fit my own data of Michigan—which I can get my hands around—as someone who is trying to weigh those facts, how are we to come out? It seems to me that, if the practitioners in the field come in and tell us that the program is what enables them to get the job done, and you are saying it doesn't work, I mean how do we square these two things?

She is out there every day and saying it does work, and you do a statistical analysis that says it doesn't work.

Mr. LUKE. I can't reconcile the findings that you got in your individual State, Senator Riegle nor in the State of Maine or North Carolina. I am sure, as we found, that this program does in fact assist low and moderate income. Roughly two-thirds of the population is low and moderate income.

It also assists them, it appears, to move into the housing market sooner. We found that to be the case.

But the question remains, through the mortgage revenue bond program, is it the most efficient and effective way to get a dollar's worth of benefits to those you want to assist at the cost it takes to get it there? That is the question.

Senator RIEGLE. I think that is an interesting question; and that, in a sense, is a far more abstract question because we can often ask that question. We can say that about any area of the Government. We have a certain approach, and we do it this way; and is this the best way? Is this the perfect way?

I suspect it is not the perfect way. It is the best way we have found. Of course the problem, is that, once you have a system that is out there and is working, that is spreading these opportunities and causing more home ownership to happen, if what we do is just go and rip it out by the roots—and that is what we are talking about here—then we have a total discontinuation, we basically just shut it down.

It is not as though we are going to replace it with the perfect, if we knew what the perfect was; and the concern I have here is that I haven't heard anybody talk about what the perfect approach is, and I am not sure we are smart enough to figure out what that is, even if somebody wanted to go down that track.

What we have is something that has been highly effective; it has worked well. It has gotten home ownership into a lot more hands. The States come in and tell us it is working well, and that is the profile across the country, not just in one or two States.

Senator BAUCUS. I don't know if we are going to convince anybody here. (Laughter)

Senator BAUCUS. Of the other side's point of view. I think the lines are pretty well drawn but let me just try something here. I am going to ask Mr. Luke a question, and I am going to ask Ms. Mitchell a question.

I am going to ask each of you to put yourself in the other person's shoes and tell this committee the best, most legitimate point that the other person has. (Laughter)

Mr. LUKE. I don't know whether we have been listening well enough. (Laughter)

Senator BAUCUS. So, Mr. Luke, I am going to ask you first. I want you to tell this committee the most legitimate point that Ms. Mitchell or Mr. Tetreault have, as you see it, and I am going to ask her to do the same for you and the GAO. Then we are going to have to wrap this up.

Mr. LUKE. Let me try it this way, Mr. Chairman. We at the GAO during the conduct of our review did not set out to find negative findings with this program. We recognize, and as we moved throughout the country, some positive benefits associated with the program in terms of assisting low and moderate income folks. And can appreciate those who are in the housing business, those who are on the front line every day providing housing assistance to those in need.

And clearly, there are cases where this program may make a difference; but the overwhelming evidence is that——

Senator BAUCUS. No, no, no. (Laughter)

Her most legitimate point is what? She is saying that these are folks who otherwise wouldn't be able to own a house.

Mr. LUKE. They are real live folks, and we can appreciate that; but again, based on our own analysis——

Senator BAUCUS. You don't have to agree with everything she says. I just want you to tell me the most legitimate point she has made.

Mr. LUKE. That they are in fact real live people and that they need some assistance.

Senator BAUCUS. All right. Ms. Mitchell?

Ms. MITCHELL. I guess GAO's most legitimate point is that we are doing our job, even before tax reform, he says; 80 percent of the people we were serving were targeted low and moderate income.

Senator BAUCUS. Now, that is not fair. (Laughter)

That is not in the spirit of this exercise.

Ms. MITCHELL. Senator, may I add one final comment, and then I will stop? We have a saying in Maine, and it goes like this; and I know Senator Mitchell will understand it: It if ain't broke, don't fix it. This is not broken.

Senator BAUCUS. Mr. Luke said there are folks out there who need help; he went that far. Now, what is the most legitimate point on his side as you see it?

Ms. MITCHELL. All right. You said my other point wasn't fair, that we were doing our job?

Senator BAUCUS. That is not quite in the spirit of what we are attempting here.

Ms. MITCHELL. All right. His most legitimate point? I am really having a tough time finding one, and I don't mean to be insulting; but I really think that the methodology is skewed and that we are serving a group of people who fall between the cracks. And I think that it is imperative that the program continue.

Senator BAUCUS. Thank you all very much.

Senator RIEGLE. Mr. Chairman, before you adjourn, let me ask permission to put into the record a copy of the Harvard report and copies of articles in support of extension of the MRB program. And I would like to make one other observation, and that is that it is my understanding that, after the GAO report was put together, the housing agencies were not asked to respond to the conclusions of the study prior to the time that they were formalized.

My understanding is that—and correct me if I am wrong—after you had done the analysis and collected your data, that you then drew your conclusions. You did not go back out to the housing agencies and say: Look, this is what we see; this is what we are going to say as our conclusions and so forth. Do you agree or disagree? I take it that there was not that kind of a process where they had any opportunity to either challenge the data, say it was wrong, say the conclusions were wrong, or what have you, until the thing was wrapped up. Is that right?

Mr. LUKE. That is not quite the case, Senator Riegle.

Senator RIEGLE. What is the case?

Mr. LUKE. I would like to have Jim Ratzenberger respond to that.

Mr. RATZENBERGER. My name is Jim Ratzenberger. I am the evaluator in charge for this project. It was a very extensive project, and we finished most of our data gathering and computer analysis in the January/February period. At that time there was not enough time to go out to the 25 agencies we visited and talk to them individually about our findings.

We did, however, several weeks ago, sit down with folks at the National Council of State Housing Agencies; the folks from ALHFA, the city of Pittsburgh, some Federal officials, and presented a two-hour briefing on our findings and allowed them to—within that time period—ask questions and state their opinions.

We also invited written comments from those two organizations. They supplied written comments; they are included in our published report, Appendixes 5 and 6.

[The information appears in the appendix.]

Senator RIEGLE. It doesn't sound to me like what you are saying conflicts with what I just said. There was not an effort made to go back to the State housing agencies and let them know what your tentative conclusions were and ask for their reactions—their reactions on the methodology of the data. That did not take place?

Mr. RATZENBERGER. That is right, sir.

Senator RIEGLE. Thank you Mr. Chairman.

Senator BAUCUS. Those reports will be in the record. Senator Moynihan was unable to be here today, but he did have a question which I will submit for the record. One is for Mr. Tetreault concerning the amendment, which you referred to earlier.

Mr. TETREAULT. That is right.

Senator BAUCUS. The income differential compared with the housing costs.

Mr. TETREAULT. That is right.

Senator BAUCUS. And the other question of Senator Moynihan's will be to Ms. Mitchell, asking her to comment on the MRB income limits. Which are greater, those against the area or State-wide median income? Those questions will be submitted for the record and I would like each of you to respond to those questions. Thank you.

Thank you all very much.

Our final panel consists of Colleen Brown, Dayton Hudson Corporation, testifying on behalf of the Targeted Jobs Tax Credit; Charles Stradford, testifying on behalf of the National Restaurant Association, Chicago, Illinois; Alec Schwartz, Director of Special Committee on Prepaid Legal Services of the American Bar Association; and Jack Curran, Legislative Director of the Laborers' International Union of North America.

Ms. Brown, why don't you proceed?

STATEMENT OF COLLEEN R. BROWN, DAYTON HUDSON CORPORATION (TEEN-MOM) PROGRAM; TESTIFYING ON BEHALF OF THE TARGETED JOBS TAX CREDIT COALITION, MINNEAPOLIS, MINNESOTA, ACCOMPANIED BY BETTY W. KINDNESS, DIRECTOR, HUMAN RELATIONS, DAYTON HUDSON CORPORATION

Ms. BROWN. Before I start, could I have the manager or the supervisor of the program say a few words first?

Ms. KINDNESS. Mr. Chairman, my name is Betty Kindness, Director of Human Relations for the Dayton Hudson Department Store Company, headquartered in Minneapolis Minnesota.

And I am here today to ask for an extension of the Targeted Jobs Tax Credit program. I am also here today to talk to you about a program called Jobs Plus. We are very excited about this program.

The Targeted Jobs Tax Credit was one of the cornerstones of developing the Jobs Plus program. I am not going to go into specifics because Colleen Brown will do that, but I would like to share some of the background information with you.

For four years, our company has had as its community focus young women at risk. We also understood that there would be a shortage of entry level employees. These two issues became the basis for Jobs Plus.

In 1985, we created a partnership with two community organizations to provide additional job readiness training for two target populations: teen moms who were at risk for long-term welfare dependency, and second pregnancies; and also high school students who were at risk for pregnancy and dropping out of school.

Now in its third year, the program has proven to be successful in enabling participants to make major life changes. To date, 151 young ladies have gone through the program, and we have had a success rate of between 60 and 65 percent.

That success rate is based upon meeting three out of four of the established criteria: completing a high school education, securing employment, reduction in public assistance, and no subsequent pregnancies.

I have two young ladies with me here today, but Colleen is going to speak. Both of the young ladies were eligible for tax credits, and they are now enjoying a very successful career with us.

After you hear Colleen's story, I am sure that you will see that the extension of Targeted Jobs Tax Credit is a must. Thank you very much. Colleen?

Ms. BROWN. Mr. Chairman, members of the committee, my name is Colleen Brown; and I am a clerical for the Dayton Hudson Department Store Company in Minneapolis. I am here today to tell you my story about how I became a Daytonian and how I got off welfare through the help of TJTC.

After high school, I worked for a year and a half in an automotive fix-it shop. I had to quit when I was seven months pregnant; I was not married at the time and had to rely on welfare in order to live. About a year after Christopher was born, I decided that I had to find a job again.

I could only afford a part-time job because full-time day care costs so much. I worked part time in an automotive parts store while a friend of mine in my apartment building took care of Christopher. After four months my friend was unable to continue to watch Christopher; so I had to quit.

The day I quit, a friend told me that there was a newspaper ad for a jobs training program at Dayton Hudson Department Store company. The ad was written for me. It was looking for a young mom who wanted a job.

They would provide training and day car and transportation. I applied and they accepted me; it was the start of a new beginning.

The training program taught us about career and goal setting, how to dress for interviews, and finding good day care. The most important thing is that it taught me how to work with others. We went on a survival retreat, which taught us to depend upon each other to get a group project done.

In my job at Dayton's in the sign shop, we have to work together to get quick jobs done for advertising. It is the same thing. Dayton has really helped me in a lot of ways.

I had to interview to get the job. They didn't just give it to me, but Dayton has helped me get off of welfare, not the Government. If they did not have a program like this one, I would still be on welfare.

I got off in April of last year. My boyfriend wanted to get married, but I was still on welfare; so I said no. I did not want him to take me off of welfare by marrying him. We got married last July. Thank you very much.

Senator BAUCUS. Thank you very much, Ms. Brown. Mr. Stradford?

[The prepared statement of Ms. Brown appears in the appendix.]

STATEMENT OF CHARLES STRADFORD, TESTIFYING ON BEHALF OF THE NATIONAL RESTAURANT ASSOCIATION, CHICAGO, IL

Mr. STRADFORD. Good morning, Mr. Chairman. I would like to thank you for the opportunity to appear before the committee for a second time in support of the Targeted Jobs Tax Credit program.

My name is Charles Stradford, and I am here on behalf of my son, Ronald, who is mentally handicapped and a former participant in the Targeted Jobs Tax Credit program. The second and perhaps most important reason for my being here is to help allay some of the concerns voiced by a few that the program is more used to accumulate tax credits rather than to promote the well-being of indigent or handicapped individuals.

My son is now 24 years old. At the time of his birth, we were advised to place him in an institution because the medical authorities felt that he would never be anything more than a vegetable and a burden to us and our other two children.

As a family unit, we refused to take the advice of the doctors. When Ronald was five years old, he wanted to go to school because his sister and brother were in school. At that time some of the psychological testers and school officials felt that he was not ready. We balked at this notion because of his persistence in wanting to be like his brother.

Two years later, Ronald wanted to become a Cub Scout like his brother. With the help of some of the other parents with mentally handicapped sons, we organized a Cub Scout unit for the mentally handicapped.

As Ronald has grown older, his physiological needs have changed. In order to help him meet those needs, my wife and I have become active participants in encounter groups and advocacy programs for the mentally handicapped.

As I mentioned earlier, Ronald has attended school since age five. Our initial intent was for him to develop motor skills and to learn basic survival skills. Later, we found that he had an aptitude for academics, and we pushed for his educational development.

My son started working for Pizza Hut under the Targeted Jobs Tax Credit program approximately five years ago. At that time, he was working two hours a day, three days a week. Over time, his hours and responsibilities have increased. He is currently working four days a week, and he has received training in almost every area of the business.

The first time I appeared before the committee, Mr. Chairman, I talked about achieving self-esteem through contributing to one's own welfare; and my feelings have not changed. In fact, having seen how my son has reacted to this financial independence, it has only strengthened those feelings. Today, as a result of his employment, Ronald has established a rather enviable savings account. He purchases his clothes and certain essentials; and when we travel, he is responsible for the purchase of his own airline ticket and most of his expenses.

Additionally, he has become a taxpayer. I am also pleased to inform you that, while Ronald is not an average individual in the work force, his coworkers have valued the difference and treated him with respect. To me, this speaks well of the management of Pizza Hut and their positive support of the program

This support by management and the respect of his coworkers has certainly had a positive influence on Ronald with regard to his desire to work.

At this point, I would also like to say that, as a result of my previous appearance here, two of Ronald's peers in our family support group have left the sheltered workshop environment to find employment with other businesses in the food and restaurant area because of this worthwhile program

The increase in self-esteem in these individuals has been significantly noticeable. Based on our experience with Pizza Hut, I believe that the Targeted Jobs Tax Credit program is a pro-active method of helping people help themselves. It is an avenue for providing skills for unskilled and semi-skilled workers; and most important, it is a means of putting the taxpayers' dollars to work.

Mr. Chairman, I thank you again for this opportunity to appear in support of the Targeted Jobs Tax Credit program.

Senator BAUCUS. Thank you, Mr. Stradford. Mr. Schwartz?

[The prepared statement of Mr. Stradford appears in the appendix.]

STATEMENT OF ALEC M. SCHWARTZ, DIRECTOR, SPECIAL COMMITTEE ON PREPAID LEGAL SERVICES, AMERICAN BAR ASSOCIATION, CHICAGO, IL

Mr. SCHWARTZ. Thank you very much, Mr. Chairman and members of the subcommittee. I would like to thank you for inviting us here today to testify on behalf of S. 2119, which would retroactively reinstate and make permanent Section 120 of the Internal Revenue Code.

For the record, my name is Alec Schwartz; I am a Staff Director of the Special Committee on Prepaid Legal Services of the American Bar Association. I also serve as Executive Director of the ABA's American Prepaid Legal Services Institute, a nonprofit organization which provides those in the prepaid legal services field with continuing education, information, and technical assistance.

I appear before you today at the request of ABA President Robert Mac Crate, to present our views on this important subject.

The American Bar Association supported the passage of Section 120 in 1976 and has continually supported this provision for the last 12 years. As you know, Section 120 determines the tax treatment of qualified legal service plans. It provides that contributions made by an employer to and the value of any legal services received by the employee under such a plan can be excluded from the employee's taxable income.

As I said before, Section 120 was originally enacted in 1976, but as a five-year experiment. In 1981, acting upon its review of the soundness of the policy it established, Congress enacted legislation to extend the provision for three more years. It reaffirmed its position in 1984 and once again as part of the Tax Reform Act of 1986.

The ABA has strongly supported Section 120 since the provision was adopted. Our support is based upon years of study and experimentation with group and prepaid legal service plans of all types. Recognizing the need to develop mechanisms to help middle income Americans gain access to personal legal servi ces, the American Bar Association has worked for over 15 years to develop and perfect the concept of prepaid legal services.

Qualified employer-paid plans have proven to be the most efficient of all prepaid legal plan systems. These arrangement make hundreds of dollars of legal service benefits to participants at a fraction of what medical and other benefit plans cost. By placing legal services on the same tax footing as other more expensive statutory benefits, Section 120 has encouraged employers and unions to look at group legal service plans as an inexpensive way and an effective way to enhance employee well-being.

Legal problems affect the emotional and financial health of employees. The incidence of these problems can have an effect on the employee's work productivity and lead to absence from work to go to court or otherwise deal with the problem personally.

I would like to present just one example of this, which I have in my testimony, and of which I have some personal knowledge because, embarrassingly enough, it occurred in my own office.

An employee was billed by a hospital for approximately $130.00 which he thought he didn't owe and which he had no money to pay in any event. Repeated requests for payment were ignored until the employee received a summons from the county court, located 35 miles away from the office.

The employee mentioned the need to take time out from work to go to court to his supervisor, who advised that the employee talk to a lawyer first. The lawyer was consulted and eventually accompanied the employee to go to court twice requiring the employee to be absent from work for one-half day each time, and settlement with payment arrangements was eventually worked out with a lawyer from the hospital.

We figured out that the cost to the employee associated with this problem was calculated at $358.84, including $225.00 in attorney's fees, $59.84 in lost wages, $28.00 in transportation to court, and $46.00 in court fees. In addition, the employer lost the services of the employee for two mornings; the Federal Government lost approximately $11.80 in tax revenue in the employee's lost earnings, and the hospital had to pay its attorney to handle the case in court.

The real point of the story, Mr. Chairman, is that the attorney for the employee indicated afterwards that, had she been called as soon as the employee had started receiving past-due notices from the hospital, she could have negotiated a payment schedule with the hospital by phone, avoiding the lawsuit, court appearances, costs, time off from work, and the worry which had plagued the employee during the three months while the situation was developing.

Now, how could an employer paid legal service benefit plan have helped? First, the employee, realizing that arrangements for consulting with and paying for a lawyer were part of his compensation, the question of whether the employee had the funds to hire an attorney would not come up.

Second, by having this barrier removed the employee would have the incentive to consult a lawyer as soon a the problem presented itself rather than waiting until the last minute and having a lawsuit filed against him.

In summary, we think that these plans do deliver services very efficiently and that the policy established by Congress in 1976 to encourage employers to make these plans available as part of the compensation package was sound. These benefits are very inexpensive. We figure right now that the average cost to the employer is $90.00 per family per year. Although the Treasury Department has indicated in the past that there are revenue losses associated with it, we feel that the savings to employers in terms of having employees on the job, the possible savings in terms of court costs and delays which plague our court system, and having people wait until they have a serious legal problem before they see a lawyer can be avoided and offset any small revenue loss.

And we also feel that if Section 120 is allowed to demise, many of the dollars that now go into legal service plans would be shifted to other forms of tax exempt benefits, thereby negating any possible savings that there might be.

I will be glad to respond, Mr. Chairman, to any other questions you might have. Thank you.

Senator BAUCUS. Thank you very much. Mr. Schwartz.

[The prepared statement of Mr. Schwartz appears in the appendix.]

Senator BAUCUS. The final witness is our first witness.(Laughter) Mr. Curran is the only one who got his testimony here on time.

STATEMENT OF JOHN "JACK" CURRAN, LEGISLATIVE DIRECTOR, LABORERS' INTERNATIONAL UNION OF NORTH AMERICA, WASHINGTON, DC

Mr. CURRAN. Thank you, sir. Mr. Chairman, my name is John Curran and I am Legislative Director of the Laborers' International Union of North America, AFL-CIO. The Laborers' International Union strongly supports pending legislation which would reinstate and make permanent the exclusion from employee taxable income of contributions by employers to group legal service plans under Section 120 of the Internal Revenue Code.

Our union is uniquely qualified to testify on issues affecting this important benefit for workers. Beginning as far back as 1971, we pioneered in the development of group legal service plans in the belief that access to legal services was as important to our members as medical care and pension benefits.

Seventeen years later we are convinced that we made the right decision. Thousands of workers every year find that they are able to get competent legal help through negotiated group legal services plans on serious family, financial, housing, and consumer problems.

Workers, whose family incomes would not otherwise allow them the luxury of retaining a lawyer, are able through these plans to use the justice system to assert their rights and seek remedies.

What we have been able to accomplish through qualified group legal service plans is precisely what Congress intended them to be when it enacted Section 120 in 1976.

By placing legal services in the same tax category as other statutory benefits and establish the public policy principle, or employers and unions should be encouraged to work out means to make basic legal services available to workers.

Section 120 was originally enacted as a five-year experiment. Policy makers were concerned about whether the benefit would wind up accruing only to highly paid executives, whether employee contributions would be insufficient to finance the arrangement, and whether inflationary pressures would escalate the cost of legal services plans as has happened in the case of medical care.

But in considering Section 120's fate in 1981, Congress agreed that non of these evils manifested themselves during the five-year trial period. In fact legal services plans were shown to benefit low and moderate income workers on a nondiscriminatory basis. The modest funding formula used to finance these plans not only was shown to provide more than adequate financial support, but costs barely increased during the period.

In light of this record, Congress enacted legislation to extend the provision for three more years. It reaffirmed its position in 1984, with a one-year extension, and again in 1986 with a two-year retroactive extension as part of the Tax Reform Act.

As a result, there are now approximately 2.5 million workers covered by qualified group legal service plans at an average cost of $89.00 per worker per year.

Since these plans also provide access to essential legal services for family members a total of 6.3 million Americans are now affected by the Congressional policy which Section 120 embodies.

Mr. Chairman, as many members of this subcommittee know, I have been involved in supporting this concept on behalf of the Laborers' Union for over 15 years. In my many discussions with members of Congress over the years, I have found no substantial opposition to the idea of group legal service benefits for workers.

Moreover, in addressing the issue of Section 120's permanence in 1981, 1984, 1985, and 1986, our union's position has enjoyed the unqualified support of other national and international unions, the AFL-CIO, the legal profession, the insurance industry, and consumer groups.

With this record of support, both within Congress and underwriters of group legal service plans, why then do I find myself appearing before you today, asking for the permanent reinstatement of this widely supported provision of the Tax Code?

The answer to this question in reality deals not with the merit of Congress' judgment in enacting and repeatedly extending Section 120; rather in considering this issue, we find ourselves caught up in a debate about whether allowing Section 120 to expire will contribute to alleviating the Federal budget deficit.

The Office of Management and Budget estimates that the tax expenditure associated with Section 120 is $75 million for 1987. Assuming that this figure is accurate, we take the position that the provision of legal services to 6.3 million Americans is certainly worth 0.0075 percent of the Federal budget.

But more importantly, the entire argument that the elimination of Section 120 would cause the Treasury to recoup even this small amount of tax revenue is based upon a false assumption. Those who would make this argument assume that, absent statutory employee benefit status, employers would continue to make taxable contributions to group legal service plans or would alternatively shift the amount of the contribution to other forms of taxable compensation.

However, I can tell you that, in today's world of the scarce benefit dollars, this outcome is improbable. Union and employers see statutory benefits as an efficient means of providing those basic health and welfare services which enable the worker to remain on the job and productive.

Our long experience in collective bargaining tells us that, in the absence of Section 120, both employers and our negotiator will reallocate legal service plans pretax employer contributions to remaining statutory benefits, rather than to taxable compensation.

If I may be allowed another 20 seconds, Mr. Chairman I will conclude?

Senator BAUCUS. Go ahead.

Mr. CURRAN. The net result then of Section 120's demise is that 2.5 million workers and members of their families now covered by legal service plans will lose their legal service coverage. Hundreds of employers and unions now looking at this inexpensive and noninflationary benefit would abandon their efforts in favor of higher cost options. And the Federal Government would net not one dime of additional revenue.

Mr. Chairman the Laborers' International Union has worked long and hard to establish wage rates, working conditions, and fringe benefits which allow our members to lead productive lives and to enjoy the rights, privileges, and benefits which our American society offers to all its citizens.

Congress has wisely provided a statutory framework under the tax laws which support the underlying philosophy of our efforts.

Section 120 is part of that framework, one which has proven effective in carrying out public policy without adding to the cost of Government.

Senator BAUCUS. Thank you.

Mr. CURRAN. Thank you, sir.

Senator BAUCUS. Thank you all very much.

[The prepared statement of Mr. Curran appears in the appendix.]

Senator BAUCUS. There is a vote on now. We have about five minutes. I have a couple of questions I would like each of you to answer very briefly.

Mr. CURRAN. Mr. Chairman, may I offer the statement of Mr. Robert Georgine, Chairman of the National Coordinating Committee for Multiemployer Plans?

Senator BAUCUS. It will be included in the record.

[The prepared statement of Mr. Georgine appears in the appendix.]

Mr. CURRAN. Thank you, sir.

Senator BAUCUS. Mr. Schwartz, not too long ago, Congress required information returns to be filed with the IRS describing the nature of the services. For this committee, could you tell us what kinds of legal services are provided and the nature of the typical person who receives this service?

Mr. SCHWARTZ. Yes. I have not seen any information from the IRS filings; but the services—the routine legal services——

Senator BAUCUS. The question is: Who is using them the most? What is the nature of employment of the persons using these services?

Mr. SCHWARTZ. I see.

Senator BAUCUS. And what is the range of the legal services for people using them the most?

Mr. SCHWARTZ. Our statistics indicate that most of the people make under $25,000 a year. They are employed in construction trades, in automobile industries, municipal employees, and teachers' groups. Most of the services are of the routine nature, for example, wills, and real estate transactions. Much of the work is handled very efficiently by telephone, involving legal advice and consultation on how to handle your own problems without necessarily getting into an expensive court battle.

This telephone preventive law service usually results in about 70 to 80 percent of the matters coming in being able to be handled over the phone, directing people on how to solve many of their own problems.

Senator BAUCUS. Congress beefed up its antidiscrimination rules. What is your reaction as they might apply to group legal services?

I21Mr. SCHWARTZ. Section 120 always had antidiscrimination rules in it and was always designed as a benefit for low and moderate income people. We support this concept.

Senator BAUCUS. So, you support the stronger antidiscrimination rules that Congress passed?

Mr. SCHWARTZ. To the extent that they apply to Section 120, yes.

Senator BAUCUS. I would like to ask Ms. Kindness the degree to which the teenage-mom program would be available, were it not for the Targeted Jobs Tax Credit.

Ms. KINDNESS. The Targeted Jobs Tax Credit program was the cornerstone in establishing the Jobs Plus program. It was a way of providing an incentive, not only for the employer, but it was a way for us to address a problem that we have got nationwide. And since that mothers at risk is a focus for our company, we thought that that was a good way to address it.

Senator BAUCUS. Would you have a teenage mom program without the Targeted Jobs Tax Credit program, anyway, but with different participants?

Ms. KINDNESS. We probably would have a teen-mom program, but we probably would not be able to bring as many of the participants on board into our company, making them an integral part of our work force.

Senator BAUCUS. How many fewer?

Ms. KINDNESS. I would say half. I would say half because we use the tax credit to defray expenses.

Senator BAUCUS. We have unfortunately run out of time. I want to thank all of you for your patience. Many of you have sat here for a couple of hours.

[The prepared statement of Governor DiPrete of Rhode Island appears in the appendix.]

Senator BAUCUS. I want to thank you for waiting and second I want to thank you for keeping your statements within the five minute limit. I think all witnesses did a very good job in that respect.

Other than that, thank you for your testimony. We appreciate your coming here, and we will take these under consideration.

The hearing is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

APPENDIX

ALPHABETICAL LIST AND MATERIAL SUBMITTED

DESCRIPTION OF EXPIRING TAX PROVISIONS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

SENATE COMMITTEE ON FINANCE

ON MARCH 28, 1988

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Subcommittee on Taxation and Debt Management of the Senate Committee on Finance has scheduled a public hearing on March 28, 1988, on expired (1987) and expiring (1988) tax provisions. This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of such tax provisions.[2]

The first part of the pamphlet is a summary listing of tax provisions that expired in 1987 and those scheduled to expire in 1988. The second part provides a brief description of the expired and expiring tax provisions including reference to recent legislative background and any current Administration or Senate legislative proposals relating to such provisions.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of Expiring Tax Provisions* (JCS-8-88), March 24, 1988.

[2] The provisions described in this pamphlet include the section 861 rule for allocation and apportionment of research expenses (expired for taxable years beginning after August 1, 1987) and the tax credit for qualified research expenditures (scheduled to expire for expenditures after December 31, 1987). The Finance Committee press release announcing the March 28, 1988 hearing stated that these two provisions, which had been the subject of an earlier hearing (held April 3, 1987) before the Subcommittee, would not be addressed at the hearing scheduled for March 28, 1988.

For a more detailed description of these two provisions, see Joint Committee on Taxation, *Description of Proposals Relating to Research and Development Incentive Act of 1987 (S. 58) and Allocation of R&D Expenses to U.S. and Foreign Income (S. 716) (JCS-6-87), April 2, 1987.*

I. SUMMARY

Expired tax provisions (1987)

The following tax provisions expired at the end of 1987, unless otherwise indicated:

(1) 10-percent energy tax credit for biomass property;

(2) Exclusion for group legal services benefits, and tax exemption for an organization providing group legal services or indemnification against the cost of legal services as part of a qualified group legal services plan;

(3) Exclusion for employer-provided educational assistance benefits; and

(4) Section 861 rule for allocation and apportionment of research expenses (expired for taxable years beginning after August 1, 1987).

Expiring tax provisions (1988)

The following tax provisions are scheduled to expire at the end of 1988, unless otherwise indicated:

(1) 20-percent tax credit for qualified research expenditures;

(2) 10-percent energy tax credits for solar and geothermal property, and 15-percent credit for ocean thermal property;

(3) Targeted jobs tax credit;

(4) Tax exemption for qualified mortgage bonds and election to issue mortgage credit certificates;

(5) Certain rules relating to financially troubled thrift institutions (reorganizations, FSLIC assistance payments, and net operating losses);

(6) The ESOP exception to the excise tax on reversion of qualified plan assets; and

(7) Partial exemption for qualified taxicabs from the motor fuels excise taxes (after September 30, 1988).

II. DESCRIPTION OF PROVISIONS

A. Expired Provisions (1987)

1. Energy tax credit for biomass property (secs. 46(a)(2) and 46(b)(2)(A)(xi) of the Code)

Prior Law

Prior to January 1, 1988, a nonrefundable tax credit was allowed for certain investments in biomass property. The rate of the credit generally was equal to 10 percent for biomass property placed in service between October 1, 1978, and December 31, 1985, 15 percent for biomass property placed in service during 1986, and 10 percent for biomass property placed in service during 1987. For purposes of the credit, biomass property generally included property used to convert any organic substance (other than oil, natural gas, or coal or their products) into a synthetic liquid, gaseous, or solid fuel, or property that is used to burn the organic substance or the synthetic fuel (Code sec. 48(l)(15).

The production of gas from biomass is eligible for the section 29 credit for producing fuel from a nonconventional source. This credit is $3 per barrel of oil equivalent of the biomass-derived gas. Some recapture of the section 29 credit may occur because of the interaction with the expired energy tax credit for biomass property.

Legislative Background

The energy tax credit for biomass property was enacted in the Crude Oil Windfall Profit Tax Act of 1980, and was scheduled to expire on December 31, 1985. The Tax Reform Act of 1986 extended the credit for biomass property for two additional years, at 15 percent for 1986 and 10 percent for 1987.

2. Exclusion for employer-provided group legal services; tax exemption for qualified group legal services organizations (secs. 120 and 501(c)(20) of the Code)

Prior Law

Under prior law, amounts contributed by an employer to a qualified group legal services plan for an employee (or the employee's spouse or dependents) were excluded from the employee's gross income for income and employment tax purposes (sec. 120). The exclusion also applied to any services received by an employee (or the employee's spouse or dependents) or any amounts paid to an employee under such a plan as reimbursement for the cost of legal services. for the employee (or the employee's spouse or dependents). In order to be a qualified plan under which employees were entitled to tax-free benefits, a group legal services plan was required to fulfill certain requirements. The exclusion for group legal services benefits expired for taxable years ending after December 31, 1987.

In addition, prior law provided tax-exempt status for an organization the exclusive function of which was to provide legal services or indemnification against the cost of legal services as part of a qualified group legal services plan (sec. 501(c)(20)). The tax exemption for such an organization expired for taxable years ending after December 31, 1987.

Section 120 required, among other things, that group legal service benefits provided under a qualified plan not discriminate in favor of highly compensated employees in certain respects. The Statement of Managers for the Tax Reform Act of 1986 indicated that the new nondiscrimination rules for employee benefits added by the 1986 Act (sec. 89) were to be applied to the exclusion for group legal service benefits in lieu of the prior-law rules if the exclusion was extended after 1987.

In 1984, Congress required that employers file information returns with respect to qualified group legal services plans (sec. 6039D). This requirement was intended to collect data with respect to the use of such plans so that Congress could evaluate the effectiveness of the exclusion.

Legislative Background

The section 120 exclusion and the section 501(c)(20) exemption were enacted initially on a temporary basis by the Tax Reform Act of 1976 (through 1981). They subsequently were extended, again on a temporary basis, by the Economic Recovery Act of 1981 (through 1984), Public Law 98-612 (through 1985), and the Tax Reform Act of 1986 (through 1987).

Proposal

S. 2119 (Senators Heinz, Moynihan, Durenberger, and Boren)

S. 2119 would reinstate the section 120 exclusion and the section 501(c)(20) exemption on a permanent basis, effective as of the termination date of the prior-law exclusion and exemption.

3. Exclusion for employer-provided educational assistance (sec. 127 of the Code)

Prior Law

General rules

Under present law, an employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to an employee, unless the cost of such assistance qualifies (under sec. 162) as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment (Treas. Reg. sec. 1.162-5(a)). In the case of an employee, such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed 2 percent of the taxpayer's adjusted gross income. No deduction is allowed for expenses incurred to qualify for a new trade or business (e.g., for law school tuition paid by a paralegal or accountant).

Under prior law, an employee's gross income and wages for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired for taxable years beginning after December 31, 1987, was limited to $5,250 of educational assistance with respect to an individual during a calendar year.

Section 127 required, among other things, that educational assistance provided under such a program not discriminate in favor of highly compensated employees in certain respects. The Statement of Managers for the Tax Reform Act of 1986 indicated that if the section 127 exclusion for educational assistance were extended, the new nondiscrimination rules for employee benefits added by the 1986 Act (Code sec. 89) were to be applied to the exclusion in lieu of the prior-law rules.

In 1984, Congress required that employers file information returns with respect to educational assistance programs under section 127 (sec. 6039D). This requirement was intended to collect data with respect to the use of such programs so that Congress could evaluate the effectiveness of the exclusion.

Tuition reduction for graduate teaching assistants

Pursuant to section 127(c)(8) (prior to its expiration), the exclusion under section 117 relating to qualified tuition reductions applied to graduate-level courses in the case of graduate teaching or research assistants at colleges or universities. Under the section 117 rules, as amended by the Tax Reform Act of 1986, the amount of qualified tuition reduction provided to an employee of an educational institution is includible in gross income and wages to the extent the tuition reduction constitutes payment for teaching, research, or other services (sec. 117(c)). Any amount of qualified tuition reduction (up to the amount of tuition) in excess of such payment may qualify for exclusion pursuant to section 117(d).

No amount of tuition reduction for graduate-level courses is excludable under section 117(d) for taxable years beginning after December 31, 1987, because of the expiration of section 127.

Legislative Background

The section 127 exclusion first was established on a temporary basis by the Revenue Act of 1978 (through 1983). It subsequently was extended, again on a temporary basis, by Public Law 98-611 (through 1985) and by the Tax Reform Act of 1986 (through 1987). The extension of the section 117(d) exclusion for qualified tuition reduction to include graduate-level courses in the case of graduate teaching or research assistants was incorporated in section 127 by Public Law 98-611.

Proposal

S. 39 (Senators Moynihan, Heinz, Boren, Pryor, Matsunaga, Riegle, Mitchell, Durenberger, Danforth, Rockefeller, and others)

S. 39 would reinstate the section 127 exclusion on a permanent basis, effective as of the termination date of the prior-law exclusion.

4. Allocation and apportionment of research expenses (secs. 861(b), 862(b), and 863(b) of the Code)

Present Law [3]

In general

U.S. persons are taxable on their worldwide income, including their foreign income. A U.S. person that earns foreign income may incur foreign income tax. Subject to the applicable foreign tax credit limitations, such a person may credit foreign income taxes against its U.S. tax liability. The purpose of the foreign tax credit and the foreign tax credit limitations is to yield primary taxing jurisdiction over U.S. persons' foreign income to foreign governments, while retaining residual taxing jurisdiction over such income for the United States and ensuring that the full U.S. tax is paid on domestic income.

The foreign tax credit limitations operate by separating the taxpayer's total U.S. tax liability before tax credits ("pre-credit U.S. tax") into 2 categories: tax on U.S. source taxable income and tax on foreign source taxable income. Pre-credit U.S. tax on foreign source taxable income is further subdivided by limitation categories, or "baskets," of income. The pre-credit U.S. tax on any particular limitation category of foreign source income serves as the upper limit on credits for foreign taxes on that type of income.

Each foreign tax credit limitation equals total pre-credit U.S. tax times the ratio of the taxable income in that limitation category to worldwide taxable income. Foreign source taxable income equals foreign source gross income less the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any deductions which cannot definitely be allocated to some item or class of gross income (Code sec. 862(b)). Deductions allocated and apportioned to foreign source gross income must be further allocated or apportioned among the separate limitation categories of foreign source gross income in order to arrive at foreign source taxable income in any one limitation category. Finally, allocation and apportionment of deductions to U.S. source gross income determines the amount of taxpayer's U.S. source taxable income (sec. 861(b)).

The Code generally articulates only the broad principles of how expenses reduce U.S. and foreign source gross income, leaving the Treasury Department to provide detailed rules for the generally fact-specific task of allocating and apportioning expenses. The ap-

[3] The provisions discussed in this section were treated more comprehensively in Part III of the April 2, 1987 pamphlet, prepared by the staff of the Joint Committee on Taxation for the Senate Committee on Finance, entitled *Description of Proposals Relating to Research and Development Incentive Act of 1987 (S. 58) and Allocation of R&D Expenses to U.S. and Foreign Income (S. 716)* (JCS-6-87).

plication of regulations to particular facts and circumstances, therefore, has a significant role in determining the proportions of taxpayers' worldwide taxable income that are treated as coming from foreign sources. These proportions control, in turn, the level of taxpayers' foreign tax credit limitations.

A taxpayer that has paid fewer foreign taxes in each limitation category than the foreign tax credit limitation with respect to that category credits all of its foreign income tax against pre-credit U.S. tax (such a taxpayer is said to have "excess limit" in each of its limitation categories). If the rules for allocating and apportioning deductions are then changed with the result that a greater proportion of the taxpayer's worldwide taxable income is deemed to come from foreign sources, the change cannot decrease the taxpayer's U.S. tax liability on its worldwide income. A taxpayer that has paid foreign taxes in excess of one or more of its foreign tax credit limitations (that is, a taxpayer with excess foreign tax credits) cannot currently use all of its foreign income taxes as credits. Upon a change of the allocation and apportionment rules, however, this taxpayer may experience a reduction in current U.S. tax liability of approximately 34 cents for every dollar of deduction that is converted from a foreign source deduction to a U.S. source deduction, thus converting a dollar of U.S. source taxable income to foreign source taxable income. Conversely, upon a change in the allocation rules that shifts deductions from U.S. to foreign income, a taxpayer with excess credits (or a taxpayer that previously had excess limit and finds itself, as a result of the rule change, with excess credits) may experience an increase in U.S. tax liability due to a reduction in the amount of its foreign income taxes that remain creditable.

Treasury Regulation sec. 1.861-8(e)(3)

Treasury Regulations promulgated in 1977 prescribe detailed rules for allocating and apportioning research and experimental expenses for purposes of computing the foreign tax credit limitation of a U.S. person, as well as for other purposes (Treas. Reg. sec. 1.861-8(e)(3)) ("the R&D regulation").[4]

The R&D regulation contemplates that taxpayers will sometimes undertake R&D solely to meet legal requirements. In some such cases, the R&D cannot reasonably be expected to generate income (beyond de minimis amounts) outside a single geographic source. If so, those deductible R&D expenses reduce gross income only from the geographic source that includes that jurisdiction.

After allocating deductions to meet legal requirements, the regulation generally allows 30 percent of deductible R&D expenses to reduce gross income from the source where over half of the taxpayer's total deductible R&D expenses are incurred. A taxpayer has the opportunity to apportion more than 30 percent of its R&D deduction exclusively to the source where R&D is performed if it can establish that a significantly higher percentage is warranted be-

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[4] By its terms, the R&D regulation would also apply, for example, in determining the U.S. source taxable income of a foreign person, and the taxable income effectively connected with a U.S. trade or business conducted by a foreign person, insofar as those determinations are necessary under other "operative" Code sections. The operative section for the foreign tax credit limitation is section 904(a).

cause the R&D is reasonably expected to have a very limited or long-delayed application outside that geographic source.

After a taxpayer makes a place-of-performance apportionment, it must apportion the amount of its R&D deduction remaining, if any, on the basis of relative amounts of domestic and foreign sales receipts. Subject to certain limitations, a taxpayer may elect to apportion its R&D deduction under an optional gross income method instead of the sales method. Under a gross income method, a taxpayer generally apportions its R&D deduction (after allocation under the legal requirements test but not the place-of-performance test) on the basis of relative amounts of gross income from domestic and foreign sources. The basic limitation on the use of optional gross income methods is that the respective portions of a taxpayer's R&D deduction apportioned to U.S. and foreign source income using a gross income method may not be less than 50 percent of the respective portions that would be apportioned to each such income grouping using the sales apportionment method (with the latter's exclusive place-of-performance allocation, typically 30 percent).

Moratorium on application of the R&D regulation for foreign tax credit purposes

Effective for taxable years beginning after August 13, 1981, and on or before August 1, 1987, the R&D regulation was suspended for purposes of allocating and apportioning U.S.-incurred R&D expenses to items of foreign source and U.S. source gross income. This suspension was initially established by the Economic Recovery Tax Act of 1981 (ERTA), covering any taxpayer's first 2 taxable years beginning within 2 years after August 13, 1981. In the taxable years governed by this aspect of ERTA, all U.S.-incurred R&D expenses were allocated to U.S.-source income. This scheme was extended by the Deficit Reduction Act of 1984 (DEFRA) and the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) through taxable years beginning on or before August 1, 1986.

For taxable years beginning after August 1, 1986 and on or before August 1, 1987, the Tax Reform Act of 1986 (TRA) introduced a modified scheme under which 50 percent of such expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source) were allocated to U.S. source income, with the remainder allocated and apportioned either on the basis of sales or gross income. In contrast with the R&D regulation, the temporary rule of TRA (a) gave taxpayers using the gross sales method of apportionment an automatic place-of-performance allocation, for U.S.-incurred R&D, of 50 (rather than 30) percent; (b) allowed taxpayers using the gross income apportionment method to use the automatic place-of-performance rule; and (c) imposed no limit on the extent to which use of the gross income method could result in decreasing the amount of R&D expenses that would otherwise be allocated to foreign source income using the gross sales method.

Under the Code and regulations as presently written, the R&D regulation governs allocation and apportionment of U.S.-incurred R&D expenses (as well as foreign-incurred R&D expenses) in all taxable years beginning after August 1, 1987.

Legislative Background

At a hearing before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee on April 3, 1987, the Treasury Department testified in favor of a proposal that would have made permanent a modified version of the TRA rules for allocating R&D expenses. The modification would have increased to 67 percent the proportion of U.S.-incurred expenses for R&D (other than amounts allocated to one geographical source because of legal requirements) automatically allocated to U.S. source income. As under TRA, taxpayers using the gross income method of apportionment (as well as taxpayers using the gross sales method) could use the 67-percent automatic place-of-performance allocation, and allocation results achieved under the sales method were not to be a limitation on the use of more favorable results obtainable under the gross income method.

The proposal endorsed at the April 3 hearing was included in H.R. 3545, the Omnibus Budget Reconciliation Act of 1987 (OBRA) as passed by the House. The House-passed provision was also included in the October 1987 budget reconciliation submission of the Senate Finance Committee to the Senate Budget Committee.[5] The provision was not included, however, in the conference agreement on OBRA.

Proposal

Administration proposal

The President's fiscal year 1989 budget proposes to allow taxpayers to allocate, for taxable years beginning after August 1, 1987, at least 67 percent of expenses for R&D to U.S. source income. The details of the President's proposal generally follow the details of the provision passed by the House and approved by the Senate Finance Committee in October 1987.

[5] This proposal had been introduced in the Senate on August 6, 1987, as S. 1617 (Senators Wallop, Baucus, Danforth, Moynihan, Chafee, Roth, Boren, Pryor, Heinz, Durenburger, Armstrong, Riegle, Rockefeller, and others).

B. Provisions Expiring in 1988

1. Tax credit for qualified research expenditures (sec. 41 of the Code)

Present Law

General rule

A 20-percent tax credit is allowed for qualified research expenditures incurred by a taxpayer in carrying on a trade or business (sec. 41). Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the taxable year exceed the average amount of the taxpayer's yearly qualified research expenditures in the specified base period, which generally is the preceding three taxable years.

Eligible expenditures

Research expenditures eligible for the 20-percent incremental credit under present law consist of (1) "in-house" expenditures by the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. Under the 1986 Act, a 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed base period, as adjusted for inflation. This modified university basic research credit was effective for taxable years beginning after 1986.

The amount of credit-eligible basic research expenditures to which the university basic research credit applies does not enter into the computation of the incremental credit. The remaining amount of credit-eligible basic research expenditures—i.e., the amount to which the university basic research credit does not apply—enters into the incremental credit computation (and in subsequent years enters into the base period amounts for purposes of computing the incremental credit).

Research definition

The 1986 Act provided statutory rules defining qualified research for purposes of the incremental credit. These rules target the credit to research undertaken to discover information that is technological in nature and that pertains to functional aspects of products. Also, the 1986 Act expressly excluded certain types of expenditures from eligibility for the credit, including post-production research activities, duplication or adaptation costs, and surveys, studies, and certain other costs. The definitional modifications were effective for taxable years beginning after 1985.

Relation to deduction

The credit is available for incremental qualified research expenditures for the taxable year whether or not the taxpayer has elected under section 174 to deduct currently its research expenditures. The amount of any section 174 deduction to which the taxpayer is entitled is not reduced by the amount of any credit allowed for qualified research expenditures.

Computation of allowable credit

General rule.—As a general rule, the credit applies to the amount of qualified research expenditures for the current taxable year that exceeds the average of the yearly qualified research expenditures in the preceding three taxable years. The base period amount is not adjusted for inflation.

New businesses.—For a base period year during which it was not in existence, a new business is treated as having research expenditures of zero in such year for purposes of computing average annual research expenditures during the base period. However, the taxpayer may be deemed to have expenditures in such a base period year pursuant to the 50-percent limitation rule (described below).

50-percent limitation rule.—In computing the credit, the amount of base period research expenditures to be subtracted from current-year expenditures is treated as at least equal to 50 percent of the taxpayer's qualified research expenditures for the current year. This 50-percent limitation applies both in the case of existing businesses and in the case of newly organized businesses.

Aggregation rules.—To ensure that the credit will be allowed only for actual increases in research expenditures, special rules apply under which research expenditures of the taxpayer are aggregated with research expenditures of certain related persons for purposes of computing any allowable credit. These rules are intended to prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related persons.

Changes in business ownership.—Special rules apply for computing the credit when a business changes hands, under which qualified research expenditures for periods prior to the change of ownership generally are treated as transferred with the trade or business which gave rise to those expenditures. These rules are intended to facilitate an accurate computation of base period expenditures and the credit by attributing research expenditures to the appropriate taxpayer.

Trade or business limitations

The credit is available only for research expenditures paid or incurred in carrying on a trade or business of the taxpayer. With one exception relating to certain research joint ventures, the trade or business test for purposes of the credit is the same as for purposes of the business deduction provisions of section 162. Thus, for example, the credit generally is not available to a limited partnership (or to any partners in such partnership, including a general partner that is an operating company) for partnership expenditures for outside or contract research intended to be transferred by the partnership to another (such as to the general partner) in return for license or royalty payments. Under the trade or business test, research expenditures of a taxpayer are eligible for the credit only if paid or incurred in a particular trade or business already being carried on by the taxpayer.

Other limitations and carryover

The 1986 Act made the research credit subject to the general business credit limitation (i.e., 75 percent of tax liability over $25,000), effective for taxable years beginning after 1985. Any excess amount of the general business credit can be carried back three years and carried forward 15 years, beginning with the earliest year.

In the case of an individual who owns an interest in an unincorporated trade or business, who is a beneficiary of a trust or estate, who is a partner in a partnership, or who is a shareholder in an S corporation, the amount of credit that can be used in a particular year also cannot exceed an amount (separately computed with respect to the person's interest in the trade or business or entity) equal to the amount of tax attributable to that portion of the person's taxable income that is allocable or apportionable to such interest. Any excess credit amount is eligible for the carryover rule described above.

Legislative Background

As enacted in the Economic Recovery Tax Act of 1981, the rate of the credit was 25 percent, and the credit was scheduled to expire after December 31, 1985. In the Tax Reform Act of 1986, the credit was extended for three years (i.e., for qualified research expenditures through December 31, 1988); also, the credit rate was reduced to 20 percent of the incremental research expenditure amount, effective for taxable years beginning after 1985.

Explanation of Proposals

Administration proposal

The President's budget proposal for fiscal year 1989 would establish a permanent tax credit for qualified research expenditures.

S. 58 (Senators Danforth, Baucus, Wallop, Boren, Durenberger, Mitchell, Riegle, Rockefeller, and others)

S. 58 would increase the research tax credit from 20 percent to 25 percent, and would make the credit permanent.[6]

[6] For a more detailed explanation of present law and S. 58, see Joint Committee on Taxation, *Description of Proposals Relating to Research and Development Incentive Act of 1987 (S. 58) and Allocation of R&D Expenses to U.S. and Foreign Income (S. 716)* (JCS-6-87), April 2, 1987.

2. Business energy tax credits for solar, geothermal, and ocean thermal property (secs. 46(a)(2) and 46(b)(2)(A)(viii), (ix), and (x) of the Code)

Present Law

Under present law, a nonrefundable energy tax credit is allowed for certain investments in solar property, geothermal property, and ocean thermal property. In the case of solar property, the rate of the credit is 15 percent for 1986, 12 percent for 1987, and 10 percent for 1988. For geothermal property, the rate of the credit is 15 percent for 1986, and 10 percent for 1987 and 1988. The rate of the credit for ocean thermal property is 15 percent for 1986, 1987, and 1988. The energy tax credit for solar, geothermal, and ocean thermal property is not available for property placed in service after December 31, 1988.[7]

Legislative Background

The energy tax credit for solar, geothermal, and ocean thermal property was enacted in the Energy Tax Act of 1978, and was scheduled to expire on December 31, 1985. The Tax Reform Act of 1986 extended the energy tax credit for these types of property for three additional years (through 1988) at the rates specified above.

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[7] For definition of solar, geothermal, and ocean thermal property, see sections 48(l)(4), 48(l)(3)(A)(viii), and 48(l)(3)(A)(ix), respectively.

3. Targeted jobs tax credit (sec. 51 of the Code)

Present Law

Tax credit provisions

The targeted jobs tax credit is available on an elective basis for hiring individuals from nine targeted groups. The targeted groups are: (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 through 24; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students aged 16 through 19; (7) economically disadvantaged former convicts; (8) Aid to Families with Dependent Children (AFDC) recipients and Work Incentive (WIN) registrants; and (9) economically disadvantaged summer youth employees aged 16 or 17. Targeted group membership must be certified.

The credit generally is equal to 40 percent of the first $6,000 of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit generally is $2,400 per individual. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 85 percent of up to $3,000 of wages, for a maximum credit of $2,550.

The credit is not available for wages paid to a targeted group member unless the individual either (1) is employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees), or (2) has completed at least 120 hours of work performed for the employer (20 hours in the case of economically disadvantaged summer youth employees). Also, the employer's deduction for wages must be reduced by the amount of the credit.

The credit is available with respect to targeted-group individuals who begin work for the employer before January 1, 1989.

Authorization of appropriations

Present law also authorizes appropriations for administrative and publicity expenses relating to the credit through September 30, 1988. These monies are to be used by the Internal Revenue Service (IRS) and Department of Labor to inform employers of the credit program.

Legislative Background

Extension of credit, authorization of appropriations

The targeted jobs tax credit was enacted in the Revenue Act of 1978 to replace an expiring credit for increased employment. As originally enacted, the targeted jobs credit was scheduled to terminate after 1981.

The availability of the credit was successively extended by the Economic Recovery Tax Act of 1981 (ERTA) for one year, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) for two years, and the Deficit Reduction Act of 1984 (the 1984 Act) for one year. For individuals who began work before 1986, the credit was available for wages paid during the first 24 months of employment. In addition, TEFRA authorized appropriations for the expenses of administering the system for certifying targeted group membership and of providing publicity to employers regarding the targeted jobs credit. The 1984 Act extended the authorization for appropriations for administrative and publicity expenses through fiscal year 1985.

The Tax Reform Act of 1986 extended the targeted jobs credit for three additional years (through 1988), with modifications. Under the 1986 Act, the modified credit is available for wages paid to targeted-group individuals who begin work for an employer after December 31, 1985 and before January 1, 1989. The 1986 Act extended the authorization for appropriations for administrative and publicity expenses through fiscal year 1988.

Modification of credit

ERTA, TEFRA, and the 1984 Act also modified the targeted group definitions and made several technical and administrative changes in the credit provisions.

The 1986 Act limited the extended credit in three respects: (1) a 25-percent credit for qualified wages paid in the second year of a targeted-group individual's employment was repealed; (2) a 50-percent credit for qualified first-year wages generally was reduced to a 40-percent credit (except that the credit allowed for wages of economically disadvantaged summer youth employees was retained at 85-percent of up to $3,000 of qualified first-year wages); and (3) no wages paid to a targeted-group member are taken into account for credit purposes unless the individual either (a) is employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees), or (b) has completed at least 120 hours of work performed for the employer (20 hours in the case of economically disadvantaged summar youth employees).

Under the Omnibus Budget Reconciliation Act of 1987, the credit is no longer available for wages paid to a targeted-group individual who performs the same or substantially similar services as an employee participating in, or affected by, a strike or lockout.

Proposal

S. 684 (Senator Heinz and others)

The bill would make the targeted jobs tax credit permanent. It would also extend the authorization for appropriations on an indefinite basis.

4. Qualified mortgage bonds and mortgage credit certificates (secs. 143 and 25 of the Code)

Present Law

Overview

Interest on bonds issued by a State or local government to finance governmental activities generally is tax-exempt (Code sec. 103). Interest on private activity bonds is taxable unless a specific exception is provided in the Internal Revenue Code. Private activity bonds are bonds that satisfy one or both of (1) a private business use and private payment test and (2) a private loan test. Private activity bonds qualifying for tax-exemption include exempt-facility bonds, small-issue bonds, qualified mortgage bonds and qualified veterans' mortgage bonds, qualified 501(c)(3) bonds, qualified student loan bonds, and qualified redevelopment bonds.

In general, the amount of private activity bonds that may be issued annually by any State (including local governments within the State) is limited to the greater of (1) $50 for every individual who is a resident of the State or (2) $150 million. Bonds subject to this limitation include qualified mortgage bonds and most other private activity bonds for which tax-exemption is permitted, and the private use portion (in excess of $15 million) of governmental issues.

Special rules applicable to qualified mortgage bonds

In general, qualified mortgage revenue bonds are bonds issued to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied homes located within the jurisdiction of the issuer of the bonds. All proceeds of an issue must be used to finance such loans.[8]

First-time homebuyer requirement

An issue is a qualified mortgage issue only if at least 95 percent of the net proceeds of the issue are used to finance residences for mortgagors who had no present ownership interest in their principal residences during the three-year period before the mortgage is executed. This first-time homebuyer requirement does not apply to mortgagors of residences located in targeted areas (as described below), mortgagors who receive qualified home improvement loans, or mortgagors who receive qualified rehabilitation loans.

[8] For this purpose, the proceeds of an issue are determined net of costs of issuance permitted to be bond-financed and of amounts invested as part of a reasonably required reserve fund.

Income limitations

Qualified mortgage bond financing is available only to mortgagors whose family incomes do not exceed 115 percent of the higher of (1) the median family income for the area in which the residence is located, or (2) the Statewide median family income. Family income of mortgagors (as well as median family income) is to be determined by the Treasury Department after taking into account the regulations and procedures under section 8 of the United States Housing Act of 1937. Unlike the rules regarding qualified residential rental projects, no adjustments for family size are made under these income limitations.

In targeted areas, two-thirds of the mortgage financing provided with the proceeds of each issue must be provided to mortgagors who have family incomes not exceeding 140 percent of the higher of (1) the median family income for the area in which the residence is located, or (2) the Statewide median income. The remaining one-third of the mortgage financing of each issue may be used to provide mortgage loans without regard to income limitations.

A targeted area is defined as (1) a census tract in which 70 percent or more of the families have incomes that are 80 percent or less of the Statewide median family income, or (2) an area of chronic economic distress designated by the Secretary of the Treasury and the Secretary of Housing and Urban Development.

Purchase price limitations

The acquisition cost of a residence financed with qualified mortgage bonds may not exceed 90 percent (110 percent in targeted areas, as defined above) of the average area purchase price applicable to the residence. The determination of average area purchase prices is made separately (1) with respect to new residences and existing, previously occupied residences, and (2) to the extent provided in regulations, with respect to one-, two-, three-, and four-family residences.

Special rule for electing limited equity housing cooperatives

Certain "limited equity housing cooperatives", while constituting owner-occupied housing, may at the election of the cooperative be financed using the targeting rules for bond-financed qualified residential rental projects, provided the other compliance rules applicable to such rental property also are met.[9] Limited equity housing cooperatives are cooperative housing corporations (as defined under sec. 216(b)(1)) in which a person is entitled to occupy a dwelling unit by reason of ownership of stock in the cooperative. The election must be made when the bonds are issued, and once made is irrevocable. If no election is made, a limited equity housing cooperative is eligible for qualified mortgage bond financing on the same

[9] To qualify for financing under the targeting and compliance rules for qualified residential rental projects, (1) the cost of any stock in the cooperative must not exceed the amount paid for the stock by the original stockholder (as adjusted for cost-of-living increases), increased by amounts paid for improvements on the stockholder's house or apartment and certain other payments attributable to the stockholder, and (2) the assets of the cooperative in excess of the combined transfer values of outstanding stock in the cooperative (and reduced by any liabilities) must be used only for public or charitable purposes or directly to benefit the cooperative and may not be used directly to benefit any stockholder.

basis as other owner-occupied housing. Such financing is subject to all the limitations applicable to qualified mortgage bonds (including the first-time homebuyer and purchase price limitations).

Change in use rules

As with other private activity bonds, interest on loans financed with qualified mortgage bonds is nondeductible if a "change in use" occurs (sec. 150(b)). For qualified-mortgage bond-financed residences, such a change in use occurs if the residence is not the principal residence of one or all of the mortgagors for a period of at least one year. Interest is again deductible following a prohibited change in use if the residence again becomes the mortgagor's principal residence.

Mortgage credit certificates

Qualified governmental units may elect to exchange qualified mortgage bond authority for authority to issue mortgage credit certificates (MCCs) (sec. 25). MCCs entitle homebuyers to nonrefundable income tax credits for a specified percentage of interest paid on mortgage loans on their principal residence. Once issued, an MCC remains in effect as long as the residence being financed continues to be the certificate-recipient's principal residence. MCCs are generally subject to the same eligibility and targeted area requirements as qualified mortgage bonds.

Each MCC must represent a credit for at least 10 percent (but not more than 50 percent) of interest on qualifying mortgage indebtedness. The actual dollar amount of an MCC depends on the amount of qualifying interest paid during any particular year and the applicable certificate credit percentage. If the credit percentage exceeds 20 percent, however, the dollar amount of the credit received by the taxpayer for any year may not exceed $2,000.

The aggregate amount of MCCs distributed by an electing issuer may not exceed 25 percent of the volume of qualified mortage bond authority exchanged by the State or local government for authority to issue MCCs. For example, a State that is authorized to issue $200 million of qualified mortgage bonds and that elects to exchange $100 million of that bond authority can distribute an aggregate amount of MCCs equal to $25 million.

Termination

Authority to issue qualified mortgage bonds and the election to trade-in bond volume authority to issue MCCs is scheduled to expire after December 31, 1988.[10]

Proposal

S. 1522 (Senators Riegle, Durenberger, Mitchell, Daschle, and others)

S. 1522 would extend the termination date for the issuance of qualified mortgage bonds for four years, to December 31, 1992. In

[10] A proposed technical amendment to section 25(h) changes the termination date from 1987 to the intended 1988 date.

addition, the bill would extend through 1992 the election to issue MCCs in lieu of qualified mortgage bonds.

5. Financially troubled thrift institutions: reorganizations, NOLs, and FSLIC assistance payments (secs. 368(a)(3)(D), 382(l)(F), and 597 of the Code)

Present Law

Continuity of interest requirement

In order for the acquisition of a financially troubled thrift institution to qualify as a tax-free reorganization, the acquisition must satisfy the judically-created "continuity of interest" requirement. The continuity of interest doctrine generally requires that the shareholders of an acquired corporation maintain a meaningful ownership interest in the acquiring corporation in order for the transaction to qualify as a tax-free "reorganization" within the meaning of section 368(a).

In the case of mutually-owned organizations, such as many thrift institutions, there is considerable uncertainty under what circumstances the continuity of interest requirement is met.

Under special rules adopted in the Economic Recovery Tax Act of 1981 (the "1981 Act"), the continuity of interest requirement need not be satisfied in the case of a merger involving thrift institutions provided the following three requirements are met (sec. 368(a)(3)(D)). First, the acquired institution must be one to which section 593 applies, namely a savings and loan association, a cooperative bank, or a mutual savings bank. Second, the Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Home Loan Bank Board (FHLBB) (or if neither has jurisdiction, an equivalent State authority) must certify that the thrift institution in insolvent, that it cannot meet its obligations currently, or that it will be unable to meet is obligations in the immediate future. Third, substantially of of the liabilities of the transferor institution (including deposits) must become liabilities of the transferee. Moreover, if these conditions are satisfied, the acquired institution need not receive or distribute stock or securities of the acquiring corporation of the transaction in order for the transactions to qualify as a tax-free reorganization under section 368(a)(1)(D).

Net operating loss carryovers

Under the rules providing limitations on net operating loss carryovers before the 1986 Act in the case of reorganizations (sec. 382(b)), the net operating loss carryovers of a corporation were reduced if the shareholders of the corporation with the net operating loss carryover did not own at least 20 percent of the stock in the corporation surviving the reorganization.

The 1981 Act also provided that, for purposes of applying the loss limitation provisions, deposits in the acquired corporation that become deposits in the surviving corporation are treated as stock of both corporations. The 1986 Act provided a special transitional rule which continued rules similar to the pre-1986 rules for financially troubled thrift institutions through 1988 (sec. 382(l)(F).

FSLIC assistance payments contributions to savings and loan associations

Generally, amounts received as insurance are includible in income or otherwise reduce any of the insured loss. Contributions to capital are excluded from the income of the recipient corporation (sec. 118). However, in the case of contributions to capital by nonshareholders, the basis of property acquired with the contribution normally must be reduced by such contributions (sec. 362(c)).

The 1981 Act provided that financially troubled savings and loan associations may exclude contributions from the FSLIC under its financial assistance program from income and need not reduce their basis for such contributions (sec. 597(b)). The provision does not apply to comparable contributions by the Federal Deposit Insurance Corporation (FDIC) to banks, including savings banks and cooperative banks.

Termination

Under present law, the above-mentioned special rules for financially troubled thrift institutions are scheduled to expire after December 31, 1988.

Legislative Background

The Economic Recovery Tax Act of 1981 provided special rules for reorganizations of financially troubled thrift institutions (described above). The Tax Reform Act of 1986 provided that the special rules terminate at the end of 1988.

6. Application of excise tax on reversion of qualified plan assets to ESOPs (sec. 4980(c)(3) of the Code)

Present Law

In general, prior to the satisfaction of all liabilities with respect to employees and their beneficiaries, the assets held under a qualified plan may not be used for, or diverted to, purposes other than the exclusive benefit of employees. However, if assets in excess of liabilities for benefits remain in a defined benefit pension plan upon plan termination as a result of actuarial error, then those assets may be paid to the employer as a reversion.

Under present law, employer reversions of plan assets are (1) includible in the gross income of the employer, and (2) subject to a 10-percent nondeductible excise tax payable by the employer. A reversion is not includible in gross income and is not subject to the excise tax to the extent the reversion is transferred to an employee stock ownership plan (ESOP) and certain requirements are satisfied.

A transfer of a reversion to an ESOP qualifies for the ESOP exception only if: (1) the amounts transferred to the ESOP are used within 90 days after the transfer to acquire employer securities or to repay loans used to acquire employer securities, (2) certain allocation rules are satisfied, (3) the securities acquired with the amounts transferred are held in the plan until distribution to plan participants, and (4) at least half of the participants in the plan from which the assets are transferred are participants in the ESOP.

The ESOP exception applies to amounts transferred (1) after March 31, 1985, and before January 1, 1989, or (2) after December 31, 1988, pursuant to a plan termination that occurs after March 31, 1985, and before January 1, 1989.

Legislative Background

The excise tax on reversions of assets from qualified plans (and the ESOP exception to the reversion tax and income inclusion rule) were added by the Tax Reform Act of 1986. Certain clarifying changes to the requirements for the ESOP exception were included in technical corrections to the 1986 Act approved by the House in the Omnibus Budget Reconciliation Act of 1987 and by the Senate Finance Committee in 1987 (but which have not yet been enacted).

7. Fuels tax exemption for certain taxicabs (sec. 6427(e)(3) of the Code)

Present Law

A 4-cents-per-gallon partial exemption from the motor fuels excise tax is provided through September 30, 1988, for fuels used in qualifying taxicabs. The excise taxes from which the exemption applies are the 9.1-cents-per-gallon taxes on gasoline (sec. 4081) and special motor fuels (sec. 4041) and the 15.1-cents-per-gallon tax on diesel fuel (secs. 4041 and 4091). The exemption is realized through a credit or refund (without interest). Qualifying taxicabs must meet certain group-ride requirements and fuel economy standards.

Legislative Background

This provision was enacted initially in the Energy Tax Act of 1978, and the partial exemption has been extended several times since then, most recently for three years (through September 30, 1988) in the Tax Reform Act of 1986.

Testimony of Congressman Michael Bilirakis

March 28, 1988

Senate Finance Subcommittee on Taxation & Debt Management

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU THIS MORNING TO DISCUSS THE TARGETED JOBS TAX CREDIT PROGRAM. FIRST, LET ME START OUT BY SAYING THAT I WHOLEHEARTEDLY SUPPORT THE REAUTHORIZATION OF THIS PROGRAM. THE GROUPS THAT ARE PRESENTLY TARGETED NEED HELP AND I FEEL IT IS FAR BETTER TO GIVE THEM A WORKING EXPERIENCE THAN A HANDOUT.

HOWEVER, MR. CHAIRMAN THERE IS A GROUP OF PEOPLE OUT THERE WHO ARE AS NEEDY AS THOSE PRESENTLY COVERED UNDER TJTC AND THEY ARE THE DISPLACED HOMEMAKERS. DISPLACED HOMEMAKERS ARE PRIMARILY WOMEN WHO HAVE BEEN FULL-TIME HOMEMAKERS FOR A NUMBER OF YEARS, BUT WHO HAVE LOST THEIR SOURCE OF ECONOMIC SUPPORT DUE TO DIVORCE, SEPARATION, ABANDONMENT, OR THE DEATH OR DISABILITY OF A SPOUSE.

I AM NOT TALKING ABOUT WOMEN WHOSE HUSBANDS HAVE DIED AND LEFT THEM WELL OFF, OR WOMEN WHO RECEIVE SUBSTANTIAL ALIMONY OR CHILD SUPPORT PAYMENTS. WE'RE TALKING ABOUT POOR WOMEN WHO HAVE BEEN OUT OF THE WORK FORCE AND CANNOT FIND DECENT JOBS EITHER BECAUSE OF A LACK OF JOB SKILLS OR AN EMPLOYER'S UNWILLINGNESS TO HIRE THEM BECAUSE THEY HAVEN'T WORKED IN YEARS OR PERHAPS NEVER WORKED OUTSIDE OF THE HOME. THEY ARE STRUGGLING TO MAKE ENDS MEET WITHOUT UNEMPLOYMENT INSURANCE, WITHOUT HEALTH INSURANCE IN MANY CASES, AND WITHOUT JOBS.

THESE ARE NOT ONLY ELDERLY WOMEN I'M TALKING ABOUT, EVEN THOUGH PRIME WORKING YEARS ARE USUALLY CONSIDERED TO BE UP TO AGE 64, BUT WOMEN WHO MAY BE IN THEIR LATE 20S, 30S, OR 40S. THEY MAY HAVE A NUMBER OF CHILDREN OR NONE AT ALL. HOWEVER, THE BASIC FACT IS THEY NEED TO EAT, HAVE HOUSING, MEDICAL CARE, ETC., ALL OF WHICH THEY COULD PAY FOR IF THEY HAD A DECENT PAYING JOB.

THE STATISTICS ON DISPLACED HOMEMAKERS ARE SHOCKING. THE DISPLACED HOMEMAKERS NETWORK HERE IN WASHINGTON, WHICH REPRESENTS LOCAL PROGRAMS SERVING DISPLACED HOMEMAKERS NATIONWIDE, IN ONE OF ITS STUDIES, INDICATES THAT WOMEN AND CHILDREN SUFFER A 73% DECLINE IN THEIR STANDARD OF LIVING THE FIRST YEAR AFTER A DIVORCE, WHILE MEN EXPERIENCE A 42% RISE. I BELIEVE WE CAN ALL APPRECIATE THE INEQUITY OF THIS SITUATION, AND IT IS OBVIOUS WHO THE VICTIMS ARE.

A 1985 CONGRESSIONAL OFFICE OF TECHNOLOGY ASSESSMENT STUDY FURTHER CONFIRMS THAT MANY DISPLACED HOMEMAKERS ARE LIVING AT OR NEAR POVERTY LEVELS. NEARLY HALF HAD FAMILY INCOMES BELOW $10,000. MOST OF THOSE DISPLACED HOMEMAKERS UNDER AGE 35 ARE LIVING WITH CHILDREN AND MOST OF THEM ARE POOR. THE QUESTION IS OBVIOUS--HOW CAN WE EXPECT CHILDREN WHO ARE BROUGHT UP IN A POVERTY RIDDEN SINGLE PARENT HOME TO REACH THEIR FULL POTENTIAL?

A NETWORK STATUS REPORT ON DISPLACED HOMEMAKERS AND SINGLE PARENTS IN THE UNITED STATES ALSO STATES THAT THERE ARE 11.4 MILLION DISPLACED HOMEMAKERS IN THE UNITED STATES. TWO THIRDS OF ALL DISPLACED HOMEMAKERS ARE WIDOWS AND 30% ARE DIVORCED OR SEPARATED. NEARLY HALF HAVE COMPLETED HIGH SCHOOL, INCLUDING 18% WHO HAVE OBTAINED SOME EDUCATION BEYOND HIGH SCHOOL. ANY WOMAN WHO HAS SUCCEEDED IN RUNNING A HOME, BUDGETING, AND POSSIBLY CARING FOR CHILDREN HAVE SKILLS THAT WILL FIT VERY NICELY IN A WORKING ENVIRONMENT OUTSIDE OF THE HOME.

IN 1983, AS WELL AS THE PAST TWO CONGRESSES, IN AN EFFORT TO GIVE DISPLACED HOMEMAKERS AN OPPORTUNITY FOR MEANINGFUL EMPLOYMENT AND JOB DIGNITY, I HAVE INTRODUCED LEGISLATION WHICH WOULD AMEND THE INTERNAL REVENUE CODE TO ALLOW EMPLOYERS A TAX CREDIT FOR HIRING DISPLACED HOMEMAKERS. BASICALLY, THIS LEGISLATION WOULD ESTABLISH DISPLACED HOMEMAKERS AS A TARGETED GROUP UNDER THE TARGETED JOBS TAX CREDIT PROGRAM. MY BILL IS INTENDED TO BE AN ENCOURAGEMENT FOR EMPLOYERS TO HIRE THOSE WHO HAVE BEEN OUT OF THE WORK FORCCE BECAUSE OF FAMILY OBLIGATIONS.

THE PROBLEMS OF DISPLACED HOMEMAKERS ARE SIGNIFICANT AND VERY COSTLY TO THE SOCIETY. IT ONLY STANDS TO REASON THAT IN THESE DEFICIT-RIDDEN TIMES WE NEED PRODUCTIVE PEOPLE WHO ARE CONTRIBUTORS TO THE COFFERS NOT RECIPIENTS OF ASSISTANCE. AN INVESTMENT IN HELPING THESE WOMEN OBTAIN JOB SKILLS, SELF-CONFIDENCE AND A PAID POSITION CAN ONLY ENHANCE THEIR LIVES AND THE LIVES OF THEIR CHILDREN, NOT TO MENTION THE SAVINGS TO TAXPAYERS.

THESE WOMEN DON'T HAVE HIGH PAID SLICK LOBBYISTS ACTING AS THEIR ADVOCATES. THEY FALL BETWEEN THE CRACKS AND OFTEN END UP AS VICTIMS ONCE AGAIN. THEY WANT TO WORK AND THEY NEED HELP TO REACH THIS GOAL. WE, AS ELECTED OFFICIALS, ARE IN A POSITION TO SEE THAT THEIR NEEDS, AND THE NEEDS OF THEIR CHILDREN ARE ADDRESSED. I BELIEVE PASSAGE OF MY BILL CALLING FOR AN EXPANSION OF THE TJTC PROGRAM WILL DO MUCH TO ADDRESS THE NEEDS OF THESE "HIDDEN POOR." THIS IS AN ISSUE OF COMPASSION, GOOD FISCAL SENSE AND PROGRESSIVE THINKING.

MR. CHAIRMAN, I URGE YOU AND THE OTHER MEMBERS OF THIS SUBCOMMITTEE TO MOVE FORWARD ON REAUTHORIZING THE TJTC PROGRAM AND EXPANDING IT TO INCLUDE A DISPLACED HOMEMAKERS TARGET GROUP. AS OUR ELDERS HAVE TAUGHT US, "IF YOU GIVE A PERSON A FISH YOU FEED THEM FOR A DAY; IF YOU TEACH A PERSON TO FISH YOU FEED THEM FOR A LIFETIME." I BELIEVE MY LEGISLATION WILL ACCOMPLISH THIS.

ALSO, MR. CHAIRMAN, I WOULD REQUEST THAT THE TESTIMONY PREPARED BY THE FACE LEARNING CENTER IN LARGO, FLORIDA, BE INSERTED IN THE RECORD. THE FACE CENTER ASSISTS DISPLACED HOMEMAKERS TOWARD ACHIEVING PERSONAL STABILITY AND ECONOMIC SELF-SUFFICIENCY. IT PROVIDES SERVICES IN THE AREAS OF PRE-EMPLOYMENT TRAINING, SETTING AND ACHIEVING REALISTIC CAREER GOALS, EDUCATIONAL PLANNING AND PROMOTION OF NON-TRADITIONAL EMPLOYMENT OPPORTUNITIES.

THE FACE PROGRAM MAINTAINS A JOB BANK AND IF A DISPLACED HOMEMAKER IS LUCKY ENOUGH TO FIND A JOB, FACE IS THERE TO HELP THEM AFTER THE FACT WITH SELF-ESTEEM COUNSELING SESSIONS AND FINANCIAL AND FAMILY ADVICE. WE ARE EXTREMELY PROUD OF THE GOOD WORK THAT FACE IS DOING IN MY CONGRESSIONAL DISTRICT AND I BELIEVE YOU WILL FIND THEIR TESTIMONY INTERESTING.

I WOULD ALSO LIKE TO INSERT FOR THE RECORD THE DISTRIBUTION OF THE DISPLACED HOMEMAKERS IN THE COUNTRY BY STATE. AS YOU WILL NOTICE, SENATOR BAUCUS, THERE ARE 33,826 DISPLACED HOMEMAKERS IN MONTANA, AND IN MY OWN STATE OF FLORIDA, THERE ARE 596,918.

THANK YOU MR. CHAIRMAN FOR PROVIDING ME WITH THIS OPPORTUNITY TO TESTIFY ON TJTC AND THE NEED FOR MY LEGISLATION.

DISPLACED HOMEMAKERS IN THE UNITED STATES BY AGE

STATES	TOTAL	<20	20-24	25-34	35-44	45-54
ALABAMA	227038	1308	6666	19214	16754	20942
ALASKA	9260	86	517	2681	1133	928
ARIZONA	111996	561	3041	10447	9165	10148
ARKANSAS	130072	721	3196	11108	7766	9800
CALIFORNIA	1148759	4091	37115	116154	116695	108997
COLORADO	172296	614	6087	34242	25006	20468
CONNECTICUT	144070	513	3618	14343	12570	11573
DELAWARE	31514	447	1158	5315	2012	2898
DIST OF COLUMBIA	50213	49	549	4514	3762	9562
FLORIDA	596918	2272	12817	43461	40951	49381
GEORGIA	290890	1243	5526	19864	32156	31212
HAWAII	26072	106	812	4423	2011	3727
IDAHO ESTIMATED	20266	85	529	1685	1349	1534
ILLINOIS	632375	1896	41000	68493	59170	61653
INDIANA	257182	1129	9287	24328	16391	17771
IOWA	137489	824	3039	10381	6201	5647
KANSAS	112688	988	3355	8180	5320	6203
KENTUCKY	188151	922	5638	13958	10829	14891
LOUISIANA	223515	1123	5931	23455	20592	23004
MAINE	58445	271	1858	5891	4245	4718
MARYLAND	188792	680	5104	19865	17059	18686
MASSACHUSETTS	322274	704	7389	29376	25303	22628
MICHIGAN	445685	2868	14561	57588	40264	37206
MINNESOTA	186376	345	3646	13397	9427	9757
MISSISSIPPI	123447	611	4298	11645	9760	12469
MISSOURI	267950	1272	7499	19695	15559	18884
MONTANA	33826	146	1009	2845	2352	2362
NEBRASKA	74887	179	1471	4313	7091	3467
NEVADA	29250	165	1085	3861	3214	3034
NEW HAMPSHIRE	37862	127	291	3600	3068	2390
NEW JERSEY	351628	892	6785	33073	32632	30952
NEW MEXICO	49849	351	1847	6010	4188	4936
NEW YORK	1008816	3010	23596	104261	101240	100595
NORTH CAROLINA	284956	1063	7127	30061	19480	24743
NORTH DAKOTA	28279	54	719	2783	2210	1698
OHIO	554177	1924	21858	60025	38655	47028
OKLAHOMA	173219	4376	5326	14005	14263	10832
OREGON	138693	623	4440	16584	18533	8782
PENNSYLVANIA	660559	1692	14576	54260	48058	56593
RHODE ISLAND	53867	141	1489	5465	4582	4065
SOUTH CAROLINA	158354	507	3965	21967	12027	21456
SOUTH DAKOTA	33209	175	875	2279	1697	1865
TENNESSEE	243427	1412	7733	21149	18317	21748
TEXAS	578355	4702	16988	65267	40387	46866
UTAH	46550	590	2341	5532	3358	2975
VERMONT	23914	167	571	2751	1620	1479
VIRGINIA	217370	872	6194	20613	17605	17817
WASHINGTON	195826	874	7921	24064	16756	14218
WEST VIRGINIA	115740	352	2419	6957	5454	8445
WISCONSIN	219449	1987	4757	16875	12025	23714
WYOMING	15166	74	492	1400	938	865
TOTAL	11430961	52183	340111	1123703	941200	997632

DISPLACED HOMEMAKERS BY AGE

	55-64	>63
ALABAMA	38971	123183
ALASKA	1423	2492
ARIZONA	18341	60293
ARKANSAS	20787	76694
CALIFORNIA	180533	585174
COLORADO	24955	60924
CONNECTICUT	20721	80732
DELAWARE	4310	15374
DIST OF COLUMBIA	8437	23340
FLORIDA	95463	352573
GEORGIA	49748	151141
HAWAII	4651	10342
IDAHO ESTIMATED	3089	11995
ILLINOIS	82017	318146
INDIANA	36123	152153
IOWA	15659	95738
KANSAS	13577	75065
KENTUCKY	39380	102533
LOUISIANA	40781	108629
MAINE	8221	33241
MARYLAND	32450	94948
MASSACHUSETTS	61082	175792
MICHIGAN	63696	229502
MINNESOTA	37766	112038
MISSISSIPPI	21186	63478
MISSOURI	37174	167867
MONTANA	5118	19994
NEBRASKA	8672	49694
NEVADA	4884	13007
NEW HAMPSHIRE	5089	23297
NEW JERSEY	56057	191237
NEW O	8595	23922
NEW YORK	154066	522048
NORTH CAROLINA	48474	154008
NORTH DAKOTA	3903	16912
OHIO	83677	301010
OKLAHOMA	22737	101680
OREGON	17385	72346
PENNSYLVANIA	110518	374862
RHODE ISLAND	7721	30404
SOUTH CAROLINA	25042	73390
SOUTH DAKOTA	4248	22070
TENNESSEE.	40413	132655
TEXAS	76662	327483
UTAH	6347	25407
VERMONT	3207	14119
VIRGINIA	31212	123057
WASHINGTON	28091	103902
WEST VIRGINIA	18631	73482
WISCONSIN	28796	131295
WYOMING	2182	9195
	1762268	6213863

Committee on Finance

Colleen Brown

Mr. Chairman, Members of the Committee, my name is Colleen Brown and I am a clerical for the Dayton Hudson Department Store Company in Minneapolis. I came here today to tell you a story about how I became a Daytonian and how I got off of welfare through the help of TJTC.

After high school I worked for a year and half in an automotive fix-it shop. I had to quit when I was 7 months pregnant. I was not married at the time and had to rely on welfare in order to live. About a year after Kristopher was born, I decided to had to find a job again. I could only afford a part-time job because full-time day care cost so much. I worked part-time in an automotive parts store while a friend of mine in my apartment building took care of Kristopher. After 4 months my friend was unable to continue to watch Kristopher so I quit. The day I quit a friend told me about the newspaper ad for the Jobs Training Program at Dayton Hudson Department Store Company. The ad was written for me. It was looking for young moms, who wanted a job. They would provided training and day care and transportation. I applied and they accepted me. It was the start of a new beginning.

The training program taught us about career and goal setting. How to dress for interviews, finding day care, about sexuality The most important thing is that it taught me how to work with others. We went on a survival retreat which taught us to depend upon each other to get a group project done. In my job at Dayton's in the sign shop we have to work together to get quick jobs done for advertising. It is the same thing.

Dayton's really helped me in alot of ways. I had to interview and get the job. They didn't just give it to me. But Dayton's helped me get off welfare, not the government. If they did not have a program like this one I would still be on welfare. I got off in April of this year. My boyfriend wanted me to get married while I was still on welfare but I said no. I did not want him to think I married him just to get off. This last July we got married.

STATEMENT BY
SENATOR JOHN H. CHAFEE
IN
THE SENATE FINANCE COMMITTEE
HEARING ON EXPIRING TAX PROVISIONS
MARCH 28, 1988

Mr. Chairman, I would like to thank you for this opportunity to examine several important provisions of the Internal Revenue Code that have expired or are expiring at the end of this year. I believe that we need to conduct a full examination of the benefits and drawbacks of these programs. We need to provide some guidance as to the likelihood that these programs will or will not be extended, especially for those that expired at the end of 1987.

The mortgage revenue bond program and targeted jobs tax credit are an important part of the state housing and employment programs in my home state. Home ownership is an important part of the American dream and I believe that we need to continue to provide tax incentives for programs that assist lower income Americans in acquiring their first home. We need to reverse the declining home ownership trend that has existed since 1980.

I have reviewed the GAO report on the mortgage Revenue Bond programs around the country. I was very disappointed in the results and conclusions of this study and was troubled by many of the conclusions that were drawn from the data. I understand that this study covered the MRB program from November, 1985 through June, 1987, and was, therefore, based on information, a majority of which came from a period before the program was targeted towards lower income, first-time home buyers.

The report states that with the additional assistance of an Adjustable Rate Mortgage (ARM), 79% of the MRB program participants could have bought the same house, or one within 10% of its purchase price. I received a letter from Mr. Edward E. Lind, the President of Eastland Savings Bank in Woonsocket, Rhode Island, that

CONTRADICTS THIS CONCLUSION WITH REGARD TO THE MRB PROGRAM IN MY HOME STATE. MR. LIND STATES THAT 74% OF ALL APPROVED MRB APPLICANTS WOULD NOT HAVE BEEN ABLE TO OBTAIN A MORTGAGE THROUGH ANY OF THE ALTERNATIVE SOURCES AVAILABLE AT THE EASTLAND SAVINGS BANK. MR. CHAIRMAN, I ASK UNANIMOUS CONSENT THAT THIS LETTER FROM MR. LIND BE INCLUDED IN THE RECORD WITH MY OPENING STATEMENT.

I HAVE RECEIVED MANY OTHER STATISTICS FROM THE RHODE ISLAND MRB PROGRAM THAT ARE IN DIRECT CONFLICT WITH THE GAO REPORT, HOWEVER, I WILL NOT TAKE THE TIME TO DISCUSS ALL OF THEM INDIVIDUALLY AT THIS TIME. MR. CHAIRMAN, I WOULD LIKE TO ASK UNANIMOUS CONSENT THAT A REPORT FROM THE EXECUTIVE DIRECTOR OF THE RHODE ISLAND HOUSING AND MORTGAGE FINANCE CORPORATION BE INCLUDED IN THE RECORD WITH MY TESTIMONY.

I WOULD LIKE TO EXPRESS MY SUPPORT FOR THE EXTENSION OF THE TARGETED JOBS TAX CREDIT. THE RHODE ISLAND EMPLOYMENT AGENCY HANDLED 2,500 REQUEST FOR CERTIFICATION DURING THE JANUARY 1 TO OCTOBER 21, 1986 PERIOD IN WHICH THE CREDIT WAS IN LIMBO. I KNOW THAT THIS CREDIT HAS BEEN AN EFFECTIVE INCENTIVE IN RHODE ISLAND FOR HIRING INDIVIDUALS THAT ARE MEMBERS OF THE TARGETED GROUPS FOR EMPLOYMENT.

THE EXCLUSION FOR EMPLOYER-PROVIDED GROUP LEGAL SERVICES IS ANOTHER IMPORTANT PROGRAM THAT HELPS A WIDE VARIETY OF INDIVIDUALS TO OBTAIN NECESSARY LEGAL SERVICES. IN A TIME OF RISING LEGAL FEES, WHEN THE COST OF ADEQUATE LEGAL REPRESENTATION IS OUT OF REACH OF MANY INDIVIDUALS, I BELIEVE WE NEED TO EXTEND THIS PROGRAM. HOWEVER, I BELIEVE THAT WE NEED TO EXAMINE IT CAREFULLY, TO INSURE THAT THOSE INDIVIDUALS WHO REALLY NEED ASSISTANCE ARE BENEFITING FROM THE PROGRAM. THIS PROGRAM MUST BE AVAILABLE TO INDIVIDUALS AT ALL INCOME LEVELS AND JOB LEVELS WITHIN A COMPANY, AND SHOULD NOT DISCRIMINATE IN FAVOR OF HIGHER INCOME EMPLOYEES.

AGAIN, MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO EXAMINE THESE IMPORTANT AND TIMELY ISSUES AND TO EXPRESS MY VIEWS ON THE PROGRAMS INVOLVED.

Eastland

Eastland Savings Bank
Eastland Bank
25 Cummings Way, P.O. Box B
Woonsocket, RI 02895-0985
401 767-3900 / Prov. 401 272-3810

The Honorable John H. Chafee
United States Senate
537 Dirksen Senate Office Building
Washington, D.C. 20510

March 22, 1988

Dear Senator Chafee:

Although I have not seen the document, I am disappointed to hear that the GAO has recently issued a report which suggests that the mortgages issued through tax exempt bonds by State Housing Agencies for citizens with low and moderate income may not be effective. As an active participant with the Rhode Island Housing and Mortgage Finance Corporation (RIHMFC), we at Eastland Bank have been extremely pleased that there is a vehicle in Rhode Island in which families with low income have been able to obtain affordable housing.

With changes in the federal law and exciting innovative programs created by RIHMFC in recent years, we have witnessed an ever-increasing percentage of the funds available going to the low income people for which this program was originally created. A review of our loan files from the most recent issue by RIHMFC support the effectiveness of the agency. Seventy-four percent of all the approved applicants would not have been able to obtain a mortgage through alternative sources available at Eastland. With house prices continuing to increase in Rhode Island faster than average wages, it is apparent that without these programs these individuals would not be able to purchase affordable housing in the near future.

Eastland Bank strongly supports the need for tax-exempt bond issues to fund affordable housing for low and moderate income citizens. I would appreciate your assistance in Congress to support the future of this worthy program.

Sincerely,

Edward Lind

Edward E. Lind
President

EEL/et

Members F.D.I.C.

Rhode Island Housing and Mortgage Finance Corporation

The General Accounting Office (GAO) has produced a report evaluating the Mortgage Revenue Bond Program. The GAO report is based on data from a sample of MRB assisted mortgages and the first-time home buyers in the 1983 American Housing Survey. In response to this report, Rhode Island Housing and Mortgage Finance Corporation has evaluated its entire portfolio of mortgages since the tax reform act. The Rhode Island data contain all mortgages made between January 1986 and February 1988.

In all cases the GAO data and tables were replicated adding the Rhode Island portfolio. These are attached to the conclusions which follow:

The GAO found little difference between the income of assisted and non-assisted first time homebuyers. In contrast, RIHMFC-assisted households have incomes that are substantially lower than those of the national sample, despite the fact that Rhode Island's median income is higher than the national average. In addition, these incomes in most cases are a result of two-worker households.

The GAO stated that since income increases greatly between the ages of 25 and 35, families simply needed to delay home purchases. Our portfolio indicates that a full 66% of our assisted borrowers were in low skill occupations with little room for advancement and wages typically tied to the minimum. Another 23% were in higher skilled occupations, such as teachers and health care providers, with a long history of low wages. A full 80% of the Rhode Island borrowers will, in all likelihood, never exceed the State's median income.

The GAO characterized assisted borrowers as younger than unassisted first time homebuyers. In addition, the GAO claimed that 50% of the assisted were unmarried The majority of Rhode Island's assisted purchasers are age 30 or over and have one or more children. Unlike the GAO survey, the majority of our recipients were not single, and many of the single recipients were working women with dependent children.

The GAO stated that the majority of assisted buyers would have been able to purchase their homes using conventional financing, and asserted that the remaining households could have gotten conventional financing if they had found homes 10-12% less expensive than the ones they purchased. Our analysis indicates that in Rhode Island, a full 80% of those who were assisted could not have purchased a home without the MRB program. Rhode Island Housing targets houses with purchase prices far below the median price ($89,000 as opposed to $119,000). There are two problems with GAO's contention about buyers being able to afford a home purchased at 10-12% less.

1) Our data indicate that even at purchase prices 10-12% lower, 73% of the households we served would still not have qualified for a conventional mortgage.

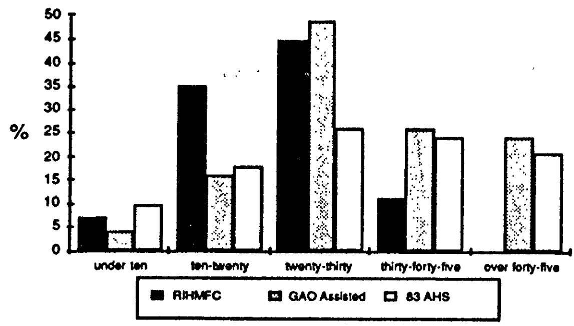
2) Our purchase price limits are already so low that if they were reduced by 10-12% almost no homes would be available in that price range. Only 4% of the homes available last year were in this reduced range.

The GAO suggested that simply by postponement of the home purchase, all assisted purchasers would be able to buy with conventional financing. The Rhode Island housing market has been devastating for first-time home buyers. Prices increased 39.5% in one year. In addition, a rental shortage has boosted rents 181% since 1980. Delaying the purchase has made homeownership out of the question for many Rhode Islanders as prices have risen six times faster than incomes. We might add that Rhode Island borrowers have to spend 28% of their income just to rent an average apartment; this doesn't make it easy to save the additional 25% of income needed for a 5% downpayment on the average home in Rhode Island.

Currently only 23% of all Rhode Islanders have family incomes over $43,000, the income needed to purchase the median priced home in the State.

In conclusion, our analysis shows that without the Mortgage Revenue Bond Program homeownership will not be attainable for a vast majority of Rhode Islanders. The impact of sunset of MRB authority would be devastating to the State of Rhode Island.

Chart 1 First-time Homebuyer Income Comparison

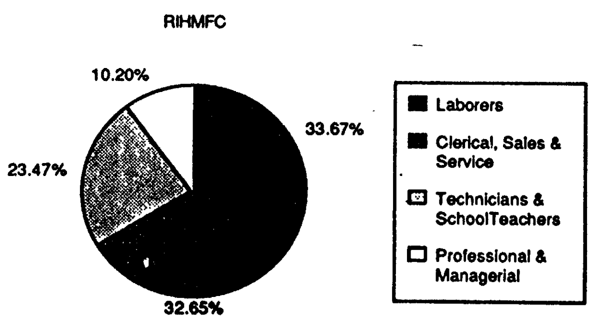


Rhode Island Housing Comments:

- Rhode Island Statewide median: 1987 $31,200
- Median Income: RIHMFC assisted $22,951, or 73% of RI median.
- Over 75% of the Married recipients had two incomes.

Conclusion:
The GAO found little difference between the income of assisted and non-assisted first time homebuyers. In contrast, the Rhode Island portfolio indicates that RIHMFC assisted incomes were substantially lower than those of the national sample, despite the fact that Rhode Island's median income is higher than the national average. In addition, these incomes in most cases are a result of two-worker households.

Chart 2 Occupation of Head of Household



Rhode Island Housing Comments:

• The majority of RIHMFC recipients, 66% were employed as laborers or lower level clerical and service workers. Many were restaurant workers. Traditionally these have been low wage positions with little opportunity for advancement and or wage increases exceeding the cost of living index.

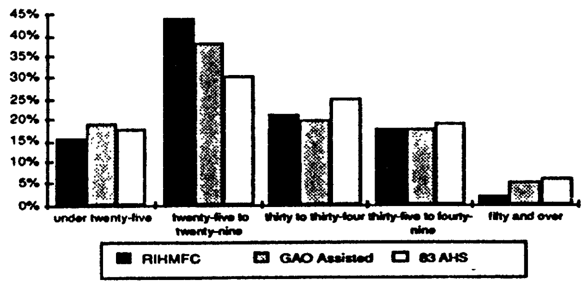
• An additional 23% of recipients were employed as school teachers or technicians, in particular many were X-Ray and health care technicians. While these occupations require a great deal of skill, wage levels are traditionally below the median.

• A full 80% of the recipients will in all probability never exceed the Statewide median income.

Conclusions:

The GAO stated that since income increases greatly between the ages of 25 and 35, families simply needed to delay home purchases. The Rhode Island portfolio indicates that a full 66% of recipients were in low skill occupations with little room for advancement and wages typically tied to the minimum. Another 23% were in highly skilled occupations, such as teachers and health care providers, with a long history of low wages. A full 80% of the Rhode Island portfolio will, in all likelihood, never exceed the State's median income.

Chart 3 Age Distribution



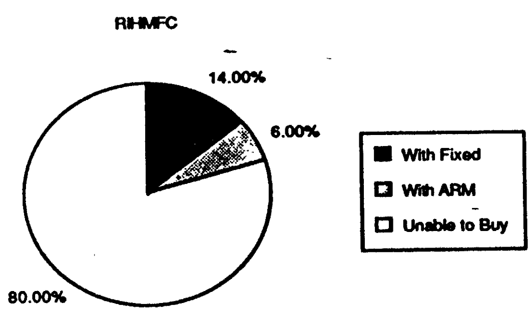
Rhode Island Housing Comments:

• RIHMFC recipients median age was 30 years.
• There were no recipients under the age of 20 years.

Conclusion:

The GAO characterized the MRB assisted as younger than unassisted first time homebuyers. The Rhode Island portfolio indicates that they are no younger than the unassisted national portfolio, with a median age of 30 years.

Chart 4 Ability to Purchase



Rhode Island Housing Comments:

• Even if recipients were to reduce by 12% the cost of the home purchased, only a total of 27% would be able to qualify for either an ARM or Fixed mortgage.

• A 12% cost reduction would bring the purchase price down to $66,000 only 3.7% of Rhode Island homes sold at or below this figure in 1987.

• Over half of Rhode Island recipients were married with at least one child and 30 years of age or older.

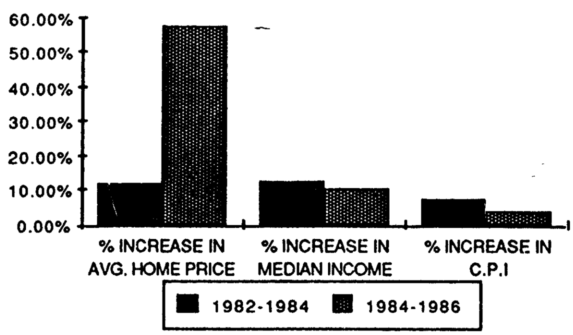
Conclusion:

The GAO stated that the majority of assisted buyers could have purchased using conventional financing and all others could have purchased a 10-12% less expensive home using conventional financing. In addition the GAO claimed that 50% of the assisted were unmarried.

The Rhode Island portfolio indicates that a full 80% of those assisted could not purchase without the MRB Program. Even reducing the purchase price by 12% a full 73% could not purchase without the MRB program. This 12% reduction results in a purchase price so low that fewer than 4% of the homes in the State would be available.

The Rhode Island portfolio indicates that the majority of purchasers are age 30 or over and have one or more children. Unlike the GAO survey the majority of our recipients were not single, however, many of the single recipients were working women with dependent children.

Chart 5: Rhode Island Percentage Increase of Home Prices, Income and CPI 1982-1986



Source: RI Department of Administration;MLS; HUD, EMAD Division; U.S.Dept of Labor

Rhode Island Housing Comment:

• The average purchase price of $75,156 for RIHMFC assisted is only 63% of the current statewide median purchase price.

• Only 6.2% of the homes sold in Rhode Island in 1987 were at or below the average.RIHMFC purchase price.

• The median priced home in Rhode Island sold for $119,000 in 1987.

• The average purchase price of a home in Rhode Island has risen six times faster than median incomes in the state.

• The state has a shortage of rental units in excess of 12,000 currently, which has caused rents to increase over 181% since 1980.

• The average rent in Rhode Island is so high that our average recipient has to devote 28% of income to rent an apartment. It would take another 26% of income to make a 5% downpayment on an average home. In one year the average purchase price of a home in Rhode Island increased by 39.5%. It is clear that without the Mortgage Revenue Bond Program, those assisted would in all likelihood never become homeowners.

• To purchase the average home in Rhode Island with a conventional mortgage requires a minimum income of $43,222 currently. Only 23% of all Rhode Islanders have a family income over $43,000.

• Only 9% of loans were for new construction, mainly condominiums.

• Only 75% of loans were for single family detached homes.

Conclusion:

The GAO found that 40% of the loans were for new construction and 90% were for single family detached homes.

The Rhode Island portfolio was substantially different with only 9% new construction, the majority of which were attached condominiums, and only 75% single family detached homes.

The GAO suggested that simply by postponing the home purchase, all assisted purchases would be able to buy with conventional financing.

The Rhode Island housing market has been devastating for first-time home buyers. Prices increases 39.5% in one year. In addition, a rental shortage has boosted rents 181% since 1980. The Rhode Island assisted have to spend 28% of their income just to rent an average apartment, this doesn't make it easy to save the additional 25% of income needed for a 5% downpayment on the average home in Rhode Island. Delaying the purchase has made homeownership out of the question for many Rhode Islanders as prices have risen six times faster than incomes.

Only 23% of all Rhode Islanders have family incomes over $43,000, the income needed to purchase the median priced home in the State.

In conclusion, our analysis shows that without the Mortgage Revenue Bond Program homeownership will not be attainable for a vast majority of Rhode Islanders. The long term impact of this situation would be devastating to the State of Rhode Island.

91-401 O - 89 - 4

TESTIMONY OF

DAVID C. COOKE
DEPUTY TO THE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

Good morning, Mr. Chairman and members of the Subcommittee. I am David Cooke, Deputy to the Chairman of the Federal Deposit Insurance Corporation ("FDIC"). I appreciate the opportunity to testify today on an issue of importance to this nation's federal deposit insurance funds.

My appearance here today is for two purposes. First, I urge the Congress to extend the tax provisions governing the tax treatment of financial assistance transactions and reorganizations of troubled thrift institutions by the Federal Savings and Loan Insurance Corporation ("FSLIC"). The FSLIC is working diligently to solve the serious problems it faces. The stability of our financial system and public confidence in that system requires that every effort be made to minimize the cost to the FSLIC insurance fund. Extending these tax provisions will provide a significant benefit for the FSLIC as it proceeds with its important task.

Second, I also recommend that those same provisions be extended to comparable transactions of the FDIC. Extension of these provisions to the FDIC will eliminate present confusion concerning the tax treatment of these transactions and permit the FDIC to more effectively perform its role in the financial system. This can be done, we believe, while producing a net positive impact on the budget due to the reduction in outlays for the FDIC.

The FDIC was established by Congress in 1933 for the primary purpose of restoring public confidence in banks by establishing a system of federal deposit insurance. The FDIC fund currently insures the deposits of millions of Americans in over 14,000 commercial and savings banks. The FDIC has served the nation and this nation's bank depositors well throughout the 55 years of its existence.

We now are facing the greatest challenge in the history of the FDIC. During 1987, 184 banks failed and 19 more required assistance in order to stay open. This is the greatest number of bank failures and assistance transactions in any single year since the FDIC began operation. The record 184 failures in 1987 eclipsed the prior record of 138 bank failures in 1986, which was up from 116 in 1985. These numbers are in clear contrast to an average of about 10 closings per year throughout most of the post-World War II period. The FDIC is experiencing another record or near record year in 1988 and does not foresee a significant reduction in its responsibilities in the foreseeable future.

Let me briefly explain the FDIC's role in a bank failure. The determination of whether an insured bank is insolvent is made by the Comptroller of the Currency in the case of national banks and by the state banking authority in the case of state chartered banks. Typically, after such a determination has been made and the bank is closed, the FDIC is appointed receiver for the failed bank.

When a bank's failure is imminent, the FDIC must consider how it will discharge its obligations as both the insurer of the bank's deposits and the likely receiver of the failed bank. Although the response of the FDIC to each possible bank failure has its own unique characteristics, there are generally three categories of alternatives available. First, the FDIC can consider direct financial assistance to keep the bank from failing. This approach is available only if the Board of Directors of the FDIC finds that the assistance required is less costly to the FDIC fund than any other alternatives available to the FDIC or that continued operation of the bank is essential to provide adequate banking service in the community. When financial assistance is provided to keep a bank open, outside investors usually join with the FDIC in recapitalizing the bank to insure its continued viability.

The second alternative available to the FDIC is a direct payoff of the insured deposits. In this situation the bank is closed and the FDIC is named receiver. The depositors are paid off up to the $100,000 limit of insurance protection and the institution is liquidated. Depositors above the insurance limit are paid, to the extent possible, only after the failed bank's assets are liquidated. A variation of a direct payoff is when insured deposits are transferred to another bank which acts as paying agent for the FDIC. A direct payoff is the least desirable, and usually most costly, alternative. It results in an interruption of vital banking services to the community served by the failed bank. In addition, because the failed bank's main office and branches are permanently closed, virtually all of the failed bank's employees lose their jobs.

The third and most prevalent alternative is a "purchase and assumption" transaction. Under this alternative, which can be structured in several ways, a healthy bank assumes all of the failed bank's deposit liabilities, including uninsured deposits, and agrees to acquire some or all of the failed bank's assets. The assuming bank receives an infusion of cash from the FDIC to make up the difference between the value of the assets and the liabilities assumed. The current FDIC policy is to try to arrange, wherever possible, so-called "whole bank" transactions where the assuming bank acquires all of the assets of the failed bank, including the bad loans.

A new temporary solution now available to the FDIC is a "bridge bank." In this case, the FDIC can operate the failed institution, for up to three years, until a buyer can be found.

Under current law, these various categories of assistance transactions have uncertain, but significant, tax consequences. The Congress has under consideration an extension of several tax provisions which apply to financial assistance payments and reorganizations of failed or failing thrift institutions by the FSLIC. These provisions are scheduled to expire December 31, 1988. The FDIC strongly supports legislation to either extend or make permanent those provisions for the FSLIC.

The FDIC performs a role with respect to the banking sector that is comparable to the FSLIC's responsibilities relative to the thrift industry.

Like the FSLIC, the FDIC now faces serious stresses due to the record volume of bank failures. Thus, to the extent that the Congress extends the FSLIC's tax provisions, the FDIC recommends that these same provisions be made applicable to the FDIC.

We believe that extending these provisions to the FDIC would have important and positive ramifications for the FDIC, the banking system and the nation. The provisions would reduce the confusion relating to the tax treatment of FDIC assistance, thus facilitating the most efficient resolution to a bank insolvency. They would reduce the cost of assistance and purchase and assumption transactions, thereby helping to preserve the insurance fund. The resulting increased use of assistance or purchase and assumption transactions would enhance the stability of the banking system and help insure adequate banking services to all communities.

The FDIC is very aware that cost is an important concern. Extending these provisions to the FDIC will have the net effect of reducing the deficit, because the benefits largely would accrue to the deposit insurance fund. We estimate that yearly reductions in FDIC outlays could range from $435 million to $870 million. Moreover, while the reduction in FDIC outlays would be recognized fully at the time of the transaction, any tax revenue cost would be stretched out over a number of years. In the final analysis, we believe the reduction in outlays will exceed whatever tax revenue cost is associated with these provisions.

Generally, there are three provisions being sought. The first provision, Section 597 of the Code, specifically clarifies that FSLIC assistance payments, whether provided through a note or other instrument, are not includable in income of the assisted institution. In addition, Section 597 provides that no reduction in the basis of assets of the recipient institution will occur as a result of the receipt of such assistance.

Section 597 was enacted by the Congress in 1981 to clarify the tax treatment of FSLIC assistance. Extending the application of Section 597 to

FDIC assistance transactions will eliminate the confusion that often arises concerning the tax treatment of these transactions. The law in this area is unclear and the transactions frequently are complicated. The FDIC assistance may be structured in a variety of forms including, but not limited to, direct cash infusion, the purchase of notes or the purchase of non-voting preferred stock. Because these transactions often must be consummated quickly, parties to the transaction usually assume the worst-case tax result, thus driving up the cost to the FDIC of rescuing a bank.

This provision would facilitate purchase and assumption transactions and interim bridge bank transactions. These methods of handling bank failures are highly preferable to closing the bank and paying off the insured depositors with the concurrent loss of jobs and banking services in the community. Moreover, such an approach minimizes the negative impact on public confidence in the banking system and thus helps stabilize the banking industry.

The second expiring provision, Section 368(a)(3)(D)(ii) of the Code, provides that a FSLIC assistance transaction may qualify as a tax free reorganization provided that certain requirements are satisfied. FSLIC must certify that the institution is insolvent, that it cannot meet its obligations currently or that it will be unable to meet its obligations in the immediate future. In addition, substantially all liabilities of the failed institution must be assumed by the acquiring institution.

This section was originally enacted in 1981 to eliminate ambiguity with respect to the continuity of interest requirements which apply generally to tax free reorganizations. It represents a significant benefit to the FSLIC in merging troubled thrift institutions with healthy thrifts. If extended to the FDIC, it would perform a similar beneficial role by significantly improving prospects for a purchase and assumption transaction in a given case, rather than a depositor pay-off and liquidation of the failed bank.

The third expiring provision is Section 382(l)(5)(F). It provides rules governing the treatment of net operating losses of a failed thrift institution with deposit liabilities that have been assumed by a healthy thrift. As a general rule, current law provides special rules for the preservation of net operating losses in Chapter 11 bankruptcy situations. The rules provided by Section 382(1)(5)(F) make it easier for the receiver of failed thrift institutions to preserve the failed thrift's net operating losses and thereby reduce the cost to the insurance fund. The FDIC would propose that if these provisions are to be extended, their benefits also be made applicable to similar transactions by the FDIC.

Mr. Chairman, I would like to raise one additional issue not encompassed by the FSLIC provisions. We would like to suggest that the Congress consider an administrative proposal to facilitate the access of the FDIC, as the receiver of failed institutions, to tax refunds to which the FDIC is entitled. This proposal addresses a problem which arises where the FDIC becomes receiver of a bank which was previously part of a bank holding company filing a consolidated federal income tax return. Under our proposal, the FDIC would be permitted to seek directly the refund to which it is otherwise entitled as receiver for the bank by permitting the FDIC to terminate the consolidation and file for the refund directly. This would eliminate a problem frequently faced by the FDIC when the representatives of the holding company of a failed bank seek refunds which are properly due to the failed bank and dissipate them before the FDIC can recover the funds.

Mr. Chairman, thank you for allowing me to testify on this issue. We are available to provide whatever assistance you require in considering these proposals.

STATEMENT OF JOHN "JACK" CURRAN, LEGISLATIVE DIRECTOR, LABORERS' INTERNATIONAL UNION OF NORTH AMERICA, AFL-CIO

March 28, 1988

Mr. Chairman, my name is John Curran and I am Legislative Director of the Laborers' International Union of North America, AFL-CIO.

The Laborers' International Union strongly supports pending legislation which would reinstate and make permanent the exclusion from employee taxable income of contributions by employers to group legal service plans under Section 120 of the Internal Revenue Code.

Our Union is uniquely qualified to testify on issues affecting this important benefit for workers. Beginning as far back as 1971, we pioneered in the development of group legal service plans in the belief that access to legal services was as important to our members as medical care and pension benefits.

Seventeen years later, we are convinced that we made the right decision. Thousands of workers every year find that they are able to get competent legal help through negotiated group legal services plans on serious family, financial, housing and consumer problems. Workers, whose family incomes would not otherwise allow them the luxury of retaining a lawyer, are able through these plans to use the justice system to assert their rights and seek remedies.

What we have been able to accomplish through qualified group legal service plans is precisely what Congress intended when it enacted Section 120 in 1976. By placing legal services in the same tax category as other statutory benefits, it established the public policy principle that employers and unions should be encouraged to work out means to make basic legal services available to workers.

Section 120 was originally enacted as a five-year experiment. Policy makers were concerned about whether the benefit would wind up accruing only to highly-paid executives, whether employer contributions would be insufficient to finance the arrangement and whether inflationary pressures would escalate the cost of legal service plans as has happened in the case of medical care.

But in considering Section 120's fate in 1981, Congress agreed that none of these evils manifested themselves during the five-year trial period. In fact, legal service plans were shown to benefit low and moderate income workers on a non-discriminatory basis. The modest funding formula used to finance these plans not only was shown to provide more than adequate financial support, but costs barely increased during the period. In light of this record, Congress enacted legislation to extend the provision for three more years. It reaffirmed its position in 1984 with a one-year extension and again in 1986 with a two-year retroactive extension as part of the Tax Reform Act.

The result? There are now approximately 2.5 million workers covered by qualified group legal service plans at an average cost of $89 per worker per year. Since these plans also provide access to essential legal services for family members, a total of 6.3 million Americans are now affected by the Congressional policy which Section 120 embodies.

Mr. Chairman, as many members of this sub-committee know, I have been involved in supporting this concept on behalf of the Laborers' Union for over 15 years. In my many discussions with members of Congress over the years, I have found no substantial opposition to the idea of group legal service benefits for workers. Moreover, in addressing the issue of Section 120's permanence in 1981, 1984, 1985, and 1986, our Union's position has enjoyed the unqualified support of other national and international unions, the AFL-CIO, the legal profession, the insurance industry and consumer groups.

With this record of support both from within Congress and underwriters of group legal service plans, why then do I find myself appearing before you today asking for the permanent reinstatement of this widely supported provision of the tax code? The answer to this question in reality deals not with the merit of Congress's judgement in enacting and repeatedly extending Section 120.

Rather, in considering this issue, we find ourselves caught up in a debate about whether allowing Section 120 to expire will contribute to alleviating the federal budget deficit. The Office of Management and Budget estimates that the tax expenditure associated with Section 120 is $75 million for 1987. Assuming that this figure is accurate, we take the position that the provision of legal services to 6.3 million Americans is certainly worth 0.0075% of the federal budget.

But more importantly, the entire argument that the elimination of Section 120 would cause the treasury to recoup even this small amount of tax revenue is based upon a false assumption. Those who would make this argument assume that absent statutory employee benefit status, employers would continue to make taxable contributions to group legal service plans or would alternatively shift the amount of the contribution to other forms of taxable compensation.

However, I can tell you that in today's world of scarce benefit dollars, this outcome is improbable. Union and employers see statutory employee benefits as an efficient means of providing those basic health and welfare services which enable the worker to remain on the job and productive. Our long experience in collective bargaining tells us that in the absence of Section 120, both employers and our negotiators will reallocate legal service plans pre-tax employer contributions to the remaining statutory benefits rather than to taxable compensation.

The net result, then, of Section 120's demise? 2.5 million workers and members of their families now covered by legal service plans would lose their legal service coverage, hundreds of employers and unions now looking at this inexpensive and non-inflationary benefit would abandon their efforts in favor of higher cost options, and the Federal government would net not one dime of additional revenue.

Mr. Chairman, the Laborers' International Union has worked long and hard to establish wage rates, working conditions and fringe benefits which allow our members to lead productive lives and to enjoy the rights, privileges and benefits which our American society offers to all its citizens. Congress has wisely provided a statutory framework under the tax laws which support the underlying philosophy of our efforts. Section 120 is part of that framework -- one which has proven effective in carrying out public policy without adding to the cost of government.

We therefore urge that legislation which would reinstate and make permanent Section 120 currently before both Houses of Congress, S. 2119 in the Senate and H.R. 1810 in the House, be adopted as swiftly as possible to preserve a law whose demise benefits no one.

STATEMENT OF SENATOR PETE V. DOMENICI

BEFORE THE SENATE FINANCE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

ON MORTGAGE REVENUE BONDS

MARCH 28, 1988

Mr Chairman and members of the Subcommittee, I want to thank you for the opportunity to share my views with you today. I would like to make a brief statement in support of tax exempt mortgage revenue bonds.

States and local governments have issued tax exempt bonds to finance home ownership for more than a decade. Under current law, the Federal government will no longer treat interest on these bonds as tax exempt after the end of this year. I believe that the mortgage bond program should be continued and that the termination date in the current law should be repealed.

We have a growing problem in the country Mr. Chairman, and that is the problem of housing affordability. A report issued by Harvard University documents this fact. It finds that there has been a sharp increase since 1980 in the number of Americans who cannot afford adequate housing.

The Harvard researchers stressed that the housing problems of different groups are interrelated. Young families who cannot afford to buy homes have stayed in rental housing, which has pushed up rents and squeezed out lower income renters. This in turn has contributed to the problem of homelessness.

In this environment, I find it remarkable that we are once again questioning whether to continue the tax exemption on mortgage bonds. It seems to me we need this first-time homebuyer program now, more than ever.

It is not a choice between this and some other program. This is the only choice we have. We all know there is no room in the budget for any new direct spending program for homeownership.

Even without the constraints on the spending side of the budget, I would still support mortgage revenue bonds. That is because it is the one housing program we have which relies exclusively on state and local governments. I believe it is the one of the best examples of federalism around.

Now I understand that the Joint Committee on Taxation has produced a preliminary estimate which shows that continuing mortgage bonds would reduce the revenue of the federal government by $10 million in FY 1989 and some $845 million over five years. Let me make it clear that I would not support extending this or any other expiring provision without an appropriate offset. But I also question the basis for the estimate in this case.

The 1986 Tax Reform Act sets a state ceiling for "private activity bonds" and included mortgage bonds under that cap. We imposed a volume cap because of concern about an explosion in tax-exempt financing for all sorts of purposes. The thinking seemed to be that state and local governments had an insatiable appetite for these programs which could only be contained with a volume cap.

Now as I understand it, the estimate produced by the Joint Tax Committee assumes that, if the tax exemption on mortgage bonds is eliminated, states will not issue up to their cap. This strikes me as highly questionable. If there is so little demand for tax-exempt financing, then why did we impose a cap at all?

Most people believe that the ceilings established in the 1986 act will in fact constrain state and local bond programs. That was not the case in 1987 because of the transition problems. But past history suggests that states would find other uses for tax exempt financing under the cap, which means there would be no revenue effect.

On balance, I believe that the decision made in the 1986 tax bill was a wise one -- put all private activity bonds in one pot, set a limit, and let the states decide how to use it. I believe that encouraging homeownership is as important a public purpose as any.

Mr. Chairman, we have been grappling with the issue of tax-exempt financing for home ownership since the 1970's. We have encumbered state and local issuers with new and increasingly tighter restrictions in 1980, 1984, and again in 1986. Now we should leave the program alone and let it operate.

Mr. Chairman and members of subcommittee, I urge you not to let this tax exemption on mortgage bonds lapse.

STATEMENT OF SENATOR JOHN HEINZ

MR. CHAIRMAN: I WELCOME THIS OPPORTUNITY TO COMMENT ON THE EXPIRING PROVISIONS IN THE TAX CODE.

WHILE I SUPPORT NEARLY ALL OF THE EXPIRING PROVISIONS, I WOULD LIKE TO DISCUSS TWO OF THE PROVISIONS, TARGETED JOBS TAX CREDITS, AND THE EXCLUSION FOR EMPLOYER-PROVIDED GROUP LEGAL SERVICES. TARGETED JOBS TAX CREDITS WAS ORIGINALLY ENACTED IN 1978. WE HAVE HAD TO EXTEND THE BILL EVERY COUPLE OF YEARS SINCE THEN. AS THE AUTHOR OF THE EXTENDER BILLS, I HAVE BEEN ONE OF ITS STRONGEST ADVOCATES. IT IS TIME WE MADE THE PROVISION PERMANENT. S. 684 WOULD MAKE THE PROVISION PERMANENT.

ONE OF THE FEW SUCCESSFUL PROGRAMS TO INDUCE THE PRIVATE SECTOR TO EMPLOY AND TRAIN THE STRUCTURALLY UNEMPLOYED IS THE TARGETED JOBS TAX CREDIT PROGRAM (TJTC). IN 1985 ALONE, THE PROGRAM RESULTED IN OVER 625,000 PEOPLE GAINING EMPLOYMENT - MOST OF WHOM WERE ON FEDERAL OR STATE ASSISTANCE PROGRAMS OR CAME FROM ECONOMICALLY DISTRESSED FAMILIES.

TJTC ENCOURAGES EMPLOYERS TO HIRE A SELECT TARGETED GROUP OF PEOPLE, AND PROVIDES A CREDIT EQUAL TO 40% OF THE FIRST $6,000 OF QUALIFIED FIRST-YEAR WAGES PAID TO THIS GROUP. THIS GROUP CONSIST OF 1. VOCATIONAL REHABILITATION REFERRALS; 2. ECONOMICALLY DISADVANTAGED YOUTHS AGED 18 THROUGH 24; 3. ECONOMICALLY DISADVANTAGED VIETNAM-ERA VETERANS; 4. SUPPLEMENTAL SECURITY INCOME (SSI) RECIPIENTS; 5. GENERAL ASSISTANCE RECIPIENTS; 5. GENERAL ASSISTANCE RECIPIENTS; 6. ECONOMICALLY DISADVANTAGED COOPERATIVE EDUCATION STUDENTS AGED 16 THROUGH 19; 7. ECONOMICALLY DISADVANTAGED FORMER CONVICTS; 8. AID TO FAMILIES WITH DEPENDENT CHILDREN (AFDC) RECIPIENTS AND WORK INCENTIVE (WIN) REGISTRANTS; AND 9. THE ECONOMICALLY DISADVANTAGED SUMMER YOUTH EMPLOYEES AGED 16 TO 17. TARGETED GROUP MEMBERSHIP MUST BE CERTIFIED.

BECAUSE THE ABOVE GROUP HAVE HAD LITTLE IF ANY WORK EXPERIENCE, PRIVATE SECTOR EMPLOYERS ARE OFTEN UNWILLING TO EXPEND THE RESOURCES NECESSARY TO TRAIN THEM UNLESS THEY RECEIVE SOME ASSISTANCE. THE CREDIT ENCOURAGES EMPLOYERS TO HIRE STRUCTURALLY UNEMPLOYED AND OVERLOOK CHARACTERISTIC OBSTACLES SUCH AS TARDINESS, ABSENTEEISM, OR PHYSICAL AND MENTAL HANDICAPS DURING THE FIRST WEEKS OF WORK.

I HAVE HELD SEVERAL HEARINGS ON THIS SUBJECT, AND HEARD TESTIMONY FROM THE INDIVIDUALS WHO HAVE OBTAINED EMPLOYMENT BECAUSE OF TJTC. THESE INDIVIDUALS TOLD HOW THEY HAD LOOKED REPEATEDLY FOR JOBS, AND WERE UNSUCCESSFUL. THEY TOLD ME THAT IF HADN'T BEEN FOR TJTC, THEY WOULD STILL BE LOOKING FOR JOBS. TJTC INVOLVES NO RED TAP FOR THE EMPLOYERS,

AND YET IT PROVIDES THE INCENTIVE NEEDED TO GIVE THIS GROUP OF PEOPLE A CHANCE.

THE COMMITTEE WILL ALSO HEAR TESTIMONY TODAY REGARDING THE EXCLUSION FOR EMPLOYER-PROVIDED GROUP LEGAL SERVICES. SENATOR MOYNIHAN AND I INTRODUCED S. 2119, WHICH WOULD MAKE SECTION 120 OF THE INTERNAL REVENUE CODE PERMANENT. THAT PROVISION, WHICH WAS ORIGINALLY ENACTED IN 1976, PROVIDED FAVORABLE TAX TREATMENT FOR EMPLOYER-PAID LEGAL SERVICES PLANS. IT EXPIRED AT THE END OF 1987.

LEGAL SERVICE PLANS FILL AN IMPORTANT NEED YET THEIR COST IS VERY MODEST. EMPLOYER PROVIDED GROUP LEGAL SERVICES HAS PROVEN ITS EFFECTIVENESS IN STIMULATING THE GROWTH OF LEGAL SERVICE PLANS AT MINIMAL COST IN FOREGONE REVENUE. ABOUT 10 MILLION PEOPLE ARE PRESENTLY COVERED BY A PLAN. IN 1983 THE REVENUE LOSS WAS ONLY $25 MILLION. LEGAL SERVICE PLANS HAVE SHOWN THAT THEY DESERVE EQUAL TAX TREATMENT WITH OTHER STATUTORY FRINGE BENEFITS.

WHILE, I HAVE ONLY DISCUSSED 2 OF THE BILLS BEING DISCUSSED HERE TODAY, I WANT TO ASSURE EVERYONE, THAT I SUPPORT THE EXTENDER BILLS FOR MORTGAGE REVENUE BONDS, EMPLOYER EDUCATION ASSISTANCE ACT AND THE RESEARCH AND DEVELOPEMENT TAX CREDIT. ALL OF THESE ITEMS NEED TO BE EXTENDED IN A TIMELY FASHION.

THANK YOU MR. CHARIMAN.

STATEMENT OF SENATOR JOHN F. KERRY
BEFORE THE SENATE FINANCE COMMITTEE
MARCH 28, 1988

Mr. Chairman, I would like to commend you for scheduling a hearing on this important issue, namely, the future of the Mortgage Revenue Bond Program.

Owning your own home has long been a part of the classic American Dream. In the Housing Act of 1949, Congress established as national policy the goal of providing "a decent home and suitable living environment for every American." That promise has been reiterated by every single housing act passed by the Congress since that date.

With affordable housing, families are stable and can raise healthy, happy children. First time homeowners are able to develop equity, as well as forward looking, future oriented, saving and investment habits. Strong families build communities with pride, pride which is needed for many American middle and lower income neighborhoods to bounce back from their ills and to prosper.

The MRB program is vital because it puts otherwise unaffordable housing within reach for many low and middle income Americans. MRBs help American Dreams become American realities. With the MRB program, we continue the commitment the Federal Government made to housing in the post-war era. Of course, the commitment I am talking about is the VA loan program, with which millions of Americans were provided with below market rate loans and down payment opportunities.

As you are aware, many middle and lower income Americans are finding it harder and harder to find affordable housing today in the 80's. MRBs have served well as a solution, but the program is now in jeopardy. I am here today to impress upon the committee the urgency of extending this program until 1992, as the bill (S. 1522) allows.

This urgency comes from the growing disparity between housing costs and incomes in the United States. In 1949, the average 30 year old man could carry a median-price home for 14% of his gross monthly pay, and over the next ten years he would see his income increase by 63% in real terms. However, a similar 30 year old man in 1973 paid 21% of his monthly pay for a median house, and on average saw no increase in salary after inflation.

But by 1984, this disparity had grown to truly shocking proportions. The average-income 30 year old, earning $17,520 annually, had to devote a full 44% of his gross monthly income to carry a median-price home. Certainly the situation for those earning less than median incomes must be taken even more seriously.

In my home state of Massachusetts, a man or woman like the one used in these examples would be a prime target for our MRB program. In Massachusetts, the Massachusetts Housing Finance Agency uses the tax exempt bonds to finance low interest mortgage loans, among other things. Additionally, the Agency arranges down payments for homebuyers that are traditionally lower than the market rate payments. In fact, between 1985 and 1987, 57% of buyers in the program made downpayments of less than 10%.

The Agency also combines MRB proceeds with other private and public funds to finance the Homeownership Opportunity Program. Money from this program can reduce Agency loans by as much as three percent.

The Homeownership program also encourages developers to build cheaper homes, so that they are affordable for those in still lower income brackets. Communities themselves help out with these efforts by speeding up building permit applications, rezoning, and contributing property.

In a development created with Homeownership Opportunity Program money, at least 30% of the homes are designed to cost an average of $75,000 or less. This price is affordable to those earning between $20,000 and $30,000 annually. The homes are then kept affordable for future buyers with resale restrictions.

Building has not yet begun on most of these Homeownership Opportunity developments, since the program began only recently in 1986. However, the Massachusetts Housing Agency has said they have already received applications for 99 projects. If we in Congress do not continue the existence of MRBs, from which the Opportunity Program gets needed funding, the completion of these developments will be threatened.

Of course, there are many other reasons for Congress to extend the MRB program. Chief among them is the fact that MRBs are a sound economic investment. According to figures the Massachusetts Housing Finance Agency supplied to me, drawn from their own studies and those of the National Council of State Housing Agencies, every $1 billion issued in MRBs results in financing for over 9000 new homes. This construction can create nearly 12,000 jobs, as well as upwards of $85 million in federal tax revenues and $15 million in state and local tax revenues. A study by the Massachusetts Agency shows that in our state, building 1000 homes creates about 650 jobs, $6.5 million in federal tax revenues and $4 million in local.

But the most important beneficiaries of the MRB program are the people themselves. Two thirds of the recipients of MRB loans in Massachusetts are between the ages of 25 and 35. This age group is important, because in this group first time home buyers are usually found.

These people are forming families and launching careers. They do not have the resources to make the massive down payments and keep up with the high interest rates that they would encounter on the open housing market. Indeed, three quarters of the borrowers in the Massachusetts program earn less than the median income.

But when we discuss first time homebuyers, one of the targets of the MRB program, we find ourselves again discussing economics. Kent Colton, the executive director of the National Association of Home Builders, said in a February

Better Homes and Gardens article on America's Commitment to Housing, "Without first-time buyers, the whole housing chain breaks down...We need them to buy our homes so we can move up."

Economics come up again when we consider that the New England experience could occur in other parts of the country. Boston Mayor Raymond Flynn says the greatest threat to New England's economy is the lack of affordable housing. As explained in a January 31st article in the Boston Globe, corporations are considering contracting some of their work outside of New England. The reason: New England lacks the workers the corporations need. Workers are reluctant to move to New England because they simply can't afford to resettle in the region's expensive homes. One study showed the average price of a home in Boston during 1987 was $181,600. The average income was $23,148, but the income needed to support the average priced house was $60,926.

In the same Globe article, Pamela Plumb has a similar story. Ms Plumb, who is the president of the National League of Cities and a member of the City Council in Portland, Maine, says that in Portland, the average price of a home was $122,000 in 1987. That figure compares to only $41,220 in 1980. Ms Plumb says that 80% of Portland's population earns less than the annual salary required to support one of the 1987 homes.

It is people like the ones who make up the Portland 80% that we should consider in voting to continue the MRB program. It is part of the American Dream to own your own home, and as more and more lower and middle class Americans are shut out from that dream, Congress must show its concern and act. I trust that I have shown you how the MRB program can help people reach the modest goal of being owners of inexpensive homes, and I hope that this committee will recommend passage of Senate Bill 1522.

Thank you, Mr. Chairman, for your attention.

Committee on Finance

Betty Kindness

Mr. Chairman, Members of the Committee, my name is Betty Kindness, Director of Human Relations for Dayton Hudson Department Store headquartered in Minneapolis, Minnesota.

We are one of 5 operating businesses of the Dayton Hudson Corporation, a 10.4 billion dollar corporation.

DHDSC is a retail department store with a sales of approximately 1½ billion. We consist of 37 locations with an employee base of 25,000 in 7 states.

I'm here today to talk to you about a program called Jobs Plus. We are very excited about Jobs Plus. TJTC was one of the important aspects of developing the program. I am not going to go into the specifics of the program because Colleen R. Brown will do that.

But I would like to share some background information with you.

For four years, our company has had as its community focus "Young Women at Risk". We also understood that there would be a shortage of entry level employees. These two issues became the basis for Jobs Plus.
In 1985 we created a partnership with the 2 community organizations to provide additional job readiness training for two target populations:

1) teen moms who were at-risk for long-term welfare dependency and second pregnancies and
2) high school students who were at-risk for pregnancy and dropping out of school.

Now in its third year, the program has proven to be successful in enabling participants to make major life changes. We at DHDSC think it is successful too because:

- It has given us a new segment of the workforce from which to recruit
- Our managers have 1st hand experience in hiring and supervising the new workforce (something we said we wouldn't do)
- Loyal employee/employer relationship

To date 150 young ladies have gone through the program and we have had a success rate of 60 to 65%.

The success rate is based upon meeting 3 out of 4 of the established criteria:

° Education

° Employment

° Reduction in public assistance

and

° no subsequent pregnancies

Jobs Plus is funded in two ways.

1) We have a grant from our foundation that covers the maintenance and training of the program.

and

2) We utilize the TJTC tax credit in order to relieve payroll expense in our stores.

Both of the young ladies here today were eligible for tax credits and are enjoying a very successful career with us. And now I'd like for Colleen to tell her story. Diedre L. Kidd, another successful program graduate is here today too.

United States General Accounting Office

Testimony

Statement of
John H. Luke, Associate Director
Resources, Community, and Economic
Development Division

Before the
Subcommittee on Taxation and Debt Management
Committee on Finance
U.S. Senate

Mr. Chairman and Members of the Subcommittee:

We appreciate this opportunity to discuss whether to extend the issuance authority for qualified mortgage bonds. As you know, we have just completed an extensive study for the Joint Committee on Taxation of the home ownership opportunities afforded by this tax-exempt financing method.[1] My remarks today summarize our findings.

I will preface my remarks by saying that our findings are not a criticism of housing agencies per se, but rather reflect the limited ability of bond-financing to provide assistance to first-time home buyers. That is, the tax-exempt financing mechanism is limited to providing a small subsidy. Thus, qualified mortgage bonds cannot be expected to make more than a marginal difference in affordability, despite the best efforts of the housing agencies that issue them.

Further, and not surprisingly, given the small subsidy provided, we found that financing below-market mortgage loans through tax-exempt borrowing does little to increase home ownership opportunities. The profile of those who received assistance strongly suggest that most of these assisted home owners would have been likely to become home owners if bond assistance had not been available. Also, most of these assisted buyers could have probably qualified for the same size, or slightly smaller, conventional loan at the time they received a bond-assisted mortgage.

Aside from helping many buyers who do not need assistance, qualified mortgage bonds are inefficient. Home buyers, on average, receive only about 36 to 39 cents in benefits for every dollar in tax revenue foregone. Moreover, changes made by the Tax Reform Act of 1986 could further reduce these benefits. Given our findings, we question whether authority to issue these bonds should be extended.

SCOPE OF GAO's STUDY

For our study, we contacted 32 state and local housing finance agencies across the country.[2] We asked each of them for computerized data on loans made from January 1983 to June 1987. Twenty-nine of the agencies supplied this information, giving us about 178,000 loans. We also spent considerable time with 25 of the agencies to learn how they operate their programs.

We are confident of our findings for several reasons. First, we performed several analyses, all of which produced the same results. Second, our large sample probably represents about one-third of the loan activity during this period. Third, our work at the housing agencies gave us a reality check for our computer analyses. And, finally, our results are consistent with the economic literature in the field.

BENEFIT RECEIVED BY THE HOME BUYER

As you know, qualified mortgage bond financing provides a fixed-rate loan at an interest rate below the market rate. Twenty-one of the 25 agencies we contacted said that they tried to achieve a 1.5 to 2.0 percentage point difference, or spread, between bond-assisted and unassisted loans. We found that the agencies achieved this spread about one-half of the time with the median spread being about 1.4 percentage points.

To determine what this spread means in dollars and cents to the assisted buyer, we compared the payments under the assisted loan with payments at the prevailing conventional rate. The median after-tax benefit was about $477 annually, or about $40 per month. A benefit of this size cannot be expected to make a material difference for any but the marginally unqualified buyer.[3]

In fact, we calculated that in some high cost metropolitan areas, the reduced interest rate is often not enough to make housing affordable for low- and sometimes, moderate-income buyers. Conversely, in more affordable areas, we calculated that many bond-assisted buyers would not need the assistance to purchase homes.[4]

CHARACTERISTICS OF THE ASSISTED BUYER

Given that qualified mortgage bonds provide only limited benefit, the results of our next two analyses are not surprising.

First, we compared assisted buyers to other first-time buyers in the country. For this comparison we used HUD's 1983 American Housing Survey, which was the latest data available. The American Housing Survey includes the characteristics of first-time buyers across the country and is valid for nationwide inferences, but not area-by-area comparisons. To make income and purchase price comparisons, we converted these variables to 1986 dollars.

We found that assisted buyers have characteristics that are strongly associated with home ownership. Although some differences exist between the two groups, both typically were white, married, and young (under 30 or 35), with median incomes around $26,000 for assisted buyers and $27,000 for all first-time buyers. Assisted buyers were slightly younger than all first-time buyers: about 60 percent of the assisted buyers and 52 percent of the buyers in the Survey were less than 30 years old. However, the likelihood of becoming a home owner increases with age as income rises and housing demand stabilizes. These attributes suggest that assisted buyers would be likely to become home owners in the future if bond assistance was not available.[5]

ASSISTANCE PROBABLY NOT NEEDED

Second, we estimated how many of the assisted buyers could have probably qualified for the same size loan at the same time at a conventional rate. Allowing 28 percent of income for housing expenses, which is a standard test of mortgage affordability, we found that 56 percent of the assisted buyers could have probably purchased the same house at the same time without bond assistance using a fixed-rate conventional loan. An additional 12 percent could have probably purchased the same house at the same time using a conventional adjustable-rate mortgage.

Other assisted buyers may have been able to purchase a slightly less expensive house. We found that for those buyers who could not have purchased the same house, 11 percent more probably could have purchased one with an adjustable-rate mortgage that was 1 to 10 percent (up to about $5,000) smaller than the mortgage they actually received.[6]

We see no public purpose being served in assisting those who could buy the same house without assistance. Yet, we found only two agencies which tried to limit their loan activities to those who could not buy conventionally. The remaining 23 did not.

I would like to address a question raised about our work. We have been told that our analysis does not differentiate between buyers served before and after the 1986 Tax Reform Act tightened home purchase price restrictions and established a household income eligibility standard. It has been asserted that, had we differentiated between pre- and post-act buyers, we would have found that the post-act buyers were substantially different, purchasing lower priced homes and having lower incomes. We disagree.

Fully 80 percent of the assisted buyers would have met the 1986 act's income eligibility requirements, and 84 percent would have met the act's purchase price requirements. These figures indicate that isolating post-act data would not have appreciably changed our results. I would also like to note that, while we attempted to make this distinction, housing agencies' files generally did not allow us to differentiate between pre- and post-act loans.

EFFICIENCY OF THE TAX-EXEMPT FINANCING MECHANISM

Up to now I have discussed the extent to which public policy goals are being achieved, which we believe is minimal. The next question is: "What do qualified mortgage bonds cost and are they worth it?" We found that bond-financing is very costly and the costs far outweigh the benefits. Published studies estimate the present value cost at between $150 and $200 million per $1 billion in bonds issued. A recent Joint Committee on Taxation analysis estimates that extending qualified mortgage bond issuance authority will cost $800 million in foregone tax revenue for the 1989 to 1993 period.

To compare the buyer's benefit with the cost to the federal government, we used different interest rate spreads and reasonable assumptions about the marginal tax rate of the assisted buyer and the expected life of the loan. In typical and best-case scenarios, we found that the benefits ranged from 12 cents to 45 cents in benefit for every dollar of cost. With the median spread that we observed of 1.4 percentage points and a typical interest rate for the period, each dollar of foregone revenue is likely to generate benefits of about 36 to 39 cents.[7] Considering that many of the buyers did not need the assistance to buy a home, the "real" benefit is markedly lower. Finally, spreads are not likely to get larger under tax reform. In fact, if tax reform causes spreads to narrow by a half of a percentage point, which has been suggested by some, the benefit may decrease to about 30 cents on the dollar.

STIMULATING CONSTRUCTION ACTIVITY

A secondary benefit cited by proponents of qualified mortgage bonds is that they stimulate the construction industry. If this occurs at all, its effects are most likely to be minimal. Available evidence indicates that the bonds probably do not significantly expand the pool of home owners. Therefore, qualified mortgage bonds are unlikely to significantly increase home-building and/or create many more construction or related jobs over time.

Even if qualified mortgage bonds increased the number of home owners over time, the increase in construction activity might not be commensurate for the following reasons. First, if there was a net increase in housing because of the bonds, the increase in jobs in the construction industry might come at the expense of jobs in other industries because the diversion of capital to housing may reduce activities in other industries. And, second, increased home ownership might reduce the number of renter households (unless the interest rate subsidy succeeds in creating more households). This reduction might eventually mean fewer rental housing units would be needed, and thus less rental housing construction would occur.

POSSIBLE EFFECT OF THE 1986 TAX REFORM ACT

My discussion so far has focused on what has happened over the past 4-1/2 years. Also important is the ability of housing agencies to provide below-market financing in the future. The effectiveness of the qualified mortgage bond program hinges on the ability of housing agencies to sell tax-exempt bonds at a rate significantly below that of conventional fixed-rate mortgages. This may be affected in the future by changes brought about by the Tax Reform Act of 1986.

There are three ways in which the Tax Reform Act may reduce the interest differential between taxable and tax-exempt bonds. First, the reduction in the marginal tax rates for higher income individuals increases the value of taxable bonds relative to tax-exempt bonds. Second, the expansion of the alternative minimum tax reduces the value of all tax preferences, including tax-exempt bonds. Third, commercial banks' loss of special interest deductions will reduce their demand for tax-exempt bonds.[8] The combined effect of these three factors will be to lower demand for tax-exempt bonds, thus increasing the yield, relative to taxable bonds, that issuers will have to offer.

On the other hand, the loss of other tax preferences may, to some extent, increase the demand for tax-exempt bonds. Among these losses is the change in the preferential tax treatment of capital gains. This provision is expected to shift funds from equity investments (e.g., stocks) to both taxable and tax-exempt debt investments. At the same time, the loss of this and other tax preferences may lead investors to increase their participation in the tax-exempt bond market compared with the taxable bond market in order to reduce their taxes owed.

The complexity of the tax changes precludes any firm prediction about the final impact of tax reform on tax-exempt bond rates. However, two recent studies suggest that rates will rise, or at best stay steady, relative to the rates on taxable bonds.[9] If the differential narrows, housing agencies would likely find it more difficult to provide an interest rate at much below the conventional rate.

ALTERNATIVES TO QUALIFIED MORTGAGE BONDS

Of course, we still have to ask if preferable alternatives exist. Although several alternatives come to mind, such as direct buy downs of loan amounts, non-interest bearing second mortgages, and tax credits, we did not study these and therefore cannot recommend alternatives. We are firm in our belief, however, that qualified mortgage bond financed loans are an ineffective and inefficient mechanism for assisting home buyers.

If the Congress does not extend issuance authority, we believe that the private activity bond volume cap should be reduced accordingly. If the cap is not reduced, then the revenue loss would remain the same if the issuers choose to use their full annual issuance authority by increasing the issuance of other types of private activity bonds.

Finally, should the Congress choose to extend bond issuance authority, we believe that it should limit assistance to those who could not otherwise purchase a home. However, the buyer's benefit will be relatively small and the bond-financing mechanism will remain cost-ineffective.

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Mr. Chairman, this concludes my prepared statement, and I welcome the opportunity to answer any questions that you may have.

[1] Home Ownership: Mortgage bonds Are Costly and Provide Little Assistance to Those in Need (GAO/RCED-88-111, Mar. 28, 1988).

[2] See exhibit I.

[3] See exhibit II for typical reductions in monthly payments given different interest rates, spreads, and mortgage sizes.

[4] See exhibit III for the results of this analysis.

[5] These results are depicted in exhibit IV.

[6] These results are presented in exhibit V.

[7] See exhibit VI.

[8] Prior to the act, commercial banks could deduct 80 percent of the interest cost when they borrowed money to purchase tax-exempt securities. In general, the 1986 act repealed this deduction.

[9] Galper, Lucke, and Toder, "The Economic Effects of Tax Reform: A General Equilibrium Analysis." Prepared for the Conference on Tax Policy at the Brookings Institution, October 30-31, 1986; J. E. Petersen, "Tax Exempts and Tax Reform: Assessing the Consequences of the Tax Reform Act of 1986 for the Municipal Securities Markets." (Washington, D.C.: Academy for State and Local Government, Feb. 1987).

STATE AND LOCAL HOUSING FINANCE AGENCIES INCLUDED IN GAO's REVIEW

STATE HOUSING FINANCE AGENCIES

California Housing Finance Agency
Florida Housing Finance Agency
Illinois Housing Development Authority
Indiana Housing Finance Authority
Iowa Finance Authority
Maryland Community Development Authority
Michigan State Housing Development Authority
Ohio Housing Finance Agency
Oklahoma Housing Finance Agency
Oregon Department of Commerce, Division of Housing
Pennsylvania Housing Finance Agency
State of New York Mortgage Agency
Texas Housing Agency
Utah Housing Finance Agency
Virginia Housing Development Authority
Washington State Housing Commission
Wisconsin Housing and Economic Development Authority
Wyoming Community Development Authority

LOCAL HOUSING FINANCE AGENCIES

California

City of Los Angeles, Community Development Department
City of Los Angeles, Community Redevelopment Agency
Contra Costa Community Development Department
Los Angeles County, Community Development Commission
Sacramento Housing and Redevelopment Agency
Yolo County Housing Authority

Illinois

Cook County (Comptroller's Office)

Maryland

Montgomery County Housing Opportunities Commission

Pennsylvania

Allegheny County Residential Finance Authority
City of Philadelphia Redevelopment Authority

Texas

Corpus Christi Housing Finance Corporation
Dallas Housing Finance Corporation
Harris County Housing Finance Corporation
Houston Housing Finance Corporation

EXHIBIT II

EXHIBIT II

FIRST YEAR AFTER TAX REDUCTION IN MONTHLY PAYMENTS OF PRINCIPAL AND INTEREST REALIZED BY HOME BUYER WITH BOND FINANCING

Conventional interest rate	After tax conventional monthly payment	After tax reduction in monthly payments for different interest spreads[a]			
		0.5%	1.0%	1.5%	2.0%
Smaller mortgage ($40,000) at 3 interest rates					
9	$277	$12	$23	$35	$46
11	326	13	25	37	49
13	378	13	26	39	52
Mid-sized mortgage ($60,000) at 3 interest rates					
9	$415	18	35	52	69
11	489	19	37	56	74
13	566	20	39	58	77
Larger mortgage ($80,000) at 3 interest rates					
9	$554	24	47	69	91
11	652	25	50	74	98
13	755	26	52	78	103

[a]We assumed a fixed-rate, 30-year loan. Monthly payments are for principal and interest only. Interest rate spreads are representative for the closed loans we reviewed. We assumed buyers would be in the 15-percent tax bracket (lowest rate for 1988). Pre-1986 Tax Reform Act brackets were higher, further limiting the monthly payment reduction.

EXHIBIT III

EXHIBIT III

INTEREST RATE THAT A TYPICAL FIRST-TIME BUYER COULD AFFORD TO PAY IN DIFFERENT HOUSING MARKETS

	Area median income	Typical first-time buyer purchase price[a]	Housing affordability ratio[b]	Interest rate that a buyer could afford to pay: Maximum eligible income[c]	Moderate income[c]	Low income[c]
More affordable areas[d]						
Illinois	$34,500	$33,100	1:1	32.0	27.8	22.2
Iowa	29,100	47,200	1.6:1	18.9	16.3	12.9
Pennsylvania	29,600	42,500	1.4:1	21.3	18.5	14.7
Michigan	32,600	36,400	1.1:1	27.4	23.9	19.0
Mid-range affordable areas[d]						
Alabama	23,900	55,000	2.3:1	13.0	11.2	8.5
California	33,600	75,600	2.3:1	13.4	11.5	8.8
Massachusetts	34,500	88,500	2.6:1	11.6	9.9	7.4
Oklahoma	27,700	57,800	2.1:1	14.5	12.5	9.7
Less affordable areas						
Phoenix, Ariz.	30,200	86,000	2.8:1	10.3	8.7	6.4
San Francisco, Ca.	29,800	125,900	4.2:1	6.1	4.8	3.0
Atlanta, Ga.	25,300	75,900	3:1	9.7	8.1	5.9
New York, N.Y.	29,500	107,300	3.6:1	7.6	6.2	4.2

[a]In 1987, first-time buyers, on average, purchased houses that cost 73 percent of the average area purchase price. This column shows house prices at 73 percent of the 1987 area average purchase price.

[b]The affordability ratio is the typical first-time buyer purchase price divided by the area median income. The greater the ratio, the less affordable the home.

[c]For qualified mortgage bond assistance, the maximum eligible household income, generally, is 115 percent of the median area income. Moderate and low income are defined by IRS to be 100 percent and 80 percent of median area income, respectively.

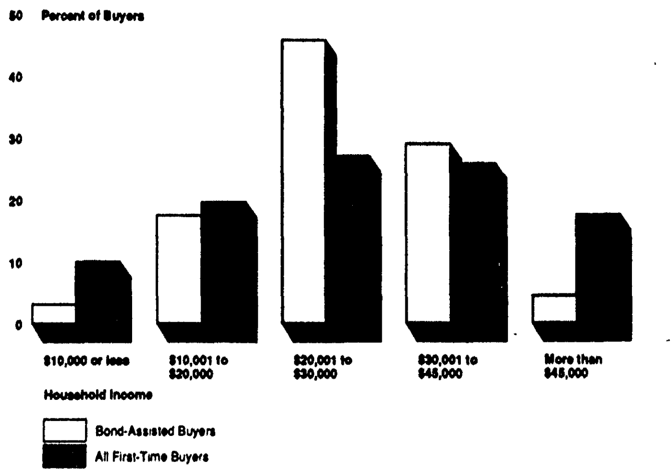
[d]Areas are statewide, exclusive of metropolitan areas.

EXHIBIT IV

EXHIBIT IV

CHARACTERISTICS OF BOND-ASSISTED AND ALL FIRST-TIME METROPOLITAN AREA HOME BUYERS

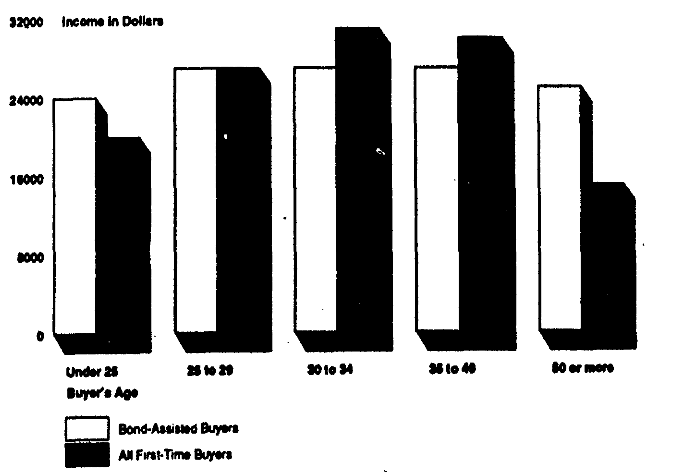
Incomes of Bond-Assisted and All Metropolitan Area First-Time Home Buyers



Note: Distribution of bond-assisted buyers contains 149,619 observations; 28,167 missing values excluded. Distribution of all first-time buyers represents 1 million buyers. Incomes are in 1986 constant dollars.

Sources: GAO data base and American Housing Survey.

Median Income of Bond-Assisted and All Metropolitan Area First-Time Buyers, Adjusted for Age



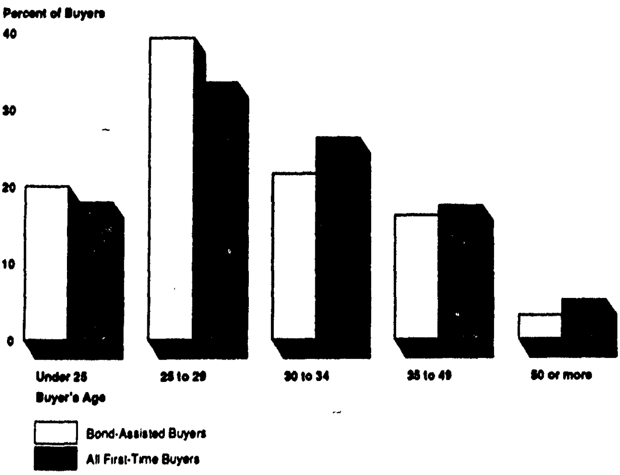
Note: Distribution of bond-assisted buyers contains 101,094 observations; 76,692 missing values excluded. Distribution of all first-time buyers represents about 1 million buyers. Incomes are in 1986 constant dollars.

Sources: GAO data base and American Housing Survey.

EXHIBIT IV

EXHIBIT IV

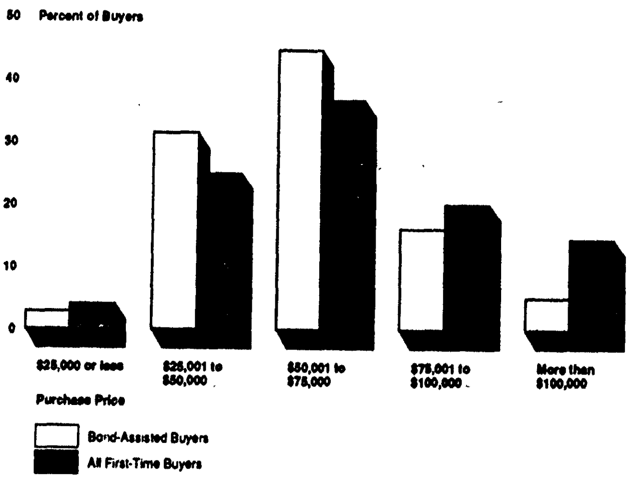
Age Distribution of Bond-Assisted and
All Metropolitan Area First-Time Buyers



Note: Distribution of bond-assisted buyers contains 111,148 observations; 66,638 missing values excluded. Distribution of all first-time buyers represents about 1 million buyers.

Sources: GAO data base and American Housing Survey.

Prices of Homes Purchased by Bond-Assisted and
All Metropolitan Area First-Time Buyers



Note: Distribution of bond-assisted buyers contains 157,244 observations; 20,542 missing values excluded. Distribution of all first-time buyers represents about 1 million buyers. Prices are in 1986 constant dollars.

Sources: GAO data base and American Housing Survey.

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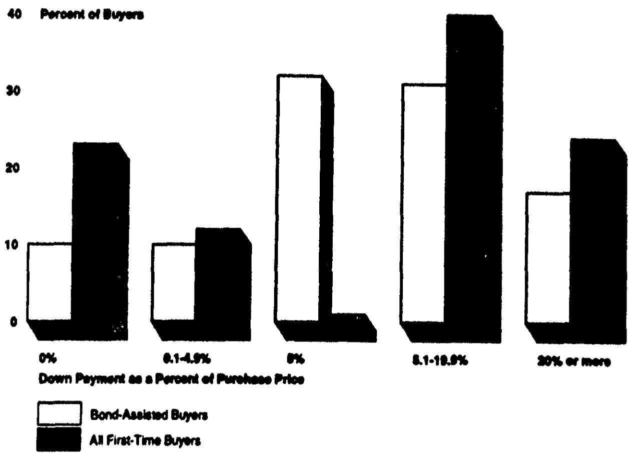
EXHIBIT IV

EXHIBIT IV

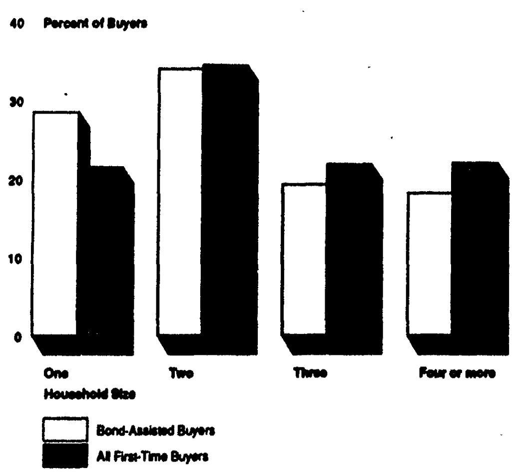
Down Payments Made by Bond-Assisted and All Metropolitan Area First-Time Buyers



Note: Distribution of bond-assisted buyers contains 160,133 observations; 17,653 missing values excluded. Distribution of all first-time buyers represents about 600,000 buyers.

Sources: GAO data base and American Housing Survey.

Household Size Distribution of Bond-Assisted and All Metropolitan Area First-Time Buyers



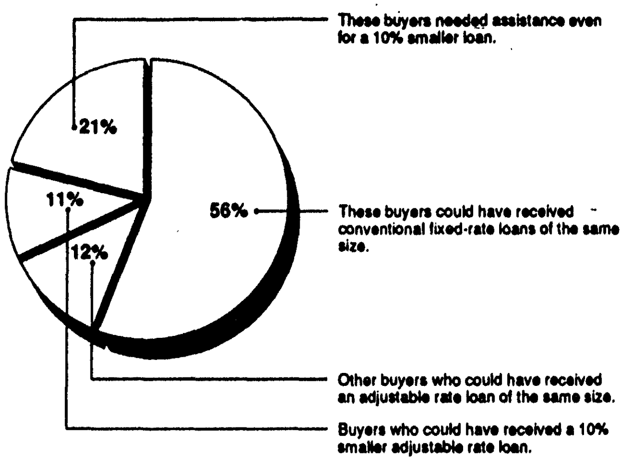
Note: Distribution of bond-assisted buyers contains 136,715 observations; 41,071 missing values excluded. Distribution of all first-time buyers represents about 1 million buyers.

Sources: GAO data base and American Housing Survey.

EXHIBIT V

EXHIBIT V

MOST ASSISTED BUYERS COULD HAVE PROBABLY BOUGHT THE SAME HOME WITHOUT BOND ASSISTANCE



Note: This analysis is based on an industry standard that allows 28 percent of income to be applied to housing expense.

Using this standard, we compared the size of the conventional mortgage that the household could have received at the prevailing interest rate with the size of the mortgage actually received.

If the size of the conventional mortgage the household could have received was the same or larger, we concluded that the assisted buyer could have bought the same home without bond assistance.

This analysis is based on published loan series data and 149,423 observations in GAO's data base, 28,363 missing values excluded.

Source: GAO.

 EXHIBIT VI

HYPOTHETICAL BENEFITS PER DOLLAR OF FEDERAL REVENUE LOST

	Typical case 90% of proceeds loaned 25% capitalization rate on 30% of proceeds			Best case 95% of proceeds loaned No capitalization occurs		
Conventional interest rate	Spread[a] 50	100	150	Spread[a] 50	100	150
10%	$0.12	0.24	0.36	$0.13	0.26	0.39
14%	0.14	0.28	0.41	0.15	0.30	0.45

[a]In basis points.

Note: The benefit calculations are made using the following assumptions: (1) the household marginal tax rate is 15 percent (1988 bottom rate); (2) households live in bond-assisted houses 10 years; (3) benefits are discounted at the conventional rate shown; and (4) mortgages are 30-year fixed-rate loans.

This table presents a "typical case" and a "best case" and shows that for each dollar cost to the federal government, only 12 to 45 cents of benefits are received. When the spread is three times larger, 150 basis points instead of 50, benefits are three times larger as well. Under the best-case scenario for bond efficiency, eliminating capitalization and increasing the ratio of lendable funds per bond issue from 90 percent to 95 percent increases the efficiency of the benefits generated by about 10 percent. The impact of tax reform on future spreads is not precisely known. However, spreads are unlikely to get larger due to tax reform. Thus, each dollar of foregone federal revenue is likely to generate less than 30 cents in benefit. For a given conventional interest rate, the federal cost is constant. However, as the spread increases, benefits increase proportionately without an increase in cost if the conventional rate stays constant.

GAO RESPONSE TO QUESTIONS POSED BY
SENATOR GEORGE J. MITCHELL
ABOUT QUALIFIED MORTGAGE BONDS

Question 1: I understand the GAO report on mortgage revenue bonds (MRB) compares approximately 600 first-time home buyers from the American Housing Survey in 1983 to 178,000 MRB mortgages made over the 1983 to 1987 period.

Please comment on the limitations of using a small sample of home buyers in a particular year to a large number of MRB purchasers over a four year period. Could the fact that the economic and home buying conditions in 1983 are different from those conditions over a four year period, from 1983 to 1987, affect your findings?

GAO Response: The American Housing Survey (AHS) is a representative national sample and is the most extensive data base on housing in the United States. The 1983 AHS was the most current survey as of the time of our review.

There were about 1 million metropolitan area first-time home buyers in 1983. The AHS contains a statistically generalizable sample of 567 observations representing these 1 million households. This sample has a confidence interval of 4 percent. Thus, the mean values for the various household characteristics could be 4 percent higher or 4 percent lower than our calculations show. For example, for a $25,000 income, a 4 percent difference would be $1,000. Therefore, our comparison of 178,000 bond-assisted buyers is to a sample that represents 1 million first-time buyers.

The characteristics of first-time buyers in the 1983 AHS sample are fully consistent with those of first-time buyers of previous years[1] and of subsequent years[2]. Also, the profile of the typical first-time home buyer is young, white, middle income, and married, and this has not changed significantly over the last several years. Thus, using the 1983 AHS does not limit the generalizability of the characteristics of current private market first-time home buyers.

Question 2: Why did you limit your study to metropolitan area loans? Were there any rural loans captured in the 1983 American Housing Survey?

GAO Response: Our analysis of 178,000 bond-assisted loans contains all loans in the agencies' data bases, including any rural loans. The 1983 AHS contains about 400 observations representing about 700,000 households which are rural first-time buyers. We excluded them from our analysis primarily because we believe that most of the bond-assisted activity probably occurred in metropolitan areas.

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[1]See Cooperstein, R.L. "Quantifying the Decision to Become a First-Time Homebuyer," PhD dissertation, University of Maryland, College Park, for first-time home buyers statistics for 1977 through 1981.

[2]See "The State of the Nation's Housing: 1988," by the Joint Center for Housing Studies, Harvard University, Cambridge, MA 1988.

To the extent this is true, a metropolitan area sample from the AHS would be a more appropriate comparison. However, rural home buyers have lower incomes and purchase lower price houses than metropolitan area buyers. By excluding the rural sample from the AHS, our comparison with bond-assisted loans is more conservative. Had we included the rural sample, the AHS households would have had somewhat lower incomes and purchased slightly lower priced houses than the bond-assisted households. This would have further strengthened our conclusion that most bond-assisted buyers probably would have bought houses anyway.

Question 3: GAO places a great deal of emphasis on its estimate that fully two-thirds of the MRB participants sampled could have purchased the same home with a conventional loan. GAO used a 28 percent ratio of mortgage debt, taxes, and insurance to income as a qualifying underwriting standard. Considerable criticism has been leveled against this assumption that private lenders will qualify buyers on that basis. Please comment on this issue.

GAO Response: We do not believe that we placed undue emphasis on our estimate that 67 percent of the bond-assisted buyers could have probably bought the same home without bond assistance. This analysis is only one of three separate approaches we used to analyze the effectiveness of bond-assisted loans, all of which yielded the same conclusion (see chapters 2-4 of our report). Therefore, this analysis should be considered in conjunction with our other complementary analyses.

The 28 percent payment to income ratio is consistent with the written underwriting standards of the major secondary market mortgage purchasers and private mortgage insurance companies we contacted. See chapter 2 and appendix II of our report.

Finally, we note that critics of our analysis have not taken a position on whether bond-assisted loans should be made to a household that could purchase the same house conventionally. We believe no public purpose is served when bond-assisted loans are made to households who could buy the same house with a conventional loan. As our report states, 23 of the 25 agencies we visited made no effort to assure that households receiving bond-assisted loans could not qualify to buy the same house with conventional financing.

Question 4: The cost-benefit model on which you base your efficiency argument assumes that investors who could no longer invest in MRBs will instead invest in the highest yielding taxable securities and that these investors will be taxed at the highest marginal tax rate. Please describe how your efficiency argument would change if you assume that purchasers of MRBs would switch to other tax-exempt bonds.

GAO Response: We did not assume that bond investors would alternatively invest in the highest yielding taxable securities and be taxed at the highest marginal rate. Rather, we reviewed more than 10 studies that analyzed the revenue loss from tax-exempt bonds. The authors of these studies include the Congressional Budget Office, the Urban Institute, and several prominent, nationally known economists. All of these studies were independent; that is, they were not sponsored by organizations with a vested point of view.

The annual revenue losses in these studies range from $20 to $30 million per $1 billion of bonds issued. For our cost-benefit analysis, we used the mid-range of the estimates and assumed a $25 million tax loss annually for each $1 billion of bonds issued. We calculated this to be $150 to $200 million in present value terms.

Consequently, our efficiency argument does not use a maximum estimate of tax loss. Even if we had used the low end of the cost estimates ($20 million tax loss per year per $1 billion of bonds issued), the benefits per lost federal tax dollar would rise, under the best case scenario, from $0.40 to about $0.50. Thus under the most optimistic scenario, half of the federal government's tax expenditure accrues to parties other than the home buyer.

If the government is to avoid the revenue loss from qualified mortgage bonds, the volume cap for private purpose tax-exempt bonds should be lowered accordingly. If not, state and local governments might continue issuing the same amount of tax-exempt bonds by replacing qualified mortgage bonds with other types of tax-exempt bonds.

Question 5: On page 16 of the report, GAO states that "Because we selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified mortgage bond activity nationwide." What does GAO mean by that qualification?

GAO Response: In order to project the characteristics of a sample onto the universe from which it is drawn, the sample must be statistically drawn. However, the lack of a centralized data base and the large cost involved in building a universal data base from which to sample, made a statistical sample infeasible. We therefore assembled a large data base (178,000 observations) choosing states that were geographically dispersed and those with high and low levels of bond-assisted loan activity.

The bonds issued (and hence, probably loans made) by the housing agencies we chose accounted for about one-third of all bond activity over 4 years. While judgmentally selected samples do not allow statistical projections to the universe, the results are nevertheless very useful. This data base provides a very strong indication of the characteristics of the population of bond assisted households. That our data could potentially be in error by $1,000-$2,000 in purchase price and income or 1-2 years in home buyer age, does not change the overall characteristics of the population, or the conclusions about their predisposition to become home owners.

Also noteworthy are the results reported in a rebuttal to our report[3]. The reported data represent bond activity nationwide and show the same results as our data for income, house price, and age. Further, it is widely known that accumulating cash for a down payment is often the largest obstacle facing first-time home buyers. Because the bond assistance mechanism does not address this constraint, there is less chance of any substantial difference between bond-assisted buyers and unassisted first-time buyers.

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[3] "A Referendum on the American Dream," National Association of Home Builders, National Association of Realtors, National Council of State Housing Agencies, Association of Local Housing Finance Agencies, 1988.

Question 6: I understand that one group has looked at the states you chose for the MRB analysis and found that the average income of potential first-time home buyers in the states chosen run from 15 to 17 percent higher than the national average. Please comment on that assertion. Also, if the states you studied do have a higher average income for first-time home buyers than the national average, how would that difference affect your comparison of MRB home buyers to those using conventional loans?

GAO Response: We do not know how the 15-17 percent figure was calculated. In order to make this calculation, the relative proportion of each state's loans contained in our data base would have to be known and included in the calculation. This information was not included in our report.

Regarding the second portion of the question, a finding that states in our sample had higher incomes than the national average in and of itself would not affect our comparison of bond-assisted buyers with those receiving conventional loans. To compare bond-assisted buyers with conventional loan market affordability, income should be examined in the context of housing prices in the area, which is what we did (see chapter 3 of our report). If housing prices are high relative to income, then the limited ability of bond-assisted financing to increase affordability is not enough to allow many potential buyers to purchase them. Conversely, if house prices in the area are relatively low, then many will be able to buy those homes without assistance. Additionally, income should be examined in terms of the mortgage payments that a household can afford. To do this, we used the size of the mortgage the purchaser actually received at bond-assisted rates and compared it to the size of the mortgage the purchaser could afford at conventional rates (see chapter 2 of our report).

Testimony of Elizabeth H. Mitchell
Executive Director, Maine State Housing Authority

Good Morning. Mr. Chairman and Members of the Subcommittee:

First, Senator Baucus, let me bring the warm regards of my colleague Dick Kain from your home state of Montana and commend you for your leadership in calling this hearing. Senator Mitchell, thank you for your kind words of introduction.

I am Libby Mitchell, the Executive Director of the Maine State Housing Authority. I am an active member of the National Council of State Housing Agencies (NCSHA), the trade association which represents all state chartered housing finance agencies. It is on behalf of NCSHA that I appear before you today. Because I have seen first-hand the value of mortgage revenue bonds (MRBs), I urge swift passage of S.1522, which would extend the program. To support this position my testimony will address the following:

- highlight the successes of the MRB program;
- rebut the recently released GAO audit;
- respond to the revenue cost estimates of the Joint Tax Committee;
- describe the growing crisis facing many young Americans as they attempt to purchase their first home; and
- close with a brief summary of the value of MRBs.

The MRB Program

Today, the MRB program remains as the only federal subsidy solely directed to potential first-time homebuyers of low- and moderate-income. Let us examine the legislative evolution of the MRB program and the practical implications of that process.

State housing finance agencies alone have provided below market mortgage money for nearly one million homebuyers. These Americans were predominantly first-time homebuyers, and as you know, the program is currently restricted to first-time buyers.

In an Occasional Paper on the MRB program being prepared by Dr. Margaret Wrightson of Georgetown University ("the Georgetown Paper"), MRB loans made in 1987 are contrasted against conventional, FHA and VA loans made to first-time homebuyers in the 1987 National Association of Realtors annual survey. MRB purchase prices in the sample drawn from 16 state housing finance agencies averaged $62,000 compared with conventional loan prices of $82,900 and FHA insured conventional loan prices of $67,100. The average income of MRB borrowers was $26,000 compared with conventional loan borrowers average of $36,700 and FHA average of $32,000. Moreover, the average age of MRB heads of households was 28 compared with 28.9 for conventional and 28.5 for FHA insured conventional loans.

Let me be specific about Maine's program. Since we made our first state financed loan in 1972, the NCSHA has provided mortgages to over 16,000 Maine families. Maine's program has always had income limits. In addition, we've always had an asset test.

In the last 3 years, over 90% of our loans have been made to people with incomes below $30,000. Our median income has been $23,200. Over 60% of our loans have been made for homes have coding less then $50,000 - over 95% have been for homes costing less than $75,000.

While providing a similar picture for each state would run well beyond the limitations of time, our program is illustrative of the programs of our sister agencies. The Maine State Housing Authority has always taken seriously Congress' intent, our statutory-mandated charter and our role as leader in identifying and addressing the state's housing needs. My colleagues share the same goals, dedication and commitment. In fact, 48 of the 49 HFAs operating single-family programs at the state level, preceded the federal government in establishing income and/or purchase price limitations for their programs.

Not only have the states shown leadership in establishing such targeting limits, they have also implemented a variety of special program strategies which allow them to serve the lowest income first time homebuyers. One-third of the states have offered assistance with down payments or closing costs; over one-half of the states have provided interest rate buydowns; over half have set-aside funds for lower income or special needs homebuyers; and over one-third have worked with non-profits or local governments to implement special affordable housing programs. In 1987 alone, Maine made $12 million available at 6% for families with incomes below $20,000. Time does not allow me to mention numerous other initiatives undertaken by our members.

Over the last eight years, the Mortgage Revenue Bond Program has been significantly amended by Congress three times, sunset for six months and open to such uncertainty during the legislative process 25 to render it ineffective for at least another eight months. Yet, we concur that the legislative changes have, for the most part, meant improvements on overall policy objectives, particularly targeting to low- and moderate-income first time buyers: a goal we share. In fact, in 1983, when MRBs, were last scheduled to sunset, and again in 1986 during the debate of the Tax Reform Act, state housing finance agencies accepted and even initiated the concept of targeting MRB usage to lower-income segments of the population. It was at NCSHA's suggestions that purchase price limitations were lowered, and upon our recommendation, that income limits were imposed.

Since the passage of the Tax Reform Act of 1986, all state HFAs have begun to work within the guidelines set forth. While our experience is limited, we believe the program finally represents the public purpose rightfully required with any form of public assistance; be it federal, state or local. Fundamentally, the program is workable. Purchase price limits and income limits now provide targeting with the necessary flexibility to be valuable in most housing markets and to many of our critical partners . . .the Realtors, builders and lenders.

Could we offer improvements? Yes. For example, due to the vagaries of the market, certain high cost areas are experiencing difficulty working within the new limitations. This issue has been very narrowly addressed by your colleague, Senator Moynihan, in a provision included in the pending technical corrections bill. I urge the chairman to support the rapid passage of that measure. In the best of all worlds, this device could be expanded and refined for impact in more markets. In addition, the Alternative Minimum Tax on private purpose bonds is having an identifiable negative impact on the value of MRBs, as it has ultimately increased the mortgage rate to the buyer. However, much as there were three goals during the Tax Reform debate . . . simplicity, fairness and equity; we would hope you would add a fourth in the immediate post-Tax reform era . . . stability.

Extend this program as is; let us make it work wherever possible. Then, we can debate together the successes and failures against Congressional intent.

The GAO Report . . . NCSHA's Rebuttal

In anticipation of the debate on extending the MRB sunset, the staff of the Joint Committee on Taxation requested an audit of the program by the General Accounting Office. We did not take lightly the efforts of this respected federal agency. Remembering well the time spent responding to GAO findings during the previous sunset debate, individual state agencies and the national organization attempted to be as cooperative as possible and provided extensive information from the outset.

Yet, after purportedly spending a great deal of time and effort examining the MRB program, the GAO report can only state, "Because we selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified mortgage bond activity nationwide" (Pg. 19 GAO/RCED-88-111). We assert that their findings are indeed not representative.

To begin, the sample of 567 homebuyers extracted from the 1983 American Housing Survey is far too small to be representative. It is common knowledge that a statistical sub-sample may be unrepresentative despite the complete representativeness of the overall sample from which it is drawn. Absent an academic explanation of their sub-sample selection techniques we are most skeptical of this, the most basic aspect of GAO's methodology. In addition, we would submit that the selection of agencies for analysis skewed the results due to the inclusion of a disproportionate number of high cost areas. Further, the comparative base line sample was not the conventional market, but a universe of first-time homebuyers which included statistics from other assisted home purchases. The underwriting criteria employed by the GAO is simplistic and theoretical . . . not utilized in the marketplace except as a basic threshold. Lastly, and most importantly, no post-Tax Reform analysis of any meaningful value was undertaken; and therefore, no significant conclusions could be drawn.

Mr. Chairman, with all due respect to the GAO as an institution, my colleagues and I resent the extreme conclusions drawn from their methodologically flawed analyses. By skirting the edges of academic analysis and then by adopting a blatantly biased tone, the GAO report, when considered by an uninitiated reader could be given validity.

A more thorough analysis prepared by the National Association of Home Builders, National Association of Realtors, Association of Local Housing Finance Agencies and NCSHA reveals the following facts about MRBs:

- MRBs serve a lower section of the first-time homebuyer market than do conventional, VA, or FHA insured conventional loans, whether income or purchase prices are considered.
- In a changing mortgage market environment, State housing finance agencies are using FHA insurance, credit enhancement innovations, and long-standing access to the mortgage finance system reach the lower extremes of the first-time homebuyer market.
- When costs are more realistically estimated both full individual and economic benefits of the program considered, the accusations of inefficiency prove unfounded.
- Finally, on-going trends in declining homeownership and the implications for the low-income rental market set forth in the recent Harvard study point to the pressing need for the MRB program.

We anticipated that GAO would dredge-up the same arguments used against the program in the past and commissioned the afore mentioned Georgetown Paper. This report will be released in the coming weeks.

One conclusion that can be drawn from GAO's report, which we anticipate will be confirmed by the Georgetown Paper, is that pre-tax MRB reform activity reveals that state agencies took seriously the earlier Congressional charge to target the program and have been performing better than Congress mandated. Especially since deeper targeting was enacted in 1986, wisdom would dictate that prior to any further tinkering with the targeting of the MRB program, time must be allowed for it to work. I pledge equally impressive results with the post Tax Reform loans.

The Cost Of The Program

One of the most hotly debated aspects of the 1986 Tax Reform Act was the imposition of a volume cap on states' issuance of (newly designated) private purpose tax-exempt bonds. At the center of that debate were two questions:

- What activities should be considered qualified purposes?
- How much revenue should the federal government be willing to forego?

At that time, support for continuing tax exemption for MRBs was overwhelming. The issue in both chambers of Congress was targeting - not elimination. There was little, if any, dissent to the opinion that homeownership for low- and moderate-income citizens is a vital concern of government. I assert that this conclusion remains valid.

On the issue of revenue loss, Congress determined that a limit of $50 per capita - or $200 million for small states like Maine and Montana - would be imposed from 1988 forward for all private purpose activities. MRBs, as restructured, fall into that category. As you would expect, Governors and state legislators have every intention to utilize the full amount of the cap. Although many have yet to accomplish this, there are several important reasons. First, we are in a transition year attempting to cope with significant changes. Second, to the degree program restrictions prevent utilization in a particular area, such as multifamily rental housing, elected officials and issuers will be discussing improvements with Congress. In addition, capital poor areas like Maine, must do everything possible to avail themselves of it in the future. All states fully intend to use their private purpose bond volume cap whether MRBs exist or not. This is necessary because the amount is minimal; federal revenue sharing has been eliminated, and other federal domestic programs have been curtailed. State governments need the money.

Therefore, despite the assessment of the Joint Committee on Taxation, the extension of MRBs cannot possibly cost the federal government any more than you have already committed to spend. In addition, when the volume limitation and private purpose definition were imposed, a necessary resource of state governments was severely restricted. Within the confines of those restrictions, the Governors and the state legislators should have the right to decide priorities, including homeownership, and allocate the cap for the purposes they deem most appropriate.

I believe that this is an accurate assessment of the Congressional policy decision during the Tax Reform deliberati~~ons and o~~f the "real world" cost. At the same time, I acknowledge that many in Congress will give credence to the Joint Committee position that extension of MRBs generates a revenue loss. Given that, I must question the static methodology. An analysis recently completed using Joint Tax methodology projected a loss up to one third lower than the $800 million five year loss Joint Tax estimates. Further, Joint Tax methodology ignores certain practical conditions. It assumes that in the absence of MRBs, investors will choose taxable securities. Mr. Chairman, while Tax Reform reduced the number of tax shelters available, some still exist. If an individual wants a tax exempt source of income, he can find one. Furthermore, the Joint Tax model fails to account for any positive economic impact attributable to MRBs. Our estimates indicate, for example, that MRBs generate $10 of economic impact for every dollar of cost to the government under conservative assumptions.

The Need For The Program

The only valid point for elimination of Mortgage Revenue Bonds would be the lack of a homeownership affordability problem. This is far from the case. Recently the Joint Center for Housing Studies of Harvard released a report entitled the "State of the Nation's Housing 1988". The report notes that the relatively high levels of housing construction, home sales and remodeling expenditures have masked an ever-increasing population of housing have-nots, including potential first time buyers. In it, Professors William C. Apgar, Jr. and H. James Brown concluded that:

- Homeownership Rates have declined throughout the decade of the 80's, representing a loss of over 2 million homeowners if the 1980 rate had merely remained constant over the last seven years.
- The decline in homeownership among young households (25-39 years of age) is most dramatic including; a 7.4 percent decrease in aged 24-29, a 8.9 percent decrease in aged 30-34 and a 7 percent decrease in aged 35-39.
- This decrease among the younger population exists in all regions of the country regardless of the individual economic climates.
- The after tax cost of homeownership remains prohibitively high for would-be first-time homebuyers equalling $7,449 or 32.4 percent of the average annual income of potential first-time buyers aged 25-29 for the typical starter home in 1987 . . . about 50 percent higher than the share of income required in the early 1970s.
- Existing debt and increasing rents dramatically impact the ability of potential first-time buyers not only to qualify for a conventional loan but to save downpayment and closing costs.

One of the critical findings is the interrelationship of each of the individual problems to one another. This gives new perspective to the term "trickle down". Today, it is the inability of families and individuals to buy their first homes, which then significantly exacerbates the housing affordability problem for other low- and moderate-income Americans.

From my own experience and appreciation of the housing needs in Maine, I must concur with these findings. For example, the average family income is approximately $27,000, while the average cost of a home is close to $80,000. Simple arithmetic shows how difficult it is for renters to save sufficiently to purchase a home. Since 1970, home costs have increased 500% in Maine while income have risen by only 186%. In your state Mr. Chairman, the numbers are similar where the average household income in 1987 was $24,385 and home price was $48,000, with a loan amount of $46,119.

Mortgage Credit Certificates

Since the creation of Mortgage Credit Certificates (MCCs), in the Deficit Reduction Act of 1984, 14 states have issued over 10,000 Certificates. Four more have converted some portion of their bond authority to credits. All states with active MCC programs are offering them as a complement to MRBs.

As originally proposed by Senator Robert Dole (R-KN), the then Chairman of the Senate Finance Committee, MCCs were to have provided a refundable sum to taxpayers whose federal income tax liability was reduced below zero. However, in final form, the program precludes refundability. Therefore, the end result is a program which is beneficial only to taxpayers with a positive tax liability. Since MCC eligibility mirrors that of MRBs, this describes only the highest income levels of MCC users. In essence then, the use of the MCC program can be interpreted to be a counter mandate to the Congressional objective of serving lower before higher income families and individuals.

However, for the higher level income eligible first time buyer, the MCC program could be considered an equally efficient form of subsidy. It is too early in our experience to draw a definitive conclusion. Therefore, again citing the principle of stability, we urge extension of this complimentary program.

Summary

In closing let me again strongly urge you to extend Mortgage Revenue Bonds and Mortgage Credit Certificates through 1992 as proposed in S. 1522 and H.R. 2640. The reasons are numerous. The critical ones include:

- A serious homeownership problem frustrates our young in all regions of the country; the need is clear.
- The MRB program has been a successful tool in helping to meet these needs and remains as the only federal subsidy addressing this problem.
- The conclusions drawn by the GAO are fundamentally flawed and fail to analyze a program dramatically changed during Tax Reform.
- The need for states to be able to use their private purpose bond cap as fully and diversely as they see fit.

Over the past several years changing governmental philosophy, spurned in part by the alarmingly high federal deficit, has resulted in a shift in the role played by the federal government in the housing arena. We at the state level are prepared to accept more of the burden. However, some federal presence must remain. In the area of homeownership, it must be MRBs and MCCs.

Earlier, I respectfully requested that you provide state housing agencies with some stability by extending the program as is. To be frank Mr. Chairman, I fully understand the difficulties of the revenue decisions confronting you and your colleagues as you debate this and other extensions. I personally believe that MRBs have a positive revenue impact, but clearly they are revenue neutral by virtue of the private purpose bond volume cap. On the other hand, should a cost be ultimately attributed to the program, the benefits derived are worth the expenditures. Finally, executive directors of all the state housing finance agencies are opposed to recommendations for program improvements. In light of the extensive discussions surrounding public finance, including the Mortgage Revenue Bond program, and the significant program improvements adopted in 1986, please allow us an opportunity to make this latest version of MRBs work.

The executive directors of the state housing finance agencies and our national organization, the National Council of State Housing Agencies, urge swift passage of S.1522 which would extend the Mortgage Revenue Bond and Mortgage Credit Certificate programs through 1992.

STATEMENT OF DR. CAREL OTTE

PRESIDENT, UNOCAL GEOTHERMAL DIVISION

UNOCAL CORPORATION

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

Mr. Chairman and Members of the Subcommittee, my name is Carel Otte; I am President of Unocal's Geothermal Division. I thank you for the opportunity to testify; I appear today representing the Geothermal Resources Association. The GRA is an association of the primary U.S. geothermal producers and developers who are actively developing geothermal resources on our nation's public and private lands. I am a Director of the Association. Members of the GRA include small, independent geothermal developers like Geothermal Resources International, California Energy Company and Oxbow Geothermal Company, and large, integrated energy producers, such as Chevron Resources Company, Freeport-McMoRan Resources, and Unocal.

My purpose in presenting testimony this morning is to urge the Subcommittee to recommend the extension of energy tax credits for qualifying geothermal energy property. This Subcommittee has been a strong advocate of energy tax credits as a means to encourage geothermal energy development.

Currently, geothermal property is eligible for a 10 percent energy tax credit. This provision of the tax code, however, is scheduled to expire on December 31, 1988. We believe that an additional three-year extension of the tax credit beyond 1988 will ensure the development of technologies to utilize geothermal resources and most importantly, will provide an incentive to geothermal developers to continue and complete projects that are now under development or on the drawing boards.

Favorable consideration of this request will be good for the development of geothermal energy resources and for our Nation's energy security. Depending upon the growth rate of electricity demand and the retirement rate of aging powerplants, it is estimated that the United States could face a serious shortage of capacity by the turn of the century. Based upon a modest two percent growth rate and 50-year lifetime for existing coal-fired powerplants, we may require as much as 100,000 megawatts of additional capacity by the year 2000. Forecasts of domestic shortages in oil and natural gas in the early nineties would make this potential shortfall that much more serious. Because new baseload powerplants require from seven to ten years to design, permit, construct and bring into service, it is now questionable as to whether projected capacity requirements can be met. Utilities, for a variety of reasons, are not planning for this additional capacity. Geothermal energy projects can be brought on line in three years or less. Further, these powerplants can be installed in smaller increments than large coal-fired powerplants today. And, finally it is estimated that new geothermal powerplants will be cost competitive with existing technologies using coal or uranium. The point is that geothermal energy is on the verge of becoming a very important part of our domestic energy resource base.

Scientists at the U.S. Geological Survey estimate that the electrical energy recoverable from high temperature geothermal systems in the United States over a 30-year period is about

23 million kilowatts. While this may be just a fraction of the nation's electricity requirements, consider that it represents the energy equivalent of about 800,000 barrels of imported crude oil per day. In that context, it represents a foreign exchange savings of more than $6 billion annually in 1987 dollars.

Geothermal energy technology has progressed beyond the stage of fantasy and experimentation to where it is now an important part of the United States' energy spectrum.

By the end of the calendar year 1987, 2,212 megawatts of geothermal-powered capacity had been constructed in the United States. By the mid-1990s, the geothermal industry will be responsible for generating more than 3,000 megawatts of electricity from an abundant and environmentally benign fuel source. Studies of California, for example, suggest that geothermal energy resources could power nearly 12 percent of the state's electrical needs.

As geothermal energy technology has progressed over the past 30 years, so has the reliability of the steam production systems. Geothermal power plants generally have an on-line availability equal to or greater than conventionally fueled power plants and significantly higher than nuclear plants.

In California's Imperial Valley, binary power plants are in operation in the East Mesa area. At the same time, two other units at East Mesa and seven plants in the Salton Sea area are on line, under construction, or being planned to utilize double flash systems.

So it is throughout California--at The Geysers in Northern California, in the Long Valley area in the Sierra Nevada near Mammoth Lakes, and in the Coso prospect--new geothermal projects utilize the latest developments in technology. These projects all tap a variety of types of hot water resources.

This is also the case in the state of Hawaii, and on federal lands in the western states of Utah and Nevada where additional flash and binary projects are on line or being planned.

Importantly, because so much of geothermal energy is located on federal lands, development will mean that payments from developers in the form of rentals and royalties will be made to the federal treasury. The Geothermal Resources Association estimates, for example, that rental payments to the federal government now approximate $2.5 million annually and bonus bids for federal leases have exceeded $80 million. According to a recent BLM publication, federal leases administered by BLM paid over $14.3 million in royalties last year.

Geothermal energy is unique. It is not an energy source like oil, natural gas, or coal which can be transported great distances to the point of end use. The most common use for this resource is to power electrical generating plants built on-site where the resource is produced. Then the electrical energy can be transported to a distant population and industrial centers through the national power grid.

Putting this resource to use requires significant capital--capital not only to drill wells and develop steam production systems, but also capital to build on-site power plants to utilize the energy.

In some cases, large public utility companies have built generating plants to utilize geothermal energy purchased from resource producers. Lately, the resource producers themselves have financed the construction of the power plant.

All of this has been done at significant risk to the producing and electrical generating companies. We have been dealing with a new technology, a new industry. At the Salton Sea, more than 20 years of research and plant operations have gone into advancing resource production technology to utilize very saline brines to the point where now commercial-size systems are being constructed.

But as with any new industry, there is the question of economics. On an installed megawatt basis, geothermal energy is competitive with nuclear and conventional power plants. On an operating cost basis it is also competitive. The difficulty is that geothermal steam contracts must be written for the term of the power plant's life, normally thirty years, since there is no alternative energy source for that plant.

These contracts fluctuate with oil prices, and when oil is abundant and prices drop as it has in the last two years, the price we receive for geothermal steam drops or the market for new installations dries up completely.

This significantly dampens the willingness of producers to continue the heavy capital investment required for expanding geothermal steam production and developing new production technology. Existence of the geothermal energy tax credit has greatly assisted in that development.

On behalf of the Geothermal Resources Association, I would urge your favorable consideration for extension of the energy tax credit for qualifying geothermal property. I would like to emphasize that in preparing my testimony for this morning I reviewed the list of geothermal projects that were on the drawing board in 1985 and compared it to our current list. Since 1985, there have been a significant number of delays in projects, sales, and/or cancellations of projects. I believe this is due, in part, to dramatically lower energy costs. But, also, the fewer number of projects is attributable to the lack of incentives or the delays in the extension of the energy tax credits as occasioned by the protracted debate on the tax bill in 1985-86. These delays in knowing whether or not the energy credit would be available resulted in the cancellation of projects. While I do not suggest that geothermal projects are totally dependent on the energy tax credit to survive, I would like to make the point that an infant industry like geothermal, highly dependent on new technology and an unknown resource base, needs such incentives to achieve a mature status. Energy tax credits serve this purpose.

Currently, the industry projects that approximately 400 megawatts will come on line between 1989 and 1991. We believe that continuation of this tax incentive for a limited period of time will make a significant contribution toward assuring development of this renewable energy resource into the 1990s and beyond and position the country with a new technology when the next energy shortages are upon us.

This is an emerging industry that has been constricted in its potential by the dramatic decrease in world prices of oil. Low costs for conventional fuels have resulted in less interest in new forms of power generation. This has also meant that utilities which are generally risk averse anyway are unwilling to participate in the development of a new, unconventional energy resource. Thus, as a geothermal energy supplier we have been required to become a generator of electricity as well. The result has been to add directly to our risks. And, until a longer track record of success is evidenced, we will be required to play the dual role of resource provider and developer. The energy tax credit is thus very important toward sustaining the progress we have made and toward "buying down" the risks that are inherent with the first generation of geothermal power plants.

Thank you for the opportunity to appear before your Committee.

STATEMENT OF

ALEC M. SCHWARTZ

on behalf of the

AMERICAN BAR ASSOCIATION

regarding

SECTION 120 OF THE INTERNAL REVENUE CODE

March 28, 1988

Mr. Chairman and Members of the Subcommittee:

My name is Alec M. Schwartz. I am the Staff Director of the Special Committee on Prepaid Legal Services of the American Bar Association. I also serve as Executive Director of the ABA's American Prepaid Legal Services Institute, a non-profit organization which provides those in the prepaid legal services field with continuing education, information and technical assistance. I appear before you today at the request of the President of the ABA, Robert MacCrate, to present our views on group legal services plans.

The American Bar Association supports passage of S. 2119, which would retroactively reinstate and make permanent Section 120 of the Internal Revenue Code, a provision which expired on December 31, 1987. Our Board of Governors selected this matter as one of a small group of top legislative priorities for 1988.

Section 120 determines the tax treatment of qualified group legal services plans. It provides that contributions made by an employer to and the value of any legal services received by the employee under such a plan can be excluded from the employee's taxable income.

Section 120 was originally enacted in 1976 as a five-year experiment. In 1981, acting upon its review of the soundness of the policy it established, Congress enacted legislation to extend the provision for three more years. It reaffirmed its position in 1984 with a one-year extension and again in 1986 with a two-year retroactive extension as part of the Tax Reform Act.

The ABA has strongly supported Section 120 since the provision was adopted by Congress in 1976. Our support is based upon many years of study and experimentation with group and prepaid legal services plans of all types. Recognizing the need to develop mechanisms to help middle-income Americans gain access to personal legal services, the American Bar Association has worked for over fifteen years to develop and perfect the concept of prepaid legal services.

We originally embarked on this path because we have known for a long time that many average Americans no longer believe that the legal system works for them. The average family - with an annual income of less than $25,000 - cannot afford personal legal services. Even families in upper middle income ranges often feel that the high cost of legal counsel, the complexities of the system and the delays in getting their case heard make the courthouse door effectively closed to them.

For over ten years, we have had this problem documented in the American Bar Foundation's landmark study on the legal needs of the public. The ABF's figures tell us that 36% of us will encounter a problem in the next twelve months which a lawyer could help resolve, yet only 10% will actually seek out legal services.

If we are going to really extend access to the justice system to the average American, we must develop and promote innovative legal service delivery systems which deal with these perceptions. Of the many approaches which have been tried in this regard, prepaid legal service plans seem to offer the most promise.

These arrangements provide a vital bridge between the person in need of legal services and the lawyers who are available to provide those services. Through pre-arrangement of the financing of the service, the establishment of networks of lawyers willing to do the work, and the education of plan members on how and when to use plan benefits, a well-thought-out legal service plan effectively overcomes the resistance to seeking legal help in time for the help to do some good.

Qualified employer-paid plans have proven to be the most efficient of all prepaid legal plan systems. These arrangements make hundreds of dollars of legal service benefits to participants at a fraction of what medical and other benefit plans cost. By placing legal services on the same tax footing as other more expensive statutory benefits, Section 120 has encouraged employers and unions to look to group legal service plans as an inexpensive and effective way to enhance employee well-being.

The rationale for legal services as a benefit for employees is much the same as that for medical and other insurance benefits: to assure the personal well-being of employees and their families so that they can continue to be permanent and productive members of the workforce. If an employee is sick, he or she cannot work. Being ill in the workplace can greatly reduce productivity. By establishing tax incentives for employers to provide or pay for medical care, the Congress has recognized the economic benefits inherent in protecting an employee's physical health.

Legal problems affect the emotional and financial health of employees. The incidence of these problems can have a significant effect on an employee's work productivity and lead to absences from work to go to court or otherwise deal with a problem personally. The following case study was compiled from actual cases where what initially was a minor personal problem led to serious personal and legal trouble:

> Robert Simpson (fictitious name) worked as a quality control inspector at an electronics plant for six years. In the seventh year of his employment, the quality of components coming off the assembly line where Mr. Simpson was stationed dropped off sharply. In addition, his attendance record began to deteriorate and he was absent from a number of important union meetings. At one point, Mr. Simpson's job performance declined so much that both his co-workers and management feared that he might not only lose the chance for promotion but also his job as well. It turns out that Mr. Simpson's job performance suffered because he was distracted by serious legal difficulties. He had moved his family to an older apartment building and signed a two-year lease, without paying much attention to the details. A month after the Simpson family moved in, a small fire broke out on the first floor of the building, and Mr. Simpson, who lived on the third floor, became concerned over the need for fire protection. The landlord refused to provide alarms and extinguishers, and Mr. Simpson, not the smartest of businessmen, decided to purchase $2,400 worth of fire protection equipment on an installment note.
>
> Had Mr. Simpson talked to a lawyer before purchasing the equipment, he would have discovered that the landlord was obligated by both state law and municipal ordinance to provide fire protection equipment. He would also have been told that the lease agreement should have contained a clause obligating the landlord to provide such equipment on request and indicating that rent could be withheld if such a request was not honored.
>
> Three months after the purchase of the equipment, Mr. Simpson discovered that he could not meet the installment payments. The finance company refused to listen to any excuses and promptly sued Mr. Simpson for $2,400 in municipal court. Mr. Simpson, unaware of the ramifications of the suit and without funds to retain a lawyer, failed to answer the complaint and a default judgment was entered against him. The fire equipment was repossessed and sold at a sheriff's sale for $400, with a deficiency balance of $2,000 showing as an unsatisfied judgment on the record of the court. Mr. Simpson was then summoned to court for a judgment-debtor hearing and his wages were immediately garnisheed.
>
> Over the next six months, as Mr. Simpson attempted to pay off the judgment against him, his other monthly obligations fell into arrears. Several law suits were filed, all resulting in default judgments. Because of the pressure of continual harassment by creditors, Mrs. Simpson informed her husband that she had had enough and filed for divorce. Simpson was served with the complaint at work, much to his embarrassment, along with motions for expense money, temporary alimony and support and custody of the children. During the next six months, numerous hearings on the pending divorce were held and Mr. Simpson had little time for anything but the legal battles that surrounded him.

Could an attorney have prevented many of Mr. Simpson's problems? Probably. Certainly, an attorney's review of the original lease agreement might have prevented the credit purchase of the fire prevention equipment in the first place, which seems to have led to many of his other difficulties. Even assuming that the purchase had been made anyway, many of the judgment-debtor problems could have been immediately relieved through the attorney's active participation with creditors. The divorce might well have been avoided if the credit problems had been alleviated initially. Even if the divorce was unavoidable, the availability of an attorney prior to the initiation of the suit by Mrs. Simpson could have prevented a lengthy contested proceeding.

Is this case atypical? We don't think so, though certainly many situations can turn out to be less disastrous. Let's take a "minor" matter which actually occurred in a Midwest office.

> An employee was billed by a hospital for approximately $130 which he thought he didn't owe and which he had no money to pay in any event. Repeated requests for payment were ignored until the employee received a summons from county court located 35 miles away from the office. The employee mentioned the need to take time out from work to go to court to his supervisor, who advised that the employee talk to a lawyer first. A lawyer was consulted and eventually accompanied the employee to court twice, requiring the employee to be absent from work for one-half day each time, and a settlement with payment arrangements was worked out with the lawyer for the hospital.
>
> The cost to the employee associated with this problem was calculated at $358.84, including $225 in attorney fees, $59.84 in lost wages, $28 in transportation to court and $46 in court fees. In addition, the employer lost the services of the employee for two mornings, the federal government lost approximately $11.80 in tax revenue on the employee's lost earnings and the hospital had to pay its attorney to handle the case in court.

The point of this story is that the attorney indicated afterward that had she been called as soon as the employee started receiving past-due notices from the hospital, she could have negotiated a payment schedule with the hospital by phone, avoiding the law suit, court appearances, costs, time off from work and the worry which had plagued the employee during the three months while this situation was developing.

How could an employer-paid legal benefit plan have helped in this second, more typical case? First, the employee, realizing that arrangements for consulting and paying for a lawyer were part of his compensation, the question of whether the employee had the funds to hire an attorney would not come up. Secondly, by having this barrier removed, the employee would have had the incentive to consult a lawyer as soon as the problem presented itself, rather than waiting until the last minute and having a law suit filed against him. Third, the employer would not have lost the services of the employee both for the time taken to go to court and in the preceding months during which the employee's attention was distracted from his work because of worry and phone calls to and from the hospital.

Do employees actually take advantage of a legal services benefit to their own and the employer's advantage? The statistics we have gathered since Section 120 was enacted in 1976 indicates that they do. Employee legal plan administrators report that an average of 20 to 30 percent of covered employees use plan benefits each year. The United Auto Workers plan which serves Chrysler, GM and Ford workers has recently experienced an even higher usage rate, exceeding 50 percent in some of their regions.

With legal service benefit plans having clearly demonstrated their effectiveness and with the success of Section 120 in stimulating the private sector to develop mechanisms for their implementation, why then have we repeatedly needed to come before you to argue for this provision's continued existence?

Over the years, we have heard no opposition from any group, including the Congress, to the idea of group legal services for employees per se. Rather, we are continually confronted with the Treasury Department's position that Section 120 causes additional government revenue loss because employer contributions are made to this tax-exempt benefit, rather than being paid to employees as wages or as payment for some taxable benefit program.

We understand that the Office of Management and Budget estimates that the tax expenditure associated with Section 120 is $75 million for 1987. Over the years, the Joint Tax Staff has offered even higher estimates, though we believe that these estimates are based upon incorrect assumptions about the number of employees on behalf of whom contributions are actually being made. Other witnesses before the Subcommittee on this issue and additional statements filed for the record will be providing more detailed testimony on these estimates.

However, regardless of the theoretical calculation of revenue loss associated with Section 120, all these estimates assume that Section 120's expiration will cause legal plan sponsors to continue to fund these programs, and that FICA and income tax withholding on the contributions will yield the disputed revenues for the Treasury. However, it is clear to us that in many instances, employers and unions -- though convinced of the value of legal service benefits -- will opt to discontinue this benefit because of the administrative difficulties which would result, and channel valuable pre-tax dollars to enhance other statutory benefit programs. We have been informed that one legal service plan has already met this fate. We believe that the number of plans so affected could be substantial, in which case any estimate of recoverable tax revenues is theoretical as best.

We therefore believe that this sole apparent objection to Section 120's continuance is without major substance. What then would be the real results of this provision's demise? The elimination of a valuable employee benefit for a major portion of the 2.5 million employees, plus members of their families, who are now covered; the tax dollars that can be saved by reductions in the use of our courts to resolve minor disputes as a result of preventive legal services being made available to employees through qualified group legal service plans; and the benefit to our economy of minimizing the impact of employee personal and legal problems on productivity in the workplace.

We conclude that no substantial public purpose is served by the elimination of Section 120, and we urge that S. 2119 be passed into law at the earliest date possible.

TESTIMONY OF RODNEY R. SHINKAWA

ON BEHALF OF THE U.S. LEAGUE OF SAVINGS INSTITUTIONS

BEFORE THE SENATE FINANCE COMMITTEE'S SUBCOMMITTEE

ON TAXATION AND DEBT MANAGEMENT

MARCH 28, 1988

Mr. Chairman, my name is Rodney Shinkawa and I am Executive Vice President and Treasurer of the First Federal Savings and Loan Association of America located in Honolulu, Hawaii. I am here today on behalf of the United States League of Savings Institutions* to urge this Committee and the Congress to extend until December 31, 1991 the special Federal Savings and Loan Insurance Corporation (FSLIC) tax rules which are scheduled to expire at the end of this year. My testimony will briefly outline the special FSLIC tax rules, examine their legislative history, set forth the reasons these rules continue to be necessary today and finally recommend a number of technical improvements to these rules for the future.

<u>Special FSLIC Tax Rules</u>

The 1981 Economic Recovery Tax Act (the 1981 Act) provided that the continuity-of-interest requirement for tax-free reorganization purposes is satisfied in the case of a merger involving a thrift institution under the following conditions:

1. The acquired institution is a Code Section 593 organization (i.e., savings and loan or mutual savings bank).

2. The Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Home Loan Bank Board (FHLBB) must certify that the Section 593 institution is insolvent and that it cannot meet its obligations currently or in the immediate future.

3. Substantially all the liabilities of the transferor institution (including deposits) become liabilities of the transferee.

If these conditions are satisfied, the acquired institution need not receive stock of the acquiring corporation to qualify as a tax-free reorganization (IRC Section 368(a)(3)(D)).

Importantly, the 1981 Act also provided that depositors in a thrift that has been certified as financially troubled whose deposits carry over to the acquiring corporation will be deemed to have continued an equity interest in the thrift to the extent of their deposits. Consequently, carryforwards of the operating losses of the acquired thrift are less likely to be limited (IRC Section 382(1)(5)(F)).

Finally, the 1981 Act made it clear that certain financially troubled thrifts need not reduce their basis for money or property contributed by FSLIC under its financial assistance program, and that such amounts are not includible in income (IRC Section 597).

Legislative History

It seems clear from the discussion and debate which accompanied the enactment of these special FSLIC tax rules in 1981 that Congress was deeply concerned by the impact of extraordinarily high interest rates on the mortgage-oriented savings and loan institutions, and that appropriate relief ought to be granted. Specifically, the Joint Commitee on Taxation noted:

> The Congress believed that recent economic conditions, including high interest rates, have had particularly adverse effects on the country's thrift institutions, which have been the primary providers of mortgage credit. These thrift institutions traditionally have engaged in short-term borrowing from their depositors, while lending on a long-term basis to their mortgagors. The recent high interest rates have required the thrift industry to pay high short-term rates to depositors; at the same time, substantial portions of mortgage portfolios consist of mortgages paying much lower rates. The resulting losses have threatened the viability of thrift institutions.
>
> General Explanation of the Economic Recovery Tax Act of 1981, Joint Committee on Taxation, Blue Book, December 29, 1981, p. 151.

The special FSLIC tax rules were again addressed in the President's 'Tax Proposals to Congress for Fairness, Growth and Simplicity' released in May 1985. In this document, the President recommended that the FSLIC rules be repealed but not until 1991. The reason for the delay is that

> ... the Administration recognizes that the thrift industry has not fully recovered from the economic conditions which prompted Congress to enact the special reorganization rules in 1981. Moreover, the FSLIC will require a transition period within which to seek authorization to charge sufficient premiums for deposit insurance.
>
> The President's Tax Proposals to Congress for Fairness Growth and Simplicity. May 1985, p. 251.

In the most recent legislative action, the FSLIC tax rules were retained by the Tax Reform Act of 1986 but only until December 31, 1988.

FSLIC Rules Essential in 1981 - Critical Today

The only thing that has changed since Congress adopted these special FSLIC tax rules is the nature and size of the problem. Today, asset quality problems, not high interest rates, generate most thrift losses. The well-publicized economic depression in the energy and farm economies has been a major reason for the precipitous decline in real estate values and the concomitant increase in real estate lender losses in those regions.

In 1981 and 1982, four-fifths of the savings institutions were booking significant losses with only a few institutions operating in the black. Now these proportions have turned around. The majority of our institutions are operating with reasonable profit margins while a small minority is booking enormous losses. It is the concentrated nature of these losses in the oil patch states which is placing increasing pressure on the insurance fund for additional assistance in the form of cash outlays.

Deposit insurance has been the great stabilizer of our banking system since the Great Depression. This insurance protection has created, however unintentionally, a partnership between government, the regulators and our federally-insured, privately-owned financial institutions in maintaining public confidence. This longstanding, informal partnership was made even more explicit by the government's 'Full Faith and Credit Guarantee' of federally-insured deposits by the Competitive Equality Banking Act of 1987 (Title IX).

Deposit insurance is at the center of this public confidence partnership. It is the insurance premiums, both regular and special, paid by healthy and profitable thrift institutions that provide the operating funds and reserve balances for normal insurance fund maintenance and case resolutions. The federal regulators also play a critical partnership role by protecting the safety and soundness of FSLIC insured institutions through the supervision of their business activities. The federal government plays only a backstop role in this partnership, and retention of these FSLIC rules would help make any further government involvement less likely.

The point of this partnership analogy is to rebut the inaccurate impression that the FSLIC rules are "unfair since they provide beneficial treatment to a selected class of beneficiaries." (General Explanation of the Tax Reform Act of 1986, Joint Committee on Taxation, Blue Book, May 4, 1987, p. 571). Every member of this partnership benefits by the extension of these rules and the resultant strengthening of the insurance fund by maximizing its available resources.

Efficiency and Neutrality Concerns Misguided

The concerns about tax neutrality and efficiency raised by the above quote are misplaced as applied to these FSLIC rules. The major beneficiary from these rules is an arm of the government itself (FSLIC) whose outlays are reduced by their availability. The usual concerns about the impact of any extension of special rules on the federal budget and budget deficit do not apply either. When FSLIC spends less to resolve a problem case because of these rules, federal outlays, and hence the budget deficit, are lower. Any projected budget pick-up from expiration of these rules is essentially illusory since, absent these rules, federal outlays will increase proportionally. One way or another the deposit guarantee will be upheld, and these special FSLIC rules are a straightforward mechanism already in place to achieve that goal.

In this regard, no one for a moment believes that FSLIC's troubled thrift caseload, whatever its true size, can be handled all at once. Even FSLIC's future industry assessments, bolstered by $10.8 billion in bond proceeds over the next three years under the Competitive Equality Banking Act of 1987 (CEBA), could prove insufficient since those dollars must be raised in the financial markets incrementally and will not be available immediately. There is no quick fix. We face a long-term problem which demands long-term solutions. In other words, we are still in the transition period the President referred to in 1985, having just begun the long-term recapitalization of FSLIC with the hope of stabilizing and eventually resolving thrift industry problems.

As a consequence, the thrift resolution strategy must consider all options for maximizing FSLIC resources to the greatest extent possible, including techniques to facilitate thrift mergers and acquisitions in the most expeditious and least costly manner. One of the most efficient ways of conserving limited FSLIC resources is to extend through 1991 the tax-free reorganization rules set to expire on December 31, 1988.

The extension of the FSLIC tax rules through 1991 would mirror the industry's recapitalization efforts and focus the maximum resources available on the thrift loss problem instead of diverting to the general revenues through taxation a substantial portion of our industry's assessments. In terms of our public confidence partnership, taxing FSLIC assistance dollars makes little sense since it would effectively cut in half the resources available for resolution of FSLIC problem cases.

Consequently, whatever merit the sunset of these provisions had in the Tax Reform Act of 1986 has clearly been eclipsed by subsequent events. At a time when the much-depleted resources of

FSLIC are being replenished by $10.8 billion in CEBA-directed contributions from our healthy thrift institutions, we must not make these assistance dollars less effective by failing to extend the FSLIC tax-free reorganization provisions for three more years.

Include FDIC in Coverage

Finally, these favorable tax rules now only apply to FSLIC. However, it is apparent that regional economic conditions in the Southwest and elsewhere are also putting great pressure on the Federal Deposit Insurance Corporation and the commercial and savings bank institutions it insures. Therefore, we would recommend that the FDIC be included under these favorable tax rules provided they could be extended through 1991 for both industries.

Related Technical Matters

In addition to the substantive tax policy issue of the desirability of the extension of these special FSLIC reorganization rules, we would like to address a number of technical adjustments to the language adopted in 1986 which would be helpful in assuring that the FSLIC can employ these provisions most effectively in 1988 and beyond.

The first of these is the failure to retain all aspects of the prior rules dealing with the preservation of net operating losses (NOLs) when a healthy institution acquires an FSLIC problem case. Prior law provided a scaledown of the NOLs passed along to the acquirer when the deposit base ratio of the problem institution fell below the 20 percent threshold of the combined entity after the merger. Because of changes elsewhere in the general treatment of business combinations, the prior scaledown has been replaced with a "cliff" at that 20 percent ratio. If the deposit base of the acquirer exceeds four times that of the problem case, all of the NOLs are lost rather than ratably scaled back.

This rule makes it difficult to dispose of any given problem case to a much larger healthy institution, the very type of entity which can most easily digest the problem institution. An adjustment here would greatly facilitate FSLIC case resolution.

A second more technical problem involves the general requirement that the ratio calculations be conducted using only voting stock, rather than all classes of stock. Mergers involving savings institutions often involve mutual, not stockholder-owned entities. It would be helpful to clarify that, for the ratio-calculation, the deposit base comparison is the correct analog for the voting stock calculations where thrift institution acquisitions are concerned.

A third technical correction should clarify that the test of eligibility as a tax-code-qualified domestic savings and loan should be performed on the institution resulting from the FSLIC-assisted merger. This test is required to qualify any FSLIC assistance payments as tax exempt under Section 597. Typically, because of declines in the values of the assets of problem institutions undergoing mergers, the 7701(a)(19)(C) test becomes difficult to apply in a meaningful way. The key tax test should be that the resulting FSLIC-insured surviving institution meets the 60 percent test enshrined in the code.

The fourth item on the technical corrections list deals with the status of any tax-exempt FSLIC "hard dollar" financial assistance payments for earnings and profits (E&P) purposes. If these payments are to be truly tax exempt and not vulnerable to subsequent taxation -- as was clearly intended by the Congress as evidenced by the clarification on the non-applicability of Section 265 -- a special rule would be helpful clarifying that assistance payments made pursuant to agreements eligible for a Section 597 exemption constitute E&P. When Section 597 sunsets, this special treatment for FSLIC assistance agreements should also sunset.

Finally, it might be helpful to clarify in report language that it was not the intent of Congress to disqualify from NOL preservation transactions where the FSLIC, via a receivership, temporarily "parks" a problem case as an interim institution -- for example, using its Management Consignment Program -- pending final resolution by sale to a healthy acquirer. Though a helpful ruling on this multiple transfer item has already been issued by the IRS, a couple of minor wording difficulties remain and a clear signal from Congress would be helpful though, given that ruling, hardly essential.

Conclusion

The preservation and adjustment of the special FSLIC tax provisions is absolutely essential to the future viability of the fund and the success of the recapitalization measure enacted by the Congress last year. Though our industry has a number of other technical correction items at stake in the legislative process this year, we would like to assure the Congress that we consider these provisions for the benefit of the FSLIC to be of the highest priority for the industry itself. We are united with the Bank Board and the FSLIC on this crucial issue.

Thank you for giving us the time to express our views. We would be happy to respond to your questions and to supply any other information we have for the record.

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* The U.S. League of Savings Institutions serves the more than 3,000 member-institutions which make up the $1.2 trillion savings association and savings bank businesses. League membership includes all types of institutions -- federal and state-chartered, stock and mutual. The principal officers include: Theo H. Pitt, Jr., Chairman, Rocky Mount, North Carolina; B. R. Beeksma, Vice Chairman, Oak Harbor, Washington; William B. O'Connell, President, Chicago, Illinois; Philip Gasteyer, Executive Vice President and Director of Washington Operations; Coley O'Brien, Senior Vice President and Legislative Counsel; and Brian Smith, Senior Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

TESTIMONY OF

CHARLES STRADFORD

IN SUPPORT OF EXTENDING

THE TARGETED JOBS TAX CREDIT PROGRAM

Good morning, Mr. Chairman, I'd like to thank you for this opportunity to appear before the committee for a second time in support of the Targeted Jobs Tax Credit program. My name is Charles Stradford and I am here on behalf of my son, Ronald, who is mentally handicapped and a former participant in the Targeted Jobs Tax Credit Program.

The second and perhaps most important reason for my being here is to help alay some of the concerns voiced by a few that the program is more used to accumulate tax credits rather than promote the well being of indigent or handicapped individuals.

My son is now twenty-four years old. At the time of his birth, we were advised to place him in an institution because the medical authorities felt that he would never be anything more than a vegetable and a burden to us and our other two children. As a family unit, we refused to take the advice of the doctors.

When Ronald was five years old, he wanted to go to school because his sister and brother were in school. At that time, some of the psychological testers and school officials felt that he was not ready. We balked at this notice because of his persistence in wanting to be like his brother.

Two years later, Ronald wanted to become a Cub Scout like his brother. With the help of some of the other parents with mentally handicapped sons, we organized a Cub Scout unit for the mentally handicapped.

As Ronald has grown older, his physiological needs have changed. In order to help him meet those needs, my wife and I have become active participants in encounter groups and advocacy programs for the mentally handicapped. As I mentioned earlier, Ronald has attended school since age five. Our initial intent was for him to develop motor skills and to learn basic suivival skills. Later we found that he had an aptitude for academics and we pushed for his educational development.

My son, Ronald, started working for Pizza Hut under the Targeted Jobs Tax Credit program approximately five years ago.

At that time he was working two hours a day, three days a week. Over time his hours and responsibilities have increased. He is currently working four days a week and he has received training in almost every area of the business.

The first time I appeared before the committee, Mr. Chairman, I talked about achieving self-esteem through contributing to one's own welfare and my feelings have not changed. In fact, having seen how my son has reacted to this financial independence has only strengthened those feelings. Today, as a result of his employment, Ronald has established a rather enviable savings account. He purchases his clothes and certain essentials, and when we travel, he is responsible for the purchase of his own airline ticket and most of his expenses. Additionally, he has become a tax payer.

I'm also pleased to inform you that while Ronald is not an "average" individual in the work force, his co-workers have valued the difference and treated him with respect. To me this speaks well of the management of Pizza Hut and their positive support of the program.

This support by management, and the respect of his co-workers has certainly had a positive influence on Ronald with regard to his desire to work.

At this point, I would like to also say that as a result of my previous appearance here, two of Ronald's peers in our family support group have left the sheltered workshop environment to find employment with other businesses in the food service/restaurant area because of this worthwhile program. The increase in the self-esteem in these individuals has been significantly noticeable.

Based on our experience with Pizza Hut, I believe that the Targeted Jobs Tax Credit program is a pro-active method of helping people help themselves. It is an avenue for providing skills for unskilled and semi-skilled workers, and most important, it is a means of putting the tax payers dollars to work.

Mr. Chairman, I thank you again for this opportunity to appear in support of the Targeted Job Tax Credit program.

STATEMENT OF

PAUL E. SUPLIZIO
DIRECTOR
TARGETED JOBS TAX CREDIT COALITION

Mr. Chairman and Members of the Subcommittee:

I am Paul E. Suplizio, director of the Targeted Jobs Tax Credit Coalition. I appreciate the opportunity to testify today on behalf of our Coalition, which consists of more than 120 employers and community-based organizations who advocate renewal of TJTC. A list of Coalition members is attached to our testimony.

A decade ago, Congress launched a broad national experiment in use of the tax code to encourage private employers to hire disadvantaged workers. Congress recognized that the marketplace alone could not cure structural unemployment. A hard core of unemployed -- some would say, unemployable -- workers were not sharing in mainstream economic progress. TJTC was enacted to deal with this problem in a way that harnessed the initiative of the private sector.

A decade later, the situation has grown much worse. We have an underclass of 8 million workers[1] and the number ccntinues to grow from a rising number of children living in poverty, a high birth rate in hispanic families who comprise our poorest minority[2], more school dropouts, more single-parent families, and a large number of semi-literate youth emerging each year from our schools.

Our economic landscape is being radically transformed by the internationalization of production and rapid technological change. Unskilled jobs are being lost in great numbers and more skills are required for the jobs that remain.[3] At the same time, the advent of the "baby bust" generation means that while the economy is generating 2.5-3.0 million new jobs each year, only 1.5 million new workers will be available to fill the jobs. At a time when the opportunity to work is becoming greater than ever, the widening gap between skills required and the skill attainment of many of our citizens threatens us with a growing class of unemployables and a declining standard of living.

To meet this challenge, Congress needs to stress not just the goal of getting people into jobs, but the goal of helping people acquire skills needed to be and stay competitive in the labor market. To accomplish this will require nothing less than an employment and training revolution. At present, the pieces of the employment and training revolution are lying around unassembled. Some of these are the displaced worker retraining program of the trade bill, welfare reform, and the Job Training Partnership Act. Another is the targeted jobs tax credit.

<u>TJTC Has Proven Effective</u>

The important innovation represented by TJTC -- using the tax code to focus the capabilities of the private sector on hiring the disadvantaged -- has proven successful. Congress decreed that employers would receive a tax credit if they hired targeted workers, and employers did precisely that. They went out and hired targeted workers, 622,000 of them in 1985, including 394,000 youth, 128,000 welfare recipients, 43,000 handicapped workers, 26,000 Vietnam veterans, and 30,000 ex-offenders. After a year's lapse while tax reform was being enacted, the program resumed in 1987. Despite a slow start-up due to inadequate funding of state Job Services, 445,000 were hired last year. TJTC is obviously working.

No one should doubt that targeted workers are hired. State Job Services must certify the eligibility of each worker for the program. A five percent sample of certifications was audited in all 50 states in 1985. According to a report to Congress by the Secretary of Labor, "Of those audited, 245 or 1.08 percent were later found to be ineligible, well within the acceptable level of under 5 percent established by the Employment and Training Administration guidelines." Of the $27.8 million made available to states for administration of TJTC this year, 16 percent is specifically earmarked for audits to guard against fraud and abuse.

TJTC has proven to be highly cost-effective. The program works through the employer's hiring system, with job orders specifying "send us TJTC eligibles" filed with the Job Service and community-based organizations who have contact with the eligible populations. Research conducted by the National Center for Research in Vocational Education shows that most TJTC workers are hired by employers who have established programs to attract TJTC eligibles from target populations. Hiring activity is conducted by the private sector with minimum bureaucracy and red tape.

Government's role is limited to making referrals (which it would do anyway), certifying eligibles, and auditing tax returns (which it does anyway).

Data obtained by the Coalition from IRS' Statistics of Income Division shows that the average tax credit claimed per worker was $987 in 1984.[4] This figure is not, however, the revenue loss to the Federal government, because Treasury regulations do not allow employers to claim a wage deduction equal to the amount of the tax credit. Adjusting for this reduces the average revenue loss per worker to approximately $700 in 1984. In congressional testimony, CBO estimated the average revenue loss to be $700-$1,000. Sar Levitan and Frank Gallo have computed a figure of $830.

In the Tax Reform Act of 1986, the TJTC credit was reduced from 50 to 40 percent, the second year credit was eliminated, and a minimum work requirement was established. This reduced the cost to the government, with the largest reduction being the 20 percent cut in the amount of the credit. This suggests that, currently, the average cost per placement for a TJTC worker is $560-$800. This compares favorably to the placement costs of other Federal programs, such as JTPA ($3,000) and Job Corps ($5,400). In our view, TJTC is the most cost-effective Federal jobs program today.

<u>The Administration's Objection to TJTC is Fallacious</u>

The Administration, which opposes renewal of TJTC, bases its opposition on the claim that most disadvantaged workers are hired without the tax credit, therefore TJTC is a windfall to employers. A little inquiry shows this to be fallacious. Suppose the black youth unemployment rate is 33 percent; this means that one out of every three in the labor force is unemployed, and two out of every three have jobs. Thus, goes the argument, if three black youths enter the labor force, two will get jobs without any tax credit, and one will be unemployed.

What this argument misses is that not all black youth are in the labor force, which means actively seeking jobs. Only 40 percent are labor force participants; the other 60 percent are what the Labor Department calls "discouraged workers", who have given up job search. Considering the entire population of black youth who are not in school and would like to work, the unemployment rate is closer to 60 percent. Even this understates the problem, since 22 percent of black youths are holding part-time jobs when they want full-time work.[5]

The foregoing holds true for all the target groups, who have far more discouraged workers than those actively seeking work. Thus, it is erroneous to maintain that "most are getting jobs without any tax credit." The aim of TJTC is to draw the discouraged population into the labor force by demonstrating that job opportunities are available.

Evaluations of TJTC are Generally Positive

A two-year, $450,000 Labor Department evaluation of TJTC performed by MACRO Systems reached the "conclusion" that, in the majority of cases, TJTC was a subsidy for people whom employers would have hired anyway.[6] We consider this finding highly suspect, because just the opposite conclusion is supported by the evidence of the study itself. Four of the component studies in the evaluation cite evidence establishing that TJTC is not a windfall to employers, while only one component study supported windfall theory. To the question, "Did TJTC reduce overall unemployment?" all component studies gave an affirmative response.[7]

The most significant contribution of the MACRO Systems evaluation was the definitive work of Dr. John Bishop in demonstrating the new job creation effect of TJTC. Previous work by Sandra Christensen of CBO had found that nearly all TJTC jobs were net new jobs. Summarizing his work, Bishop reported:

> "It can be seen that among eligibles, the TJTC program had a fairly sizeable positive impact on employment probability. The increases were of the order of 10 percentage points. The program effect for noneligibles was positive (but much smaller) in most cases, implying no net displacement of noneligibles by eligibles. The overall job creation estimates were typically of the order of 200,000 to 300,000 additional persons employed. Most of the additional employment accrued to noneligibles, however. If we accept the magnitude of the estimates, then net job creation tended to be around 15 to 30 percent of the level of certification, as compared to the 100 percent reported by CBO.

" In summary, our analyses, which could be said to reflect a full, general equilibrium impact evaluation of TJTC, suggested (1) no displacement of noneligibles by certified workers and (2) small positive levels of net job creation."[8] (Emphasis in original).

This finding is of enormous significance because, until now, all that could be claimed for the TJTC program was that new hires filled existing jobs. There was little evidence to demonstrate that, by lowering the effective wage, the employer's demand for labor would increase, adding new jobs to the economy. Bishop has now supplied that evidence, and even though he states the net effect is small, the fact that there is any effect at all has a vast impact upon the cost-effectiveness of the program. For the workers in those 200,000-300,000 new jobs created by TJTC pay taxes, revenues flow to the Treasury, and even the most rudimentary calculations demonstrate that in such cases TJTC pays for itself and could even be revenue positive.

Another significant evaluation of TJTC was performed for the National Commission for Employment Policy by Dr. Edward C. Lorenz. This study examined the impacts of TJTC on the earnings of 1,031 persons hired under the program in Missouri and Maryland in 1982, compared to a control group of 796 persons who were eligible but did not get TJTC jobs. The study found that, "Most subgroups among those vouchered before hire experienced income gains significantly greater than the comparison group."[9]

Sar A. Levitan and Frank Gallo of George Washington University's Center for Social Policy Studies have also thoughtfully examined the TJTC program. Writing in the Labor Law Review Journal of October, 1987 they express reservations about the program's administration and indifferent oversight by the Treasury and Labor Departments, but state their belief that "the tax credit might be an important experiment in aiding the poor", even though "the verdict is still out on the usefulness of wage subsidies."[10]

While works like these have significantly advanced our understanding and ability to improve the operation of TJTC, they have a tendency to become overly absorbed in matters of administration and miss the main point: a jobs credit works. There is no doubt that use of the tax code provides a strong incentive to private employers to adopt behavior that would not be adopted based on market signals alone.

<u>TJTC Should Be Renewed and Adapted to Today's Challenge</u>

These hearings provide an occasion for Congress to weigh the full impact of this successful tax incentive, because in dealing with the employment and training problems that confront our nation, Congress will inevitably have to spend money. The question then becomes how best to spend it, directly or through the tax code? Consider the possibilities:

- o TJTC could be expanded to include economically disadvantaged older workers, single-parent families, and displaced homemakers;

- a tax credit could be devised to help the working poor escape from poverty by targeting the credit on higher-wage jobs;

- a tax credit could be devised to stem school dropouts through a program that combines schooling with a part-time job;

- a tax credit could be devised to ensure that displaced workers are trained for real jobs and not nonexistent jobs.

The dimensions of the employment and training challenge are huge, and both Federal money and the private sector will inevitably be involved. American business is already spending $25 billion each year to give workers the skills they need, and remedy the deficiencies of our schools. But business alone may be unable to make the investments needed to propel the labor force into the information age.

When it comes to hiring policies and training, companies may not be willing to hazard their economic survival on various sorts of direct subsidies that are perceived to bring unwanted government interference. In the largest pilot youth demonstration project of the Carter years, only 18 percent of private employers were willing to participate even when offered 100 percent wage subsidies. Jobs for the school dropouts in this program had to be found in the public sector. During the first year of JTPA, only 5 percent of employers surveyed said they intended to take measures to reach hard-to-employ people, such as teenage parents, former drug users, and the physically or mentally handicapped. Providing indirect incentives through the tax code may turn out to be the most workable approach.

The relevance of TJTC to the coming employment and training revolution is that using the tax code works. The annual battle over the Federal deficit has obscured this fact, and prevented TJTC from being constructively adapted to emerging labor force problems. We learn from our mistakes; we can learn from our successes as well. Congress should renew TJTC, and consider applying the same principle to the employment and training challenges at hand.

Mr. Chairman, this concludes my statement. Are there any questions?

Footnotes

1. "Poverty and the Underclass", in Isabel V. Sawhill (ed), Challenge to Leadership (Washington, Urban Institute, 1988), pp. 229-230.

2. Julie Kosterlitz, "Behind Hispanics' Deepening Poverty", National Journal, September 20, 1986, p. 2263. Bureau of the Census, The Hispanic Population in the United States, Current Population Reports Series p. 20, No. 416, August 1987.

3. William Johnston (ed), Workforce 2,000, (Indianapolis, Hudson Institute, 1987).

4. IRS, Statistics of Income Division, Individual Tax Returns 1983 and 1984, Corporate Income Tax Returns 1983, and Partnership Returns 1983 and 1984.

5. Richard B. Freeman and Harry J. Holzer, "Young Blacks and Jobs -- What We Now Know", The Public Interest, Winter 1985, p. 20.

6. Robert Crosslin, Kevin Hollenbeck, and Philip Richardson, Impact Study of the Implementation and Use of the Targeted Jobs Tax Credit Program, Overview and Summary, July 1986, p. VII-1.

7. Ibid., pp. VII-1 and VII-2.

8. Ibid., p. VI-2.

9. Edward C. Lorenz, The Targeted Jobs Tax Credit: An Assessment, report prepared for National Commission for Employment Policy, April 1985, p. iii.

10. Sar A. Levitan and Frank Gallo, "The Targeted Jobs Tax Credit: An Uncertain and Unfinished Experiment", Labor Law Journal, October 1987, pp. 641 and 649.

MEMBERS OF TJTC COALITION

Wickes Companies, Inc., Santa Monica, CA
Zayre Corporation, Framingham, MA
Wal-Mart Stores, Inc., Bentonville, AR
TGI Friday's Inc., Addison, TX
The Vons Companies, Inc., El Monte, CA
Shoney's South Inc., Memphis, TN
T.J. Maxx, Natick, MA
Malone & Hyde, Inc., Memphis, TN
The Principal Financial Group, Des Moines, IA
Foodmaker Inc., San Diego, CA
American Medical International, Inc., Beverly Hills, CA
Chili's Inc., Dallas, TX
Reliance Insurance Company, Philadelphia, PA
Shaw's Supermarkets, Inc., East Bridgewater, MA
Appalachian Computer Services, Inc., London, KY
Imperial Palace, Las Vegas, NV
SRC Services Inc., Columbia, SC
LTW Management Services, Freehold, NY
The Alameda Company, Alameda, CA
Annco, Inc., Austin, TX
K& S Associates, Inc., Perth Amboy, NJ
Personnel Services, Ltd., Redondo Beach, CA
ATSCO, Pittsburgh, PA
SER/Jobs for Progress, Inc., Corpus Christi, TX
SER/Jobs for Progress, Inc., Yuma, AZ
SER/Jobs for Progress, Inc., Miami, FL
SER/Jobs for Progress, Inc., Waukegan, IL
SER/Jobs for Progress, Inc., Las Cruces, NM
EASA, Inc., Solvang, CA
Borg Warner Protective Services, Parsippany, NJ
Pay Less Drug Stores, Wilsonville, OR
Boss Manufacturing Company, Kewanee, IL
DiGiorgio Corporation, San Francisco, CA
Wells Lamont Corporation, Chicago, IL
Shaklee Products Inc., San Francisco, CA
Grace Home Centers West, Brea, CA
Levi Strauss Inc., San Francisco, CA
Commercial Bank & Trust Company, Miami, FL
Sysco/Gulf-Atlantic Food Services, Jacksonville, FL
Scotty's Inc., Winter Haven, FL
Suddath Van Lines., Tampa, FL
Misner Marine Inc., Tampa, FL
Bud Suarez, Inc., Tampa, FL
Heinicke Jet Aviation, Hollywood, FL
Williams Management Enterprises, Orlando, FL
Samar Management, Burger King, Port Richey, FL
Aragon & Sons, Inc., Dania, FL
Fast Food Enterprises, Vero Beach, FL
Merit Electric Company, Inc., Largo, FL
Florida Power Corporation, St. Petersburg, FL
Fleetwood Enterprises, Riverside, CA
Florida Rock Industries, Inc., Jacksonville, FL
Gabriel Communication Corporation, Ft. Lauderdale, FL
Tropical Circuits, Inc., Ft. Lauderdale, FL
K&G Box Company, Jacksonville, FL
Asplundh Tree Expert, Company, Willow Grove, PA
Stimpson Company Inc., Bayport, NY
Fronton Inc., West Palm Beach, FL
Sanaware Corporation, Tampa, FL
Rogers & Ford Construction Corporation, Boca Raton, FL

Creative Hairdressers, Arlington, VA
Bestway, Miami, FL
Food Lion, Salesbury, NC
Rollins, Inc., Atlanta, GA
Key Pharmaceuticals, Inc., Miami, FL
Institutional Management Services Inc., Shreveport, LA
Braman Inc., Miami, FL
Carrols Corporation Inc., Syracuse, NY
White's City, Inc., White City, NM
Peter Piper, Inc., Phoenix, AZ
Lowrey's Freshies, Denver, CO
Peter Echrich, Ft. Wayne, IN
Cortez III, Alamogordo, NM
Aunt Nellie's Food, Inc., Clyman, WI
Caremore, Inc., Cleveland, TN
Showbiz Pizza Place, Brock Corporation, Irving, TX
The Posthauer/Pinckert, Inc., Houston, TX
Circle K Corporation, Phoenix, AZ
Value Plus, Alamogordo, NM
Justin Boot, Inc., Ft. Wayne, TX
Longs Drug Stores, Inc., Walnut Creek, CA
Cooper's Western Wear, Inc., Albuquerque, NM
Swords to Plowshares, Inc., San Francisco, CA
Oakland Chinese Community Council, Inc., Oakland, CA
CET Center for Employment Training, San Jose, CA
Associated Industries of Florida, Tallahassee, FL
The Boury Corporation, Wheeling, WV
C.M. Uberman Enterprises, Bethesda, MD
Florida Fast Food Services, Inc., Lakeland, FL
Lakeland Fast Food Services, Inc., Lakeland, FL
Restaurant Management Inc., Williamsport, PA
McFaddin Ventures, Inc., Houston, TX
National Trading Management Inc., Miami, FL
Merchants Bank of Miami, Miami, FL
Classic Motor Carriages, Miami, FL
Mayor's Jewelers, Inc., Miami, FL
Tropex Batteries Inc., Miami, FL
International Medical Centers., Miami, FL
George Williamson Cadillac Co., Miami, FL
National Medical Management, Miami, FL
The Forge Restaurant, Miami, FL
Restaurant Administration Services, Winter Park, FL
Montanari Clinical School, Hialeah, FL
A&A Glass and Mirror, Miami, FL
Dadeland Dodge, Miami, FL
Atlantic Cost Structural Forming, Inc., Hialeah, FL
Hickory Farms of Ohio, Maumee, Ohio
Crown Carrier Systems, Miami, FL
Solitron Devices, Inc., Rivera Beach, FL
Sausman Hotel Group, Boca Raton, FL
Palm Beach Lincoln-Mercury, West Palm Beach, FL
Witters Construction Company, Hialeah, FL
Aaron Rents, Inc., Atlanta, GA
Health & Tennis Corporation of America, Inc., Los Angeles, CA
Davgar Restaurants Inc., Winter Park, FL
Uno Restaurants., West Roxbury, MD
Belvedere Construction Company, West Palm Beach, FL
Assisting the Disabled with Employment, Placement & Training, San Jose, CA
Q. Masters Dove, Inc., Lauderhill, FL
Weekly Asphalt Paving, Inc., Hallendale, FL
Randy's Ribs Inc., Lake Worth, FL
Norstrom, Santa Ana, CA
Numerical Financial Services, Clearwater, FL
Brown Group, Inc., St. Louis, MO
Florida Progress Corporation, St. Petersburg, FL

STATEMENT OF

BERNARD L. TETREAULT, EXECUTIVE DIRECTOR

MONTGOMERY COUNTY, MD HOUSING OPPORTUNITIES COMMISSION

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

ON BEHALF OF THE ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES (ALHFA), I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS EXTENSION OF THE DECEMBER 31, 1988 "SUNSET" ON AUTHORITY TO ISSUE TAX-EXEMPT MORTGAGE REVENUE BONDS (MRBs) AND MORTGAGE CREDIT CERTIFICATES (MCCS). I'M BERNIE TETREAULT, EXECUTIVE DIRECTOR OF THE MONTGOMERY COUNTY, MARYLAND HOUSING OPPORTUNITIES COMMISSION AND PAST PRESIDENT OF ALHFA.

AS YOU MIGHT IMAGINE, ALHFA MEMBERS HAVE A KEEN INTEREST IN SUNSET EXTENSION, AND WE WELCOME THE OPPORTUNITY TO RESPOND TO THE JUST-RELEASED STUDY OF THE PROGRAM BY THE GENERAL ACCOUNTING OFFICE.

BY WAY OF BACKGROUND, MR. CHAIRMAN, ALHFA IS A NONPROFIT, NATIONAL ASSOCIATION OF PROFESSIONALS IN THE FIELD OF AFFORDABLE HOUSING FINANCE. OUR 133 MEMBERS ARE CITY AND COUNTY GOVERNMENT AGENCIES* WHICH FINANCE HOMEOWNERSHIP AND RENTAL HOUSING OPPORTUNITIES FOR LOW- AND MODERATE-INCOME PERSONS. ALHFA'S PURPOSE IS TO SERVE ITS MEMBERS AS AN ADVOCATE BEFORE CONGRESS AND THE EXECUTIVE BRANCH ON AFFORDABLE HOUSING POLICY ISSUES, AND, THROUGH EDUCATIONAL ACTIVITIES, TO ENHANCE THE ABILITY OF LOCAL HOUSING FINANCE AGENCIES TO IMPLEMENT RESPONSIBLE AND PROFESSIONALLY-ADMINISTERED AFFORDABLE HOUSING PROGRAMS FOR LOW- AND MODERATE-INCOME PERSONS.

AT THE OUTSET MR. CHAIRMAN, I WANT TO COMMEND YOU FOR HOLDING THESE HEARINGS. WE ARE CONFIDENT THAT THE TESTIMONY YOU RECEIVE FROM ALHFA AND OTHERS WILL DEMONSTRATE THE LEGITIMATE AND IMPORTANT PUBLIC PURPOSE SERVED BY LOCAL AND STATE AGENCY MORTGAGE REVENUE BOND PROGRAMS, AND PROVIDE A SOUND BASIS FOR EXTENDING THE MRB SUNSET DATE. AS YOU KNOW S. 1522, INTRODUCED JULY 22 BY SENATOR DON RIEGLE, NOW HAS 60 COSPONSORS (INCLUDING 13 MEMBERS OF THE FINANCE COMMITTEE), WITH THAT NUMBER GROWING ALMOST DAILY. THESE SENATORS DID NOT ADD THEIR NAMES TO THE COSPONSOR LIST LIGHTLY, AS I'M SURE THEY WOULD ATTEST. RATHER THEY, LIKE WE IN ALHFA, FIRMLY BELIEVE THAT THE MRB PROGRAM IS SOUND PUBLIC POLICY AND APPROPPIATELY ASSISTS FIRST-TIME HOMEBUYERS -- MOST OFTEN THOSE WHOM THE CONVENTIONAL MORTGAGE MARKET HAS LEFT BEHIND -- IN PURCHASING A HOME. ALHFA STRONGLY SUPPORTS S.1522 AND URGES ITS PROMPT ADOPTION BY THIS COMMITTEE AND THE CONGRESS.

BEFORE COMMENTING MORE ON LOCAL AGENCY MRB PROGRAMS, I WISH TO SPEND A FEW MOMENTS RESPONDING TO THE GAO REPORT.

IN A WORD, MR. CHAIRMAN, WE ARE SHOCKED AT WHAT PURPORTS TO BE AN OBJECTIVE ANALYIS OF THE PROGRAM. WE FIND IT ANYTHING BUT OBJECTIVE. ITS TONE, ITS METHODOLOGY, ITS CONCLUSIONS LEAD US TO WONDER WHETHER GAO WAS GIVEN A CONCLUSION, i.e. THAT THE PROGRAM DUPLICATES MORTGAGE ASSISTANCE AVAILABLE CONVENTIONALLY AND IS THEREFORE A WASTE OF FEDERAL TAX REVENUE, AND ASKED TO JUSTIFY IT.

GAO'S REPORT SUGGESTS SOME FINDINGS THAT REFLECT POSITIVELY ON THE PERFORMANCE OF SINGLE-FAMILY BOND-FINANCED PROGRAMS.

FOR INSTANCE:

- MOST ASSISTED BUYERS WERE IN THE "25 TO 29" AGE CATEGORY AND LIVED IN A HOUSEHOLD COMPRISED OF TWO PEOPLE; THIS SUGGESTS THAT SINGLE-FAMILY BOND PROGRAMS BRING LOW- AND MODERATE-INCOME INDIVIDUALS INTO THE HOUSING MARKET EARLY IN THEIR ADULT YEARS PERMITTING THEM TO ENJOY HOMEOWNERSHIP BENEFITS SOONER THAN THE CONVENTIONAL MARKET PERMITS.
- FORTY PERCENT OF ASSISTED BUYERS PURCHASED NEW HOMES AND 80 PERCENT OF BOND ISSUERS SET ASIDE SOME PORTION OF BOND PROCEEDS FOR DEVELOPERS; THIS DEMONSTRATES THAT SINGLE-FAMILY BOND PROGRAMS ADD SIGNIFICANTLY TO NEW HOUSING CONSTRUCTION AND THE NATION'S OVERALL AFFORDABLE HOUSING STOCK, PROVIDING INCREASED HOMEOWNERSHIP OPPORTUNITIES.
- ASSISTED HOMEBUYERS PURCHASED HOMES THAT COST 70 PERCENT OF THE AVERAGE PURCHASE PRICE AND 80 PERCENT OF ASSISTED BUYERS HAD INCOMES AT OR BELOW 115 PERCENT OF THE AREA MEDIAN INCOME; THIS SUGGESTS THAT HOUSING FINANCE AGENCIES ADMINISTERED SINGLE-FAMILY PROGRAMS <u>BEFORE</u> THE 1986 TAX ACT IN A MANNER THAT GENERALLY COMPLIED WITH THE ACT'S NEW INCOME AND PRICE RESTRICTIONS.

THESE FINDINGS DEMONSTRATE THAT HOUSING FINANCE AGENCIES HAVE LARGELY SUCCEEDED IN ACHIEVING THE VERY FUNDAMENTAL OBJECTIVES OF THE PROGRAM ENUNCIATED BY CONGRESS: TO ENCOURAGE HOMEOWNERSHIP AMONG LOW- AND MODERATE-INCOME HOUSEHOLDS BY PROVIDING AN INCENTIVE TO PURCHASE IN THE FORM OF AN AFFORDABLE MORTGAGE, AND TO EXPAND HOMEOWNERSHIP OPPORTUNITIES FOR SUCH HOUSEHOLDS BY EXPANDING THE AFFORDABLE HOUSING STOCK.

GAO, HOWEVER, DOES NOT REACH THESE CONCLUSIONS NOR ANY OTHERS THAT REFLECT FAVORABLY ON THE MRB PROGRAM, AS IF TO SAY THAT THE 29 HOUSING FINANCE AGENCIES SELECTED DID NOTHING DURING THE STUDY PERIOD TO IMPROVE HOMEOWNERSHIP OPPORTUNITIES OR TO CONTRIBUTE IN ANY POSITIVE WAY TO HOUSING AFFORDABILITY.

THE ISSUE OF OBJECTIVITY BECOMES MORE CRITICAL WHEN WE CONSIDER THE VERY SERIOUS FLAWS IN GAO's DATA AND METHODOLOGY. SURPRISINGLY, GAO VERY ELOQUENTLY STATES THE PROBLEM:

> "BECAUSE WE SELECTED HOUSING AGENCIES JUDGMENTALLY, WE CANNOT ASSERT THAT OUR FINDINGS ARE REPRESENTATIVE OF QUALIFIED MORTGAGE BOND ACTIVITY NATIONWIDE." (P. 19)
>
> "SOME HOUSING AGENCY DATA FILES WERE INCOMPLETE FOR A SUBSTANTIAL NUMBER OF DATA ITEMS IN EACH CASE. BECAUSE OF MISSING OBSERVATIONS, WE CAN BE LESS CERTAIN THAT OUR RESULTS REPRESENT THE TRUE DISTRIBUTION OF THE POPULATION ... CAUTION MIGHT BE PRUDENT IN RELYING ON THE DISTRIBUTION OF THE OBSERVED VALUES ..." (P. 28)

IN SPITE OF THESE VERY STRONG AND NECESSARY STATEMENTS ABOUT THE DATA LIMITATIONS AND THE TOTAL INAPPROPRIATENESS OF GENERALIZING FROM THE SURVEY TO ALL BOND-ASSISTED PROGRAMS, GAO CHARGES FULL SPEED AHEAD IN DRAWING SUCH CONCLUSIONS AS:

> "...QUALIFIED MORTGAGE BONDS ARE AN INEFFICIENT AND COSTLY WAY TO PROVIDE ASSISTANCE TO FIRST-TIME HOME BUYERS, SERVE MOSTLY BUYERS WHO COULD AFFORD HOMES ANYWAY, AND HAVE DONE LITTLE TO INCREASE HOME AFFORDABILITY FOR LOW- AND MODERATE-INCOME PEOPLE.... GAO QUESTIONS WHETHER BOND ISSUANCE AUTHORITY SHOULD BE EXTENDED." (P. 5)
>
> "MOST HOME BUYERS RECEIVING ASSISTANCE THROUGH QUALIFIED MORTGAGE BONDS COULD HAVE PROBABLY PURCHASED THE SAME HOMES USING GENERALLY AVAILABLE MORTGAGE INSTRUMENTS, OR WOULD HAVE EVENTUALLY BECOME HOME OWNERS IF BOND ASSISTANCE WAS NOT AVAILABLE...." (P. 21)

AS ALHFA POINTED OUT IN ITS MARCH 11 RESPONSE TO GAO'S BRIEFING AND AS WE NOW CONFIRM AFTER STUDYING GAO'S WRITTEN REPORT, GAO USED DATA, ASSUMPTIONS, AND A METHODOLOGY THAT COULD YIELD <u>ONLY</u> PEJORATIVE CONCLUSIONS ABOUT THE MRB PROGRAM.

THE BASIS FOR OUR CLAIM INCLUDES SUCH ISSUES AS:

O GAO ACKNOWLEDGES THE "LARGE PROPORTION OF MISSING OBSERVATIONS" IN ITS SURVEY OF 29 HOUSING FINANCE AGENCIES YET IT "DID NOT CONDUCT ANY TESTS TO DETERMINE WHETHER THE DISTRIBUTIONS OF THE OBSERVED AND MISSING VALUES ARE REASONABLY THE SAME." (P. 82) EVEN WITHOUT KNOWING THIS DISTRIBUTION, GAO DRAWS SWEEPING CONCLUSIONS ABOUT ASSISTED HOMEBUYERS;

O GAO STATES THAT THE ANNUAL HOUSING SURVEY (AHS) OBSERVATIONS ARE "INSUFFICIENT TO MAKE STATISTICALLY VALID INFERENCES ON AN AREA-BY-AREA BASIS BUT PROVIDES VALID ESTIMATES OF FIRST-TIME HOMEBUYER CHARACTERISTICS NATIONWIDE." (P. 83) WITHOUT TESTING THE STATISTICAL VALIDITY, GAO BOLDLY MAKES INFERENCES ABOUT ASSISTED FIRST-TIME HOMEBUYER CHARACTERISTICS NATIONWIDE FROM A SURVEY OF 29 "JUDGEMENTALLY-SELECTED" LOCATIONS.

O APART FROM MENTIONING A 28-PERCENT HOUSING COST-TO-INCOME RATIO, THE GAO REPORT ENUMERATES NO OTHER CONVENTIONAL UNDERWRITING CRITERIA RELATED TO THEIR ANALYSIS. ON THIS BASIS ALONE GAO CONCLUDES THAT FULLY 67 PERCENT OF ASSISTED HOMEBUYERS COULD HAVE PURCHASED HOMES WITH UNASSISTED CONVENTIONAL FINANCING (56 PERCENT WITH 30 YEAR FIXED-RATE LOANS, AND 11 PERCENT WITH ADJUSTABLE-RATE LOANS). MR. CHAIRMAN, YOU KNOW AS WELL AS I THAT MORTGAGE APPLICANTS DO NOT WALK OUT OF A BANK OR MORTGAGE COMPANY WITH A LOAN SIMPLY BECAUSE THEY MEET THE 28-PERCENT TEST. ACHIEVING THAT THRESHOLD IS MERELY THE FIRST STEP IN AN OFTEN LONG AND DETAILED PROCESS. WE DOUBT VERY SERIOUSLY THAT GAO COULD HAVE QUALIFIED 67 PERCENT OF ASSISTED HOMEBUYERS FOR CONVENTIONAL LOANS IF IT HAD CONSIDERED THE PURCHASERS' NET WORTH, INCOME STABILITY, EMPLOYMENT HISTORY, HOUSING EXPENSES, CREDIT RATINGS, OTHER FINANCIAL OBLIGATIONS, CLOSING COSTS, AND FEES - ALL THINGS CONSIDERED IN THE REAL WORLD OF MORTGAGE FINANCE.

O IN DISCUSSING BENEFITS, GAO CONTENDS THAT MRB PROGRAMS DO NOT IMPROVE HOMEOWNERSHIP AFFORDABILITY AND ADVOCATES THE USE OF GRADUATED-PAYMENT MORTGAGES, ADJUSTABLE-RATE MORTGAGES, AND FHA INSURANCE AS MORE EFFICIENT AND EFFECTIVE MEANS TO ACHIEVE AFFORDABILITY. GAO MAKES THIS CLAIM EVEN THOUGH IT FAILED TO "DETERMINE HOW EFFECTIVELY GRADUATED-PAYMENT AND ADJUSTABLE-RATE MORTGAGES AND FHA INSURANCE REDUCE THE IMPEDIMENTS TO FIRST-TIME HOMEOWNERSHIP COMPARED WITH BOND FINANCING." (EMPHASIS ADDED, P. 63)

O GAO WOULD HAVE US BELIEVE THAT, WITHOUT FAIL, "10 TO 40 PERCENT OF THE PRESENT VALUE OF THE [PROGRAM] SUBSIDY IS CAPTURED BY DEVELOPERS" WHO RAISE HOUSE PRICES WHEN BOND-FINANCED MORTGAGE FUNDS ARE SET ASIDE FOR PARTICULAR PROJECTS. IF GAO HAD GONE BEYOND ITS LITERATURE REVIEW AND PERFORMED A REALITY TEST, IT WOULD HAVE FOUND THAT, IN LOS ANGELES FOR INSTANCE, DEVELOPERS HAVE LOWERED PRICES BY $5,000 PER UNIT TO PARTICIPATE IN THE PROGRAM BECAUSE OF THE CERTAINTY OF FINANCING.

O AS FINAL EVIDENCE OF HOW GAO DENIES OR UNDERSTATES PROGRAM BENEFITS, CONSIDER THIS ...

"EVEN IF QUALIFIED MORTGAGE BONDS INCREASED THE NUMBER OF HOMEOWNERS OVER TIME, THE INCREASE IN CONSTRUCTION ACTIVITY MIGHT NOT BE COMMENSURATE FOR THE FOLLOWING REASONS. FIRST, IF THERE WERE A NET INCREASE IN HOUSING BECAUSE OF THE BONDS, THE INCREASE IN JOBS IN THE CONSTRUCTION INDUSTRY MIGHT COME AT THE EXPENSE OF JOBS IN OTHER INDUSTRIES BECAUSE THE DIVERSION OF CAPITAL TO HOUSING MAY REDUCE ACTIVITIES IN OTHER INDUSTRIES." (P. 64)

MR. CHAIRMAN, THIS INCREDIBLE STATEMENT ARGUES AGAINST ANY FEDERAL PARTICIPATION IN THE ECONOMY AT ALL. GAO GOES ON ...

"AND SECOND, INCREASED HOME OWNERSHIP MIGHT REDUCE THE NUMBER OF RENTER HOUSEHOLDS ... THIS REDUCTION MIGHT EVENTUALLY MEAN FEWER RENTAL HOUSING UNITS WOULD BE NEEDED, AND THUS LESS RENTAL HOUSING CONSTRUCTION." (p. 64)

MR. CHAIRMAN, ALHFA APPLAUDS ANY MOVEMENT OF RENTER HOUSEHOLDS TOWARDS HOME OWNERSHIP. ALHFA ALSO RECOGNIZES THE VERY REAL AND CURRENT CRISIS IN AFFORDABLE RENTAL HOUSING; WE HAVE MUCH TO SAY ON THIS TOPIC BUT RENTAL HOUSING IS NOT THE ISSUE TODAY.

O RELYING ON THE ESTIMATES OF THE JOINT TAX COMMITTEE, GAO REPORTS THAT THE REVENUE LOSS ASSOCIATED WITH MRBs IS $20 TO $30 MILLION FOR EACH $1 BILLION OF BONDS ISSUED, OR $150 MILLION TO $200 MILLION IN PRESENT VALUE TERMS. (P. 66)

MR. CHAIRMAN, WE FIND IT INCREDIBLE TO ATTRIBUTE ADDITIONAL REVENUE LOSS TO A USE OF TAX-EXEMPT BONDS WHICH IS ALREADY SUBJECT TO THE UNIFIED VOLUME CAP ENACTED IN 1986. IF BONDS AREN'T ISSUED FOR MORTGAGES THEN THEY COULD BE ISSUED FOR OTHER PURPOSES BUT ONLY UP TO THE CAP AMOUNT. GAO AND THE JOINT TAX COMMITTEE CANNOT HAVE IT BOTH WAYS.

WE BELIEVE THAT THE GAO STUDY SHOULD BE REJECTED OUT-OF-HAND AS BIASED AND AS A DISSERVICE TO THE MORTGAGE REVENUE BOND PROGRAM RECIPIENTS AND THE AGENCIES WHICH ADMINISTER IT.

ALLOW ME TO SPEND THE BALANCE OF MY TESTIMONY POINTING UP THE NEED FOR EXTENDING AUTHORITY TO ISSUE MRBs AND DISCUSSING THE POSITIVE CONTRIBUTIONS WHICH THE PROGRAM MAKES TO ENCOURAGING AFFORDABLE HOMEOWNERSHIP AND TO EXPANDING THE AFFORDABLE HOUSING STOCK.

THE JOINT CENTER FOR HOUSING STUDIES AT HARVARD, IN ITS RECENT STUDY THE STATE OF THE NATION'S HOUSING REPORTS THAT: "ALTHOUGH THE PERCENT OF HOUSEHOLDS OWNING THEIR OWN HOMES DID INCREASE NATIONWIDE FROM 1973 TO 1980, THIS SHARE HAS SINCE FALLEN FROM 65.6 PERCENT IN 1980, TO 64.0 PERCENT IN 1987. THE DECLINE IN HOMEOWNERSHIP IS A NATIONWIDE PHENOMENON AFFECTING AREAS WITH STRONG AND WEAK ECONOMIES ALIKE.... THE DECLINE IN HOMEOWNERSHIP IS REMARKABLE FOR SEVERAL REASONS: FIRST, IT OCCURRED DURING ONE OF THE MOST VIGOROUS AND SUSTAINED HOUSING RECOVERIES ON RECORD. SECOND, IT HAS REDUCED THE NATION'S HOMEOWNERSHIP RATE TO ITS LOWEST LEVEL IN OVER 15 YEARS. THIRD, LOWER HOMEOWNERSHIP RATES FOR YOUNG ADULTS [AGED 25 TO 29, WHERE THE RATE FELL FROM 43.3 PERCENT IN 1980, TO 35.9 PERCENT IN 1987] ARE FOUND IN ALL REGIONS OF THE COUNTRY.... APPARENTLY, THE CONTINUING HIGH AFTER-TAX CASH COST OF HOMEOWNERSHIP AND THE GROWING RENTAL PAYMENTS BURDEN ARE PREVENTING RENTERS IN ALL REGIONS OF THE COUNTRY FROM ACCUMULATING THE RESOURCES NEEDED TO MAKE THE DOWN PAYMENT AND MEET THE INITIAL YEAR CARRYING COSTS OF HOMES OF THEIR OWN." IT IS AGAINST THIS BACKDROP THAT CONGRESS MUST ADDRESS CONTINUATION OF THE MRB PROGRAM.

IN MONTGOMERY COUNTY WE HAVE USED MRBs FOR A MORTGAGE PURCHASE PROGRAM (MPP). THIS PROGRAM PROVIDES A SOURCE OF MORTGAGE FINANCING FOR FAMILIES WHO MIGHT OTHERWISE BE UNABLE TO PURCHASE THEIR FIRST HOME AT EXISTING INTEREST RATES. BY PROVIDING THIS FINANCING IN THE FORM OF COMMITMENTS OF PERMANENT FINANCING TO DEVELOPERS, HOC PROMOTES THE CONSTRUCTION OF NEW, MODEST HOMES FOR FIRST-TIME HOMEBUYERS WITHIN THE COUNTY. BECAUSE OF THE NATURE OF OUR HOUSING MARKET, THESE AFFORDABLE HOMES, ABSENT BOND FINANCING, WOULD NOT HAVE BEEN BUILT. DEVELOPERS WHO RECEIVE ALLOCATIONS OF THIS LOWER INTEREST RATE FINANCING MUST MEET CRITERIA WHICH INCLUDE QUALITY OF CONSTRUCTION, ENERGY EFFICIENCY, LOCATION AND PRICE -- THE MAXIMUM LIMITS OF WHICH ARE WELL BELOW FEDERAL RESTRICTIONS ON PURCHASE PRICE. IN NO CASE HAVE WE FOUND THAT DEVELOPERS HAVE RAISED PRICES BECAUSE OF THE MPP -- THEY ARE PRECLUDED FROM DOING SO BECAUSE OF OUR REQUIREMENTS.

IN ADDITION, SOME OF THE UNITS OFFERED FOR SALE BY BUILDERS AND FINANCED THROUGH THE MPP ARE MODERATELY PRICED DWELLING UNITS (MPDUs). THESE ARE UNITS BUILT ACCORDING TO COUNTY LAW AND SOLD AT SALES PRICES BELOW MARKET VALUE FOR SIMILAR UNITS. THE COUNTY ALSO CONTROLS THE RESALE PRICE FOR A PERIOD OF FIVE TO TEN YEARS.

SINCE THE PROGRAM BEGAN IN 1979, SOME 5,440 HOMEBUYERS HAVE BEEN ASSISTED. DURING THIS TIME, THE PROGRAM HAS BEEN SHARPLY TARGETED SO THAT THE AVERAGE LOAN PURCHASED BY THE COUNTY'S PROGRAM DURING THIS NINE-YEAR PERIOD HAS BEEN $52,000, 39 PERCENT OF THE CURRENT AVERAGE AREA PURCHASE PRICE SAFE HARBOR OF $132,570. THE HOUSEHOLD INCOME OF BORROWERS OVER THIS TIME FRAME AVERAGED $25,725, 58 PERCENT OF THE COUNTY'S CURRENT MEDIAN INCOME OF $44,500, AND THE AVERAGE DOWNPAYMENT MADE BY THOSE ASSISTED WAS ABOUT 7.5 PERCENT.

TYPICAL OF THOSE ASSISTED WERE A SINGLE FEMALE PARENT WITH TWO SMALL CHILDREN, A SCHOOL TEACHER, A BLUE COLLAR WORKER, A WIDOW WITH SMALL CHILDREN. COULD THEY HAVE GOTTEN CONVENTIONAL MORTGAGES? NOT AT ALL.

THIS THEN, MR. CHAIRMAN, IS HOW THE PROGRAM WORKS IN MONTGOMERY COUNTY AND HOW IT SQUARELY ADDRESSES THE ISSUE OF AFFORDABILITY AND OF EXPANDING THE STOCK OF AFFORDABLE HOUSING.

ANOTHER EXAMPLE OF THE USE OF MRBs TO PROMOTE HOMEOWNERSHIP AND TO IMPROVE THE HOUSING STOCK EXISTS IN PITTSBURGH. THOUGH DIFFERENT FROM MONTGOMERY COUNTY IN THAT IT'S A CENTRAL CITY WITH DECLINING POPULATION AND DETERIORATED HOUSING STOCK IN NEED OF REDEVELOPMENT, THE URBAN REDEVELOPMENT AUTHORITY OF PITTSBURGH HAS PROVIDED $56 MILLION OVER THE LAST 10 YEARS IN BELOW-MARKET MORTGAGE FINANCING FOR 1,472 HOUSEHOLDS TO PURCHASE NEW OR EXISTING HOMES. THROUGH ITS BOND-FINANCED HOME IMPROVEMENT LOAN PROGRAM, THE AUTHORITY HAS PROVIDED $63 MILLION OVER THE LAST 10 YEARS TO FINANCE IMPROVEMENTS TO 12,238 UNITS, NEARLY ONE IN EVERY SIX OWNER-OCCUPIED UNITS WITHIN THE CITY.

UNDER THE 1987 HOMEOWNERSHIP PROGRAM FOR EXAMPLE, PITTSBURGH MADE AN AVERAGE FIRST MORTGAGE LOAN OF $33,432 ON AN AVERAGE HOME SALES PRICE OF $35,638 (63 PERCENT OF THE MAXIMUM AREA PURCHASE PRICE) TO A BORROWER WHOSE INCOME WAS $24,381 (80 PERCENT OF THE MEDIAN INCOME OF $30,400). OF THE 275 BORROWERS, NEARLY 23 PERCENT HAD INCOMES BELOW $20,000, WHILE 84 PERCENT HAD INCOMES BELOW $30,000.

UNDER THE PITTSBURGH HOME IMPROVEMENT PROGRAM, THE AVERAGE LOAN MADE IN 1987 WAS FOR $6,251 WHILE THE AVERAGE BORROWER HAD AN INCOME OF $17,558 (70 PERCENT OF MEDIAN).

THESE PROGRAMS, COMBINED WITH SUCH FEDERAL PROGRAMS AS UDAG AND CDBG, HAVE REVITALIZED TARGETED NEIGHBORHOODS THROUGH REHABILITATION OF DETERIORATED HOUSING STOCK AND HAVE PROMOTED ECONOMIC INTEGRATION BY ENCOURAGING HIGHER INCOME (THOUGH NOT WEALTHY) HOUSEHOLDS TO PURCHASE IN TARGETED NEIGHBORHOODS.

I CITE MONTGOMERY COUNTY, A GROWING COUNTY WITH AFFORDABILITY PROBLEMS AND PITTSBURGH, A CENTRAL CITY WITH DECLINING POPULATION AND THE NEED FOR REDEVELOPMENT AS PROTOTYPICAL OF LOCAL HOUSING FINANCE AGENCY MRB PROGRAMS, RESPONSIBLY CONCEIVED AND IMPLEMENTED. IF CONGRESS FOLLOWS GAO'S RECOMMENDATION THAT THE SUNSET NOT BE EXTENDED, THESE VERY VALUABLE PROGRAMS COULD CEASE. THERE ARE MANY, MANY MORE -- FROM CHICAGO TO MINNEAPOLIS-ST.PAUL, FROM LOS ANGELES TO PHILADELPHIA, FROM SAN ANTONIO TO NEW YORK TO ATLANTA, FROM SAN FRANCISCO TO ORANGE COUNTY, FL, TO NAME BUT A FEW.

SOME OF THESE CITIES -- NEW YORK, CHICAGO, SAN FRANCISCO, AND LOS ANGELES -- DO HAVE A PROBLEM MAKING THESE PROGRAMS WORK BECAUSE THEY ARE AREAS OF EXCEPTIONALLY HIGH HOUSING COSTS. UNFORTUNATELY IN THESE CITIES, THE MAXIMUM INCOME LIMIT OF 115 PERCENT OF MEDIAN IS NOT HIGH ENOUGH TO PURCHASE HOMES WHOSE PRICE IS WELL WITHIN THE MAXIMUM PURCHASE PRICE LIMITS (90 PERCENT OF AVERAGE AREA PURCHASE PRICE) PERMITTED UNDER THE MRB PROGRAM. LOS ANGELES VIVIDLY ILLUSTRATES THE PROBLEM. HOUSEHOLDS WITH INCOMES UP TO $38,180 (115 PERCENT OF MEDIAN) IN LOS ANGELES MAY PURCHASE HOMES UP TO $127,500 (90 PERCENT OF AVERAGE AREA PURCHASE PRICE). HOWEVER, $38,180 IS INSUFFICIENT INCOME TO PURCHASE EVEN A HOUSE COSTING $113,360, OR 80 PERCENT OF AVERAGE AREA PURCHASE PRICE. THE SITUATION IS EVEN MORE SEVERE IN NEW YORK CITY AND ITS SUBURBS AND WE'RE PLEASED TO NOTE THAT SENATOR MOYNIHAN IS WORKING ON THIS PROBLEM. WE SUPPORT HIS EFFORTS AND URGE THE SUBCOMMITTEE TO RESPOND TO THE VERY REAL PROBLEM PRESENTED IN HIGH COST AREAS. WE WOULD BE PLEASED TO WORK WITH THE SUBCOMMITTEE, AS WE ARE ALREADY DOING WITH THE JOINT TAX COMMITTEE STAFF, IN DEVELOPING A MEANS TO ADJUST INCOME LIMITS IN THESE HIGH COST AREAS TO RESPOND TO THE PROBLEM.

BY WAY OF CLOSING MR. CHAIRMAN, I REITERATE ALHFA'S SUPPORT FOR A FOUR-YEAR EXTENSION OF THE MRB SUNSET AS EMBODIED IN S. 1522 AND URGE ITS PROMPT CONSIDERATION AND PASSAGE, TOGETHER WITH AN INCOME LIMIT ADJUSTMENT FOR CERTAIN HIGH COST AREAS.

* INCLUDING SUCH CITIES AS NEW YORK, CHICAGO, ATLANTA, SAN FRANCISCO, LOS ANGELES, MINNI ST.PAUL, AND DENVER AND SUCH COUNTIES AS LOS ANGELES, COOK, AND DADE.

alhfa ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES
1101 Connecticut Ave., N.W., Suite 700 • Washington, D.C. 20036 • 202/857-1197

April 12, 1988

The Honorable Max Baucus
Chairman
Senate Subcommittee on Taxation
and Debt Management
SD 205 Dirksen Senate Office Bldg.
Washington, DC 20510

Dear Mr. Chairman:

You will recall at the hearing your Subcommittee held March 28, 1988 with respect to the issue of extending the December 31, 1988 sunset on Mortgage Revenue Bond issuing authority you asked for a response to the GAO's statement on the "efficiency" of mortgage revenue bonds and for a written response to Senator Moynihan's question regarding the problems in implementing MRB programs in high housing cost areas. I wish to elaborate on my answer regarding MRB efficiency and respond to Senator Moynihan.

The GAO asserts (p 62) "...that for each dollar cost to the federal government, only 12 to 45 cents of benefits are received." My response when you asked for a reaction to this was: What is the alternative - a direct federal expenditure program? This is not likely to happen given the fact that direct federal expenditure programs for housing have been reduced over 75 percent since 1981. In addition, one cannot disregard the fact that direct expenditure programs carry a cost in terms of their administration.

I also want to point out that many studies have challenged the methodology utilized by GAO to determine the efficiency of MRB. As excerpts from the attached study "A Referendum on the American Dream," prepared by the National Council of State Housing Agencies in cooperation with ALHFA, the National Association of Home Builders and the National Association of Realtors points out, GAO's approach exaggerates the cost and under-counts the benefits of the program. In short, GAO assumes that the entire interest income foregone through MRB investment would be fully subject to tax, an unlikely proposition. GAO also limits the program's benefits solely to interest rate savings to the homebuyer, disregarding other economic benefits stimulated by the program including the jobs created and the materials purchased for new home construction as well as the associate taxes generated. When this is taken into account, the benfits of the program clearly exceed its costs.

Sen. Moynihan has asked "whether the present MRB income limits work fairly in communities where housing costs are high relative to median income?" Our analysis indicates that the new income limits do not work fairly in at least 11 so-called high housing cost areas. These include New York, San Diego, Phoenix, San Francisco, Denver, Los Angeles, Boston, Tacoma, Portland, Norfolk and Nashville. As pointed out in ALHFA's testimony, incomes at 115 percent of area median are insufficient to purchase a new home at 75 percent of average area purchase price to say nothing of the 90 percent allowed by law. As shown on the attached chart, this analysis assumes a tax exempt mortage interest rate of 8.90%, a loan-to-value ratio of 90% and a qualifying window of $5,000 below the maximum allowed income in order to permit a reasonable income range for marketing purposes. In these 11 areas, the income limit under present law is insufficent to purchase a home at 75 percent of average area purchase. New York is the most extreme example with a gap of $14,787.

To remedy this, we propose an upward adjustment in the income limits for high cost areas and would be pleased to work with you and your staff in devising a specific formula.

Sincerely,

Bernie Tetreault

Bernard T. Tetreault
Past President

A Referendum on the American Dream

A Response to the
General Accounting Office Report on Homeownership

National Association of Home Builders
National Association of Realtors
National Council of State Housing Agencies
Association of Local Housing Finance Agencies

GAO Presented a Flawed and Biased Portrait of the MRB Program

At the request of the Joint Committee on Taxation, the General Accounting Office (GAO) examined the Mortgage Revenue Bond Program (MRB) which provides below market interest rate mortgage capital to qualified first-time homebuyers. The MRB program is subject to a uniform volume cap placed upon all private purpose bonds. States are allowed to issue private purpose bonds in amounts equal to the greater of $50 per capita or $200 million.

In order to qualify for an MRB financed mortgage, a prospective borrower may not have an income higher than the greater of 115% of state or area median and may not be purchasing a home costing more than 90% of the average area purchase price. These restrictions are the result of the Tax Reform Act of 1986 (Pl 99-514). Prior to that time period, both volume restrictions and qualifying standards were considerably higher. It is the targeting of the pre-Tax Act 1986 program which encompasses the bulk of the GAO report.

The National Association of Home Builders, National Association of Realtors, National Council of State Housing Agencies, and Association of Local Housing Finance Agencies take exception with GAO's portrayal of the MRB program and the first-time homebuyer market generally. Not only is the portrayal flawed, but GAO's basic assumptions disavow the nation's belief that homeownership is a desirable public goal. In one instance, the basic motivation of individuals to own a home is questioned.

It is ironic that on the week GAO released its report, the Joint Center for Housing Studies at Harvard University released its report on "The State of The Nation's Housing," 1988. Harvard presented a very different picture of the first-time homebuyer market and showed clearly how the difficulties encountered in this market are having repercussions throughout the rental housing market as well. Professors William C. Apgar, Jr. and H. James Brown concluded that:

- Homeownership Rates have declined throughout the decade of the 80's, representing a loss of over 2 million homeowners if the 1980 rate had merely remained constant over the last 7 years.
- The decline in homeownership among young households (25-39 years of age) is most dramatic including a 7.4 percent decrease in ages 24-29, an 8.9 percent decrease in ages 30-34 and a 7 percent decrease in ages 35-39.
- This decrease among the younger population exists in all regions of the country, regardless of the individual economic climates.
- The after tax cost of homeownership remains prohibitively high for would-be first-time homebuyers equalling $7,449 or 32.4 percent of the average annual income of potential first-time buyers aged 25-29 for the typical starter home in 1987 . . . about 50 percent higher than the share of income required in the early 1970s.

- Existing debt and increasing rents dramatically impact the ability of potential first-time buyers not only to qualify for a conventional loan but to save for downpayment and closing costs.

Significant Methodological Problems Skew GAO Conclusions

The General Accounting Office has presented a disturbing analysis of the MRB program, disturbing not for the finding which GAO purported to show, but for the distorted portrait that was drawn. GAO's analysis rests upon the acceptance of certain basic assumptions, which upon close scrutiny, are unsupportable. To accept the GAO findings, the reader must accept that:

- GAO has effectively analyzed the MRB program in the context of the first-time homebuyer market;
- conventional loans would be readily available to the first-time homebuyer market in the absence of MRBs;
- GAO's narrow definition of efficiency sufficiently explains the revenue implications to the federal government and the role MRBs play in the economy; and
- GAO possesses an understanding of housing policy and finance.

There is very little in this report that resembles the program and housing market environment with which we are familiar. Certain factors must thus be borne in mind when considering the GAO report.

GAO Skewed Beneficiary Analysis

Page 16 ***"Because we selected housing agencies judgmentally, we cannot assert that our findings are representative of qualified mortgage bond activity nationwide."***

The General Accounting Office analysis of the MRB program is based upon flawed methodological assumptions ranging from a skewed baseline sample to a fundamental ignorance of today's housing demographics. This analysis will show that had the GAO undertaken an impartial examination, its conclusion would have been significantly different. In fact, an objective observer of GAO's charts would conclude that the MRB program served the households Congress intended during the period 1983-1986 by implementing and exceeding the targeting rules Congress imposed over that period. Moreover, the successful efforts of issuing agencies to serve lower- before higher-income households as Congress instructed is clearly evident.

Private Market Mortgage Alternatives Were Not Examined

Page 57 ***"We did not determine how effectively graduated-payment mortgages, adjustable-rate mortgages, and FHA insurance reduces the impediments to first-time home ownership compared with bond financing."***

Throughout the report the GAO makes forthright statements or insinuates that MRBs are superfluous because they replicate the private sector in serving the first-time homebuyer market. Yet, GAO acknowledges above that it did not examine how well the private market, even using FHA insurance, is serving this market. Furthermore, underwriting standards employed by GAO are hypothetical and simplistic, particularly when used to analyze the high risk first-time homebuyer market. As will be discussed in the course of this report, GAO failed to grasp the dynamics of this segment of the homeownership market. For this reason the conclusions they drew are invalid.

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The Efficiency Calculation Overstated Costs, Understated Benefits

> **Page 61** ***". . . federal tax loss for a typical bond issue is about $25 million annually for $1 billion of bonds issued*** **(a 1981 Study cited).** ***We calculated the benefits based on the value of the mortgages made, the prevalence of developer set-asides, the interest rate spread, and the marginal tax rate of the homebuyers."***

GAO employed its standard approach to calculating efficiency, assuming the highest possible cost to the government and the narrowest definition of benefit. Then, GAO took its cost-benefit analysis and implies that this simple measure should be the standard upon which the worth of the program is measured. We will show that a more sophisticated cost-benefit approach presents a different picture of efficiency and value.

I. Beneficiary Analysis Proves that MRBs Served the Population Congress Intended

GAO places a great deal of emphasis on a very detailed analysis of 177,000 MRB loans from 29 issuing agencies over the period from 1983 to June 1987. As a baseline for comparison, the GAO compressed a universe of first-time homebuyers from the 1983 American Housing Survey (AHS). There are, however, problems related to the sample size. The AHS is well designed for its stated purpose . . . to collect data on the general housing characteristics of the United States. The AHS uses a sophisticated sampling plan to collect data on approximately 68,000 housing units that are representative of the existing inventory in this country. To determine its basis of comparison, GAO extracted a total of 567 cases from the sample. These cases represented "the observations in the AHS sample of first-time metropolitan homebuyers" (GAO Page 83). However, the sampling design for the 1983 AHS did not control for the specific characteristic of first-time homebuyer. It is recognized that a very small targeted sub-sample may be biased even if the total sample is not. Although the methodology of the AHS is laudable for its stated purpose, GAO's method of creating this basis for comparison is questionable. Since an accurate basis for comparison is critical to this or any evaluation, GAO should provide both the criteria they used for drawing the sub-sample as well as the justification for their belief that the sub-sample was not biased.

In addition to this major concern, the GAO estimates that 10 percent of that universe includes MRB assisted buyers. Moreover, GAO made no attempt to remove other federal, state or local subsidies from their sample. These two concerns, taken together, result in a baseline significantly skewed to the lower end of the first-time homebuyer universe. A more accurate comparison would be one which has removed MRBs and other subsidies to allow analysis of income of users of MRB program with those of the conventionally financed, non-assisted first-time homebuyer market.

Note too that the GAO sample of MRB loans contains four of the highest housing cost areas in the nation: California, New York, Illinois and Los Angeles. In fact, so disproportionately high are housing costs in these areas, that the Senate version of the Technical Corrections bill contains an MRB high cost adjustment factor which will, if enacted, allow for higher income limits in these areas (or portions thereof). In the words of the staff of the Joint Committee on Taxation, this amendment is drawn as "tightly as possible." This fact serves to illustrate the extreme high cost skewing. Additionally, an analysis of the MRB state issuers chosen by the GAO shows that the average income of potential first-time homebuyers in the states chosen to generate data for GAO run from 15 to 17 percent higher than the national average.

Table 1
Representativeness of GAO State Issuer Sample

	National Average	GAO States Selected		
Rental Households (married with children)	$20,899	$24,500	Difference	15%
Rental Households (married without children)	$29,028	$34,820	Difference	17%

Source: Joint Center For Housing Studies , Harvard University

Clearly then, the GAO prepared an analysis of higher than average income MRB samples with a first-time homebuyer universe that was skewed by the presence of assisted loans. GAO counters that the American Housing Survey universe used excluded rural areas, thereby creating a distortion to the high-end. No explanation was given for excluding the rural areas. The conclusion that must be drawn is that the GAO comparison is not representative.

An interim draft report on Mortgage Revenue Bonds by Dr. Margaret Wrightson of the Georgetown University Center for Public Policy, initiated at the request of the National Council of State Housing Agencies which also funded the research, provides a more realistic comparison of the MRB program. The following charts compare purchase prices and incomes of 1984-1987 for 141,800 MRB users from 16 states with the conventionally financed first-time homebuyer, including conventional loans secured with FHA insurance or VA guarantee, drawn from annual surveys conducted by the National Association of Realtors. The charts are used with permission of the author and present a much more accurate view of the program's impact.

Table 2
First-time Homebuyers with MRBs, Conventional, VA, and FHA Loans
Medians for Selected Financial and Demographic Variables
1984-1987*

	MRB	Conventional	VA	FHA
Purchase Price:				
1984	$56,000	$62,500	$68,500	$63,000
1985	54,000	69,800	69,000	64,000
1986	56,000	70,000	68,400	63,000
1987	62000	82900	70300	67,100
1984-1987	$55,000	$71,000	$69,000	$64,500
Income:				
1984	$27,000	$31,300	$32,500	$30,400
1985	26,000	37,000	32,600	30,600
1986	26,000	38,200	33,000	32,600
1987	27000	39600	35000	32,700
1984-1987	$26,000	$36,700	$33,100	$32,000
	(n=141,814)	(n=558)	(n=245)	(n=498)

* Data are unadjusted

Source: Data compiled from Georgetown Public Policy Program MRB beneficiary data base. Conventional and FHA data compiled from National Association of Realtors Residential Mortgage Panel Questionnaire, 1984, 1985, 1986, 1987.

The table above clearly indicates the success that states have had in fitting into the lowest end of the homeownership market. The most important point however, is that throughout the period studied MRB incomes not only were lower but remained constant when compared with the conventional, VA, and FHA buyers.

Likewise, MRB purchase prices started out lower and despite the constant escalation of real estate prices, grew at a significantly lower rate.

Statistical manipulations also flaw the GAO analysis of the purchase price and income distributions. GAO's upwardly skewed MRB statistics compared against a downwardly skewed first-time homebuyer sample provided a distorted analysis. The following purchase price and income analysis is based on MRB purchase prices from 16 states over the 1983-1987 period compared with the National Association of Realtors Residential Mortgage Panel Questionnaire in each year.

Table 3
Purchase Prices of
MRB, Conventional, VA, and FHA
First Time Homebuyers, 1984-1987*

Purchase Price:	MRB		Conventional		VA		FHA	
	%	(c%)	%	(c%)	%	(c%)	%	(c%)
less than $36,000	15	(15)	6	(6)	4	(4)	5	(5)
36,000-40,999	8	(23)	4	(10)	3	(7)	4	(9)
41,000-50,999	16	(39)	10	(20)	16	(23)	15	(24)
51,000-60,999	20	(9)	15	(35)	19	(61)	21	(45)
61,000-70,999	16.2	(75)	14	(49)	19	(61)	17	(62)
71,000-80,999	11.3	(86)	20	(69)	18	(79)	15	(77)
81,000-90,999	6.6	(92)	10	(79)	23	(90)	10	(87)
91,000 or more	8	(100)	20	(99)	9	(90)	10	(100)
	(n=141,814)		(n=558)		(n=245)		(n=498)	

* percentages do not sum to 100% due to rounding error. Data are adjusted.

Source: MRB data compiled from Georgetown Public Policy Program MRB beneficiary data base. Conventional and FHA data compiled from National Association of Realtors Residential Mortgage Finance Panel Questionnaire, 1984, 1985, 1986, 1987.

Table 4
Family Income of
MRB, Conventional, VA, and FHA
First Time Homebuyers, 1984-1987*

Income:	MRB		Conventional		VA		FHA	
	%	(c%)	%	(c%)	%	(c%)	%	(c%)
less than $25,000	38	(38)	12	(12)	9	(9)	15	(15)
25,000-29,999	22	(60)	19	(31)	24	(33)	24	(39)
30,000-34,999	18	(78)	15	(46)	26	(59)	28	(67)
35,000-39,999	10	(88)	14	(60)	16	(75)	15	(82)
40,000-44,999	6	(94)	11	(71)	11	(86)	10	(92)
45000 or more	6	(100)	29	(100)	14	(100)	8	(100)
	(n=141,814)		(n=558)		(n=245)		(n=498)	

* percentages do not sum to 100% due to rounding error. Data are adjusted.

Source: MRB data compiled from Georgetown Public Policy Program MRB beneficiary data base. Conventional and FHA data compiled from National Association of Realtors Residential Mortgage Finance Panel Questionnaire, 1984, 1985, 1986, 1987.

Tables 3 and 4 set out the statistical range for MRB, conventional, VA and FHA homebuyers. Once again MRB financing has clearly served the lower end of the spectrum. As would be expected, FHA and VA are more prevalent in the middle ranges, and conventional financing plays an increased role at the upper-end of the first-time homebuyer universe as income levels and purchase prices rise.

A Distorted Treatment of Downpayments

Perhaps no individual segment of the GAO report is more indicative of the distorted GAO analysis than their attempt to portray downpayments.

GAO's downpayment chart (Figure 2.5, Page 32) contains five statistical columns. The first compares down payments at zero. The GAO asserts 21 percent of all first-time homebuyers buy homes with no down payment. This is simply not the case. Further those that do receive no down payment loans are, for the most part, recipients of federal subsidies such as VA guarantees or Farmers Home Administration Section 502 loans. This fact highlights the illusions created by the failure to distill the conventional market from the overall first-time homebuyer universe.

The second and third columns compare downpayments in the 0.1 - 4.9 percent range and 5 percent specifically. The fourth column illustrates down payments in the range from 5.1 - 19.9 percent. After a three column spread of only 5 percentage points, the fourth column covers a dramatic spread of 14.8 points. This unusual variation could be considered a blatantly intentional distortion since the bulk of our data indicates that MRB loans are in the 7 - 9 percent range.

The fifth and final column covers all downpayments of 20 percent and more. However, GAO fails to illustrate the percentage of those loans which MRB users qualified for and received due to special underwriting criteria. For example, in many of the over 20 percent downpayment MRB loans the borrower is in a high cost area and has a low-income. Fifteen state agencies, including Maryland, New York, North Carolina, Rhode Island and the District of Columbia, have created downpayment and/or closing cost assistance programs. In addition, conventional guidelines such as disallowance of gifts for downpayments are overlooked. In many areas, high purchase prices relative to incomes mandate high downpayments regardless of how the loan is underwritten.

GAO's Case Against Young and Single Homebuyers

Throughout the discussion of their comparison of their MRB loan sample with the 1983 American Housing Survey, GAO sought to imply that MRB homebuyers were younger than the 1983 sample. This analysis is not borne by Georgetown University's analysis as the chart below indicates.

Table 5
First-Time Homebuyer
Head of Household's Median Age, 1984-1987
(MRB, Conventional, VA, and FHA)

Year:	MRB	Conventional	VA	FHA
1984	28	27.8	31.0	28.3
1985	28	29.0	30.0	28.6
1986	28	29.8	30.0	28.6
1987	29	29.0	31.1	28.2
1984-1987	28	28.9	30.5	28.5
	(n=211,958)	(n=1,844)	(n=845)	(n=513)

Source: MRB data compiled from Georgetown Public Policy Program MRB beneficiary data base. Conventional and FHA data compiled from National Association of Realtors Residential Mortgage Finance Panel Questionnaire, 1984, 1985, 1986, 1987.

GAO has some interesting observations on young or single individual households and their ability to purchase a home. The following quotations are indicative of their misperceptions:

Page 29 ***"The flexibility of renting and avoiding the higher costs of moving into and out of owner-occupied housing is generally more important to single persons."***

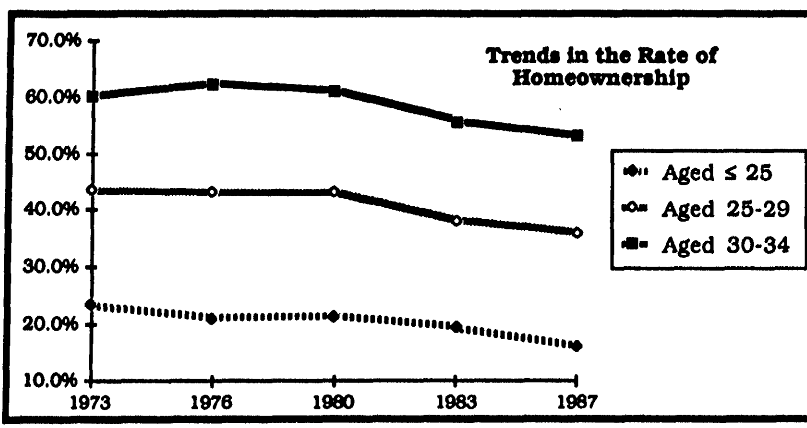
This statement flies in the face of a historic tenet of the nation's housing policies. The whole idea of the "American Dream" and the philosophy behind the mortgage interest deduction has been that both individuals or families would prefer to pay monthly mortgage payments on a home that they own rather than use the money for one-shot rental payments with no financial return. Homeownership brings with it the single most important tax benefit that ordinary American's enjoy, the mortgage interest deduction. Finally, as will be discussed at the close of this paper, GAO ignored the cost squeeze that is occurring in the rental market, a squeeze which in some metropolitan markets is beginning to make homeownership cheaper than renting.

GAO also completely ignored current trends in the homeownership markets as the following comment indicates.

Page 25 ***"the likelihood of becoming a home owner rises until about age 30 to 35."***

As the chart below indicates, the actual homeownership trends for all househsholds under age 35 are deteriorating.

Chart 1



Source: State of the Nation's Housing 1988, The Joint Center For Housing Studies, Harvard University

Finally, GAO uses questionable methodology to imply that MRB borrowers under age 25 are an especially elite group.

Page 23 ***"In particular, median income for all households nationwide (owners and renters) under age 25 is only $13,000, compared with $24,000 for assisted buyers under age 25."***

Such a comparison is deceiving because it shifts the focus of comparison from MRB participants to other first-time homebuyers, to a comparison with the entire population within the age group. It would be surprising if such a comparison did not indicate the above income differences. Wide variations in income are expected in a population that includes individuals and families who are jobless, in the military, in school, or working.

The flawed, sloppy analysis done by GAO in this particular sub-part of the report is indicative of the bias and flaws that marred the entire report. Even where the data would suggest a positive impact from the MRB program, GAO went to great pains to prove why such an impact actually was not the case . . . note the GAO discussion of purchase prices.

II. The Conclusion That So Many Could Have Gotten A Conventional Loan Results From A Misunderstanding of Loan Underwriting And The Secondary Market

GAO makes two invalid assumptions about the current state of the mortgage market that badly distorts the picture facing potential first-time homebuyers. First, GAO relies on out-dated and incomplete underwriting standards to assert that significant percentages of MRB participants could have purchased a conventionally financed home. Second, GAO ignores problems being experienced in the mortgage market that are affecting first-time homebuyers.

In analyzing the availability of market-rate loans for MRB borrowers, GAO used a housing expense-to-income ratio of 28 percent for conventionally fixed- and adjustable-rate mortgages for determining loan eligibility. Yet the afore cited "State of the Nation's Housing Report" stated that the cost of buying a typical starter home in 1987 was $7,449, or 32.4 percent of the average annual income of potential first-time homebuyers aged 25-29. GAO claims to have contacted lenders to determine underwriting criteria for conventional loans, so it is difficult to understand the reasons for selecting the 28 percent ratio. This simple ratio would not be available to most moderate-income first-time homebuyers, and wherever used by lenders, it represents only the first qualifying threshold.

Most first-time homebuyers, including MRB participants, have only limited amounts of funds available to use as a downpayment on their homes. Over the past three years, mortgage lenders and insurers have greatly tightened their underwriting standards for low downpayment loans. Generally, borrowers putting less than 10 percent down must meet a housing expense-to-income ratio of 25 percent and total payment-to-income ratio of 33 percent. Many MRB borrowers would be unable to meet these stricter requirements. In addition, many mortgage lenders and insurers have greatly reduced their activity in loans with loan-to-value ratios (LTVs) of greater than 90 percent, particularly in areas of the country experiencing economic difficulties.

The presence of discount points is also ignored by GAO in minimizing the advantages of MRBs. Discount points compensate the lender for the difference between the commitment interest rate on the loan and the market interest rate. MRB loans typically carry only a single discount point regardless of the market interest rate. By contrast, discount points on conventional loans have been known to rise into double digits and are frequently encountered in the range of 2 to 3 points, even on a day-to-day basis, as the market interest rate changes the amount of discount points which may be charged also changes. The difference in discount points charged on a $55,000 loan is expressed in the table below.

Table 6
Advantage of the One Discount Point MRB Loan

	MRB Loan	Conventional	Difference
Interest Rate	8.35%	9.75%	1.40%
Discount Points	1	3	2
Up-front Cost	$550	$1,650	$1,100
Effective Interest Rate	9.19%	10.54%	1.43%

Should the discount rate on a conventional loan increase to 5, the borrower must come up with an additional $2,200 above that required with an MRB to purchase the home. Such advantages cannot be ignored.

GAO is also remiss in touting adjustable rate mortgages (ARMs) as an easily obtainable alternative to MRB mortgages. For many lenders their hesitancy to originate high LTV ARMs is even greater than their hesitancy to take on high LTV fixed rate loans. In addition, ARM underwriting standards are becoming much stricter. For mortgages that adjust every year (the most popular type of ARM), lenders require applicants who put less than 20 percent down to qualify at the interest rate that would be in effect after the first year's adjustment. This requirement greatly offsets and sometimes completely eliminates the affordability benefits that the lower initial rates on ARMs once provided moderate income borrowers.

These underwriting changes, along with others . . . restrictions on seller contributions, gift letters, etc. . . . cast serious doubts on GAO's assertion that MRB borrowers could easily obtain conventional financing for their homes.

The following table dramatically illustrates the real world underwriting criteria used and the practical implications on purchasing a home. Mortgage underwriting practices throughout the private sector tightened dramatically during the years 1985-86. Lenders and secondary market institutions were responding to growing real estate losses. Currently, FHA is considering a reduction in its 2nd ratio from 42 percent to 38 percent. Moreover, adjustable rate loans are no longer being purchased by the secondary market. In the table below, note that by combining MRBs with FHA insurance, the ability to continue reaching the lower end into the potential first-time homebuyer market is retained. Viewing these numbers, it is understandable that preliminary results from the National Council of State Housing Agencies' 1987 Annual Survey found 40 percent of the MRB loans to be secured by FHA insurance with another 6 percent secured by the VA last year.

Table 7
Current Mortgage Underwriting Practices

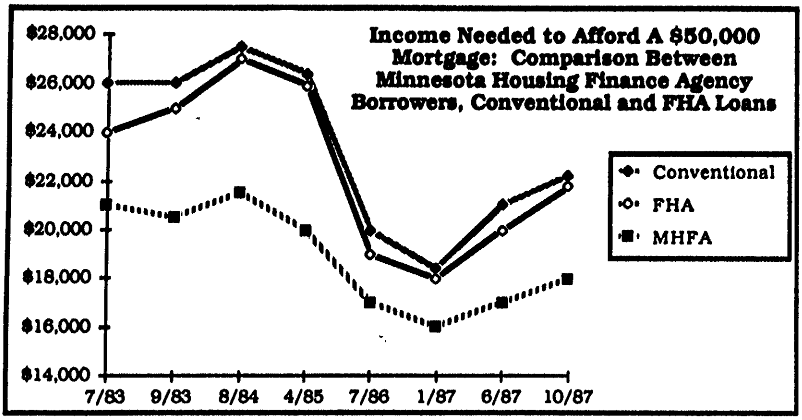
	GAO	Conventional		FHA	MRB +PMI	MRB + FHA
Downpayment	20%	20%	5%	5%	5%	5%
Ratio 1						
% of Income to Mortgage Debt Service	28%	28%	25%	29%	28%	29%
Ratio 2						
% of Income to Mortgage Debt Service Plus Debt in Excess of 6 months	N/A	36%	33%	42%	40%	42%
Interest Rate fixed for 30 Years	9.75%	9.75%	9.75%	9.75%	8.35%	8.35%
Average Annual Gross Income of Borrower	$26,000	$26,000	$26,000	$26,000	$26,000	$26,000
Monthly Income	$2,167	$2,167	$2,167	$2,167	$2,167	$2,167
Monthly Income x Ratio 1	$607	$607	$542	$628	$607	$628
Maximum Mortgage At Ratio 1	$70,612	$70,612	$63,046	$73,134	$80,003	$82,860
Maximum Sales Price At Ratio 1	$88,265	$88,265	$66,365	$76,983	$84,213	$87,221
Monthly Income x Ratio 2	N/A	$780	$715	$910	$867	$910
Monthly Income x Ratio 2 Less Other Debt	N/A	$180	$115	$310	$267	$310
Actual Maximum Mortgage	N/A	$20,951	$13,385	$36,082	$35,166	$40,880
Actual Maximum Sales Price	**N/A**	**$26,189**	**$14,090**	**$37,981**	**$37,017**	**$43,032**

'Monthly Debt Assumptions

One Car Payment	$280
One Child in Day Care	220
Consumer Debts	100
Total Debts	$600

In Minnesota, the housing finance agency standards were so much more lenient that borrowers needed substantially less income to qualify for a loan with the MRB program than with either the conventional market or FHA/VA.

Chart 2



The GAO also concludes that there were a number of MRB borrowers who could have qualified for a loan if they requested a loan only 10 percent smaller. Even GAO admits that MRB buyers purchase homes at 70 percent of the average first-time home purchase price. Their conclusion fails to address supply. In many instances, such low-cost homes do not exist in the market at the time of the purchase, or if they do, they are not of a caliber equal to or better than the rental units occupied by the buyer. It serves no public purpose to place a financially constrained first-time homebuyer in a home that requires immediate and significant expenditures to meet current building code standards or be made habitable. This is one underwriting standard which housing finance agencies share with the private sector.

To understand why underwriting standards are becoming more stringent, it is necessary to look at the situation in the mortgage insurance industry. Five years ago, private insurance competed vigorously for housing finance agency business. Favorable underwriting standards and costs competitive with FHA insurance or VA guarantee were offered. Pool insurance to back the bond issue and 100 percent LTV coverage was available. Beginning in 1985-86, the private mortgage insurers began limiting coverage and increasing premiums to cover losses occurring in the mortgage markets. According to FHA Commissioner Thomas Demery, private mortgage insurers on loans with downpayments of less than 10 percent accounted for 22 percent of all loans in 1987. In that year, only 7 percent of all private mortgage insurance loans had downpayments of less than 10 percent. Coverage of only 25 percent of the mortgage amount has become common for primary mortgage insurance policies and pool insurance is virtually unaffordable.

William Boling, BancBoston Mortgage Corporation and Chairman of the Mortgage Bankers Association of America, expressed the situation clearly in the March issue of Mortgage Banking.

"Mortgage insurers (MIs) (do not) penalize a first-time homebuyer, but MIs do give a compensating factor to an applicant who has previously owned a home. But MIs are pretty tough on the low- to moderate-income borrower, who typically will not have the stability and a history of employment as strong as MIs like to see. FHA is definitely more liberal and accepting of these borrowers. Also, the MIs do not consider compensating factors, such as overtime, secondary income, etc. to the same extent as do FHA and VA. And MIs do not appear to be interested in working with state housing agencies issuing bonds to serve the low-to moderate-income borrower in our areas of bond programs which are Florida, Georgia, and Alabama. This is because the MIs have increased underwriting criteria limits and the limits on seller's contribution creates problems. All of our housing authority bonds now are FHA and VA. (Mortgage Banking, February 1988)."

The National Council of State Housing Agencies has preliminarily estimated that 46 percent of the loans made by state agencies in 1987 carried FHA and VA mortgage insurance. Recognizing the declining-affordability problem confronting first-time homebuyers, HFAs are responding by combining MRBs with FHA and VA insurance to reach the lowest possible qualifiable borrower.

Finally, GAO woefully underestimates the affordability problem. The GAO study concludes that the lower rate available on MRB mortgages

Page 38 ***". . . is not likely to make a material difference in affordability for any but the marginally unqualified buyer."***

Even the most rudimentary analysis shows the inaccuracy of such a statement. GAO's concentration on the after-tax value of MRB interest savings is irrelevant when analyzing the impact of MRBs on affordability. Lenders consider gross income, not after tax payments and income, when applying mortgage underwriting ratios. Analysis on that basis shows that the interest savings on MRB mortgages contribute importantly in helping moderate income borrowers qualify for home financing.

The GAO study shows that, in half the cases examined, the spread between conventional and bond-assisted rates was greater than 144 basis points (a basis point represents 1/100 of a percent). The table below provides a very straight-forward response to GAO's claim than MRBs have little affect on affordability.

Table 8
MRBs Ability to Improve Affordability

Loan Amount	$55,000
MRB Interest Rate	8.35%
Conventional Interest Rate	9.75%
Monthly Interest Saving	$55
Annual Interest Rate Savings	$666
Reduction in Income Needed to Afford the Home	$2,500

That reduction in mortgage payments would reduce the income needed to qualify for the mortgage by more than $2,500 or 12 percent. An income change of that magnitude, which may represent two or even three years worth of pay increases for many moderate-income families, cannot be considered insignificant.

In addition, MRBs allow moderate-income first-time homebuyers to "lock-in" an affordable interest rate. As witnessed during the mortgage market turmoil of last spring, rate commitments on conventional financing can quickly evaporate as rates swing upward, thwarting many families' home purchase plans.

III. Involvement of Builders in the Program to Encourage New Construction for the First-Time Homebuyer Market is A Worthwhile Public Purpose.

The GAO study greatly exaggerates and grossly misrepresents the affect of builder set-asides on prices of new homes financed with MRB mortgages. GAO incorrectly assumes that most of the new homes financed with MRBs (40 percent of all homes in the GAO sample) were produced by builders who controlled access to the MRB mortgages. In the real world, builder set-asides or reservations are not the typical way in which MRB funds are dispersed. Thirteen state HFAs currently have builder set-aside programs and 11 states have never used this approach. Only 13 state HFAs allow MRB funds to flow to builders through participating mortgage lending institutions and in each case, the amount is limited. Moreover, GAO simply overestimates the extent of new construction activities. In 1987, only 27 percent of loans made by state HFAs were for new home purchases.

Typically, states do not provide for builder set-asides within bond issues and most of those that do use the set asides selectively to meet community housing needs. Builder reservations rarely account for even as much as 50 percent of the proceeds from any single MRB issue and frequently do not play any role in the distribution of MRB mortgages. The North Carolina Housing Finance Agency is typical. In the past, this agency used builder reservations to address housing stock shortages in selected areas, but has not provided builder set-asides in the past two years.

For GAO's claim that builders widely inflate prices of MRB financed homes to be true, builders not only must control access to MRB funds, but also must face no competition in the market. It would be rare for MRB funds to be channelled to just one builder. When set-asides are used, a number of competing builders are offered the funds in the same market and those firms face additional competition from the existing stock of lower-priced existing homes.

GAO did not perform original research to substantiate its claim that builders "capitalize" the MRB subsidy by raising home prices. Instead, GAO relied on earlier academic papers. These academic papers made no attempt to evaluate the prevalence of builder set-asides as tools for allocating MRB proceeds or the typical markets and circumstances in which builder set-asides are employed. Rather, they sought-out the rare exceptions where builder set-asides could be isolated from other competitive forces. Such data collection techniques created a more convenient analytical environment, but resulted in research that ignored or distorted the real world. For example, the Benjamin and Sirmans paper, "Who Benefits From Mortgage Revenue Bonds?" based its entire sample on student condominiums located in a university setting. GAO's own findings demonstrate that such homes and purchasers are not typical of the MRB program. Another paper cited by GAO, "Evidence on the Efficiency and Distribution of Mortgage Revenue Bond Subsidies: The Effects of Behavior Responses to the Subsidies" by D. Durning also stacked the deck against MRBs by excluding from the market rate sample homes those that exceeded the MRB purchase price limits, even if those homes were comparable to MRB financed houses. Furthermore, both of these studies examined transactions that occurred in 1983, which have little, if any, relevance to the MRB program as it operates under the tighter restrictions of the 1986 Tax Act.

Builder set-asides help bolster production of affordably priced homes by assuring builders that their customers will obtain financing when the homes are complete. The following table shows the escalation of home sales prices over the period 1982-1986. A builder set-aside can maintain some presence in the lower end of a market which is rapidly decreasing. With the advent of greater volatility in the mortgage markets, builders of moderately priced homes have lost customers when mortgage rates jumped before sales were closed. This increased marketing risk has led builders to focus more of their efforts on building homes for customers that are well above the affordability margin. MRB reservations have been an important tool in helping maintain builder production in affordable price ranges. In addition, agencies can employ builder set-asides to reduce their risk that interest rate declines will prevent utilization of bond proceeds. Finally, builder set-asides are used as incentives for the construction of affordable, low maintenance, energy efficient homes. The following table illustrates the trend toward the construction of higher priced homes and away from building those most affordable by moderate-income first-time homebuyers.

Table 9
New Home Sales by Price Range: 1982-1986
(percent distribution)

	1982	1983	1984	1985	1986
United States	100	100	100	100	100
Under $50,000	16	10	7	7	5
50,000-59,999	17	13	12	10	7
60,000-69,999	19	18	16	14	11
70,000-79,999	13	15	15	14	13
80,000-99,999	15	18	20	21	22
100,000-119,999	6	8	9	10	12
120,000-149,999	6	8	9	11	11
150,000 to over	8	9	12	14	19

Source: Characteristics of New Housing: 1986, Construction Reports C25-86-13, U.S. Department of Commerce, Bureau of the Census and U.S. Department of Housing and Urban Development, June 1987.

IV. By Defining Benefits As Narrowly As Possible and Attributing the Highest Costs, The Program Was Made to Look Inefficient

As it did in 1983, the GAO again asserts that bond financing is an inefficient means to generate a subsidy. It claims that for every dollar of revenue foregone by the federal government only between $0.12 and $0.45 of subsidy are received by the homeowner. Examination of the GAO's methodology once again reveals a rudimentary, static analysis. The issue of the inefficiency of tax-exempt bonds is one which has been debated for more than a decade. It is not as simple as frequently discussed.

First, inefficiency arguments relying solely on the cost/benefit approach that was employed by GAO are inadequate. GAO's model is designed to overestimate cost by assuming unrealistic investor behavior.

Second, GAO excludes economic or broader individual benefits in it's cost-benefit analysis. While this is standard practice in Congressional revenue estimating, it unrealistically confines the cost-benefit methodology by defining benefits too narrowly.

Third, MRBs now operate in a highly specialized and focused environment. It is a targeted resource and its use is limited by law.

GAO Employs a Limited Form of Cost-Benefit Analysis

GAO's cost-benefit efficiency analysis of the cost of MRBs assumes that if one less dollar of tax-exempt MRBs are issued, a high-bracket taxpayer is going to invest his money in a fully taxable savings instrument. It is much more likely that this investor will find other untaxed or partially taxed investment opportunities, such as tax shelters, pension savings, or assets, which offer appreciation possibilities. The tax on these investments is deferred until the gains are realized, possibly for many years. In fact, the small interest rate spread between tax-exempt and comparable taxable bonds that presently exists suggests that there are many other tax favored investment opportunities. Due to the existence of these other investment opportunities, the cost of MRBs is at least 35 to 40 percent lower than estimated.

Likewise, the determination of benefits is inadequate. GAO calculates the benefits of MRBs as resulting only from the interest-rate advantage and resulting cost savings that tax-exempt bond financed mortgages provide the homebuyers. GAO ignores the investment implications of homeownership versus renting. GAO also denies that any economic benefit could be attributed to MRBs. Note that economic benefits are not considered in Congressional estimates of the revenue impact of tax provisions due to constraints of the Congressional Budget Office's forecast of GNP growth. But GAO is undertaking a cost-benefit analysis, not calculating a revenue estimate. The two are different analyses with different underlying assumptions. (Although a case can be made for considering economic impacts in the revenue estimate.)

By excluding any economic benefits, GAO ignores that the homebuilding industry is, in fact, an industry. It is a major source of jobs and a consumer of manufactured materials. Aside from direct local economic benefits, one only needs to observe the economies in forestry products regions, carpet making, fixtures or appliance making areas. When housing starts decline, the economic impact is felt throughout these area and regional economies.

GAO argues that these economic resources are denied other sectors of the economy when being used for housing. Yet this argument ignores the relatively high proportion of domestically manufactured products consumed by the housing industry.

Likewise, the resale of homes has economic implications. Homes are improved prior to sale and afterward. Local retail sales result and nationally, manufacturing orders are produced. The local service sector, Realtors, attorneys, and lenders feel incomes shift with the rates of home sales.

The benefits of this economic activity should not be ignored in a cost-benefit analysis. Precisely because MRBs create individual benefits and economic benefits, states value their use. Especially for states and regions that need infusions of capital, the MRB has become an important resource.

Expanding Upon GAO's Static Cost-Benefit Approach

When the traditional Cost-Benefit approach is refined to account for the above factors, the benefits can be shown to far outweigh the costs. A cost-benefit model prepared by NCSHA and reviewed by a local university economist shows how the costs and benefits, when adjusted in the manner suggested above, produce a dramatically different picture of efficiency than that calculated using the type of model GAO seems to have employed. (Only a brief explanation was provided.)

	Impact
Dollars of MRBs Issued	$100.00
Lendable Proceeds Available Capped at 95% of proceeds in the 1986 Tax Reform Act	$95.00

GAO Type Efficiency Model

Cost From Revenue Foregone assumes total interest income of investor taxed at highest marginal rate	**$2.92**

Individual Benefits	**$1.13**
limits benefits to interest saved by homebuyer with an MRB	
Ratio of Individual Benefits/Cost From Revenue Foregone	**38.70%**

Two counters can be made to this approach. As noted in Galper and Toder's "Modelling Revenue and Allocation Effects of the Use of Tax-Exempt Bonds for Private Purposes," investors have options and varying investment motivations. Using the Galper and Toder model to derive a marginal tax rate for investors allowing for sophistication, the expected revenue impact on the treasury is much less than estimated by GAO.

Investor Sensitive Efficiency Model

Cost From Revenue Foregone	**$1.69**
assumes Galper and Toder model of investor behavior	
Individual Benefits	**$1.13**
limits benefits to interest saved by homebuyers with an MRB	
Ratio of Benefits/Cost	**66.70%**

In addition, economic benefits must also be considered. Even when using the contested GAO finding that only 30 percent of homebuyers would not have purchased a home without MRBs, a significant contribution to gross national product (GNP) can be calculated. Based on an economic impact estimating process designed by the National Association of Realtors, economic benefits of $14.69 are created for every $100 of bonds issued. Thus when reasonable economic benefits are added to the individual benefits and costs reduced by the federal revenues generated, the benefits far outweigh the costs.

Efficiency Model Considering Economic Benefits

Cost From Revenue Foregone	**$1.45**
accounts for sophisticated investor behavior and federal revenues resulting from economic activity generated	
Individual and Economic Benefits	**$16.47**
accounts for mortgage interest savings and economic activity generated	
Resulting Benefit - Cost Ratio	**1,139.71%**

An Efficient Delivery Vehicle for Low-Cost Mortgage Capital

GAO also resorts to a standard argument against tax-exempt bond financing by insinuating that significant portions of a bond issue are siphoned off by the bond underwriters, counsel, and issuers. The truth is that in 1987, 98 percent of the proceeds from bonds issued by state housing finance agencies under the Tax Reform Act of 1986 went into loans. GAO ignores that underwriters discounts, counsel and issuance costs are borne whenever securities are issued. Conventional loans sold on the secondary market carry transaction costs just like MRBs. While the legal costs of an MRB transaction is slightly greater than that of a conventional Mortgage Backed Security due to the need to ascertain the tax-exempt status to the satisfaction of the bond holder, this cost is more than off-set by the benefit provided the homebuyer.

An Important Role in the Housing Capital Market Has Been Created

One frequently ignored benefit of MRBs is their ability to direct capital to housing. The reality of recent years belies the notion that the private market will supply the full capital needs of the lower margins of the mortgage market. As noted above, HFAs have had such difficulty getting credit enhancements for these mortgages that many are relying increasingly on FHA insurance, examining forms of self-insurance, or are sharing risk with private insurers as a way to support the capital flow. Mortgage Backed Securities which provide a dynamic source of mortgage capital have not impacted upon the markets which HFAs have served with tax-exempt bonds. Leon Kendall, Chairman of MGIC, the largest provider of mortgage insurance, has stated on numerous occasions that MRBs have been the most effective available means for directing capital to the first-time homebuyer market in recent years.

The volume of bonds which may be issued under both programs is limited by the uniform volume cap for so-called "private activity bonds." Each state has a fixed amount of bond authority to use in financing development projects, whether it is housing, student loans, manufacturing facilities, ports, or private pollution control facilities. The Governor has the discretion to allocate this authority to the purposes of his choosing. Housing must compete with other uses for a piece of pie the size of which is known and limited.

In sum, MRBs augment rather than supplant private capital markets. Precisely because they are targeted, MRBs serve a housing market segment that is marginal to the private capital markets. MRBs provide low-cost, credit enhanced capital which is critical for lending institutions to make loans to perceived "higher risk" borrowers. MRBs are efficient precisely because they rely on existing private sector channels . . . realtors, mortgage lenders, investment bankers, and builders . . . to reach a targeted market with financing.

A Housing Program Delivery Capacity Has Been Created Around MRBs

Housing finance agencies have grown into the principal low- and moderate-income housing program delivery vehicle, largely due to their experience with MRBs. This organizational capacity is unlike that created by direct subsidy programs. Financial and underwriting skills exist unlike anywhere else in government outside of FHA. A variety of innovative programs has been built with these skills. These programs provide a centralized funding source which serves to promote low- and moderate-income homeownership and rental housing production.

Finally, GAO offers no alternative to MRBs for the ability to attract mortgage capital to a state through an efficiently functioning, public-purpose driven capital conduit. MRBs create no federal bureaucracy. Bond issuers fund their operations from nominal fees or agency reserves. Private-sector participants actually earn incomes from MRBs consistent with reasonable compensation in the market. It is time to put GAO's tired old inefficiency argument to rest. When benefits and costs are more broadly and reasonably defined, the inefficiency argument disappears.

V. GAO Ignored the Reality of Today's Housing Markets

The only valid point for elimination of Mortgage Revenue Bonds would be the lack of a homeownership affordability problem. This is far from the case. As mentioned earlier, the "State of the Nation's Housing 1988" has concluded that the relatively high levels of housing construction, home sales and remodeling expenditures have masked an ever-increasing population of housing have-nots, including potential first-time buyers.

Homeownership Rates have declined throughout the decade of the 80's, representing a loss of over 2 million homeowners if the 1980 rate had merely remained constant over the last seven years. Among young households (25-39 years of age) the decline is most dramatic, including a 7.4 percent decrease in ages 24-29, a 8.9 percent decrease in ages 30-34 and a 7 percent decrease in ages 35-39. The decrease among the younger population exists in all regions of the country regardless of the individual economic climates. In addition, the after tax cost of homeownership remains prohibitively high for would-be first-time homebuyers equalling $7,449 or 32.4 percent of the average annual income of potential first-time buyers aged 25-29 for the typical starter home in 1987. . .about 50 percent higher than the share of income required in the early 1970s. Finally, existing debt and increasing rents dramatically impact the ability of potential first-time buyers not only to qualify for a conventional loan but to save for downpayment and closing costs.

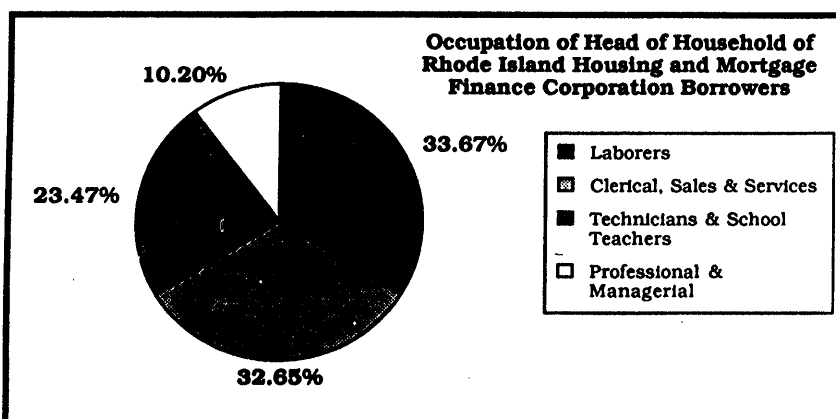
One of the critical findings is the interrelationship of each of the individual problems to one another. This gives new perspective to the term "trickle down". Today, it is the inability of families and individuals to buy their first homes, which then significantly exacerbates the housing affordability problem for other low- and moderate-income Americans.

The "State of the Nation's Housing Report" points out that as renters find it impossible to buy, rents are increased and affordable rental apartments are rehabilitated to take advantage of increased rents. Fewer affordable units remain in the stock and rent burdens continue to rise to unacceptable levels particularly for the low-income. As the private rental stock becomes less affordable to low-income Americans, governmental assisted units become the housing of last and only resort. The initial objective to provide quality subsidized housing as an interim measure prior to moving up is less achievable today. Finally, with the significant increases in individuals below the poverty line, homelessness becomes too often the result of all the above.

It is important to understand these interrelationships when considering the issue of homeownership as a public policy goal. GAO simply ignored this issue as though it were irrelevant. They failed to grasp the changing mortgage market and ignored the human side of the benefit calculation.

Various state, such as Rhode Island, have compiled profiles of typical MRB participants.

Chart 3



For too long, detractors have inferred that the MRB program is a "yuppie" program. Yet, individuals in the types of occupations portrayed below are hardly likely to experience the 62 percent annual increase cited by GAO in their *"representative sample"* footnote 8 on page 22. This footnote is one of the most misleading aspects of the report. The income and purchase price information cited above and the occupational profiles of the type gathered in Rhode Island are instead the reality.

Reaching the most marginal potential first-time homebuyers is extremely difficult and requires the type of commitment that housing finance agencies have demonstrated through their targeting efforts. In fact, with only a few exceptions, states began imposing income and/or purchase price limitations with their first single-family bond issues in the 1970's. It was not until the 1980's that these targeting limits were required by the federal government. Not only did the states show their leadership by implementing targeting strategies *earlier* than the federal government, but by continuing to set limits which are *lower* than those required by federal regulation.

More significantly, the states have implemented a variety of strategies to facilitate homeownership for those first-time homebuyers with the lowest incomes. Special strategies employed by the states include:

- setting **income and/or purchase price limits at the state level** before and/or below the federally-established limits (98 percent of the states have done this);
- providing **downpayment or closing cost assistance** (31 percent of the states);
- providing **mortgage payment assistance** (20 percent of the states);
- **buying the interest rate down** on a portion of, or for an entire bond issue (53 percent of the states);
- establishing **special set-asides of funds**, to ensure that lower income or special needs groups have guaranteed access to mortgage money (55 percent of the states);
- offering **special incentives for new construction/developers of affordable housing** (33 percent of the states);
- working with **non-profits** or local governments, establishing **limited equity, sweat equity/self help, lease-purchase,** or other creative mechanisms (33 percent of the states); and,
- the implementation of any other **systems which promote** the use of funds by **lower income borrowers before other (qualified) higher income borrowers, such as income ranking** (18 percent of the states).

Many states have chosen to set income and/or purchase price limits well below the federal guidelines. For instance, in Oregon, where income limits never exceed 100 percent of the state's median, they are often set lower based on interest rates and an affordability ratio. Many states have done set-asides of funds for those borrowers at or below 80 percent of median, such as Indiana did in 1980 (40 percent of bond proceeds were set aside for this purpose). Many states combine set-asides for special income groups with interest rate buydowns, enabling them to target even deeper than 80 percent of median. For instance, in New York this year, $10 million in bond proceeds were offered at a 4% interest rate, with special income and purchase price limits (loans closed thus far indicate average borrower incomes of $17,500, and $50,000 average purchase prices--well below 50 percent of the state's medians for income and purchase price). Several agencies, like the District of Columbia, offer downpayment assistance, enabling borrowers with limited savings to enter very high cost markets.

It is important to note that while all of the state agencies have implemented one or more of these special strategies, their ability to do so has been dependent on the availability of both agency reserves and state appropriations. Changes in the tax code since 1980 have seriously eroded the states' capacity to implement these special targeting programs, and, therefore their ability to serve the lowest end of the homebuyer market.

Conclusion

The GAO report demonstrates a total lack of understanding of housing finance. Their statistical methodology and analyses are in need of justification and clarification. Hence, as the report now stands, its conclusions are simply not supportable.

The data herein presents a much more accurate analysis of the workings of the Mortgage Revenue Bond program. From this rebuttal, the following conclusions can be drawn:

- **The MRB program has historically served lower-income populations than FHA, VA, or the conventional market and continues to do so.**
- **MRB financing has historically been used to finance lower-cost homes than FHA, VA, or the conventional market and continues to do so.**
- **The age and marital status of the population served by MRBs is roughly equivalent to that served by conventional loans even with FHA or VA security.**
- **MRBs are not only an efficient mechanism for financing, but have a positive revenue impact on the area served.**

The MRB program is effective. It expands homeownership opportunities. It dramatically improves affordability. It brings mortgage capital to regions and markets in need of these funds. It provides a boost to regional and the national economy. It efficiently serves the first-time homebuyer market through a long standing public-private partnership and without creating a massive bureaucracy. The MRB Program should be extended through the swift passage of S 1522/HR 2640.

Appendix 1

Description of Efficiency Model Methodology

A major argument against the Mortgage Revenue Bond Program by GAO was that of inefficiency. GAO presented a table that ostensibly showed that in the worst case, only 12 cents of every dollar cost to the government reaches beneficiaries. Under the best case, only 45 cents of benefit per dollar cost are generated.

Exception has been taken with GAO's assumptions as discussed in the body of this paper. A series of seven tables follow which show the calculations used to estimate the efficiency of $100 of Mortgage Revenue Bonds issued in each of the next five years. The model was developed on a standard computer spread-sheet program, Microsoft Exel, and displays decimal point to three to four places. The assumptions used in the calculations are indicated.

A series of seven tables are presented. The first table portrays a cost-benefit approach similar to the one GAO is assumed to have used. Table 2 presents adjustments that should be made to the GAO type method. The third table calculates the basic tax-revenue assumed to be foregone when tax exempt bonds are issued. On the fourth table, the mortgage interest savings and interest deductions are consolidated from tables 6 and 7. Table 5 presents the basic economic impact assumptions used in Table 2. Table 6 presents the monthly amortization of a conventional mortgage over 10 years, with the MRB mortgage amortization presented in Table 7.

Table 1 The Simple Cost-Benefit Approach

The cost to the federal government portrayed in the line "Tax Revenue Foregone on Each $100 Bonds Issued Annually till 1993" is drawn from Line 6 on Table 3 and represents the taxes foregone by the federal government when a tax-exempt bond is issued. This number conforms with a commonly used assumption that each tax-exempt bond dollar held by an investor would be replaced by fully taxable security, the income from which would be taxed at the highest marginal tax rate. The Congressional Budget Office projection of 10 Year Treasury Bond yield was used as a baseline for projecting the taxable mortgage security and MRB interest rates lines 1-3 on Chart 3. The annual interest is based on the resulting yield curve. A 28 percent marginal tax rate was used here rather than the potential actual rate of 33 percent.

The assumption driving the benefits are indicated in the second box. An interest spread between the tax exempt mortgage interest rate and the conventional mortgage interest rate of 1.40 percentage was used. This interest rate spread represents the average spread GAO estimated in its survey of MRB loans during the period 1983-1986. It must be noted however, that during this period, the conventional mortgage interest rate experienced a period of decline almost unprecedented in its steepness and rapidity. In these market environments, the spread between MRB rates and conventional rates at the time of loan origination historically narrows.

Throughout this calculation, 95 percent of bond proceeds are assumed to be loaned. As an aside, in 1987, MRBs issued under the 1986 Tax Reform Act guidelines had an average of 97.5 percent lendable proceeds. The interest rate savings are drawn from Table 4 based on the loan amortization calculations made in Tables 6 and 7. As with the bond interest rates, both mortgage interest rates are adjusted according to the CBO projected 10 Year Treasury Bond Yield.

Table 2 Necessary Adjustments to the Basic Efficiency Model

The cost to the government of MRBs is adjusted according to a portfolio theory put forth in Galper & Toder's "Modelling Revenue and Allocation Effects of the Use of Tax Exempt Bonds for Private Purposes." Using suggested methodology to account for sophisticated portfolio analysis, a 17 percent marginal tax rate is suggested for calculating the revenue foregone. The revenue foregone is also adjusted to account for the federal tax revenues generated from MRB created economic activity.

The benefit estimate is adjusted according to the amount of economic activity generated by MRB proceeds used for homes which would not otherwise have been constructed or resales that otherwise would not have occurred. In this analysis, the contested GAO assumption that only 30 percent of the loans made were to individuals who otherwise would not have been able to make a home purchase is used. GAO disregards the presence of an economic impact and this contention is disputed in the body of the paper.

Table 3 Estimates of Tax Exempt Bond Cost

The key parts of this table are the projection of interest rates for bonds, the calculation of taxable yield for the years 1989-1993 over an assumed 10 year bond life, the calculation of tax revenue foregone at the highest marginal rate, and the calculation of tax revenue foregone at the adjusted marginal rate.

Table 4 Consolidated Annual Mortgage Impacts

Mortgage interest savings and mortgage interest deductions for the assumed 10 year life of the loans are consolidated from Tables 6 and 7 on this page for quick reference.

Table 5 Economic Impact Multipliers

The National Association of Realtors' Economic and Research estimates the economic impact of new home construction and resales. The 1987 estimates are provided. Federal, state, and local tax impact assumptions are also provided as indicated.

Tables 6 & 7 Mortgage Amortization

Table 6 contains a monthly amortization of a conventional for the 95 percent of bond proceeds available for loans. The annual interest is expressed and the tax subsidy calculated at the marginal rate indicated in the assumption section on Table 1. Likewise, Table 7 contains the amortization of an MRB loan.

EFFICIENCY OF MORTGAGE REVENUE BONDS
TABLE 1
Basic Efficiency Model

Cost to the Federal Government

	1989	1990	1991	1992	1993
Tax Revenue Foregone on Each $100 Bonds Issued Annually till 1993	$2.928	$5.526	$7.695	$9.468	$11.17

Direct Benefits to Homebuyers

Assumption:	Tax Exempt Mortgage Interest Rate	8.35%
	Interest Rate Spread	1.40%
	Marginal Tax Rate	15.00%
	Conventional Mortgage Interest Rat	9.75%

		1989	1990	1991	1992	199
Bond Issue Amount		$100.00	$100.00	$100.00	$100.00	$100.0
Lendable Proceeds (95% of Bond Issue Amount)		95.000	95.000	95.000	95.000	95.00
Interest Rate Savings	1989	1.333	1.341	1.348	1.355	1.36
	1990		1.334	1.342	1.349	1.35
	1991			1.335	1.341	1.34
	1992				1.333	1.34
	1993					1.33
Annual Benefits (Interest Savings)		1.333	2.675	4.025	5.379	6.74
After Tax Benefits		1.133	2.273	3.421	4.572	5.73
Individual Benefits		$1.133	$2.273	$3.421	$4.572	$5.73
Typical Benefits/Cost Ratio		38.70%	41.14%	44.46%	48.29%	51.28

Present Value of Costs and Benefits For Each Cash Stream	
Cost to the Government	19.40
Individual Benefits	7.51
Discount Rate is the 3/88 10 Year Treasury Bond Rate 8.29%	

TABLE 2
Necessary Adjustments to the Basic Efficiency Model

Accounting for Diverse Portfolio Investment and Increased Economic Activity

	1989	1990	1991	1992	1993
Actual Marginal Tax Rate	17%	17%	17%	17%	17%
(Modelling Revenue and Allocation Effects of the Use of Tax Exempt Bonds for Private Purposes, Galper & Toder)					
Adjusted Revenues Foregone	1.699	3.198	4.435	5.431	5.431
Federal Tax Revenues Generated	0.254	0.254	0.254	0.254	0.254
Adjusted Revenue Impact	$1.445	$2.944	$4.181	$5.177	$5.177

Economic Impact

Uses GAO's Contested Assumption That Only 30% of Beneficiaries Would Not Have Gotten A Loan Without MRBs

Assumption: % New Construction	20%
Construction Otherwise Not Occurt	10%
% Existing Home Purchase	80%
Resales Otherwise Not Occuring	20%

	1989	1990	1991	1992	1993
New Homes (Otherwise Not Occuring)					
Portion of Lendable Proceeds to New Construction	9.500	9.500	9.500	9.500	9.500
Value of New Construction (Cost of Land Omitted)	5.795	5.795	5.795	5.795	5.795
Expenditures At Sale	0.503	0.503	0.503	0.503	0.503
Expenditures After Sale	0.180	0.180	0.180	0.180	0.180
Lenders Income Net Cost of Funds	0.133	0.133	0.133	0.133	0.133
Mortgage Insurers Income	0.004	0.004	0.004	0.004	0.004
Multiplier Effect	3.320	3.320	3.320	3.320	3.320
Impact of New Construction	9.936	9.936	9.936	9.936	9.936
State and Local Tax Revenues Generated	0.642	0.642	0.642	0.642	0.642
Resale Homes (Otherwise Not Occuring)					
Portion of Lendable Proceeds to Resales	19.000	19.000	19.000	19.000	19.000
Expenditure Before Sale	0.190	0.190	0.190	0.190	0.190
Expenditures At Sale	1.805	1.805	1.805	1.805	1.805
Expenditures After Sale	0.380	0.380	0.380	0.380	0.380
Lenders Income Net Cost of Funds	1.139	1.139	1.139	1.139	1.139
Mortgage Insurers Income	0.002	0.002	0.002	0.002	0.002
Multiplier Effect	1.245	1.245	1.245	1.245	1.245
Impact of Resale	4.762	4.762	4.762	4.762	4.762
Total Economic Benefits	$14.698	$14.698	$14.698	$14.698	$14.698
State and Local Taxes	$0.642	$0.642	$0.642	$0.642	$0.642
Adjusted Benefits	$16.473	$17.613	$18.761	$19.912	$21.070
(Individual Benefits + Economic Benefits Generated)					

Present Value of Costs and Benefits For Each Cash Stream	
Cost to the Government	9.57
Individual & Economic Benefits	109.10
Discount Rate is the 3/88 10 Year Treasury Bond Rate 8.29%	

Adjusted Benefit/Cost Ratio	1139.71%	598.32%	448.71%	384.60%	406.97%

TABLE 3
Estimate of Tax-exempt Bond Cost

Assumptions:
Change in Bond Yield: CBO Projected 10 Year Treasury Bond Rate

	3/88	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
CBO Projection															
1. 10 YearTreasury Yield	8.29%	9.5%	9.0%	8.4%	7.8%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%
2. Taxable Mortgage Sec	9.75%	11.2%	10.6%	9.9%	9.2%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%
3. MRB with AMT	8.35%	9.6%	9.1%	8.5%	7.9%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%

Year		Issue Amt	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Taxable Yield			11.2%	10.6%	9.9%	9.2%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%
	1989	$100.00	11.173	10.585	9.879	9.174	8.703	8.703	8.703	8.703	8.703	8.703				
	1990	$100.00		10.585	9.879	9.174	8.703	8.703	8.703	8.703	8.703	8.703	8.703			
	1991	$100.00			9.879	9.174	8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703		
	1992	$100.00				9.174	8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703	
	1993	$100.00					8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703	8.703
Total Interest			11.173	21.170	29.638	36.685	43.516	43.516	43.516	43.516	43.516	43.516	34.813	26.110	17.407	8.703
4. Standard Marginal Tax Rate Used			28%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%
Taxes Foregone on Taxable Debt			3.1285	5.9276	8.2987	10.2745	12.1846	12.1846	12.1846	12.1846	12.1846	12.1846	9.7478	7.3107	4.8738	2.4369
5. Less Reduced Interest Deduction																
	1989		1.1857	1.1761	1.1656	1.1542	1.1418	1.1284	1.1138	1.1761	1.0807	1.0619				
	1990			0.2000	0.2012	0.2024	0.2036	0.2047	0.2058	0.2068	0.2076	0.2084	0.2089			
	1991				0.2000	0.2012	0.2023	0.2034	0.2044	0.2053	0.2061	0.2068	0.2073	0.2076		
	1992					0.2000	0.2011	0.2021	0.2030	0.2039	0.2046	0.2053	0.2057	0.2060	0.2060	
	1993						0.2000	0.2010	0.2019	0.2027	0.2035	0.2041	0.2045	0.2048	0.2049	0.2047
	Total		1.1857	1.3761	1.5668	1.7578	1.9488	1.9396	1.9289	1.9948	1.9025	1.8865	0.8264	0.6184	0.4109	0.2047
6. Taxes Foregone			1.9428	4.5516	6.7319	8.5167	10.2357	10.2450	10.2557	10.1898	10.2821	10.2980	8.9212	6.6923	4.4629	2.2322
7. Alternative Marginal Tax Rate			17%	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%
Taxes Foregone on Taxable Debt			1.8994	3.5989	5.0385	6.2381	7.3978	7.3978	7.3978	7.3978	7.3978	7.3978	5.9182	4.4387	2.9591	1.4796
8. Less Reduced Interest Deduction																
	1989		1.1857	1.1761	1.1656	1.1542	1.1418	1.1284	1.1138	1.1761	1.0807	1.0619				
	1990			0.2000	0.2012	0.2024	0.2036	0.2047	0.2058	0.2068	0.2076	0.2084	0.2089			
	1991				0.2000	0.2012	0.2023	0.2034	0.2044	0.2053	0.2061	0.2068	0.2073	0.2076		
	1992					0.2000	0.2011	0.2021	0.2030	0.2039	0.2046	0.2053	0.2057	0.2060	0.2060	
	1993						0.2000	0.2010	0.2019	0.2027	0.2035	0.2041	0.2045	0.2048	0.2049	0.2047
	Total		1.1857	1.3761	1.5668	1.7578	1.9488	1.9396	1.9289	1.9948	1.9025	1.8865	0.8264	0.6184	0.4109	0.2047
9. Taxes Foregone			0.7137	2.2229	3.4717	4.4803	5.4489	5.4582	5.4689	5.4030	5.4953	5.5112	5.0918	3.8203	2.5482	1.2749

TABLE 4
Consolidated Annual Mortgage Impacts

Mortgage Interest Savings

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Conv	9.2381	9.1813	9.1188	9.0499	8.9740	8.8904	8.7982
MRB	7.9046	7.8404	7.7706	7.6947	7.6123	7.5227	7.4254
Indiv Savings	1.3335	1.3410	1.3482	1.3552	1.3617	1.3677	1.3728

	Year 8	Year 9	Year 10
Conv	8.6966	8.5847	8.4613
MRB	7.3196	7.2046	7.0796
Indiv Savings	1.3770	1.3801	1.3817

Mortgage Interest Deduction

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Conv	1.3857	1.3772	1.3678	1.3575	1.3461	1.3336	1.3197
MRB	1.1857	1.1761	1.1656	1.1542	1.1418	1.1284	1.1138
Fed Savings	0.2000	0.2011	0.2022	0.2033	0.2043	0.2051	0.2059

	Year 8	Year 9	Year 10
Conv	1.3045	1.2877	1.2692
MRB	1.0979	1.0807	1.0619
Fed Savings	0.2066	0.2070	0.2073

TABLE 5
Economic Impact Multipliers

Impact of Home Sales and New Construction on GNP

	Resale	New
Value of Construction		0.6100
Expenditure before Sale	0.0100	
Expenditure At Sale	0.0950	0.0530
Expenditure After Sale	0.0200	0.0190
Lenders' income - funds cost	0.0600	0.0140
Mortgage Insurers Income	0.0001	0.0004
Multiplier Effect	0.0656	0.3495

Source: National Association of Realtors, Economic and Research Division

Federal Tax Impacts		
Individual Taxes		
1 Contract Job/$50,000 Construction (Bureau of Labor Statistics)		0.00002
Annual Wages = 1,900 Hours at Avg $10/Hour	$19,000	0.3800
Tax Rate 15%		$0.057
Corporate Taxes		
10% Profit on Construction		0.5795
Tax Rate 34% (Earnings over $100,000, rate is 39%)		$0.197
Total Federal Taxes		$0.254
State Tax Impacts		
Individual Taxes		
@ 3% Rate Typical		$0.174
Corporate Taxes		
@ 4% Rate Typical		$0.232
Sales Taxes		
3% of Contract/Construction Cost		$0.174
Local Tax Impacts		
Local Sales Taxes		
1% of Contract/Construction Cost		$0.058
Ad Valorem Taxes		
40% Valuation		3.8000
Millage Rate 12 ($12/$1,000)		$0.005
Total State and Local Taxes		0.64201

Source: National Association of Homebuilders/National Association of Realtors

TABLE 6
1989 Conventional Mortgage Amortization

Mon	Int	Prin	$95.00	Ann Int	Tx Subsidy	Ann Tx Sub
Princ Amt		$95.00				
Mon Pmt		0.8162				
1	0.7719	0.0443	94.9557		0.1158	
2	0.7715	0.0447	94.9110		0.1157	
3	0.7712	0.0450	94.8660		0.1157	
4	0.7708	0.0454	94.8205		0.1156	
5	0.7704	0.0458	94.7748		0.1156	
6	0.7700	0.0462	94.7286		0.1155	
7	0.7697	0.0465	94.6821		0.1155	
8	0.7693	0.0469	94.6352		0.1154	
9	0.7689	0.0473	94.5879		0.1153	
10	0.7685	0.0477	94.5402		0.1153	
11	0.7681	0.0481	94.4922		0.1152	
12	0.7677	0.0484	94.4437	9.2381	0.1152	1.3857
13	0.7674	0.0488	94.3949		0.1151	
14	0.7670	0.0492	94.3456		0.1150	
15	0.7666	0.0496	94.2960		0.1150	
16	0.7662	0.0500	94.2460		0.1149	
17	0.7657	0.0504	94.1955		0.1149	
18	0.7653	0.0509	94.1447		0.1148	
19	0.7649	0.0513	94.0934		0.1147	
20	0.7645	0.0517	94.0417		0.1147	
21	0.7641	0.0521	93.9896		0.1146	
22	0.7637	0.0525	93.9371		0.1145	
23	0.7632	0.0530	93.8841		0.1145	
24	0.7628	0.0534	93.8307	9.1813	0.1144	1.3772
25	0.7624	0.0538	93.7769		0.1144	
26	0.7619	0.0543	93.7226		0.1143	
27	0.7615	0.0547	93.6679		0.1142	
28	0.7611	0.0551	93.6128		0.1142	
29	0.7606	0.0556	93.5572		0.1141	
30	0.7602	0.0560	93.5011		0.1140	
31	0.7597	0.0565	93.4446		0.1140	
32	0.7592	0.0570	93.3877		0.1139	
33	0.7588	0.0574	93.3303		0.1138	
34	0.7583	0.0579	93.2724		0.1137	
35	0.7578	0.0584	93.2140		0.1137	
36	0.7574	0.0588	93.1552	9.1188	0.1136	1.3678
37	0.7569	0.0593	93.0959		0.1135	
38	0.7564	0.0598	93.0361		0.1135	
39	0.7559	0.0603	92.9758		0.1134	
40	0.7554	0.0608	92.9150		0.1133	
41	0.7549	0.0613	92.8538		0.1132	
42	0.7544	0.0618	92.7920		0.1132	
43	0.7539	0.0623	92.7297		0.1131	
44	0.7534	0.0628	92.6670		0.1130	
45	0.7529	0.0633	92.6037		0.1129	
46	0.7524	0.0638	92.5399		0.1129	
47	0.7519	0.0643	92.4756		0.1128	
48	0.7514	0.0648	92.4108	9.0499	0.1127	1.3575
49	0.7508	0.0654	92.3454		0.1126	
50	0.7503	0.0659	92.2795		0.1125	
51	0.7498	0.0664	92.2131		0.1125	
52	0.7492	0.0670	92.1461		0.1124	

Table 6	53	0.7487	0.0675	92.0786		0.1123	
	54	0.7481	0.0681	92.0106		0.1122	
	55	0.7476	0.0686	91.9419		0.1121	
	56	0.7470	0.0692	91.8728		0.1121	
	57	0.7465	0.0697	91.8030		0.1120	
	58	0.7459	0.0703	91.7328		0.1119	
	59	0.7453	0.0709	91.6619		0.1118	
	60	0.7448	0.0714	91.5904	8.9740	0.1117	1.3461
	61	0.7442	0.0720	91.5184		0.1116	
	62	0.7436	0.0726	91.4458		0.1115	
	63	0.7430	0.0732	91.3726		0.1114	
	64	0.7424	0.0738	91.2988		0.1114	
	65	0.7418	0.0744	91.2244		0.1113	
	66	0.7412	0.0750	91.1494		0.1112	
	67	0.7406	0.0756	91.0738		0.1111	
	68	0.7400	0.0762	90.9976		0.1110	
	69	0.7394	0.0768	90.9208		0.1109	
	70	0.7387	0.0775	90.8433		0.1108	
	71	0.7381	0.0781	90.7652		0.1107	
	72	0.7375	0.0787	90.6865	8.8904	0.1106	1.3336
	73	0.7368	0.0794	90.6071		0.1105	
	74	0.7362	0.0800	90.5271		0.1104	
	75	0.7355	0.0807	90.4464		0.1103	
	76	0.7349	0.0813	90.3651		0.1102	
	77	0.7342	0.0820	90.2831		0.1101	
	78	0.7336	0.0826	90.2005		0.1100	
	79	0.7329	0.0833	90.1171		0.1099	
	80	0.7322	0.0840	90.0332		0.1098	
	81	0.7315	0.0847	89.9485		0.1097	
	82	0.7308	0.0854	89.8631		0.1096	
	83	0.7301	0.0861	89.7771		0.1095	
	84	0.7294	0.0868	89.6903	8.7982	0.1094	1.3197
	85	0.7287	0.0875	89.6028		0.1093	
	86	0.7280	0.0882	89.5147		0.1092	
	87	0.7273	0.0889	89.4258		0.1091	
	88	0.7266	0.0896	89.3362		0.1090	
	89	0.7259	0.0903	89.2458		0.1089	
	90	0.7251	0.0911	89.1547		0.1088	
	91	0.7244	0.0918	89.0629		0.1087	
	92	0.7236	0.0926	88.9704		0.1085	
	93	0.7229	0.0933	88.8771		0.1084	
	94	0.7221	0.0941	88.7830		0.1083	
	95	0.7214	0.0948	88.6881		0.1082	
	96	0.7206	0.0956	88.5925	8.6966	0.1081	1.3045
	97	0.7198	0.0964	88.4962		0.1080	
	98	0.7190	0.0972	88.3990		0.1079	
	99	0.7182	0.0980	88.3010		0.1077	
	100	0.7174	0.0988	88.2023		0.1076	
	101	0.7166	0.0996	88.1027		0.1075	
	102	0.7158	0.1004	88.0024		0.1074	
	103	0.7150	0.1012	87.9012		0.1073	
	104	0.7142	0.1020	87.7992		0.1071	
	105	0.7134	0.1028	87.6964		0.1070	
	106	0.7125	0.1037	87.5927		0.1069	
	107	0.7117	0.1045	87.4882		0.1068	
	108	0.7108	0.1054	87.3828	8.5847	0.1066	1.2877
	109	0.7100	0.1062	87.2766		0.1065	
	110	0.7091	0.1071	87.1696		0.1064	
Table 6	111	0.7083	0.1079	87.0616		0.1062	
	112	0.7074	0.1088	86.9528		0.1061	
	113	0.7065	0.1097	86.8431		0.1060	
	114	0.7056	0.1106	86.7325		0.1058	
	115	0.7047	0.1115	86.6210		0.1057	
	116	0.7038	0.1124	86.5086		0.1056	
	117	0.7029	0.1133	86.3953		0.1054	
	118	0.7020	0.1142	86.2810		0.1053	
	119	0.7010	0.1152	86.1659		0.1052	
	120	0.7001	0.1161	86.0498	8.4613	0.1050	1.2692

TABLE 7
1989 MRB Mortgage Amortization

	Mon	Int	Prin	$95.00	Ann Int	Tx Subsidy	Ann Tx Sub	
	Princ amt		$95.00					
	Mon Pmt		0.7204					
	1	0.6610	0.0594	94.9406		0.0992		
	2	0.6606	0.0598	94.8809		0.0991		
	3	0.6602	0.0602	94.8207		0.0990		
	4	0.6598	0.0606	94.7601		0.0990		
	5	0.6594	0.0610	94.6991		0.0989		
	6	0.6589	0.0614	94.6376		0.0988		
	7	0.6585	0.0619	94.5758		0.0988		
	8	0.6581	0.0623	94.5135		0.0987		
	9	0.6577	0.0627	94.4507		0.0986		
	10	0.6572	0.0632	94.3876		0.0986		
	11	0.6568	0.0636	94.3239		0.0985		
	12	0.6563	0.0641	94.2599	7.9046	0.0985	1.1857	1
	13	0.6559	0.0645	94.1954		0.0984		
	14	0.6554	0.0649	94.1304		0.0983		
	15	0.6550	0.0654	94.0650		0.0982		
	16	0.6545	0.0659	93.9992		0.0982		
	17	0.6541	0.0663	93.9329		0.0981		
	18	0.6536	0.0668	93.8661		0.0980		
	19	0.6532	0.0672	93.7988		0.0980		
	20	0.6527	0.0677	93.7311		0.0979		
	21	0.6522	0.0682	93.6630		0.0978		
	22	0.6517	0.0687	93.5943		0.0978		
	23	0.6513	0.0691	93.5252		0.0977		
	24	0.6508	0.0696	93.4556	7.8404	0.0976	1.1761	2
	25	0.6503	0.0701	93.3855		0.0975		
	26	0.6498	0.0706	93.3149		0.0975		
	27	0.6493	0.0711	93.2438		0.0974		
	28	0.6488	0.0716	93.1722		0.0973		
	29	0.6483	0.0721	93.1002		0.0972		
	30	0.6478	0.0726	93.0276		0.0972		
	31	0.6473	0.0731	92.9545		0.0971		
	32	0.6468	0.0736	92.8809		0.0970		
	33	0.6463	0.0741	92.8068		0.0969		
	34	0.6458	0.0746	92.7322		0.0969		
	35	0.6453	0.0751	92.6571		0.0968		
	36	0.6447	0.0757	92.5814	7.7706	0.0967	1.1656	3
	37	0.6442	0.0762	92.5052		0.0966		
	38	0.6437	0.0767	92.4285		0.0966		
	39	0.6431	0.0772	92.3513		0.0965		
	40	0.6426	0.0778	92.2735		0.0964		
	41	0.6421	0.0783	92.1952		0.0963		
	42	0.6415	0.0789	92.1163		0.0962		
	43	0.6410	0.0794	92.0369		0.0961		
	44	0.6404	0.0800	91.9569		0.0961		
	45	0.6399	0.0805	91.8764		0.0960		
	46	0.6393	0.0811	91.7953		0.0959		
	47	0.6387	0.0817	91.7137		0.0958		
	48	0.6382	0.0822	91.6315	7.6947	0.0957	1.1542	4
	49	0.6376	0.0828	91.5487		0.0956		
	50	0.6370	0.0834	91.4653		0.0956		
	51	0.6364	0.0839	91.3813		0.0955		
	52	0.6359	0.0845	91.2968		0.0954		
	53	0.6353	0.0851	91.2117		0.0953		
	54	0.6347	0.0857	91.1260		0.0952		
Table 7	55	0.6341	0.0863	91.0397		0.0951		
	56	0.6335	0.0869	90.9528		0.0950		
	57	0.6329	0.0875	90.8653		0.0949		
	58	0.6323	0.0881	90.7771		0.0948		
	59	0.6317	0.0887	90.6884		0.0947		
	60	0.6310	0.0894	90.5990	7.6123	0.0947	1.1418	5
	61	0.6304	0.0900	90.5091		0.0946		
	62	0.6298	0.0906	90.4185		0.0945		
	63	0.6292	0.0912	90.3272		0.0944		
	64	0.6285	0.0919	90.2354		0.0943		
	65	0.6279	0.0925	90.1429		0.0942		
	66	0.6272	0.0931	90.0497		0.0941		
	67	0.6266	0.0938	89.9559		0.0940		
	68	0.6259	0.0944	89.8615		0.0939		

Table 7

69	0.6253	0.0951	89.7664		0.0938		
70	0.6246	0.0958	89.6706		0.0937		
71	0.6240	0.0964	89.5742		0.0936		
72	0.6233	0.0971	89.4771	7.5227	0.0935	1.1284	6
73	0.6226	0.0978	89.3793		0.0934		
74	0.6219	0.0985	89.2808		0.0933		
75	0.6212	0.0991	89.1817		0.0932		
76	0.6206	0.0998	89.0818		0.0931		
77	0.6199	0.1005	88.9813		0.0930		
78	0.6192	0.1012	88.8801		0.0929		
79	0.6185	0.1019	88.7781		0.0928		
80	0.6177	0.1026	88.6755		0.0927		
81	0.6170	0.1034	88.5721		0.0926		
82	0.6163	0.1041	88.4680		0.0924		
83	0.6156	0.1048	88.3632		0.0923		
84	0.6149	0.1055	88.2577	7.4254	0.0922	1.1138	7
85	0.6141	0.1063	88.1514		0.0921		
86	0.6134	0.1070	88.0444		0.0920		
87	0.6126	0.1078	87.9367		0.0919		
88	0.6119	0.1085	87.8282		0.0918		
89	0.6111	0.1093	87.7189		0.0917		
90	0.6104	0.1100	87.6089		0.0916		
91	0.6096	0.1108	87.4981		0.0914		
92	0.6088	0.1116	87.3866		0.0913		
93	0.6081	0.1123	87.2743		0.0912		
94	0.6073	0.1131	87.1612		0.0911		
95	0.6065	0.1139	87.0473		0.0910		
96	0.6057	0.1147	86.9326	7.3196	0.0909	1.0979	8
97	0.6049	0.1155	86.8171		0.0907		
98	0.6041	0.1163	86.7008		0.0906		
99	0.6033	0.1171	86.5837		0.0905		
100	0.6025	0.1179	86.4658		0.0904		
101	0.6017	0.1187	86.3470		0.0902		
102	0.6008	0.1196	86.2275		0.0901		
103	0.6000	0.1204	86.1071		0.0900		
104	0.5992	0.1212	85.9859		0.0899		
105	0.5983	0.1221	85.8638		0.0897		
106	0.5975	0.1229	85.7409		0.0896		
107	0.5966	0.1238	85.6171		0.0895		
108	0.5958	0.1246	85.4924	7.2046	0.0894	1.0807	9
109	0.5949	0.1255	85.3669		0.0892		
110	0.5940	0.1264	85.2405		0.0891		
111	0.5931	0.1273	85.1133		0.0890		
112	0.5922	0.1281	84.9851		0.0888		
113	0.5914	0.1290	84.8561		0.0887		
114	0.5905	0.1299	84.7262		0.0886		
115	0.5896	0.1308	84.5953		0.0884		
116	0.5886	0.1318	84.4636		0.0883		
117	0.5877	0.1327	84.3309		0.0882		
118	0.5868	0.1336	84.1973		0.0880		
119	0.5859	0.1345	84.0628		0.0879		
120	0.5849	0.1355	83.9273	7.0796	0.0877	1.0619	10

Appendix 2

State Mortgage Revenue Bond Activity

1987 MRB Borrower and Mortgage Characteristics
State Mortgage Revenue Bond Programs

Agency	Average Mortgage Amount	Average Purchase Price	Average Term (Years)	Average Down-payment	Average % Down-Payment	Average Borrower Income	Average Age of Head Of Household	% of Loans to Single-Hd o Hs
Alabama HFA	$57,000	N/A	27	N/A	6.0	$25,000	N/A	N/A
Alaska HFC	N/A	97,948	N/A	N/A	9.2	$44,004	N/A	N/A
Arizona DoC*								
Arkansas DFA	$45,005	48,275	30	$3,270	7.0	$22,837	32	N/A
California HFA	$84,519	89,120	30	$4,600	5.2	$33,990	N/A	22.2
Colorado HFA	$60,708	62,164	30	$1,218	2.3	$27,078	31	38.8
Connecticut HFA	$79,554	92,370	17	$13,287	14.4	$31,684	31	51.3
D.C. HFA	N/A	68,423	N/A	N/A	18.0	$28,648	N/A	N/A
Delaware SHA	$62,105	70,266	30	$8,480	11.0	$28,000	29	69.0
Florida HFA	$59,852	61,980	29	N/A	N/A	$28,020	30	45.0
Georgia RFA	$52,793	51,839	30	N/A	5.0	$25,889	32	
Hawaii HA	$69,304	76,000	30	N/A	9.0	$26,880	30	18.0
Idaho	none	none	none	none	none	none	none	none
Illinois HDA	$63,681	72,184	30	$9,708	12.0	$34,704	29	43.0
Indiana HFA	N/A	47,300	N/A	N/A	10.0	$24,000	N/A	N/A
Iowa FA	none	none	none	none	none	none	none	none
Kansas DoC*								
Kentucky HC	$37,277	38,644	25	$1,138	N/A	$20,015	31	13.4
Louisiana HFA	$46,000	50,000	30	$5,818	5.0	N/A	N/A	N/A
Maine SHA	$56,900	61,264	30	$4,274	7.5	$24,038	30	5.1
Maryland CDA	$50,423	50,991	30	N/A	5.0	$23,559	30	32.6
Massachusetts	$74,868	87,418	27	$13,100	15.0	$31,719	31	3.0
Michigan SHDA	$34,294	36,693	N/A	$2,867	8.0	$20,461	30	31.0
Minnesota HFA	$51,101	54,482	30	$3,513	6.5	$22,900	29	27.0
Mississippi HFC	$43,856	47,849	25	$3,993	8.3	$21,433	N/A	N/A
Missouri HCD	$46,222	47,130	30	N/A	N/A	$24,548	30	N/A
Montana BoH	$46,119	48,000	30	N/A	N/A	$24,385	32	N/A
Nebraska IFA	N/A	46,600	N/A	N/A	9.6	$25,673	30	N/A
Nevada HDA	$69,600	69,500	30	N/A	2.0	$26,500	N/A	23.0
New Hampshire HFA	$75,343	84,808	30	$9,465	11.2	$34,526	30	N/A
New Jersey H&MFA	$58,266	67,510	30	$9,234	13.7	$31,747	32	50.3
New Mexico MFA	$55,600	59,200	30	$2,900	5.0	$23,900	30	35.0
New York CHDC	•••	•••	•••	•••	•••	•••	•••	•••
New York MLEAC	•••	•••	•••	•••	•••	•••	•••	•••
New York SMA	$56,854	65,828	29	$8,974	12.0	$31,072	31	N/A
New York SDHCR	•••	•••	•••	•••	•••	•••	•••	•••
New York SHFA	•••	•••	•••	•••	•••	•••	•••	•••
North Carolina HFA	$50,401	55,131	29	N/A	N/A	$24,232	30	7.0
North Dakota HFA	$46,870	49,086	30	$2,216	5.0	$25,178	30	26.0
Ohio HFA	$65,754	71,534	29	$5,825	9.3	$35,512	30	N/A
Oklahoma HFA	$49,744	50,622	30	$2,520	5.0	$28,311	N/A	32.0
Oregon HA	$41,385	45,000	30	$3,618	5.0	$23,493	30	53.8
Pennsylvania HFA	$47,166	55,364	30	N/A	N/A	$22,581	N/A	N/A
Puerto Rico HBFA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Puerto Rico HFC	•••	•••	•••	•••	•••	•••	•••	•••
Rhode Island H&MFC	$64,262	75,376	30	$11,044	14.7	$29,692	31	33.0
South Carolina SHA	$41,501	47,702	30	$6,202	13.0	$26,178	N/A	N/A
South Dakota HDA	$48,340	49,701	30	$2,855	5.7	$29,541	31	26.3
Tennessee HDA	$41,358	41,753	30	$700	N/A	$18,188	31	9.0
Texas HA	N/A	59,549	N/A	N/A	5.0	$23,700	N/A	N/A
Utah HFA	$55,400	57,700	30	N/A	4.0	$27,300	28	N/A
Vermont HFA	$48,737	53,875	25	$5,131	9.0	$25,792	30	16.7
Virgin Islands HFA								
Virginia HDA	$63,727	65,435	29	$1,708	2.6	$27,941	30	40.0
Washington SHFC	N/A	64,800	N/A	N/A	3.8	$29,800	N/A	N/A
West Virginia HDF	$49,962	54,494	25	$3,000	5.0	$30,232	31	N/A
Wisconsin H&EDA	$41,451	48,332	29	$6,881	14.2	$24,772	29	45.0
Wyoming CDA	N/A	53,018	N/A	N/A	5.0	$28,734	N/A	N/A
AVERAGE	$54,833	$59,832	29	$5,432	8.1	$27,139	30.3	30.6

Note: N/A = Data not submitted, although applicable program does exist.
••• = Data not applicable, because HFA does not operate such a program.
* = No state HFA

Average Borrower Purchase Prices
State Mortgage Revenue Bond Programs
1983-87

State HFA	'83 Average Purchase Price	'84 Average Purchase Price	'85 Average Purchase Price	'86 Average Purchase Price	'87 Average Purchase Price
Alabama HFA	$41,719	N/A	$57,273	N/A	N/A
Alaska HFC	85,059	88,458	92,156	96,000	97,948
Arizona DoC*					
Arkansas DFA	42,655	49,365	44,489	47,161	48,275
California HFA	73,820	76,721	79,312	88,275	89,120
Colorado HFA	47,029	55,730	58,144	60,644	62,164
Connecticut HFA	N/A	57,400	63,359	72,157	92,370
D.C. HFA	N/A	62,998	48,200	48,183	68,423
Delaware SHA	N/A	N/A	60,619	58,000	70,266
Florida HFA	N/A	54,534	52,422	53,714	61,980
Georgia RFA	44,723	46,445	50,357	48,026	51,839
Hawaii HA	N/A	72,228	77,632	92,198	76,000
Idaho HA	N/A	48,334	49,054	49,054	none
Illinois HDA	37,865	53,043	55,105	55,910	72,184
Indiana HFA	N/A	N/A	42,000	45,585	47,300
Iowa F A	N/A	35,711	44,000	N/A	none
Kansas DoC*					
Kentucky HC	N/A	37,405	34,905	34,031	38,644
Louisiana HFA	N/A	57,100	56,540	N/A	50,000
Maine SHA	37,414	40,125	46,000	48,450	61,264
Maryland CDA	53,170	48,467	50,684	48,062	50,991
Massachusetts HFA	49,795	53,547	63,174	74,223	87,418
Michigan SHDA	41,711	39,896	37,128	40,698	36,693
Minnesota HFA	47,831	54,028	53,548	53,114	54,482
Mississippi HFC	36,326	43,850	49,025	48,506	47,849
Missouri HCD	34,700	35,000	40,199	44,461	47,130
Montana	N/A	51,300	52,000	52,000	48,000
Nebraska IFA	33,135	43,838	46,683	46,424	46,600
Nevada HDA	N/A	N/A	65,000	70,000	69,500
New Hampshire HFA	40,402	54,957	59,445	68,168	84,808
New Jersey H& MFA	252	62,164	60,169	62,040	67,510
New Mexico MFA	45,401	49,704	50,000	54,000	59,200
New York City HDC	•••	•••	•••	•••	•••
New York MLEAC	•••	•••	•••	•••	•••
New York SMA	N/A	57,955	62,000	71,012	65,828
New York State HCR	•••	•••	•••	•••	•••
New York State HFA	•••	•••	•••	•••	•••
North Carolina HFA	29,507	46,517	50,000	53,872	55,131
North Dakota HFA	47,968	50,920	50,200	50,602	49,066
Ohio HFA	N/A	N/A	47,200	48,090	71,534
Oklahoma HFA	51,623	58,039	56,645	N/A	50,622
Oregon HHD	46,431	46,664	46,000	46,475	45,000
Pennsylvania HFA	38,500	42,183	44,555	46,563	55,364
Puerto Rico HBFA	N/A	N/A	N/A	N/A	N/A
Puerto Rico HFC	•••	•••	•••	•••	•••
Rhode Island H&MFC	46,125	47,950	57,890	68,013	75,376
South Carolina SHA	N/A	43,633	47,500	N/A	47,702
South Dakota HDA	N/A	44,242	46,310	47,734	49,701
Tennessee HDA	35,899	38,769	41,000	41,960	41,753
Texas HA	N/A	62,588	60,867	62,388	59,549
Utah HFA	53,242	N/A	56,175	62,000	57,700
Vermont HFA	41,581	46,720	51,377	52,797	53,875
Virgin Islands HFA	N/A	N/A	N/A	N/A	N/A
Virginia HDA	47,249	51,542	53,281	54,498	65,435
Washington SHFC	N/A	49,872	60,191	59,600	64,800
West Virginia HDF	39,800	42,025	47,300	50,482	54,494
Wisconsin H&EDA	43,667	N/A	43,491	48,146	48,332
Wyoming CDA	60,016	67,725	60,586	56,504	53,018
AVERAGE	$44,342	$51,659	$53,494	$56,360	$59,832

Note: N/A = Data not available, although applicable program does exist.
* = No state HFA

Average Borrower Incomes
State Mortgage Revenue Bond Programs
1983-87

State HFA	'83 Average Income	'84 Average Income	'85 Average Income	'86 Average Income	'87 Average Income
Alabama HFA	$19,641	N/A	$24,661	N/A	$25,000
Alaska HFC	36,888	36,660	39,240	42,396	44,004
Arizona DoC*					
Arkansas DFA	26,975	21,409	21,611	21,107	22,837
California HFA	29,300	30,096	31,106	33,610	33,990
Colorado HFA	N/A	N/A	23,567	25,697	27,078
Connecticut HFA	N/A	26,200	26,700	26,881	31,684
D.C. HFA	N/A	29,336	26,000	21,474	28,648
Delaware SHA	N/A	N/A	28,579	25,900	28,000
Florida HFA	N/A	19,427	23,910	23,454	28,020
Georgia RFA	25,000	25,855	25,632	26,966	25,889
Hawaii HA	N/A	28,032	30,432	32,982	26,880
Idaho HA	N/A	22,662	24,138	24,175	none
Illinois HDA	26,604	30,675	29,400	30,804	34,704
Indiana HFA	N/A	N/A	23,000	24,400	24,000
Iowa F A	N/A	22,715		N/A	none
Kansas DoC*					
Kentucky HC	N/A	20,097	20,063	19,587	20,015
Louisiana HFA	N/A	N/A	32,949	N/A	N/A
Maine SHA	22,397	21,961	22,000	23,935	24,038
Maryland CDA	25,525	25,426	25,347	24,426	23,559
Massachusetts HFA	26,395	27,222	27,957	29,360	31,719
Michigan SHDA	21,951	20,506	20,486	21,191	20,461
Minnesota HFA	24,309	22,947	24,106	23,280	22,900
Mississippi HFC	20,960	21,280	21,422	21,565	21,433
Missouri HCD	N/A	23,000	20,679	22,857	24,548
Montana	N/A	N/A	25,000	27,000	24,385
Nebraska IFA	30,066	19,514	26,268	28,000	25,673
Nevada HDA	N/A		25,000	27,500	26,500
New Hampshire HFA	25,258	25,528	29,107	30,898	34,526
New Jersey H& MFA	N/A	35,863	31,617	32,887	31,747
New Mexico MFA	23,036	N/A	30,000	30,000	23,900
New York City HDC	***	***	***	***	***
New York MLEAC	***	***	***	***	***
New York SMA	N/A	33,355	36,300	36,539	31,072
New York State HCR	***	***	***	***	***
New York State HFA	***	***	***	***	***
North Carolina HFA	23,212	22,808	26,000	24,682	24,232
North Dakota HFA	27,101	22,784	22,800	23,058	25,178
Ohio HFA	N/A	27,648	26,700	28,586	35,512
Oklahoma HFA	25,036	25,555	30,000	N/A	28,311
Oregon HD	21,799	22,939	23,940	23,522	23,493
Pennsylvania HFA	22,500	21,961	22,080	22,276	22,581
Puerto Rico HBFA	N/A	N/A	N/A	N/A	N/A
Puerto Rico HFC	***	***	***	***	***
Rhode Island H&MFC	19,725	20,340	31,240	27,467	29,692
South Carolina SHA	N/A	N/A	23,000	N/A	26,178
South Dakota HDA	N/A	26,113	27,740	27,986	29,541
Tennessee HDA	18,937	18,726	20,000	19,375	18,188
Texas HA		23,736	24,033	25,423	23,700
Utah HFA	26,840	N/A	30,000	24,700	27,300
Vermont HFA	24,648	24,371	26,302	26,507	25,792
Virgin Islands HFA	N/A	N/A	N/A	N/A	N/A
Virginia HDA	23,126	24,385	25,556	25,010	27,941
Washington SHFC	N/A	24,492	27,940	27,300	29,800
West Virginia HDF	23,200	24,565	27,441	28,725	30,232
Wisconsin H&EDA	23,653	43,770	22,392	23,969	24,772
Wyoming CDA	30,030	30,661	28,244	29,315	28,734
AVERAGE	**$24,790**	**$25,503**	**$26,285**	**$26,472**	**$27,139**

Note: N/A = Data not available, although applicable program does exist.
none = No loans made.
* = No state HFA

Average Borrower Downpayment
State Mortgage Revenue Bond Programs
1983-87

State HFA	'83 Average Downpayment	'84 Average Downpayment	'85 Average Downpayment	'86 Average Downpayment	'87 Average Downpayment
Alabama HFA	N/A	7.5	10.0	N/A	6.0
Alaska HFC	8.4	N/A	11.0	5.0	9.2
Arizona DoC*					
Arkansas DFA	8.7	7.3	9.5	N/A	7.0
California HFA	7.2	7.2	8.6	N/A	5.2
Colorado HFA	5.7	5.0	4.0	N/A	2.3
Connecticut HFA	15.0	15.0	12.0	N/A	14.4
D.C. HFA	11.0	N/A	10.0	N/A	18.0
Delaware SHA	5.0	7.0	12.4	5.0	11.0
Florida HFA	10.0	N/A	8.3	8.0	N/A
Georgia RFA	3.4	6.0	6.6	5.0	5.0
Hawaii HA	10.0	N/A	9.7	9.0	9.0
Idaho HA	7.6	7.3	10.5	N/A	none
Illinois HDA	13.0	10.0	15.0	N/A	12.0
Indiana HFA	12.0	18.0	5.0	N/A	1.0
Iowa FA	7.0	7.0	7.5	N/A	none
Kansas DoC*					
Kentucky HC	4.4	6.0	6.0	N/A	N/A
Louisiana HFA	10.4	10.0	8.3	N/A	5.0
Maine SHA	8.0	10.5	9.0	5.0	7.5
Maryland CDA	3.4	4.5	5.0	5.0	5.0
Massachusetts HFA	12.6	12.0	10.5	N/A	15.0
Michigan SHDA	9.7	7.0	9.2	N/A	8.0
Minnesota HFA	10.3	11.0	12.0	N/A	6.5
Mississippi HFC	8.0	8.6	7.0	8.0	8.3
Missouri HCD	4.0	N/A	5.5	N/A	N/A
Montana	7.0	7.1	6.0	6.0	N/A
Nebraska IFA	5.0	N/A	9.5	N/A	9.6
Nevada HDA	3.0	3.0	3.0	5.0	2.0
New Hampshire HFA	12.5	14.6	7.8	N/A	11.2
New Jersey H& MFA	11.0	N/A	16.0	N/A	13.7
New Mexico MFA	N/A	7.0	5.0	5.0	5.0
New York City HDC					
New York MLEAC					
New York SMA	15.0	16.7	14.0	14.0	12.0
New York State HCR					
New York State HFA					
North Carolina HFA	5.0	5.0	5.0	5.0	N/A
North Dakota HFA	9.8	5.0	8.9	N/A	5.0
Ohio HFA	8.0	7.0	5.0	N/A	9.3
Oklahoma HFA	10.0	9.3	10.2	N/A	5.0
Oregon HHD	5.1	5.1	5.7	N/A	5.0
Pennsylvania HFA	14.6	15.0	8.0	15.0	N/A
Puerto Rico HBFA					
Puerto Rico HFC					
Rhode Island H&MFC	18.0	N/A	13.0	8.0	14.7
South Carolina SHA	8.0	15.0	5.0	N/A	13.0
South Dakota HDA	6.5	6.6	5.0	N/A	5.7
Tennessee HDA	4.5	5.9	1.3	N/A	N/A
Texas HA	6.0	9.3	5.0	5.0	5.0
Utah HFA	8.7	10.0	5.0	N/A	4.0
Vermont HFA	11.1	11.8	10.9	N/A	9.0
Virgin Islands HFA					
Virginia HDA	5.6	5.6	7.0	N/A	2.6
Washington SHFC	9.0	N/A	5.0	N/A	3.8
West Virginia HDF	8.6	5.0	9.5	N/A	5.0
Wisconsin H&EDA	12.0	14.0	13.0	N/A	14.2
Wyoming CDA	7.0	13.0	6.9	5.0	5.0
AVERAGE	8.6	8.9	8.2	6.9	7.9

Note: N/A = Data not available, although applicable program does exist.
* = No state HFA

91-401 0 - 89 - 8

[illegible]	[illegible]
LTV	90.00%
PITI RATIO	30.00%
TAXES/INS./MO.	$175
QUALIFYING WINDOW	$5,000

	CITY	AVG. PRICE NEW	MEDIAN INCOME	115%	PRICE/AVG. AREA 80.00%	MIN. QUAL. INCOME/NEW	+/- NEW	PRICE/AVG 75.00%	MIN. QUAL. INCOME/N	+/-	PRICE/AVG. AREA 70.00%	MIN. QUAL. INCOME/NEW	+/- NEW	PRICE/AVG. AREA 65.00%	MIN. QUAL. INCOME/NEW	+/- NEW
1	NEW YORK CITY	$169,100	$29,500	$33,925	$135,280	$46,153	($17,228)	$126,825	$43,706	($14,781)	$118,370	$41,259	($12,384)	$109,915	$38,812	($9,887)
2	PHOENIX	$146,500	$30,200	$34,730	$117,200	$40,920	($11,190)	$109,875	$38,800	($9,070)	$102,550	$36,680	($6,980)	$95,225	$34,560	($4,880)
3	SAN DIEGO	$151,900	$31,400	$36,110	$121,520	$42,171	($11,061)	$113,925	$39,973	($8,863)	$106,330	$37,774	($6,664)	$98,735	$35,576	($4,466)
4	SAN FRANCISCO	$183,700	$39,800	$45,770	$146,960	$49,534	($9,764)	$137,775	$46,875	($7,105)	$128,590	$44,217	($4,447)	$119,405	$41,558	($1,788)
5	DENVER	$155,600	$35,900	$41,285	$124,480	$43,027	($6,742)	$116,700	$40,776	($4,491)	$108,920	$38,524	($2,280)	$101,140	$36,272	$13
6	LOS ANGELES/LONG BC	$141,700	$33,200	$38,180	$113,360	$39,809	($6,629)	$106,275	$37,758	($4,578)	$99,190	$35,708	($2,520)	$92,105	$33,657	($477)
7	BOSTON	$158,300	$37,400	$43,010	$126,640	$43,653	($6,643)	$118,725	$41,362	($3,962)	$110,810	$39,071	($1,061)	$102,895	$36,780	$1,280
8	TACOMA	$117,000	$29,400	$33,810	$93,600	$34,090	($5,280)	$87,750	$32,397	($3,587)	$81,900	$30,704	($1,894)	$76,050	$29,011	($201)
9	PORTLAND	$131,100	$32,900	$37,835	$104,880	$37,355	($4,520)	$98,325	$35,458	($2,628)	$91,770	$33,560	($728)	$85,215	$31,663	$1,172
10	NORFOLK	$114,900	$29,700	$34,155	$91,920	$33,604	($4,449)	$86,175	$31,941	($2,786)	$80,430	$30,278	($1,123)	$74,685	$28,616	$539
11	NASHVILLE	$112,800	$29,500	$33,925	$90,000	$33,048	($4,123)	$84,375	$31,420	($2,498)	$78,750	$29,792	($867)	$73,125	$28,164	$761
12	SEATTLE	$132,100	$35,900	$41,285	$105,680	$37,586	($1,301)	$99,075	$35,675	$610	$92,470	$33,763	$2,522	$85,865	$31,851	$4,434
13	RALEIGH	$119,500	$33,400	$38,410	$95,600	$34,469	($1,359)	$89,625	$32,940	$470	$83,650	$31,210	$2,200	$77,675	$29,481	$3,929
14	ANAHEIM/SANTA ANA	$154,200	$40,400	$46,460	$123,360	$42,703	($1,243)	$115,650	$40,472	$988	$107,940	$38,240	$3,220	$100,230	$36,009	$5,451
15	NEW HAVEN	$125,300	$34,600	$39,790	$100,240	$36,012	($1,222)	$93,975	$34,199	$591	$87,710	$32,385	$2,405	$81,445	$30,572	$4,218
16	CHARLOTTE	$101,900	$30,500	$35,075	$81,520	$30,594	($519)	$76,425	$29,119	$956	$71,330	$27,645	$2,430	$66,235	$26,170	$3,905
17	CHATTANOOGA	$73,200	$24,800	$28,520	$58,560	$23,949	($429)	$54,900	$22,889	[illegible]	$51,240	$21,830	$1,880	$47,580	$20,771	$2,740
18	PITTSBURGH	$101,000	$30,400	$34,960	$80,800	$30,386	($426)	$75,750	$28,924	$1,036	$70,700	$27,462	$2,498	$65,650	$26,001	$3,959
19	GREENVILLE	$88,400	$28,100	$32,315	$70,720	$27,468	($158)	$66,300	$26,189	$1,126	$61,880	$24,910	$2,405	$57,460	[illegible]	$3,685
20	COLUMBIA	$101,000	$31,000	$35,650	$80,800	$30,385	$265	$75,750	$28,924	$1,726	$70,700	$27,462	$3,188	$65,650	$26,001	$4,649
21	CHICAGO	$128,700	$36,800	$42,320	$102,960	$36,799	$621	$96,525	$34,937	$2,383	$90,090	$33,074	$4,246	[illegible]	$31,212	$6,108
22	DALLAS	$122,700	$35,600	$40,940	$98,160	$35,410	$530	$92,025	$33,634	$2,306	$85,890	$31,859	$4,081	$79,755	$30,083	$5,857
23	ORLANDO	$97,200	$30,500	$35,075	$77,760	$29,506	$869	$72,900	$28,099	$1,976	$68,040	$26,692	$3,288	$63,180	$25,286	$4,789
24	HARTFORD	$136,100	$38,800	$44,620	$108,880	$38,512	$1,108	$102,075	$36,543	$3,077	$95,270	$34,573	$5,047	$88,465	$32,604	$7,016
25	FT.LAUDERDALE	$100,600	$32,000	$36,800	$80,480	$30,293	$1,507	$75,450	$28,837	$2,963	$70,420	$27,381	$4,419	$65,390	$25,925	$5,875
26	MIAMI	$87,400	$29,700	$34,155	$69,920	$27,236	$1,919	$65,550	$25,972	$3,183	$61,180	$24,707	$4,448	$56,810	$23,442	$5,713
27	NEW ORLEANS	$91,100	$30,900	$35,535	$72,880	$28,093	$2,442	$68,325	$26,775	$3,760	$63,770	$25,457	$5,078	$59,215	$24,138	$6,397
28	MINN/ST.PAUL	$128,000	$38,600	$44,390	$102,400	$36,637	$2,758	$96,000	$34,785	$4,605	$89,600	$32,932	$6,458	$83,200	$31,080	$8,310
29	PHILADELPHIA	$89,400	$32,200	$37,030	$71,520	$27,700	$4,380	$67,050	$26,406	$5,624	$62,580	$25,112	$6,918	$58,110	$23,818	$8,212
30	RICHMOND	$95,700	$33,700	$38,755	$76,560	$29,158	$4,557	$71,775	$27,773	$5,982	$66,990	$26,388	$7,367	$62,205	$25,004	$8,751
31	DETROIT	$87,200	$35,500	$40,825	$69,760	$27,190	$8,635	$65,400	$25,928	$9,897	$61,040	$24,666	$11,159	$56,680	$23,405	$12,420

A Rebuttal
of the General Accounting Office
of the United States'
Report on Qualified Mortgage Revenue Bonds

Table 8
New Home Sales by Price Range: 1982-1986
(percent distribution)

	1982	1983	1984	1985	1986
United States	100	100	100	100	100
Under $50,000	16	10	7	7	5
50,000-59,999	17	13	12	10	7
60,000-69,999	19	18	16	14	11
70,000-79,999	13	15	15	14	13
80,000-99,999	15	18	20	21	22
100,000-119,999	6	8	9	10	12
120,000-149,999	6	8	9	11	11
150,000 to over	8	9	12	14	19

Source: Characteristics of New Housing: 1986, Construction Reports C25-86-13, U.S. Department of Commerce, Bureau of the Census and U.S. Department of Housing and Urban Development, June 1987.

III. By Defining Benefits As Narrowly As Possible and Attributing the Highest Costs, The Program Was Made to Look Inefficient

As it did in 1983 the GAO again asserts that bond financing is an inefficient means to generate a subsidy. It claims that for every dollar of revenue foregone by the federal government only between $.12 and .45 of subsidy are received by the homeowner. Examination of the GAO's methodology once again reveals a simplistic static analysis. The issue of inefficiency of tax-exempt bonds is one which has been debated for more than a decade. The issue is not as simple as frequently discussed.

First, inefficiency arguments relying on the cost/benefit approach that was employed by GAO are inadequate. They tend to overestimate cost and under estimate benefits by using a static and simplistic model.

Second, MRBs now operate in a highly specialized and focused environment. It is a targeted resource and its use is limited by law.

The Typical Inefficiency Arguments Are Inadequate and Misplaced

Inefficiency is a frequently used criticism of tax-exempt bond financing for housing and other types of development. The argument typically revolves around a cost-benefit analysis. The tax-exempt interest income represents "cost" in the form of revenue "foregone" by the Treasury. This cost is compared with "benefits" received in the form of a difference between the interest rate a household would pay for a conventional mortgage and for a tax-exempt bond mortgage.

The above approach was used prior to passage of the Ullman Bill in 1980 and again by the General Accounting Office in its 1983 study of MRBs and 1985 study of Multifamily Development Bonds (MFDBs). The GAO argument continues to suffer from limitations inherent in a strict Cost/Benefit approach. Such approaches frequently tend to exaggerate the cost and under-count the benefits.

GAO Employs a Limited Form of Cost/Benefit Analysis

GAO's analysis of the cost of MRBs assumes that the entire interest income foregone would be subject to tax. The resulting large amount of revenue foregone is overstated. The estimates are based upon assumptions that if one less dollar of tax-exempt MRBs is issued, a high-bracket taxpayer is going to invest his money in a fully taxable savings instrument instead. It is much more likely that this investor will find other untaxed or partially taxed investment opportunities, such as tax shelters, pension savings, or assets which offer appreciation possibilities, the tax on which is deferred until the gains are realized, possibly for many years. In fact, the small interest rate spread between tax-exempt and comparable taxable bonds that presently exists suggests that there are many other tax favored investment opportunities. Due to the existence of these other investment opportunities, the cost of MRBs is at least 35 percent lower than estimated. Moreover, the tax revenues generated by the economic activity resulting from new construction that otherwise would not occur should also offset the estimated revenue loss.

Likewise, the determination of benefit has also been inadequate. GAO calculates the benefits of MRBs as resulting only from the interest rate advantage and resulting cost savings that tax-exempt bond financed mortgages provide the homebuyers. This represents a dramatic undercounting. New construction that would otherwise not occur is created by these programs. New economic activity results and revenue is generated. Home construction represent jobs created and materials purchased. Income, sales, and property taxes are also generated.

Expanding Upon GAO's Static Cost-Benefit Approach

When the traditional Cost/Benefit approach is refined to account for the above factors, the benefits can be shown to far outweigh the costs. A cost-benefit model prepared by NCSHA and reviewed by a local university economist shows how the costs and benefits, when adjusted in the manner suggested above, produce a dramatically different picture of efficiency than that calculated by GAO.

Under the approach detailed in Appendix 1, the limited GAO type calculation is adjusted to account for more sophisticated investor behavior and economic impact.

Table 9
Efficiency of Mortgage Revenue Bonds

	Impact
Dollars of MRBs Issued	$100
Lendable Proceeds Availabe	$95
Basic Efficiency Model	
Cost From Revenue Foregone	$1.94
Individual Benefits	$1.13
Benefit Cost Ratio	58.34%
Present Value of Cost	$12.87
Present Value of Benefits	$7.51
Adjusted Efficiency Model	
Cost From Revenue Foregone	$0.46
Individual Benefits	$16.47
Benefit Cost Ratio	3,583.39%
Present Value of Cost	$3.04
Present Value of Benefits	$109.10

When the costs are adjusted to account for more sophisticated investor behavior and the federal taxes generated from economic activity is accounted for, a reduction to $0.46 for $100 of MRBs results. Even using the contested GAO finding that only 30 percent of homebuyers would not have purchased a home without MRBs, a significant contribution to gross national product (GNP) can be calculated. Based on an economic impact estimating process designed by the National Association of Realtors, economic benefits of $14.69 are created for every $100 of bonds issued. When added to the individual benefits, the use of a benefits to cost ratio appears silly.

GAO denied that any economic benefit could be attributed to home purchases that would not otherwise occur. Similarly, when the Joint Committee on Taxation estimates the revenue impact of the MRB extension, it feels constrained to use the Congressional Budget Office's forecast of GNP growth and discount any economic benefit from MRBs. The position in both cases is debatable, but especially weak when taken in the context of a cost-benefit analysis.

The homebuilding industry is just that, an industry. One needs only to observe the economies in forestry products regions, carpet making, fixtures or appliance making regions. When housing starts decline, the economic impact is felt throughout these regional economies. Nor is it a simple matter of resources being shifted to other sectors of the economy. Some of this shifting occurs but lags and slippages result that diminish the economic vibrancy of the overall economy. Experience shows that skilled workers can be idled or even lost to the housing industry in the interim.

Likewise, resales of homes have economic implications. Homes are improved prior to sale and afterward. Realtor and lenders income shifts with the rates of home sales.

The benefits of this economic activity should not be ignored. Precisely because MRBs create individual benefits and economic benefits, states value their use. Especially for states and regions that need infusions of capital, the MRB has become an important resource.

An Important Role in the Housing Capital Market Has Been Created

One frequently ignored benefit of MRBs is their ability to direct capital to housing. The reality of recent years belies the notion that the private market will supply the full capital needs of the lower margins of the mortgage market. As noted above, HFAs have had such difficulty getting credit enhancements for these mortgages that many are relying increasingly on FHA insurance, examining forms of self-insurance, or are sharing risk with private insurers as a way to support the capital flow. Mortgage Backed Securities which provide a dynamic source of mortgage capital have not impacted upon the markets which HFAs have served with tax-exempt bonds. Leon Kendall, Chairman of MGIC, the largest provider of mortgage insurance has stated on numerous occasions that MRBs have been the most effective available means for directing capital to the first-time homebuyer market in recent years.

The volume of bonds which may be issued under both programs is limited by the uniform volume cap for so-called "private activity bonds". Each state has a fixed amount of bond authority to use in financing development projects, whether housing, student loans, manufacturing facilities, ports, or private pollution control facilities. The Governor has the discretion to allocate this authority to the purposes of his choosing. Housing must compete with other uses for a piece of a pie the size of which is known and limited.

In sum, MRBs augment rather than supplant private capital markets. Precisely because they are targeted, MRBs serve a housing market segment that is marginal to the private capital markets. MRBs provide low-cost, credit enhanced capital which is critical for lending institutions if they are to make loans to perceived "higher risk" borrowers. MRBs are efficient precisely because they rely on existing private sector channels . . . Realtors, mortgage lenders, investment bankers, and builders . . . to reach a targeted market with financing.

A Housing Program Delivery Capacity Has Been Created Around MRBs

Housing finance agencies have grown into the principal low- and moderate-income housing program delivery vehicle, in large measure due to the experience with MRBs. This organizational capacity is unlike that created by direct subsidy programs. Financial and underwriting skills exist unlike anywhere else in government outside of FHA. A variety of innovative programs has been built with these skills. These programs provide a centralized funding source which serves to promote low- and moderate-income homeownership and rental housing production.

When benefits and costs are more broadly and reasonably defined, the inefficiency argument disappears.

IV. GAO Ignored the Reality of Today's Housing Markets

The only salient point for elimination of Mortgage Revenue Bonds would be the lack of a homeownership affordability problem. This is far from the case. Recently the Joint Center for Housing Studies of Harvard released a report entitled the "State of the Nation's Housing 1988". The report notes that the relatively high levels of housing construction, home sales and remodeling expenditures have masked an ever-increasing population of housing have-nots, including potential first time buyers. In it, Professors William C. Apgar, Jr. and H. James Brown concluded that:

- Homeownership Rates have declined throughout the decade of the 80's, representing a loss of over 2 million homeowners if the 1980 rate had merely remained constant over the last seven years.
- The decline in homeownership among young households (25-39 years of age) is most dramatic including a 7.4 percent decrease in ages 24-29, a 8.9 percent decrease in ages 30-34 and a 7 percent decrease in ages 35-39.
- This decrease among the younger population exists in all regions of the country regardless of the individual economic climates.
- The after tax cost of homeownership remains prohibitively high for would-be first time homebuyers equalling $7,449 or 32.4 percent of the average annual income of potential first time buyers aged 25-29 for the typical starter home in 1987. . .about 50 percent higher than the share of income required in the early 1970s.
- Existing debt and increasing rents dramatically impact the ability of potential first time buyers not only to qualify for a conventional loan but to save downpayment and closing

One of the critical findings is the interrelationship of each of the individual problems to one another. This gives new perspective to the term "trickle down". Today, it is the inability of families and individuals to buy their first homes, which then significantly exacerbates the housing affordability problem for other low and moderate income Americans.

STATEMENT OF THE

NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

COMMITTEE ON FINANCE

of the

UNITED STATES SENATE

on

EXPIRING TAX PROVISIONS (MORTGAGE REVENUE BONDS)

MARCH 28, 1988

Mr. Chairman and Members of the Subcommittee:

My name is Mark Tipton and I am from Greenville, North Carolina.

I am here as Vice President and Secretary of the National Association of Home Builders (NAHB), an association of more than 150,000 home builders and small businessmen.

I am also a home builder and my corporation, the Whistler Corporation, is involved with a broad range of real estate activities from land development to the construction of homes and commercial properties in eastern North Carolina.

Since 1977, I also have served on the Board of Directors of the North Carolina Housing Finance Agency. I am currently chairman of the Personnel/Budget and Legislative Committees as well as a member of the Executive Committee.

My purpose here is to request your support for S.1522, a bill that will extend the use of mortgage revenue bonds and mortgage credit certificates through December 1992.

State and local housing finance agencies use mortgage revenue bonds to obtain tax-exempt funds at low rates of interest and these funds are used to purchase qualified mortgages. Mortgage revenue bonds make housing more affordable to homebuyers because interest rates are generally about two percentage points below conventional rates.

Mortgage credit certificates, which are subject to the same targeting requirements as mortgage revenue bonds, provide homebuyers with a tax credit equal to a percentage of mortgage interest payments. This federal tax credit increases the disposable income of home buyers and makes conventional mortgage rates more affordable. Up to 25 percent of mortgage revenue bond authority may be "traded-in" for mortgage credit certificates. Mortgage credit certificates are a new program but are proving to be an effective complement to the mortgage revenue bond program.

Members of the Subcommittee, the problem we face is simple yet devastating:

With spiraling housing costs and with federal housing funds decreasing, many young, hard-working Americans cannot buy a home; since 1980, the homeownership rate has dropped 20 percent among young families 25 to 34 years of age. The homeless population is increasing and many of the homeless are families who cannot afford a place to live within their limited resources. Elderly couples are living in substandard conditions because the cost of financing home repairs would deprive them of other basic necessities. These are not exaggerations; this is becoming a part of life in America that some want to ignore.

Though not a solution to this growing problem, mortgage revenue bonds do provide affordable housing options for these struggling, first-time homebuyers. Actually, mortgage revenue bonds and mortgage credit certificates are the only assistance provided through the Internal Revenue Code that specifically target low- and moderate-income, first-time homebuyers.

Mortgage revenue bonds have made a sizeable impact on young homebuyers' housing needs. Since the 1970's, about one million low- and moderate-income Americans have bought a home. All of these homes were sold, financed and -- in many cases -- built by private businessmen who have supported housing finance agency programs. Every state and local housing finance agency relies on the private sector -- not the public sector -- to make mortgage revenue bond programs work.

The mortgage revenue bond program is available because Congress has already recognized the critical need to provide support for lower-income homebuyers; Congress has recognized the role of homeownership in our economy and as a part of our social values.

If mortgage revenue bonds were important in the past, they are even more critical now.

In 1985, the Reagan Administration proposed to eliminate mortgage revenue bonds. NAHB was pleased that Congress did not follow the Administration on this issue, but instead extended mortgage revenue bonds through 1988.

While we describe ourselves as the best housed nation in the world, recent studies point out that this nation is beginning to face a major housing problem. A recent study, entitled "The State of the Nation's Housing," points out that America is increasingly becoming a nation of housing haves and have-nots. This study was prepared by the Joint Center for Housing Studies at Harvard University.

Consider these dramatic statistics:

While the percentage of households owning their own homes has been increasing nationwide since the Great Depression, since 1980, there has been a downward trend in homeownership -- from 65.6 percent in 1980 to 64.0 percent in 1987.

The decline in homeownership has been most significant among younger households. For households aged 25 to 29, the homeownership rate fell from 43.3 percent in 1980 to 35.9 percent in 1987. Households aged 30 to 34 suffered similarly sharp declines in homeownership -- 61.1 percent in 1980 to 53.2 percent in 1987. Among households aged 35 to 39, the decline in homeownership was from 70.8 percent in 1980 to 63.8 percent in 1987.

Are we willing to turn back the clock on decades of progress? Without the assistance provided by mortgage revenue bonds, the homeownership rate among younger households will drop even further.

Ladies and gentlemen, the use of mortgage revenue bonds is not a complete solution to the problem I described; unfortunately, no complete solution exists. It is, however, a part of the answer. It has been tested and it does work.

For example, assuming market mortgage interest rates are 10 percent, a mortgage provided from mortgage revenue bond funds typically would carry an interest charge of at least 1.5 percentage points lower, or 8.5 percent. If the assisted family was borrowing $70,000, they would save more than $900 a year in housing payments; in addition, the income needed to qualify for the mortgages would be reduced by more than $3,600, or 12 percent.

In my home state of North Carolina, mortgage revenue bonds have always been targeted to households in need; families receiving mortgage revenue bond loans are almost exclusively first-time homebuyers that earn less than the state median income and buy homes costing less than the state average.

In North Carolina, the average family receiving a mortgage revenue bond loan has a family income of $25,110, obtains a $48,434 mortgage and makes a 5% down payment. In the agency's assistance program, the family income of borrowers is $13,350, and $41,670 is borrowed. Mr. Chairman, I may not understand home buyers in Washington, D.C., but in North Carolina these buyers are school teachers, textile and construction workers, nurses and probably government employees.

And what about retired homeowners whose homes are badly in need of repairs? The housing finance agency also uses mortgage revenue bonds to help homeowners improve their homes.

The average borrower in the home improvement loan program is 62 years of age, has a family income of $16,080 and borrows $10,660 for rehabilitation costs. Where will these families find financing of this type if not through mortgage revenue bond programs?

The mortgage revenue bond program is not a new topic to Congress; this program has been reviewed and refined several times.

The Tax Reform Act of 1986 placed several restrictions on mortgage revenue bonds. First, all so-called "private purpose" tax-exempt bonds -- including mortgage revenue bonds -- are subject to a statewide volume cap equal to the greater of $50 per capita or $150 million. Second, mortgage revenue bonds must be limited to persons whose income is not greater than 115 percent of the higher of area or state median income. Third, the purchase price of a mortgage revenue bond financed residence cannot exceed 90 percent of the average area purchase price of a residence. Fourth, at least 95 percent of mortgage revenue bond proceeds must be used to provide loans to first-time home buyers. While there are exceptions for economically distressed areas, in North Carolina less than two percent of the state's population are not under these stringent guidelines.

If there is any concern about the program, it should be whether in our diligence to have a targeted program, we have gone too far and now have requirements that present real obstacles to conduct viable programs.

As an example, in addition to providing tighter program restrictions on mortgage revenue bonds, the Tax Reform Act of 1986 revised the tax treatment of mortgage revenue bond holders through changes in the minimum tax calculation.

For individuals, income from private purpose tax-exempt bonds is treated as an item of tax preference. For corporations, the calculation of alternative minimum tax includes adding one-half of the excess of book income over taxable income. Tax-exempt interest from all bonds is counted in determining book income.

The effect of these minimum tax provisions is to make investments in mortgage revenue bonds less attractive, particularly for individual investors. Furthermore, the bond investor's required yield has increased by 25 to 50 basis points. This higher bond yield results in a higher mortgage rate, and prevents issuers from better serving low-income households.

Recently, the General Accounting Office (GAO) issued a report that criticizes some aspects of the mortgage revenue bond program. The study has a number of faults, particularly in the selection of loans analyzed, virtually none of which were originated after the new targeting provisions of the Tax Reform Act of 1986.

Also, the cost of the mortgage revenue bond program is grossly misrepresented. It ignores one basic fact. If a builder constructs a house for a buyer using a mortgage revenue bond loan, that builder needs a carpenter, a roofer, an electrician, a plumber and a cement mason. All of these employees pay income taxes. And the new home is subject to state and local property taxes. The real estate industry -- and the home building industry in particular -- will generate more than enough in new revenue to pay for this program. Every $1 billion in mortgage revenue bonds results in financing for about 9,250 new homes, generating nearly 12,000 jobs and about $100 million in tax revenues, including $85 million in federal tax revenue.

The GAO report also criticizes the use of builder set-asides from mortgage revenue bond issues. Plainly, the report misses the point on how and why home builders use mortgage revenue bonds.

First of all, builder reservations are not the typical channel for mortgage revenue bond borrowers to purchase new homes. It is far more common for such funds to be funneled through participating lending institutions, not under the control of builders. A larger number of states do not provide builder set-asides at all; many only use them selectively to respond to specific housing needs.

Second, in certain areas set-asides are required to give builders a stable source of mortgage money, which encourages the construction of homes that are affordable to moderate-income families. Without a set-aside, builders are not assured their customers will receive bond-financed mortgages; with the volatility in the mortgage markets, builders face the unacceptable risk that targeted customers will not qualify for financing.

One more comment on the GAO report. It states that "most mortgage revenue bond assisted buyers would have probably been served by the conventional market."

I assume no representative of GAO visited Macon County North Carolina -- a rural, mountainous county in the western tip of the state with a population of 23,550 -- where a commitment from the North Carolina Housing Finance Agency allows the financing of owner-built housing for families earning less than $16,160 a year; or Murfreesboro, North Carolina -- a Coastal Plain community of 2,800 -- where home buyers earning less than $18,320 can afford a duplex conversion project as a result of a mortgage commitment by the North Carolina Housing Finance Agency.

There are ways of improving the mortgage revenue bond program. As I mentioned earlier, removal of the alternative minimum tax would lower bond yields and allow lower income home buyers to be served. Second, mortgage revenue bonds should receive a separate cap so they don't have to compete with other private purpose bonds. These conditions existed before the Tax Reform Act of 1986. Third, state and local housing finance agencies should be allowed to set income and sales price limits in urban areas where escalating property values make it impossible for many families to work and live in the same community. And, finally, the mortgage revenue bond program should be extended -- permanently.

On behalf of the National Association of Home Builders, I strongly urge that Congress enact legislation similar to S. 1522 and H.R. 2640 that will extend mortgage revenue bonds and mortgage credit certificates through 1992.

Testimony today is not only about mortgage revenue bonds; it is about housing our young families and offering them the quality of life that previous generations of Americans enjoyed.

It is about developing neighborhoods and creating neighbors. It is about people enjoying a roof over their heads, and living the American Dream.

STATEMENT OF
DANA L. TRIER
ACTING TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to present the views of the Treasury Department regarding a number of tax provisions that expired during calendar year 1987 or will expire during 1988. Several of these provisions would be reenacted or extended by proposed legislation pending before the Committee.

The following provisions expired during 1987: (1) the tax credit for investments in biomass property; (2) the exclusion for employer-provided group legal services and exemption for qualified group legal services organizations; (3) the exclusion for employer-provided educational assistance; and (4) the moratorium on application of regulations allocating domestic research and experimentation expenses for purposes of determining the foreign tax credit limitation. The following provisions will expire during 1988: (1) the tax credit for qualified research expenditures; (2) the tax credits for investments in solar, geothermal, and ocean thermal property; (3) the targeted jobs tax credit; (4) the authority to issue qualified mortgage bonds and mortgage credit certificates; (5) the exceptions from the arbitrage rules for tax-exempt student loan bonds; (6) the partial exemption from the motor vehicle fuels excise taxes for fuels used in qualifying taxicabs; (7) certain provisions relating to financially troubled thrift institutions; and (8) the exception from income and excise tax on qualified plan reversions that are transferred to an employee stock ownership plan.

The provisions that allow a tax credit for research expenditures and prescribe the method for allocating domestic research and experimentation expenses for foreign tax credit purposes have been or will be the subject of separate hearings; therefore, I will not discuss them in this testimony. I will first discuss the expired tax credit for biomass property and the expiring tax credits for solar, geothermal, and ocean thermal property. I will then discuss each of the other provisions separately.

Business Energy Tax Credits

Background

A tax credit is allowed under section 46 of the Internal Revenue Code of 1986 (the "Code") for investments in certain "energy property." For "solar property," the tax credit was 15 percent in 1986, 12 percent in 1987, and is 10 percent in 1988. For "geothermal property," the tax credit was 15 percent in 1986, 10 percent in 1987, and is 10 percent in 1988. For "ocean thermal property," the tax credit was 15 percent in 1986 and 1987, and is 15 percent in 1988. These credits expire at the end of 1988. Prior to 1988, a tax credit was also allowed for investments in "biomass property," at a rate of 15 percent in 1986 and 10 percent in 1987.

Solar property consists of equipment that uses solar energy to generate electricity or steam or to provide heating, cooling, or hot water in a structure. Geothermal property consists of equipment, such as turbines and generators, that converts the internal heat of the earth into electrical energy or another form of useful energy. Ocean thermal property consists of equipment, such as turbines and generators, that converts ocean thermal energy into electrical energy or another form of useful energy. Biomass property consists of property used either to convert into a synthetic fuel or to burn waste, sewage, sludge, grain, wood, and other organic substances (other than substances that are products of oil, natural gas, or coal).

The tax credits for solar, geothermal, ocean thermal, and biomass property were originally scheduled to expire at the end of 1985, but were extended for three years (two years in the case of biomass property) by the Tax Reform Act of 1986 (the "1986 Act").

Discussion

The tax credits for solar, geothermal, ocean thermal, and biomass property were enacted to stimulate the development and business application of these energy sources as alternatives to nonrenewable fossil fuels, such as petroleum, natural gas, and coal. The methods for producing these alternative energy sources were generally well known, but they were not being fully exploited because of price and other advantages of fossil fuel systems. The energy tax credits were intended to increase demand for property producing or using energy from these alternative sources, thereby stimulating technological advances in the design, production, and operation of such equipment.

We do not believe that the tax credits for solar, geothermal, ocean thermal, and biomass property should be extended. These investment incentives apply only to certain targeted activities. Thus, they produce a tax differential among investments that is inconsistent with the fundamental concepts underlying the 1986 Act. This tax differential distorts the allocation of resources by encouraging businesses to make investments that, without the tax credit, would be uneconomical at current and expected future market prices. We do not believe that this allocative inefficiency can be justified in this case.

Although we oppose extension of the energy tax credits, we recognize the importance of preparing for increased future use of alternative energy sources in light of the Nation's limited reserves of fossil fuels. For this reason, the Federal Government provides substantial support for the development of alternative energy sources through energy research and development programs. The President's fiscal year 1989 budget requests spending authority of $125 million for solar and renewable energy research and development. This research covers a broad range of technologies, with emphasis on the generation of electricity from solar, biomass, geothermal, and wind energy. We believe that these research and development expenditures represent the most appropriate way to promote technological advances with respect to alternative energy sources.

Revenue Estimate

We estimate that extension of the tax credits for solar, geothermal, and ocean thermal property through the end of calendar year 1991 would reduce revenues by $35 million in fiscal year 1989, $50 million in fiscal year 1990, $48 million in fiscal year 1991, and $20 million in fiscal year 1992. Extension of the tax credit for biomass property through the end of calendar year 1991 would reduce revenues by $47 million in fiscal year 1988, $81 million in fiscal year 1989, $85 million in fiscal year 1990, $90 million in fiscal year 1991, and $29 million in fiscal year 1992.

Employer-Provided Group Prepaid Legal Services

Background

Prior to 1988, the value of employer contributions to, and employee benefits provided under, a "qualified group legal services plan" was excluded from an employee's income under section 120 of the Code. Amounts excluded from income were also excluded from an employee's social security tax wage base. A qualified group legal services plan was defined as a separate written plan of an employer for the exclusive benefit of its employees or their spouses or dependents. The plan was required to provide specified personal (i.e., non-business) legal services to employees through prepayment of, or provision in advance for, all or part of an employee's legal fees for such services. Benefits under the plan were required to be provided in a manner that did not discriminate in favor of officers, owners, or highly compensated employees. In addition, no more than 25 percent of the amounts paid to the qualified plan could be for the benefit of persons holding a more than five percent ownership interest in the employer.

Prior to 1988, section 501(c)(20) of the Code exempted from tax organizations or trusts the exclusive function of which was to form part of a qualified group legal services plan under section 120. These organizations were permitted to provide other legal services or indemnification against legal costs without jeopardizing their tax-exempt status.

With the expiration of section 120, the benefit to an employee of coverage under an employer-provided legal services plan generally is included in the employee's gross income and social security tax wage base. An offsetting income tax deduction would be allowable to the employee only in very limited circumstances.

S. 2119

S. 2119 would permanently reinstate sections 120 and 501(c)(20) of the Code, effective January 1, 1988.

Discussion

The Treasury Department opposes the permanent reinstatement of sections 120 and 501(c)(20) as proposed in S. 2119. These sections created inequitable distinctions among taxpayers that, in our view, cannot be justified.

The exclusion for group legal services permitted a limited group of employees to achieve the effect of a deduction for their personal legal costs (and an exclusion of such amounts from the social security wage base), simply because their employers operated qualified group legal services plans. According to a Labor Department study, only 3 percent of all employees had access to such plans in 1985.1/ Thus, although the intent of section 120 was to increase access to legal services for middle income taxpayers, only a small percentage of taxpayers actually benefitted. Moreover, section 120 produced an inequitable tax advantage for participants in group legal services plans as compared to the vast majority of other individuals, who, because they could not deduct their personal legal expenses, paid such expenses with after-tax dollars. Even among participants in a qualified group legal services plan, the tax exclusion provided the greatest benefits to higher-income participants who were subject to higher marginal rates of income tax.

Revenue Estimate

We estimate that reinstating section 120, effective January 1, 1988, would reduce income and social security tax revenues by $125 million in fiscal year 1988 and by $140 million in fiscal year 1989.

Employer-Provided Educational Assistance

Background

Under section 127 of the Code, up to $5,250 of the value of educational assistance provided by an employer pursuant to a qualified educational assistance program was excluded from an employee's income. In order to qualify for the exclusion, the educational assistance program was required to meet several conditions, including that the assistance be provided in a manner that did not discriminate in favor of officers, owners, or highly compensated employees. In addition, no more than five percent of the amounts paid under a qualified educational assistance program could be for the benefit of persons holding a more than five percent ownership interest in the employer. Section 127 expired on December 31, 1987.

Section 117(d)(2) excludes from taxable income amounts of "qualified tuition reduction," i.e., reduced tuition provided on a nondiscriminatory basis to an employee of an educational organization for education (below the graduate level) of the employee or the employee's spouse or dependent children. Section 117(d)(2) is subject to the limitation contained in section 117(c), added by the 1986 Act, that makes the exclusion inapplicable to any amount that represents payment for teaching, research, or other services by the student if the performance of such services is required as a condition for receiving the tuition reduction. Prior to the expiration of section 127, section 127(c)(8) provided that, in the case of a graduate student engaged in teaching or research activities, section 117(d) was applied without regard to the requirement that the education be below the graduate level. Accordingly, since the enactment of the section 117(c) limitation (and before the expiration of section 127), section 127(c)(8) served to exclude from income only the portion, if any, of a graduate student tuition reduction that was in excess of amounts paid as compensation for teaching or research services.

With the expiration of section 127, an employer's payment or reimbursement of an employee's educational expenses must be included in the employee's income unless the cost of such assistance qualifies under section 162 of the Code as a deductible job-related expense of the employee. (Employer payments of job-related expenses may be either excluded from the employee's income or included in the employee's income subject to an offsetting deduction.) If an employer pays or reimburses an employee for educational expenses that are not job-related, the employee must include such amounts in income and no offsetting deduction is available.

In general, educational expenses are treated as job-related only if the education maintains or improves skills required in the individual's employment or is required as a condition of the employee's retention of his job, job status, or rate of compensation. Education that qualifies the employee for a new job (with the same or a different employer) is not considered job-related.

S. 39

S. 39, the Employee Educational Assistance Act of 1987, would permanently reinstate section 127 of the Code, effective January 1, 1988.

Discussion

The Treasury Department opposes the permanent reinstatement of section 127 as proposed by S. 39. We oppose reinstatement of section 127 because it provided tax benefits to only a small proportion of similarly situated taxpayers and did not principally benefit those most in need of educational assistance.

The tax-favored treatment of educational expenses under section 127 applied to only a small percentage of persons taking courses to train for a new job or occupation, thus creating an inequitable distinction among taxpayers. The tax benefit was not available to unemployed persons or to workers whose employers did not offer such programs. Self-employed individuals and many small business owners were, as a practical matter, unable to benefit effectively from section 127 plans.2/ As Table 1 indicates, 84 percent of all adult education courses taken in 1984 to qualify for a new job or occupation were paid for by the student himself. Thus, only 16 percent of such training could have benefitted from section 127.

The tax treatment of educational expenses that are not job-related should be the same for all individuals. The operation of section 127 was inherently inequitable in that it provided favorable tax treatment to only a small, fairly select group of individuals. If educational training taken in order to qualify for a new job or occupation is deserving of government support, then all such training expenses should be deductible, not just those of certain employees.

Moreover, the available data suggest that section 127 did not principally benefit less educated or less skilled workers who would be most in need of further educational training. A Labor Department survey found that higher-paid professional and administrative employees were more likely than production workers to have employer educational assistance plans offered to them, and were more likely to be offered full, rather than partial, reimbursement.3/ In addition, as Table 2 indicates, less educated workers in lower-paying jobs represented a smaller fraction of participants in adult education courses in 1984 than in 1969 (before the enactment of section 127).

In summary, we believe that section 127 unfairly provided, at a substantial revenue cost, preferential treatment to a relatively small group of individuals, a disproportionately high percentage of whom were higher-paid professional and administrative personnel. For these reasons, we oppose the reenactment of section 127 in S. 39.

Lesser concerns would be presented by a reenactment of section 127(c)(8). The imposition of the limitation of section 117(c) upon graduate student tuition reductions under section 127(c)(8) effectively required that the tuition reduction be included in gross income to the extent the tuition reduction constituted compensation for services. We believe that such treatment of graduate student tuition reductions is appropriate and consistent with the purposes of the 1986 revisions to the general tax treatment of scholarships. Accordingly, we would oppose a provision intended to exclude the entire amount of such graduate student tuition reductions from income. We would not, however, object to a provision specifying that, under appropriate conditions (including satisfaction of nondiscrimination tests), the amount of a graduate student tuition reduction that exceeds reasonable compensation for services may qualify as a scholarship under section 117 or as an excludable fringe benefit under section 132.

Revenue Estimate

We estimate that reinstatement of section 127, effective January 1, 1988, would reduce revenues by $275 million in fiscal year 1988 and by approximately $400 million annually thereafter.

Targeted Jobs Tax Credit

Background

Section 51 of the Code allows employers a tax credit for the employment of individuals belonging to one of nine targeted groups. The amount of the allowable targeted jobs tax credit ("TJTC") is generally equal to 40 percent of the first $6,000 of wages paid to a member of a targeted group in the first year of employment. The employer's deduction for wages is reduced by the amount of the credit. A targeted group member must be employed at least 90 days (14 days in the case of summer youth employees) or perform a minimum of 120 hours of work (20 hours in the case of summer youth employees) before an employer qualifies to claim the TJTC. The credit is unavailable for wages paid to an individual who begins work after December 31, 1988.

The nine targeted groups of employees are the following: economically disadvantaged youths (ages 18-24); economically disadvantaged summer youths (ages 16-17); economically disadvantaged youths participating in cooperative education programs; economically disadvantaged Vietnam-era veterans; economically disadvantaged ex-convicts; certain handicapped workers; certain work incentive employees (AFDC recipients and WIN program registrants); Supplemental Security Income recipients; and general assistance recipients.

The targeted group with the most members is the group of economically disadvantaged youths aged 18 through 24. For purposes of the TJTC, a worker is economically disadvantaged if the worker's family income is below 70 percent of the Bureau of Labor Statistics lower living standard income levels during the prior six months. To claim the credit for an employee, an employer must receive a written certification that the employee is a targeted group member. Certifications of eligibility for employees are generally provided by State employment security agencies. The employer must have received, or filed a written request for, a certification on or before the date a targeted worker begins employment.4/

S. 684

S. 684 would make the TJTC permanent.

Discussion

The Treasury Department opposes making the TJTC permanent as proposed by S. 684. The TJTC was intended to increase employment of targeted workers by reducing the wage costs of employing these workers. The credit achieves its desired effect only when it results in the hiring of targeted employees who would not otherwise have been hired. Where an employer claims the credit with respect to workers who would have been hired without regard to the credit, the credit does not serve its intended incentive effect but is merely a windfall for the employer.

The evidence that the credit has not had the intended incentive effect is quite strong. The Labor Department estimated, for example, that in 1981 2.4 million to 3.0 million disadvantaged youths found employment in the private sector of the economy, whereas only 176,000 economically disadvantaged youths received certification for the TJTC. Thus, in that year over 92 percent of economically disadvantaged youths who found employment did so without benefit of the credit.

A net increase in targeted employment may not result even when the TJTC is directly responsible for the employment of a targeted worker. That is, if newly hired certified targeted employees replace previously employed targeted employees who are no longer eligible for the credit or are hired in place of uncertified targeted workers, targeted employment will not increase on a net basis. Moreover, we believe it is likely that any increase in hiring of targeted workers as a result of the credit is achieved at the expense of other low-skilled workers who have not qualified for the credit but have job skills similar to those of the targeted groups. Finally, increases in targeted employment by firms claiming the credit are partially offset by the loss of employment in other sectors of the private economy.

Other Federal programs currently provide assistance to many of those eligible for the TJTC. Under the Job Training Partnership Act, grants are made to the states to prepare low-income and unskilled youths and adults for entry into the labor force and to provide specialized job training to handicapped persons. The Administration has proposed spending over $2.6 billion in fiscal year 1989 for this program. In addition, the Administration has requested budget authority of approximately $1 billion for the Job-Corps and other training programs. The Job-Corps provides remedial training and job skills training for disadvantaged youth. Other training programs are targeted to veterans, native Americans, and migrant and seasonal farm workers.

Revenue Effect

We estimate that a three-year extension of the TJTC would reduce revenues by $64 million in fiscal year 1989, $151 million in fiscal year 1990, and $237 million in fiscal year 1991.

Qualified Mortgage Bonds and Mortgage Credit Certificates

Background

State and local governments discovered during the 1970s that they could issue tax-exempt bonds to sponsor mortgage revenue bond programs that would provide below-market rate mortgage loans to their residents at no cost to themselves. As a result, the issuance of tax-exempt bonds for owner-occupied housing grew to 20 percent of total tax-exempt financing by 1980. There were no restrictions on who could benefit from the below-market rate mortgage loans provided by tax-exempt mortgage revenue bonds. Beginning with the Mortgage Subsidy Bond Tax Act of 1980 (the "1980 Act"), a series of legislative changes were enacted to target the subsidy to those individuals with the greatest need and to curtail the mounting federal revenue losses from the issuance of these tax-exempt bonds.

First, eligibility requirements were imposed on mortgages financed with bond proceeds. The 1980 Act required that (a) the mortgages finance only principal residences; (b) the mortgagor not have owned a principal residence during the immediately preceding three years; and (c) the acquisition cost of the residence not exceed 90 percent of the average area purchase price for single family residences. In certain targeted low-income areas, the first-time homebuyer requirement was waived, and the purchase price limitation was increased to 110 percent of the average area purchase price.

These eligibility requirements were liberalized by the Tax Equity and Fiscal Responsibility Act of 1982 (the "1982 Act"). Under the 1982 Act, up to 10 percent of the bond proceeds in non-targeted areas were permitted to be used by existing homeowners, and the purchase price limitations were increased to 110 percent (120 percent in targeted areas) of the average area purchase price. The eligibility requirements were, however, tightened again in 1986. The 1986 Act imposed a household income limit of 115 percent of the higher of the area or Statewide median income. In targeted areas, the income limit is increased to 140 percent of the median and is waived for one-third of the mortgage financing. The income limit is not adjusted for family size. The 1986 Act reduced to five percent the amount of bond proceeds that may be used by existing homeowners in non-targeted areas and reinstated the lower purchase price limit that applied before the 1982 Act.

Second, restrictions have been imposed on the volume of tax-exempt mortgage revenue bonds. In addition to the tremendous revenue losses that would have occurred if the issuance of such bonds had continued unchecked, an unlimited volume of bonds would have increased borrowing costs of State and local governments for traditional public projects. The 1980 Act imposed a volume cap on the aggregate amount of qualified mortgage bonds that could be issued within any State during a calendar year. The annual volume cap for each State was the greater of $200 million or 9 percent of the average annual amount of mortgages for owner-occupied residences originated in the State during the preceding three years.

Finally, in order to ensure that some portion of the benefit of the tax-exempt financing accrued to homebuyers, provisions have been adopted to limit the amount of arbitrage profits that may be be earned by the issuer. Under the provisions contained in the 1980 Act, the effective interest rate on mortgages made to homebuyers was limited to one percentage point above the yield on the bonds. In addition, any arbitrage profits earned from investing the bond proceeds in non-mortgage investments was required to be paid or credited to the mortgagors (or, if the issuer elected, to the Treasury). The 1982 Act increased the maximum effective interest rate on the mortgages to one and one-eighth percentage points above the yield on the bonds.

The Deficit Reduction Act of 1984 (the "1984 Act") allowed State and local governments to elect to trade some or all of their qualified mortgage bond authority for authority to issue mortgage credit certificates ("MCCs"). The trade-in rate was set at 20 percent of the nonissued bond amount.. MCCs entitle a homebuyer to a nonrefundable income tax credit in the amount of 10 percent to 50 percent (as determined by the issuing authority) of interest paid on a mortgage loan incurred to finance the mortgagor's principal residence. The maximum annual credit per recipient is $2,000. Eligibility for the credit was based on the same criteria as for qualified mortgage bonds. The 1986 Act increased the MCC trade-in rate from 20 percent to 25 percent.

The 1980 Act provided that the qualified mortgage bond program would expire at the end of 1983. The 1984 Act extended the sunset for qualified mortgage bonds through 1987. Authority to issue MCCs was also scheduled to expire at the end of 1987. The 1986 Act extended the authority to issue qualified mortgage bonds through 1988. A proposed technical correction would extend the MCC expiration date through 1988 to parallel this extension.

S. 1522

S. 1522 would extend issuing authority for qualified mortgage bonds under section 143 of the Code through 1992. The mortgage credit certificate program under section 25 of the Code would be extended retroactively from January 1, 1988 through 1992.

Discussion

The Treasury Department opposes extension of the authority to issue qualified mortgage bonds through 1992 as proposed by S. 1522. The reasons for our opposition are that Federal support for owner-occupied housing for low- and moderate-income families is sufficient without qualified mortgage bonds or mortgage credit certificates and that tax-exempt bonds are an extremely costly and inefficient means of providing assistance to low- and moderate-income homebuyers.

The Federal income tax rules provide substantial assistance to homeowners through the allowance of a deduction for interest on mortgages of up to $1 million incurred to purchase a principal (or second) residence, allowance of a deduction for real estate taxes, rollover of capital gains on sales of a principal residence, and allowance of a one-time exclusion of capital gains of up to $125,000 on the sale of a principal residence by a taxpayer aged 55 or older. As a result, the income from owner-occupied housing investments is exempt from tax over the entire lifetime of most taxpayers. The mortgage interest and real estate tax deductions allow taxpayers to reduce their withholding taxes and have more take-home pay with which to make monthly mortgage payments. We estimate that these special tax provisions provide over $50 billion in assistance to owner-occupied housing in fiscal year 1988.

In addition to preferential tax treatment, other Federal programs aid home buyers. For example, the Federal Housing Administration and Veteran's Administration provide mortgage insurance that allows many first-time homebuyers to purchase a home with a low downpayment.

Tax-exempt bond financing is an extremely inefficient means of providing assistance to low- and moderate-income homebuyers. The subsidy is possible because high-income individuals and other persons subject to a high marginal rate of tax are willing to accept lower interest rates on qualified mortgage bonds because of the tax-exemption. The portion of the benefits captured by the purchasers of bonds is large, due to the large outstanding volume of tax-exempt bonds, including mortgage bonds. A GAO study estimates that because of these inherent inefficiencies, as well as the overhead costs of administering the subsidy, less than half of the tax benefits were passed along to homebuyers.5/ Because of its inherent inefficiencies, the qualified mortgage bond program provides a low rate of subsidy to prospective homebuyers.

In addition, because income limits are not adjusted for family size, relatively high income single persons who are least in need of assistance benefit disproportionately. Thus, the program is unlikely to encourage home ownership for persons who would not otherwise be purchasing homes. This fact is suggested by the GAO study, which found that two-thirds of assisted households could have afforded the homes they purchased without assistance, and that most of the rest would have become homeowners in the near future without assistance.

Finally, the costs of this program are potentially very high. The Joint Committee on Taxation estimates that, although extending the qualified mortgage bond program would cost less than $50 million in fiscal year 1989, this revenue loss would grow to $300 million in fiscal year 1992. The first year cost is relatively small because the extension would only affect nine months of the fiscal year and new bonds issued would be outstanding for an average of only 4-1/2 months during the year. It must be recognized, however, that the first year revenue loss resulting from a new tax-exempt bond issue vastly understates the long-term revenue loss. The long-term revenue loss reflects up to 30 years of tax subsidies. For example, we estimate that the revenue loss from all of the outstanding qualified mortgage bonds in fiscal year 1988 is $1.8 billion, almost all of which is attributable to bonds issued before 1988.

In summary, extension of the qualified mortgage bond program is unnecessary, inefficient, and extremely expensive. The qualified mortgage bond program is the least cost-effective means of providing Federal assistance to owner-occupied housing, and does not provide sufficient assistance to those who may need it to justify its large cost. The increased supply of tax-exempt bonds resulting from the program also tends to raise interest costs for State and local governments in financing traditional public projects such as schools, roads, sewers, and public buildings. If Congress deems that additional assistance for first-time homebuyers is necessary, it should consider providing all of such assistance in the form of mortgage credit certificates rather than qualified mortgage bonds.

Arbitrage Exceptions for Student Loan Bonds

Background

Section 148(f) of the Code requires issuers of State and local bonds to rebate to the United States arbitrage profits earned from investing gross proceeds of an issue of tax-exempt bonds in investments that are not acquired to carry out the governmental purpose of the tax-exempt bond issue. One of the principal objectives of the enactment of section 148(f) was to eliminate so-called "collapsible" escrow bond issues in which the bond proceeds are invested in a higher-yielding escrow before being used for a governmental purpose. In these transactions, the arbitrage profits earned during the escrow period were sufficient to provide a net profit to the issuer or other parties after payment of all bond issuance expenses, if the issue was "collapsed" by retiring all the bonds prior to the use of the bond proceeds for a governmental purpose. This collapsible structure facilitated the issuance of bonds for projects for which financing might never actually be needed or used.

Section 148(f) of the Code generally eliminated these collapsible bond issues by requiring issuers to rebate arbitrage profits earned during the escrow period. Section 148(f)(4)(d) contains an exception from this rule, however, for bonds issued on or before December 31, 1988 to finance Federally guaranteed student loans ("GSL bonds"). Under this exception, issuers of GSL bonds can use arbitrage profits earned during the escrow period to pay bond issuance costs, even if no student loans are financed. Moreover, issuers of GSL bonds can use arbitrage profits earned during the escrow period to pay program costs.

Section 148(a) of the Code provides generally that a bond is an arbitrage bond if the proceeds are used to acquire higher yielding investments. Section 148(c), however, provides that a bond is not treated as an arbitrage bond solely because the proceeds are invested for a reasonable temporary period until needed for a governmental purpose. The temporary period for proceeds to be used to make or finance loans generally may not exceed six months. This six-month period is, however, extended to eighteen months for GSL bonds issued on or before December 31, 1988.

Qualified scholarship funding corporations are authorized to issue tax-exempt GSL bonds. Qualified scholarship funding corporations are not, however, authorized to issue tax-exempt bonds to finance student loans that are not Federally guaranteed ("supplemental student loan bonds").

__S. 2149__

S. 2149 would make permanent the temporary arbitrage exceptions for GSL bonds and expand these exceptions to cover supplemental student loan bonds. The bill also would authorize qualified scholarship funding corporations to issue supplemental student loan bonds.

__Discussion__

The Treasury Department opposes the permanent extension of the temporary arbitrage exceptions for GSL bonds and the expansion of these exceptions to cover supplemental student loan bonds as proposed by S. 2149. The stated reason for the temporary arbitrage exceptions for GSL bonds was to permit issuers of such bonds to continue to issue bonds while they find other sources of revenue to defray bond issuance and program costs. H.R. Rep. No. 841, 99th Cong., 2d Sess. II-753 (Conference Committee). For the following reasons, these arbitrage exceptions are not warranted and should not be extended or expanded to cover supplemental student loan bonds.

First, issuers of GSL bonds are permitted under Treasury regulations to recover all of their bond issuance and program costs from the student borrowers by receiving higher interest payments on the student loan notes than the issuers pay on the bonds.6/ The temporary rebate exception, therefore, permits recovery of the same costs twice, once from the temporary investment arbitrage and again from the student borrowers. Furthermore, if the bond proceeds are not used to finance student loans and are used solely to earn arbitrage profits, the issuers can still recover their bond issuance costs from the arbitrage profits. Thus, the temporary rebate exception permits risk-free, collapsible escrow bonds to be issued, contrary to the purpose of the arbitrage rebate provisions.

Second, there is no basis for treating these private activity bonds more favorably than bonds issued for essential government purposes. GSL bonds are not distinguishable from other bonds to which the arbitrage rebate rules fully apply. Moreover, the special rebate exception is not necessary for the issuance of GSL bonds. The risk that bond issuance costs will have to be paid out of other available funds if the bond proceeds are not used to finance student loans can be eliminated by delaying issuance until the bond proceeds are actually needed to finance the student loans. To the extent the bonds are issued earlier than necessary, the early issuance risk should be borne by the issuers -- not by the Federal government.

Third, many issuers of GSL bonds have accumulated large surpluses over the years from issuing GSL bonds and investing the bond proceeds in higher yielding investments and student loan notes. A special exception that permits these historically favored issuers to use temporary investment arbitrage to issue bonds at no risk, and to recover the same costs twice, is not defensible as a matter of tax policy.

Finally, student loans financed by supplemental student loan bonds are not subject to the income limits applicable to Federally guaranteed student loans. Thus, these bonds do not fulfill with precision the Federal policy goal of aiding lower income families, and the authority to issue them should not be expanded.

Fuel Excise Tax Exemption for Certain Taxicabs

Background

Federal excise taxes generally are imposed on motor vehicle fuels at the rate of 9.1 cents per gallon on gasoline and special motor fuels and 15.1 cents per gallon on diesel fuel. A 4 cents per gallon refund or credit of these Federal excise taxes is allowed under section 6427(e)(3) of the Code for fuel that is used in providing qualifying taxicab services. This exemption was enacted as part of the Surface Transportation Act of 1978. The stated purpose of the exemption was to encourage ride-sharing, thereby reducing energy consumption by substituting taxicab use for personal automobile use. The exemption is scheduled to expire on September 30, 1988.

Discussion

The Treasury Department opposes extension of the partial exemption from the motor vehicle fuel excise taxes for fuel used in providing taxicab services. Our reasons for opposing extension of the exemption are that the exemption provides a very small reduction in costs for the taxicab industry which is unlikely to have any measurable incentive effect and that the small value of the program is not worth the associated administrative costs on the part of the Internal Revenue Service and the private sector.

During the last five years, the total amount of refunds and credits claimed with respect to qualified taxicab services has averaged only $2 million annually. In 1985, the refunds and credits accounted for only 0.3 percent of the gasoline and oil costs of the taxicab industry, and for only 0.04 percent of the industry's total operating costs. This minuscule reduction in cost would have little, if any, effect on the use of taxicab services.

In addition, only a small percentage of taxicab owners eligible for the exemption apply for the refund or credit. In 1985, for example, only $2 million in refunds and credits were claimed, which represents less than 10 percent of the estimated $21 million in exemptions available to potentially qualified taxicabs. It appears that the administrative costs of applying for the credit or refund outweigh the monetary advantage of the exemption for most eligible taxpayers.

Although the revenue cost of this exemption is not substantial, the exemption is not justified on policy grounds. The $3 million in foregone revenues could be better used in the Highway Trust Fund, which receives the bulk of the proceeds of the Federal excise taxes on motor vehicle fuels. Expiration of the exemption would also reduce the administrative expenses of the Internal Revenue Service in administering this ineffective subsidy.

Reorganizations of Financially Troubled Thrifts

Background

Under current law, certain acquisitions of the stock or assets of one corporation by another in transactions described in section 368(a) of the Code qualify as tax-free reorganizations. In order to qualify as tax-free, a corporate acquisition generally must satisfy a non-statutory "continuity of interest" test as well as the pertinent requirements of section 368(a). To satisfy the continuity of interest test, the owners of the acquired corporation must retain a significant equity interest in that corporation through their ownership of the acquiring corporation. Subject to a variety of limitations that may apply to limit the unrestricted transfer of tax benefits, including the provisions of section 382 of the Code, the tax attributes of a corporation acquired in a tax-free reorganization (e.g., net operating losses) generally carry over to the acquiring corporation under section 381 of the Code.

Special rules enacted in the Economic Recovery Tax Act of 1981 (the "1981 Act"), and repealed as of December 31, 1988 by the 1986 Act, permit certain acquisitions of financially troubled thrift institutions to qualify as tax-free reorganizations, without regard to the continuity of interest requirement, provided that certain conditions are met. First, the acquired institution must be a domestic building and loan association, a non-stock cooperative bank organized and operated for mutual purposes without profit, or a mutual savings bank. Second, the Federal Savings and Loan Insurance Corporation ("FSLIC"), Federal Home Loan Bank Board ("FHLBB"), or, where neither has supervisory authority, an equivalent State authority, must certify that the acquired thrift is insolvent, that it cannot meet its obligations currently, or that it will be unable to meet its obligations in the immediate future in the absence of action by the supervisory authority. In addition, the acquiring corporation must acquire substantially all of the assets, and must assume substantially all of the liabilities (including the liabilities to depositors), of the acquired thrift.

If a supervisory thrift reorganization is treated as tax-free under these special rules, another special rule in effect until December 31, 1988 permits the acquiring corporation to succeed to the net operating loss carryovers, built-in losses, and excess credits of the acquired thrift, without limitation under section 382, provided that the shareholders, creditors, and depositors of the acquired thrift acquire a 20 percent ownership interest in the acquiring corporation as a result of the acquisition. If the shareholders, creditors, and depositors of the acquired thrift do not acquire the requisite interest in the acquiring corporation, the use of the acquired thrift's net operating loss carryforwards will be subject to the limitations imposed by section 382(a). Application of these limitations in the context of the reorganization of a troubled thrift would, in most cases, substantially reduce the value of the net operating loss carryover (and built-in losses) in the hands of the acquiring corporation.

In addition to providing special rules for tax-free treatment and carryover of net operating losses in supervisory thrift reorganizations, current law provides, in section 597 of the Code, a special exclusion from income for amounts received by a domestic building and loan association from the FSLIC under its financial assistance program. Section 597 also provides that no reduction in the basis of the recipient's assets is required on account of such a payment. No similar provision applies with respect to amounts received by a financial institution from the Federal Deposit Insurance Corporation ("FDIC"). The 1986 Act repealed section 597 as of December 31, 1988.

Discussion

The favorable tax rules for financially troubled thrift institutions were enacted in 1981 to strengthen and restore stability to thrifts and the institutions that insure their deposits during a period of restructuring. These favorable rules permit the relevant supervisory authority to arrange mergers with healthy corporations at a lower cost to the supervisory authority.

In the 1986 Act, Congress repealed these provisions, effective after a two-year transition period, because it believed that the provisions were inconsistent with the rules generally applicable to other financial institutions and corporations. Thus, repeal of these provisions was in accord with one of the basic themes of the 1986 Act, that the tax laws should not provide beneficial treatment to some industries, or segments of an industry, and not others. The Treasury Department generally supports this decision as sound tax policy. In general, we do not support the subsidization of specific industries through the Federal tax laws.

The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity in May 1985 recommended, however, that the repeal of the special provisions for thrift reorganizations not be effective until January 1, 1991. We believed that a transition period of more than two years would be required to permit the thrift industry to recover from adverse economic conditions.

The Treasury Department remains concerned that the two-year transition period provided in the 1986 Act may be insufficient. Despite significant declines in interest rates, the thrift industry still faces substantial problems. The expiration of the special rules would terminate beneficial tax treatment and consequently place greater demands on the resources of the FSLIC and other supervisory authorities. Accordingly, if Congress were to determine that repeal of the special rules for reorganizations of financially troubled thrifts should be delayed until 1991, the Treasury Department would not object to such a delay. This would provide some relief to the thrifts, the FSLIC, and the FHLBB as they address the problems that persist in the industry. The intervening period would also provide an opportunity for examination of the tax treatment of troubled thrift reorganizations and allow resolution of technical problems that create uncertainty.

Extension of Exception for Transfers of Reversions to ESOPS

Background

The law provides significant tax advantages to employer-maintained plans that provide nondiscriminatory retirement and deferred compensation benefits to employees and that satisfy various plan qualification requirements. Qualified plans are of two basic types: defined contribution plans and defined benefit plans. Defined benefit plans provide employees with retirement benefits determined under benefit formulas and funded actuarially in a manner similar to the funding of an insurance reserve. Defined contribution plans provide employees with benefits equal to the assets allocated to such employees under the plan. An employee stock ownership plan ("ESOP") is a special type of defined contribution plan that invests employees' benefits in securities of the employer maintaining the plan.

Under a defined benefit plan, an employee's benefit is stated as an annual amount to be paid for the employee's life commencing on the normal retirement age. The benefit is generally based on a formula that takes into account the employee's years of service and compensation and is independent of the amount of contributions to the plan or the investment of the plan's assets. An employer funds a defined benefit plan in accordance with actuarial funding methods that are based on the plan's investment experience and on the employees' currently earned and projected future retirement benefits. As a result, a defined benefit plan generally has assets in excess of the total of employees' benefits to secure both current and future benefits. Furthermore, employees' benefits under a defined benefit plan are guaranteed (up to specified levels) by the Pension Benefit Guaranty Corporation.

Upon the termination of a defined benefit plan, an employer may receive any plan assets remaining after all plan liabilities have been satisfied (an "employer reversion"). The amount of the reversion is includible in the employer's income. Section 4980 of the Code, which was added by the 1986 Act, imposes an additional 10 percent, nondeductible excise tax on employer reversions. This excise tax applies to reversions attributable to plan terminations occurring after December 31, 1985.

The provision of retirement income benefits to employees is the objective that justifies granting various tax preferences to qualified plans under current law. The adoption of the 10 percent excise tax on employer reversions appropriately reflects this objective by recapturing at least a portion of the value of the tax preferences provided with respect to a qualified plan's assets that are not used to provide retirement benefits to employees. The excise tax is particularly important with respect to defined benefit plans under which employers are encouraged to accumulate tax-favored reserves to secure both current and future benefits. This tax-favored reserve affords employers the opportunity to gain access to the qualified plan tax preferences for nonretirement benefit purposes through receipt of tax-favored funds on plan termination.

Under a defined contribution plan, an employee's benefit is equal to the value of the contributions and other amounts allocated to the employee's account under the plan, adjusted appropriately for gains and losses. Generally, defined contribution plan assets are invested on a diversified basis by an investment manager or are invested at the direction of employees. Because employees' benefits are directly dependent on the value of the plan's assets, employees ultimately bear the risk of investment experience. Profit-sharing plans and cash or deferred arrangements (i.e., 401(k) plans) are examples of defined contribution plans.

An ESOP is a defined contribution plan that invests in employer securities, rather than in a diversified asset portfolio or in employee-directed investments. Generally, ESOPs are intended to provide equity ownership benefits to employees.

The tax law provides numerous advantages for ESOPs and transactions involving ESOPs, indicating that ESOPs are to be treated differently from other qualified plans in recognition of their nonretirement purposes. Many of these preferences are simply increases in the preferences provided generally to other qualified plans, and others reflect the differences between ESOPs and qualified plans. There is an exception from the prohibited transaction rules generally applicable to qualified plans permitting the employer to secure loan financing through a leveraged ESOP. In a leveraged ESOP transaction, the employer is effectively able to deduct principal payments on the ESOP loan. To facilitate such transactions, the applicable deduction limit for employer contributions to a qualified plan is increased from 15 percent to 25 percent of participants' compensation to the extent the contributions are to repay principal on the ESOP loan. An additional ESOP preference permits greater allocations of ESOP benefits to highly compensated employees than is permitted generally under qualified plans by increasing the maximum annual amount that may be allocated to a participant's account from $30,000 to $60,000.

Several additional ESOP preferences were adopted in the Deficit Reduction Act of 1984. One permits an employer to deduct dividends paid on employer stock held by an ESOP. A second preference permits banks and certain other financial institutions to exclude from income 50 percent of the interest received on ESOP loans; this has significantly reduced the borrowing costs of many companies that maintain ESOPs. A third preference enables stockholders to defer the taxation of gains on sales of employer stock to ESOPs to the extent that the sales proceeds are reinvested in certain domestic companies. A fourth preference permits certain ESOPs to assume the estate tax liability of the deceased owner of a company.

The 1986 Act added several additional tax preferences for ESOPs. A special estate tax benefit, significantly restricted last year in the Omnibus Budget Reconciliation Act of 1987, permits certain estates to deduct up to 50 percent of the proceeds from certain sales of employer stock to ESOPs. In addition, in recognition that ESOPs are not retirement plans, there is a special exception from the 10 percent excise tax on early distributions from qualified plans for early distributions from ESOPs.

One of the special advantages added by the 1986 Act with respect to ESOPs is a provision under section 4980 that excepts certain reversions transferred from defined benefit plans to ESOPs from the income tax and 10 percent excise tax on reversions. If an employer transfers all or a portion of a reversion to an ESOP, the amount transferred is neither subject to the excise tax nor includable in the employer's income if the ESOP satisfies certain investment, allocation, and participation requirements. The exclusion of employer reversions from the excise and income taxes does not apply to reversions transferred to ESOPs pursuant to plan terminations occurring after December 31, 1988.

Discussion

The Administration opposes the extension of the excise and income tax exclusion for reversion transfers to ESOPs. Extension would add a tax preference to the large number of tax preferences already provided for ESOPs at a time when it is uncertain whether the numerous ESOP preferences are warranted. Furthermore, the reversion exclusion is inconsistent with sound retirement policy because it encourages employers to replace retirement benefits under a defined benefit plan, which are funded by a diversified asset portfolio and guaranteed by the Pension Benefit Guaranty Corporation, with benefits secured only by more volatile employer securities.

As discussed above, ESOPs and certain transactions involving ESOPs are provided with numerous, significant tax and nontax advantages under existing law. The exclusion from the excise and income taxes for reversions transferred to ESOPs is another significant tax benefit that effectively permits an employer to use the tax-favored reserve that is essential to benefit security under a defined benefit plan to prefund, on a deductible and tax-exempt basis, future contributions to an ESOP. In the usual situation, the transferred amounts were originally contributed to a defined benefit plan and deducted by the employer years prior to the transfer and have grown, between the time of contribution and transfer, on a tax-exempt basis. Such tax-favored prefunding is not available for other defined contribution plans, much less for other types of employer business expenses. It is thus difficult to justify such favorable treatment, particularly where the tax-favored amounts are paid directly to the employer for treasury stock.

The often stated justification for the numerous ESOP preferences is that, unlike qualified retirement plans, ESOPs provide employees with an equity ownership interest in their employers and thus increase employee productivity and company profitability. However, there are serious questions about whether, even with all the tax preferences, the existing ESOP rules actually provide employees with meaningful ownership benefits. For example, employees' voting rights under an ESOP are severely limited if the employer's stock is not publicly traded. Also, even ~~if~~ dividends are declared on the class of employer stock held by the ESOP, there is no certainty that employees actually will accrue the benefit of the dividends. Furthermore, there often are restrictions on the ability of employees to receive distributions in the form of employer stock. Finally, even if they actually receive the employer stock, employees often sell the stock back to the employer soon after receipt. In many situations, therefore, it appears that ESOPs deliver about the same ownership benefits delivered by stock appreciation programs, which exist currently without the significant tax preferences.

In addition, there is uncertainty about the extent to which employee ownership of employer stock actually increases productivity and profitability. The General Accounting Office recently reported that it finds little evidence of such results. Furthermore, there is increasing concern about the role that ESOPs play in takeovers and buy-outs. Some argue that, in these and similar situations, ESOPs are used primarily to strengthen the position of corporate management, often to the detriment of other stockholders, employees, and the long-term viability of the highly leveraged company.

If ESOPs actually deliver the positive corporate benefits that ESOP proponents maintain, it is unclear why the significant number of existing preferences are needed to encourage employers to maintain ESOPs. If the existing preferences are not sufficient to encourage sufficient numbers of employers to adopt ESOPs, we do not believe that the remedy is to provide additional ESOP preferences, such as continuing the reversion exception. Instead, attention should be paid to assuring that ESOPs actually provide employees with meaningful ownership benefits.

Our second major objection to extending the section 4980 exclusion for reversion transfers to ESOPs is that, because this preference is available only upon the employer's termination of a qualified plan, it is not consistent with sound retirement policy. Indeed, the tax preference has the unfortunate effect of encouraging employers to terminate defined benefits plans with assets in excess of currently earned benefits. As a result, the retirement income security of employees covered by the terminated plan may be seriously jeopardized. Even though existing benefits under the terminated plan must be protected by the purchase of an annuity contract, funds that had been set aside to provide future benefits and possible benefit increases are no longer available for such purposes. In addition, an ESOP does not adequately replace the lost retirement security because the benefits under a defined benefit plan are backed by a diversified asset portfolio, which is managed by persons subject to meaningful fiduciary requirements, and are guaranteed by the Pension Benefit Guaranty Corporation, while the security of ESOP benefits is directly dependent upon the financial viability of the employer. Thus, in addition to our skepticism about whether the special advantage to ESOPs represented by the reversion transfer exception is justified by the benefits provided by ESOPs, we believe that the reversion exception for ESOPs potentially frustrates the policy objectives relating to qualified retirement plans.

For these reasons, the Administration opposes extension of the section 4980 exclusion for reversion transfers to ESOPs. Moreover, the Administration believes that the time has come for a comprehensive assessment of the costs and benefits of the existing tax preferences for ESOPs. These preferences have grown steadily over recent years without adequate analysis. In these times of budgetary restraint, it is not appropriate for ESOPs to be exempt from the same standard of review and scrutiny that is applied to other tax preferences and subsidy programs.

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

1/ U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1986.

2/ Although section 127 provided that self-employed individuals and sole proprietors could technically qualify for the benefits of that section, in practice these benefits were primarily available only to larger businesses. Closely held businesses were unable to benefit from section 127 because of the requirement that no more than five percent of the amounts paid under the educational assistance program be for the benefit of persons holding a more than five percent ownership interest in the employer.

3/ U.S. Department of Labor, Bureau of Labor Statistics, 1986, Employee Benefits in Medium and Large Firms, Washington: U.S. Government Printing Office.

4/ If the employer has received a written preliminary determination that the employee is a member of a targeted group, the employer may file a written request for a final certification within five calendar days after the targeted worker begins employment.

5/ U.S. General Accounting Office, Home Ownership: Mortgage Bonds Are Costly and Provide Little Assistance to Those in Need, 1988.

6/ A pending technical correction would clarify that amounts designated as interest on student loan notes were not intended to be treated as a reimbursement of costs for purposes of the rebate exception.

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Table 1

Adult Education in 1984
Reason for Taking Course and Source of Payment
(in thousands)

		Job-Related Courses				
	Total Courses	**Improve in Current Job**	**New Job in Same Occupation**	**New Job in New Occupation**	**Non-job-Related Courses**	**Unknown**
Total Courses	39,097	19,703	984	3,818	14,448	145
Employer Paid	14,003	12,328	242	549	857	28
Employer Paid as a Part of Total Course	36.3	62.6	24.6	14.4	5.9	19.3

Source: Tabulated from: U.S. Department of Education, Center for Educational Statistics, Trends in Adult Education 1969-1984. Tables G-H, pp. 33-36.

Table 2

Distribution of Adult Education Participants and the Adult Population 17 Years and Older, by Selected Characteristics May 1969 and 1984

Characteristic	Adult participants 1969	Adult participants 1984	Population 17 years old and over 1969	Population 17 years old and over 1984
Total number (in thousands)	13,041	23,303	130,251	172,583
Total percent	100%	100%	100%	100%
Education level:				
Less than 12th grade	16	8	44	27
High school graduates	39	30	34	38
Some college (1 to 3 years)	20	26	12	18
Bachelor's degree or higher	26	36	10	17
Income group:				
Above median family income	68	65	50	50
Below median family income	32	35	50	50
Occupational groups:*				
Executive/managerial	11	15	9	11
Professional/technical	33	31	13	15
Administrative support	17	17	15	16
Sales and service	16	20	27	26
Other	23	17	36	32

* The basis of these percents are employed adult education participants and the employed population 17 years and older.
\- Not available.

Note: Details may not add to totals because of rounding.

Source: U.S. Department of Education, Center for Educational Statistics, Trends in Adult Education 1969-1984, Table 1, page 3, 1987.

Testimony of Mr. M. Danny Wall, Chairman
and Mr. Lawrence J. White, Board Member
The Federal Home Loan Bank Board

Introduction

Thank you, Mr. Chairman, for this opportunity to testify on behalf of the Federal Home Loan Bank Board ("Bank Board") and its constituent deposit insurance agency, the Federal Savings and Loan Insurance Corporation ("FSLIC"). The Bank Board and the FSLIC are the principal Federal regulators, supervisors, and insurers of the nation's savings and loan associations and Federal savings banks.

The Expiring FSLIC Tax Provisions Should Be Extended

Since 1981, the tax law has contained a number of provisions ("the FSLIC tax provisions") that were enacted to help the FSLIC fulfill its statutory mandate of protecting the safety of almost a trillion dollars of savings deposits in thousands of insured thrift institutions nationwide. Although the provisions are currently scheduled to expire at the end of 1988, there are good and compelling reasons for the Congress to extend them for an additional three years, until the end of 1991.

Role and Importance Of FSLIC Tax Provisions

When a thrift institution is troubled by low net worth, poor asset quality, bad management, or any combination of these problems, the FSLIC stands ready to make depositors whole through the payment of deposit insurance of up to $100,000 for each insured account. The Congress has repeatedly asserted its commitment that FSLIC-insured deposits "are backed by the full faith and credit of the United States."

In the vast majority of cases, however, the most efficient, effective, and least cost means of dealing with a financially troubled institution is not to liquidate the institution and pay off the insured depositors, but instead to arrange for the troubled institution's acquisition by a healthier institution. Instead of paying off all of the depositors and liquidating assets, the accounts and assets are transferred to a new institution. Since the troubled institution typically has a negative net worth, the FSLIC usually must provide various forms of financial assistance to induce the acquirer to take over the sick institution's liabilities and problem assets.

In addition to the reduced cost of assisted acquisitions, there are important intangible benefits -- in terms of the general level of confidence in the nation's financial system -- from being able to avoid the failure and liquidation of a depository institution.

There are two basic areas in which the expiring FSLIC tax provisions affect the FSLIC's ability to arrange for assisted acquisitions of troubled thrift institutions.

First, Code section 597 provides that assistance paid by the FSLIC in connection with an assisted acquisition will not be considered taxable income. This tax benefit does not inure to the troubled institution or the acquirer, but helps the FSLIC by reducing the amount of assistance otherwise needed. For example, if under current law the FSLIC must pay an acquirer $100 as an inducement to acquire a troubled thrift, the FSLIC may need to pay potential acquirers $150 if that assistance payment is to be subject to tax.

Second, special provisions in the tax code's corporate reorganization rules clarify that a FSLIC-supervised merger or acquisition can qualify as a tax-free reorganization and that the net operating losses and built-in tax losses of the troubled institution can be fully utilized by the acquiring institution. Here again, although the incidence of these tax benefits is with the acquiring institution, the real benefit inures to the FSLIC through contractual agreements requiring that tax benefits enjoyed by the acquiring institution must be accounted for and rebated back to the FSLIC.

By making each dollar of FSLIC assistance go farther, the extension of these provisions will allow the FSLIC to resolve a greater number of cases, and to resolve them more quickly than it would if these provisions were allowed to expire. Resolving cases more quickly, in turn, means that the overall cost of resolution for those cases will be lower.

Why, however, should this be a concern of the tax writing committees? In particular, why should the tax code be used in this fashion, instead of simply increasing the amount of money available to the FSLIC to resolve cases?

There are several good reasons. First of all, some important background on the FSLIC's current financial situation.

Relationship of the FSLIC Tax Provisions to the FSLIC Recapitalization

During the next three years the FSLIC will be involved in a major effort to stem the most serious problems in the thrift industry. We are not requesting an unlimited extension of the FSLIC tax provisions, but are seeking an extension only for this three-year period. This three year period is related, in part, to the FSLIC Recapitalization provisions of the recently enacted Competitive Equity Banking Act of 1987 ("CEBA").

The FSLIC Recapitalization provisions of CEBA were the end product of a difficult, but worthwhile process of negotiation and Congressional decision making that authorized the infusion of $10.825 billion of capital from the private sector to the FSLIC insurance fund -- at no cost to the Federal government -- to enable the FSLIC to resolve a backload of cases that otherwise could not have been resolved because of the FSLIC's own liquidity problems.

Unlike most other government agencies, the FSLIC does not receive annual appropriations from the Congress, but is funded by statutorily mandated insurance premiums. In 1985, in light of its growing financial difficulties, the FSLIC used its statutory authority to increase those premiums through a "special assessment" that has remained in effect since then. Unfortunately, one of the difficult aspects of relying on this form of "user fee" to finance an essential governmental function is the fact that those institutions with the greatest need are often those with the least ability to pay.

Because it is clear that resolving cases more quickly ends up saving money in the long run, economists and academicians might theorize that more capital should somehow be made available to the FSLIC from some other source. And it is possible that a number of options may be considered down the road. The FSLIC Recapitalization provisions enacted last year authorized $10.8 billion of private sector borrowing by the FSLIC, to be financed by the FSLIC through insurance premiums paid by insured institutions. Other approaches may also be considered. But because the FSLIC Recapitalization provisions were intended to be implemented over a three year period, and because the FSLIC does not receive annual appropriations of any kind, we believe that 1991 is the earliest date by which Congress will have reviewed in depth the FSLIC's financial condition and agreed upon any further action.

As a result, the question for the next three years is not whether some new source of funding for the FSLIC will be magically discovered, but whether the funds that are going to be expended in the next three years will be spent in the most efficient and effective way possible.

Given these realities, we believe there are three reasons to extend the FSLIC tax provisions, in order to make the available funds go as far as is possible.

Why The FSLIC Tax Provisions Should Be Extended

1. Resolving Cases Earlier Is Cost Effective

First of all, we are not dealing with a series of static problems that will remain largely the same until we get around to addressing them. The fact is, if the FSLIC can resolve more cases and resolve them sooner, the overall cost of resolution will be reduced. In contrast, if its problem cases remain unresolved because of financial constraints, the size and nature of the problems will grow -- in some cases exponentially.

There are several reasons for this: they amount to reducing waste, stopping fraud and abuse, and restoring depositor confidence.

First, let me address the issue of waste and inefficiency. In many cases FSLIC assisted acquisitions result in economies of scale and administrative cost savings. For example, in the Bank Board's current plan for addressing problem insitutions in Texas, the Southwest Plan, it is estimated that over $600 million of annual cost savings could result from the closing or consolidation of duplicative branches, operations, and administrative structures. To the extent this type of consolidation were to be deferred because of financial constraints, the FSLIC would have to absorb the wasteful expense of allowing its problem institutions to maintain unnecessary branches and bear unnecessary administrative costs. Those costs are ultimately the FSLIC's because they will become part of the negative net worth that the FSLIC will have to restore when it eventually obtains the money to resolve the cases.

Second, let me address the issue of fraud, abuse, and mismanagement. Once an institution is removed from the FSLIC caseload and safely acquired by a healthy and well-managed institution, that is one less institution that the FSLIC and the Bank System supervisors must keep a tight vigil over. Our finite supervisory capacities, which are particularly strained by the severe economic conditions in the Southwest, are designed to be just that -- supervisory. It is difficult to manage the day to day operations of hundreds of institutions, some of which have been wracked by mismanagement or worse. And yet, if the FSLIC does not have the funds to close an institution, or does not even have the funds to arrange for an assisted acquisition, it has no choice but to maintain a costly supervisory vigil of admittedly limited effectiveness until it obtains the funds to take action that would result in a change in management.

There is a particularly perverse form of this supervisory problem that should be mentioned. When an institution is in trouble -- but cannot immediately be liquidated or merged because of the FSLIC's financial constraints -- there is little downside risk and much upside potential gain for management to take unreasonable investment risks, since any profits may save the management from the effects of a liquidation, but virtually all losses will be borne by the FSLIC. Thus, we need tighter supervision of such institutions. The sooner we can close or merge such institutions and replace existing management, the sooner we can shift our scarce supervisory resources to other needed areas. We also have a greater chance of stopping what may become a financial hemorrhage in the increasingly rare (but not impossible) event of a shortfall in supervision.

Third, let me address the issue of depositor confidence. The existence of so many troubled institutions on the FSLIC caseload, particularly in the Southwest, has led to something called the Texas Premium. In certain areas of the Southwest interest rates paid on savings deposits are higher -- even for healthy institutions -- than the rates in other parts of the country. This higher cost of funds means that borderline institutions may become sick, and sick institutions may become sicker. As the FSLIC resolves more cases the Texas Premium will be reduced and ultimately eliminated. But if the pace of the FSLIC's case resolution is slowed, then the higher cost of funds remains a quiet, constant drain on the system, with higher ultimate costs to the FSLIC as well as the economy of the Southwest.

2. <u>The Law Without The Tax Provisions Is Unclear</u>

The second reason to extend the FSLIC tax provisions is that there is considerable uncertainty as to the tax rules that would apply to FSLIC-supervised acquisitions in the absence of these statutory tax rules. Allowing the tax provisions to expire would not only "change the rules" in the middle of a very important stage of the FSLIC's case resolution, it would leave the tax rules quite muddled.

The uncertainty relates to the unique status of a deposit insurer in a reorganization of a financially troubled, insured institution. Without going into great detail, let me simply say that there are good arguments that many of the tax benefits accorded by the expiring statutory provisions may theoretically be available even without those provisions, under other statutory provisions and applicable case law. Thus the FSLIC tax provisions as they were enacted in 1981 may have simply clarified and codified prior law.

Unfortunately, the FSLIC may not have very much time to wait for IRS regulations or rulings, and potential acquirers are not willing to take the risks of possible litigation with the IRS. Unfortunately, given the costs of delay, mere uncertainty as to the availability of a favorable tax result can be almost as bad as the certainty of an unfavorable tax result.

3. Revenue Losses Will Be Offset By Reduced Outlays

Finally, Mr. Chairman, we are well aware of the difficult budgetary constraints that the Finance Committee and the entire Congress is operating under. We are particularly mindful of the the deficit limitations imposed by the Gramm-Rudman-Hollings provisions. In this regard, Mr. Chairman, we would be happy to work with the Finance Committee and the relevant tax and budget estimating agencies to substantiate our belief that an extension of the FSLIC tax provisions will not only be cost effective in the long run, but will have no adverse affect on the overall Federal budget deficit, principally because of direct outlay savings that will offset any revenue losses.

I would respectfully ask the Subcommittee's permission to submit for the record a technical submission detailing the specific tax provisions involved in our recommendation, together with comments on a number of appropriate technical corrections and refinements.

Thank you, Mr. Chairman. We would be happy to respond to any questions the Subcommittee may have.

Technical Appendix To The Testimony Submitted By The Federal Home Loan Bank Board On Expiring FSLIC Tax Provisions

Submitted For Inclusion In The
March 28, 1988 Hearing Record of the
Subcommittee on Taxation and Debt Management of the
U.S. Senate Committee on Finance

Introduction

The following technical comments are submitted as a supplement to written and oral testimony on behalf of the Federal Home Loan Bank Board ("the Bank Board") given on March 28, 1988 by Bank Board Chairman M. Danny Wall, and Bank Board Member Lawrence J. White. That testimony requested that the Congress extend for three years -- until December 31, 1991 -- the currently scheduled expiration date for certain statutory tax provisions affecting FSLIC-supervised acquisitions of financially troubled thrift institutions. These comments are submitted in order to clarify the technical aspects of that request.

Background

In 1981, the Economic Recovery Tax Act of 1981 enacted a number of provisions to clarify the tax treatment of FSLIC-supervised acquisitions of financially troubled thrift institutions. Those provisions included:

Internal Revenue Code ("Code") Section 597 (providing that financial assistance provided by the FSLIC to a building and loan association would not be included in income and would not require any basis adjustment of the recipient's assets);

Amendments to Code Section 368 (providing that the "continuity of interest" required for tax-free reorganizations of certain troubled thrift institutions would be deemed satisfied if substantially all of the assets and liabilities of the transferor are transferred to the transferee, without regard to whether any stock or securities in the transferee are received or distributed in the transaction);

Amendments to Code Section 382 (providing, in effect, that the net operating losses of the transferor would be carried over to the transferee without limitation under then applicable Code Section 382 if transferred deposits constituted 20% or more of the combined deposits and stock of the surviving institution, and that such net operating losses would be subject to proportional limitation to the extent the transferred deposits failed to meet the 20% requirement).

The Tax Reform Act of 1986 ("the 1986 Act") enacted a "sunset" date of December 31, 1988 for these favorable rules.

Effect and Operation Of Statutory Provisions

When the FSLIC arranges a qualifying supervisory acquisition of a troubled thrift institution by a healthy institution, the tax attributes of the acquired institution (including net operating loss carryovers and built-in losses reflected in the basis of acquired assets) are carried over to the surviving entity. Assuming that the 20% continuity of interest test of Code Section 382 (as applicable to supervisory mergers) is also met, the net operating loss carryforwards and built-in losses are available for use by the surviving institution without limitation.

In addition, Code Section 597 has the effect of ensuring that payments of FSLIC financial assistance in connection with the transaction will not be included in the income of the surviving institution, either immediately or on a deferred basis through an adjustment to the basis of that institution's assets. FSLIC financial assistance typically consists of (1) cash or notes sufficient to restore regulatory net worth from a negative amount to zero, (2) interest on any such notes, (3) guarantees and payments on guarantees, for a specified period of time, against the risk that certain transferred assets ("covered assets") may yield less than a specified market yield ("yield maintenance") or may be satisfied or sold at a price less than their book value ("capital loss coverage").

The fact that the transferor's basis carries over to the surviving institution allows that institution to recognize a tax loss if the asset is sold or satisfied at less than its basis. This, coupled with the tax-free treatment of FSLIC assistance payments, enables the FSLIC to reimburse losses on covered assets at a lower overall cost. Similarly, the yield maintenance and interest on FSLIC notes may be paid at a lower "after-tax" rate, thereby reducing the overall cost of assistance.

Proposed Technical Corrections

The proposed Technical Corrections Act of 1988, as introduced in the Senate and House of Representatives, contains a number of helpful technical corrections to the FSLIC tax provisions. These include several clarifications of the operation of the 20% continuity of interest test for carryover of net operating losses and built-in losses. See Section 106(d)(8), Technical Corrections Act of 1988. The Bank Board supports these helpful and appropriate corrections.

There are two additional technical corrections or modifications which we believe should also be included, either in the proposed Technical Corrections Act, or in any measure extending the expiration date of the FSLIC tax provisions.

1. Definition Of Qualifying Thrift Institutions

The first technical modification relates to the definition of savings institutions covered by the FSLIC tax provisions. Under current law, in order for a troubled institution to qualify for favorable tax treatment in a supervisory acquisition, it must be an institution to which Code Section 593 applies. Code Section 593, in turn, applies to "domestic building and loan associations" as defined in Code Section 7701(a)(19), and certain mutual savings banks or mutual cooperative banks without capital stock. As a practical matter, most FSLIC-insured institutions currently on the FSLIC caseload would be required to qualify as domestic building and loan associations.

There is a three-part definition of such associations, two aspects of which are unproblematic, but one part of which is both problematic and, we believe, inappropriate to the purposes of the FSLIC tax provisions.

A domestic building and loan association must meet a "supervisory" test (requiring it either to be FSLIC-insured or subject to supervision and examination by an equivalent state or Federal regulatory authority), and a "business" test (requiring that the association's business consist principally of acquiring the savings of the public and investing in loans).

In addition, however, the association must meet an "asset test" that requires 60% of its assets to be loans secured by residential real property or certain other qualifying loans. Unfortunately, a large number of the troubled thrift institutions on the FSLIC caseload may not be able to meet this test. A narrow statutory modification would be the simplest and most efficient approach to solving this problem. The modification we would recommend is fully consistent with the policies underlying the FSLIC tax provisions.

The 60% asset test, of course, is the same test used in determining a thrift institution's qualification for special bad debt deductions designed to promote residential real estate lending. While the asset test is entirely appropriate to that specialized purpose, it is wholly inappropriate to the determination of whether the FSLIC should be able to arrange for the acquisition of that institution under the FSLIC tax provisions.

The FSLIC tax provisions have no direct relationship to encouraging real estate lending. Rather, they are intended to reduce the financial burden on the FSLIC in fulfilling its statutory function of protecting depositors in financially troubled institutions. In short, it is the liability side of the balance sheet, not the asset side, that is the proper concern of the FSLIC tax provisions.

Ironically, the very same supervisory and management problems that have allowed many institutions to get into financial difficulty are responsible for many of those institutions failing to meet the 60% asset test. Since the management and shareholders of that institution are to be removed in the supervised merger, and since the FSLIC must protect the institution's depositors in any event, it would serve no useful purpose to penalize the FSLIC for the old institution's failure to satisfy the 60% assets test. However, that is precisely the effect of requiring the 60% asset test to be met as a condition for the transaction qualifying for the FSLIC tax provisions.

Accordingly, we would recommend that the Code should be amended to provide that a troubled thrift's failure to satisfy the 60% asset test of Code Section 7701(a)(19)(C) will not disqualify the institution for the supervisory merger provisions and tax-free FSLIC assistance provisions, as long as the institution is a FSLIC-insured institution, as defined in Code Section 7701(a)(19)(A)(i). Because of the relevance of this point to transactions currently being planned and negotiated by the FSLIC, we believe that the effective date for this change should be as early as possible. One possible approach would be to use the same effective date as is used for the provisions affecting the FSLIC tax provisions already contained in the proposed Technical Corrections Act, i.e., applying generally after January 1, 1987.

Of course, in the event the Congress decides to extend the benefits of the FSLIC tax provisions to transactions involving the FDIC, this point becomes even more salient. That is, the only relevant qualification for the transferor institution should be that it is either a FSLIC-insured or FDIC-insured institution.

2. Restoration Of Pre-1986 Phase-Out Rule For NOLs

The second technical correction relates to the limitation of loss carryovers where the 20% continuity of interest requirement (as applied to supervisory thrift mergers) is not satisfied. Under the rules in effect from 1981 until 1986, a failure to satisfy the test resulted in a phase down of permissible carryovers at the rate of 5% for each 1% reduction in continuity of interest below 20%.

Although the Tax Reform Act of 1986 was intended to preserve the pre-existing rules (until December 31, 1988) for FSLIC-supervised mergers, the Act as drafted actually replaced the phase-out rule of prior law with a "cliff" rule under which loss carryovers are completely disallowed if the 20% test is not fully satisfied. The Senate version of the Technical Corrections Bill of 1987 would have corrected this, and restored the phase-out rule. See S. 1350. Section 6721((a)(2).

We recommend that the phase-out rule be restored, along with any extension of the FSLIC tax provisions.

Based on Bank Board and FSLIC data, we understand that there is likely to be a revenue effect to this modification. At the same time, we believe that with this provision, as with all of the FSLIC tax provisions, the overall budgetary effect is likely to be either neutral, or a reduction in the budget deficit, because of outlay savings that will equal or exceed any revenue losses. Accordingly, to the extent that outlay savings permit, we believe this correction should be made along with the extension of the FSLIC tax provisions. In the event revenue and outlay considerations do not permit that, the FSLIC tax provisions should be extended without restoration of the phase-out rule.

Although it would be helpful in some cases for the effective date of this change to be the same as the other technical corrections, it would be acceptable to have a prospective effective date if revenue and outlay considerations warranted that approach.

COMMUNICATIONS

Testimony of
Mr. Terry Westhafer
President
American Retreaders' Association
In Support Of
S. 684

Mr. Chairman and Members of the Committee, I appreciate this opportunity to submit testimony in support of S. 684. The proposed legislation that you are considering would make permanent the targeted jobs tax credit.

My name is Terry Westhafer and I serve as President of the American Retreaders' Association (ARA). I also operate Central Tire Corporation in Verona, VA. ARA is a national nonprofit trade association representing approximately 1700 small business owners nationwide who are engaged in the retreading of tires, the repairing of tires, and the sale of related products and services.

As you know, the targeted jobs tax credit (Code section 51) was first enacted in the Revenue Act of 1978 (PL 95-600) to replace the expiring credit for increased employment (the "new jobs credit"). As originally enacted, the targeted jobs credit was available for wages paid before 1982. The availability of the credit was successively extended by the Economic Recovery Act of 1981 (PL 97-34), the Tax Equity and Fiscal Responsibility Tax Act of 1981 (PL98-248), and the Deficit Reduction Act of 1984 (PL98-369). Following a lapse in early 1986, the credit was again extended to December 31, 1988.

Targeted jobs tax credits are available on an elective basis for hiring individuals from one or more of the nine targeted groups. Those groups include: (1) vocational rehabilitation referrals; (2) economically disadvantaged youths; (3) economically disadvantaged Vietnam-era veterans;

(4) supplemental security income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) Aid to Families with Dependent Children (AFDC) recipients and Work Incentive Program (WIN) registrants; and (9) economically disadvantaged summer youth employees.

The bill before you makes permanent the credit. A companion House bill (H.R. 3719) would extend the program for 3 years and would extend the credit to economically disadvantaged elderly.

The current program provides a tax credit of 40 percent of the first $6,000 in wages paid to targeted employees. For economically disadvantaged youths between the ages of 16 and 18, a credit of 85 percent of the first $3,000 in wages is available during the summer months.

In 1985, 625,000 people on Federal or state assistance programs or from economically distressed families worked under this program at an average cost of 1/10 of what it costs to employ a Comprehensive Employment Training (CETA) worker. While the Job Training Partnership Act (JPTA) provides needed training for the jobless, the targeted jobs tax credit is critically important in securing employment.

This type legislation has positive social value and is especially beneficial to small businesses in the service sector. Many first-time positions are in the service sector, in establishments such as a retread shop or a tire dealership. The service sector has proved to be a traditional doorway to the job market for the young, the minority, and unskilled job seeker. Indeed the credit has been used widely by ARA members.

Continuation of the targeted jobs tax credit is a positive incentive to small business owners in the service sector. Because it is due to expire this year, ARA supports S. 684 and urges a timely and positive consideration by this Subcommittee.

Philip G. Bartko
P.O. Box 4005
Ione, Ca. 95640

Laura Wilcox
205 Dirkson Office Building
Washington, DC 20501

April 4, 1988

Dear Laura,

The tax structure of our country has become totally unjustified. The statements of Senator David Pryor,(D. Arkansas), concerning penalty reform, must be acted upon immediately. Senator Pryor said it appeared that some tax penalties have become so large that an increasing number of taxpayers feel forced to compromise with the Internal Revenue Service over tax disputes, even though the taxpayers feel they owe no additional taxes. Taxpayers fear that the Internal Revenue Service can bankrupt them with penalties if they don't compromise.

The power of the Internal Revenue Service seems to have no limits. They can demand payment of taxes and penalties, regardless of proof of taxpayers responsibility or ability to pay.

Hearings can be denied due to not contacting the appropriate authority at the appropriate time.

Copies of tax documents important to taxpayers case may be requested from Ogden, Utah, and Fresno, California, but the request will probably be misplaced, forgotten about or sent too late to be considered in a case. The taxpayer is assumed negligent and the penalties rise.

The Internal Revenue Service can levy bank accounts, savings accounts and Individual retirement accounts. They can garnish wages and lien assets to further the fear and financial ruin of the taxpayer.

It may take months to negotiate with agents, who are constantly being replaced by others who know nothing of past progress, while the penalties rise. This also is considered the taxpayers burden.

A taxpayer must make payment, then he may file a suit with the United States District Court having jurisdiction, or the United States Claims Court, for the recovery of any tax or penalty. The financial position of the taxpayer at this point can not meet the added burden of legal aid to risk gambling on a dubious outcome. Is this really the American way?

The absolute height of injustice is placing a penalty on underpayment of estimated income taxes. To place a penalty on taxes not yet due from income one is not sure he will earn is surely unconstitutional.

As a loyal American citizen who fought in a war for this country, one who has been honest and law abiding, I resent these dictatorial tactics being a new source of revenue.

You, as a representative of the people, will take this problem seriously I hope and strive to remedy the situation before the Internal Revenue Service claims many more victims.

Sincerely,

Philip G. Bartko

Philip G. Bartko

Written Testimony
to the United States Senate Finance Committee
Subcommittee on Taxation and Debt Management

Submitted by
Dale Colby, President
California Association of REALTORS
April 8, 1988

As president of the California Association of REALTORS (C.A.R.)--the statewide trade organization representing the interests of over 115,000 real estate licensees in California--I am grateful to have the opportunity to present our perspectives on the Mortgage Revenue Bond (MRB) and Mortgage Credit Certificate (MCC) programs which are currently set to expire at the end of 1988. This testimony will focus on the programs' impact on the California housing market and is submitted in conjunction with, and in support of, that presented by the National Association of REALTORS. The business activities of C.A.R.'s membership involve the brokerage of real property as well as providing assistance to homebuyers in securing mortgage financing for their purchases. It is this business focus of our membership, and the important role the MRB/MCC programs have played in meeting the needs of California's low- and moderate-income homebuyers, that motivates C.A.R.'s interest in the issues presently before this Subcommittee.

I. Introduction

The focus of this testimony is to illustrate the importance of the MRB and MCC programs to California's low and moderate income households and to present evidence of the critical need for affordable housing and the effectiveness of these programs in providing realistic housing alternatives for both home owners and renters. As you are probably aware, our state has a particularly difficult affordability situation. First-time buyers face substantial barriers, not only in finding a home which they can afford but also in saving enough to make the often substantial downpayment required to qualify for conventional financing. Low income families face a shrinking supply of affordable rental units which will only accelerate in the years ahead. The MRB and MCC programs have provided desperately needed affordable alternatives that musn't be allowed to expire.

Since the initial authorization of tax-exempt mortgage revenue bonds in 1982, the availability of below-market rate funds made possible through these bonds has made homeownership possible for many first-time home buyers who would otherwise have been unable to purchase a house. In addition to increasing the opportunities for homeownership, the MRB program has also provided favorable financing for the construction of rental housing units, at least 20 percent of which are targeted for low and very low income families. The program was further expanded in 1984 with the authorization of "Mortgage Credit Certificates" (MCCs) which enabled state and local government housing agencies to provide a federal income tax credit to first-time homebuyers through an exchange of mortgage revenue bonding authority. MCCs allow home buyers a direct credit against their federal income tax liability, reducing their tax bill in an amount equal to a specified percentage of the interest paid on their mortgage.

II. How the Programs Work

The MRB and MCC programs were created to assist in meeting the need for decent, affordable housing for low- and moderate- income households. Through the sale of tax-exempt bonds, funds are loaned, through participating private lenders, to qualified persons and families for homeownership. For rental housing developments, funds are loaned directly to qualified borrowers or indirectly through private lending institutions. And, since interest on the bonds is exempt from federal and state taxation, the funds are available at lower interest rates which are passed on to the home buyers and to owners and tenants of rental housing. The following sections show how each of the programs work and give examples of how housing is made more affordable to those who need it.

A. How MRBs Help First-Time Home Buyers

Simply put, mortgage revenue bonds work because they enable the issuing authority to supply funds to homebuyers at a discount. The tax-exempt status of most of the mortgage revenue bonds issued means that investors are willing to purchase the bonds at yields below those of taxable securities. As a result, the administering agency, typically a state or local housing agency, is able to make mortgage money available to qualified home buyers at financing rates that have averaged from 1 to 2 percentage points below market rates. As shown in the following example, the increase in affordability which results from the availability of tax-exempt bond financing is significant.

Exhibit 1

	Conventional	CHFA			
Interest Rates	10.0%	7.5%	8.4%	9.15%	9.25%
Monthly Payment	$877	$699	$762	$815	$822
Min. Qualifying Income	$37,610	$30,000	$32,650	$35,000	$35,260
% of Households who could qualify	40%	51%	47%	44%	43%

Last year the average market interest rate for conventional mortgage loans was 10.0 percent. In 1987, the California Housing Finance Agency was able to make MRB proceeds available to lenders and developers at interest rates of 7.5 percent, 8.4 percent, 9.15 percent and 9.25 percent. Exhibit 1 illustrates the difference in monthly mortgage payments and the minimum income needed to qualify for a $100,000 mortgage loan using a conventional loan rate of 10.0 percent compared to the significantly lower CHFA rates. The savings in monthly mortgage payments would range from approximately $180 a month ($2,160 a year) at the lowest CHFA rate of 7.5 percent to $55 a month ($660 a year) at CHFA's 9.25 percent rate. Additionally, the homebuyer would qualify for a CHFA loan with a substantially lower level of annual income, ranging from approximately $7,600 to $2,400 less than the income required by conventional lenders at a 10.0 percent rate. These examples illustrate how the lower financing rates for mortgage money made available through mortgage revenue bonds helps mitigate the impact of higher conventional rates.

B. How MCCs Help First-Time Home Buyers

Mortgage Credit Certificates (MCCs) are an important tool in increasing the "effective home buying power" of first-time buyers. Legislation passed in 1984 gave housing finance agencies the option of exchanging some or all of their MRB issuance authority for MCCs at a maximum exchange ratio of 5 to 1. The Tax Reform Act of 1986 changed the exchange ratio to 4 to 1. In other words, if a housing finance agency has $20 million in MRB authority, it could exchange it for a maximum of $5 million in MCCs. This certificate entitles first-time home buyers to a tax credit equal to a percentage of the interest they pay on their mortgage. The tax credit effectively increases the buyer's after-tax income, enabling them to qualify for a home purchase that otherwise would have been out of reach.

The amount of assistance that an MCC generates depends on its "credit rate" which can vary between 10 and 50 percent. In California most existing programs issue MCCs worth 20 percent of the annual interest paid on a mortgage. The following example illustrates how the credit works. Consider the case of a home a buyer who secures a loan for $100,000 at 10.0 percent for 30 years and also has an MCC with a credit rate of 20 percent. In the first year the buyer pays roughly $9,975 in mortgage interest but because of the 20 percent MCC, receives a federal income tax credit of $1,995. This reduction in the homebuyer's federal income tax bill enables an increased allocation of income toward housing expenses. Exhibit 2 shows that the monthly credit amount of approximately $167 ($1,995/12) which results from a 20 percent MCC rate is equivalent to saving over 200 basis points in interest costs.

Exhibit 2

	With MCC	Without MCC
Mortgage Loan Amount	$ 100,000	$ 100,000
Mortgage Interest Rate	10.0%	10.0%
Monthly Mortgage Payment	$ 877	$ 877
MCC Rate	None	20%
Monthly Credit Amount	None	$ 167
"Effective" Monthly Payment	$ 877	$ 710
"Effective" Interest Rate	10.0%	7.65%

C. How the Multi-Family Bond Program Works

Tax-exempt industrial development bonds (IDBs) are issued by state and local governments to help finance development projects including multi-family residential rental projects. In order to qualify for tax exemption on interest paid, bond financed projects must meet one of the two following requirements: 1) At least 40 percent of the rental housing units must be occupied by tenants having incomes of 60 percent or less of area median income; or 2) At least 20 percent of rental housing units must be occupied by tenants having incomes of 50 percent or less of area median income.

Once a tenant initially qualifies as "low-income" they continue to meet this requirement as long as their family income does not increase above 140 percent of the initial income cap. These qualification requirements continue to exist until the latest of 1) the date which is 15 years after 50 percent of the units are occupied, 2) the first day on which no bonds are outstanding with respect to the project, or 3) the date on which any Section 8 assistance provided to the project ends.

The ability to exempt interest paid on bond financed apartment projects was a major stimulus to multi-family housing construction in California in the first half of this decade. But the Tax Reform Act of 1986 brought single-family MRBs and multi-family IDBs, along with other private activity bonds, under a single dollar volume limit. At the same time, the Tax Act redefined the limit in such a way as to significantly reduce the volume of tax-exempt housing bonds which can be issued in states such as California which had historically high levels of housing bond usage. The impact of this has been to reduce tax-exempt bond financing as shown in Exhibit 6.

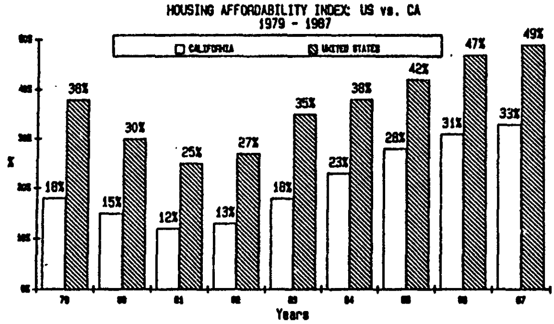
III. Why MCCs and MRBs Are Needed

The MRB and MCC programs have served thousands of homebuyers who otherwise might have been excluded from the ownership market. They have also encouraged the production and preservation of rental housing offering substantial direct and indirect benefits to low-income renters. The importance of these programs have been highlighted by the worsening housing affordability problem, as described below and the fact that those hurt the worst by this trend are first-time homebuyers and low-income renters.

A. Housing Affordability

Housing affordability is a critical national issue. In states such as California, where housing prices are considerably higher than for the rest of the U.S., the housing affordability problem is particularly acute. Last year only one-third of California's households could afford to purchase the median priced home of just over $139,000 based on C.A.R.'s housing affordability index. And in fact, in most of California's major cities housing affordability levels are much worse. For example, C.A.R. has estimated that only 18 percent of the households in the San Francisco Bay area could afford the median priced home there last year of over $171,000. In L.A., only 30 percent of the households could qualify for financing on the $139,500 median priced home and 31 percent in San Diego could purchase their median price of $129,000. Comparable statistics for the U.S. as a whole show that just under half the nation's households could afford the 1987 median priced home of $84,900.

Exhibit 3

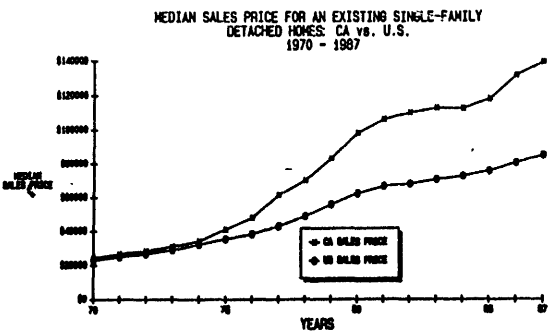


As shown in Exhibit 3, housing affordability has improved since bottoming out in 1981-82. This is due largely to the lower level of mortgage interest rates since that period. But, as we will demonstrate, many of the underlying factors affecting housing affordability have worsened substantially, making affordability much more vulnerable to the fluctuations in financing costs.

Rapidly rising home prices, as shown in Exhibit 4, have been a major contributor to the housing affordability squeeze. In California, the median priced existing single-family home in 1970 was $23,900. By 1987, the median priced home had risen to $139,420--a jump of 474 percent. In comparison, over the same period, median home prices for the U.S. as a whole increased 270 percent from $23,000 in 1970 to $85,000 in 1987.

Housing prices in the state have risen rapidly due to a combination of a high level of demographically-induced demand and tight supplies, as building activity has been constrained by high land costs, development fees, rent controls and anti-growth measures. Many of the large metropolitan areas of the state face stronger upward pressure on home prices than the state as a whole. For example, while the increase in the median price of existing single-family homes sold in California last year was 6 percent, areas such as Orange County experienced a much higher 13 percent increase in home prices over the year before. Likewise, San Diego had a 9 percent rise in its median home price and L.A. recorded over 8 percent.

Exhibit 4



And while home prices have skyrocketed, incomes over the period have increased at a much slower pace. According to the California State

Census Data Center, "Current Population Survey Report", household income in California experienced a 212 percent increase in household income from $9,300 in 1970 to $29,000 in 1987. This percentage increase is only half the pace of home price increases. As a result, the ratio of the median household income to the median home price (another measure of housing affordability), has dropped from 39 percent in 1970 to 21 percent in 1987.

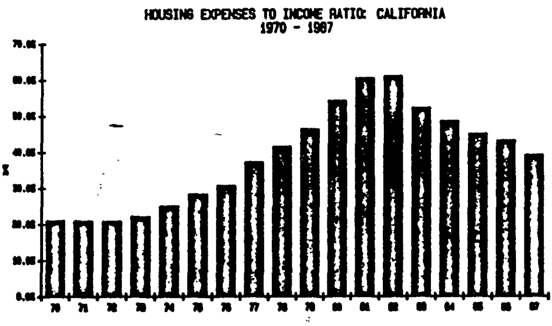
Under these circumstances, it is little wonder that low and moderate income potential first-time home buyers have a hard time affording a home and nowhere is this better reflected than in the decline in the homeownership rate. From 1970 to 1980, California experienced an increase in homeownership from 54.9 percent to 58.8 percent. Since 1980, however, the percent of California households who own their home has been declining. In 1987 the state's homeownership rate was 53.4 percent--below the 1970 rate of 54.9 percent. And the experience of certain segements of the population, such as younger first-time buyers is decidedly worse. While a similar downward trend can be observed for the U.S. as a whole, the nationwide homeownership rate is much higher at 63.8 percent, again reflecting the higher level of housing affordability than in California.

B. <u>The Role of Financing</u>

Financing plays a crucial role in the purchase of a home as the majority of home buyers rely on financing a major portion of the costs. Mortgage interest rates are the most volatile factor in the home financing picture. The most recent peak in interest rates in 1982, when rates soared as high as 17 percent, sent housing affordability plummeting. In California, for example, only 13 percent of the state's households could afford the median priced home in 1982. Resale transactions which had peaked at 605,000 homes in 1978 in California totaled only 232,000 the same year. Housing affordability has improved somewhat since then due to a combination of lower interest rates and improvements in income coming out of the 1980 to 1982 recession.

The higher mortgage interest rates are the heavier housing expenses (monthly payment, taxes and insurance) the demand on the family budget. This burden, while much improved from its level in the first part of this decade, remains well above the level experienced in the early 1970s. Exhibit 5 illustrates that in 1970 the housing expenses to income ratio in California was only 21 percent compared to 39 percent last year. During the high interest period in 1982, the ratio exceeded 61 percent.

Exhibit 5



There is a direct relationship between a rise in interest rates and the number of households able to qualify for a home. C.A.R. has estimated that when the mortgage interest rate rises from 9 percent to 11 percent there is a 7 percentage point drop in the proportion of California households which can afford to purchase the median priced home in the state, falling from 35 percent to only 28 percent. (Assuming a 20 percent downpayment and no change in the median price of the home.) If these percentages are applied to the number of households in the state, 9.7 million, then the number which could afford to buy the median priced home would drop from 3.4 million to 2.7 million. In other words, 700,000 fewer households can afford to purchase when interest rates jump the 200 basis points from 9 and 11 percent.

C. First-Time Homebuyers

In addition to the problems rapidly rising home prices combined with a slower rate of income growth have created for households trying to afford the monthly mortgage payment, there is also need to accumulate a sufficient down payment. Households who already own a home and sell it to buy another are able to take advantage, in most cases, of the capital gains they realize on the sale of their current home to help with their next home purchase. In this way, repeat buyers can ease the increasing wealth constraints involved in buying a home.

First-time home buyers, however, do not have this advantage and therefore face a substantial barrier to homeownership in the form of the often large downpayment they must accumulate in order to qualify for conventional home financing. In fact, prospective first-time home buyers tend to face both wealth and income restraints. They are often younger households who have yet to accumulate substantial savings for a downpayment and are at the lower end of their income earning curve.

Data collected by C.A.R. and published in our Annual Housing Finance Survey report, provides evidence of some of the following difficulties faced by first-time home buyers.

- First-time home buyers purchase significantly less expensive housing than repeat buyers. In California the median purchase price for first-time buyers was $120,500 in 1987 compared to $159,000 for repeat buyers.

- First-time buyers have lower annual incomes. In California, first-time buyers had a median annual income of $42,000 last year compared to $50,000 for repeat buyers. They are also younger with a median age of 30 years compared to 38 years for repeat buyers.

- First-time buyers make significantly smaller downpayments and have higher loan-to-value ratios. The median loan-to-value ratio for California first-time buyers was 90 percent compared to only 80 percent for repeat buyers. Almost a third of California's first-time home buyers utilized the FHA/VA loan programs and over 16 percent borrowed money from relatives to help with the downpayment.

D. Renters

Affordability is also a major problem in the rental market. Although rent inflation generally has not been as dramatic as that of single-family home prices, rents have risen throughout the 1970s and 1980s faster than incomes. From 1970 to 1985 median rents have increased 237 percent compared to a 172 percent gain in median household income in the corresponding period. And despite an increase in rental vacancies in some areas, contract rents have moved up steadily since 1981.

Statistics from the 1980 Census showed that almost 53 percent of renter households (over 1.9 million renters) in California spent 25 percent or more of their income on rent. Only 29.4 percent of owner households faced the same housing payment burden. Moreover, the situation was worse for lower income renters. For example, over 80 percent of renter households with incomes less than $10,000 in 1980 paid 25 percent or more of income for housing compared to 55 percent of owners in the same category.

The ability to use tax-exempt bond financing to help make rental housing projects "pencil out" will become even more critical over the next several years. First, many of the tax incentives to invest in rental housing were eliminated by the tax code changes contained in the Tax Reform Act of 1986 which went into effect on January 1, 1987. Owners of residential rental properties are being hit hard by the elimination of the capital gains exclusion, repeal of accelerated depreciation methods, a longer depreciation period, and the classification of all rental real estate activity as passive along with the limitation on the amount of passive losses which can be deducted. In California, these tax changes have already adversely affected construction acitivity. Multi-family housing construction last year dropped over 30 percent from 168,000 units in 1986 down to 117,000 units in 1987. Over the longer run C.A.R. has estimated that these tax changes will cause rents to rise by as much as 12 percent in order to maintain pre-tax reform rates of return on rental housing construction projects.

The drastic reduction in low-income housing units over the next 20 years as government subsidy contracts expire is another reason why the preservation of tax-exempt rental housing bond financing is becoming increasingly critical. During the 1960's and 1970's, rental housing owners signed up for government subsidies in return for providing housing units to low-income renters. A large number of these contracts are set to expire or are eligible for prepayment at which time the owner can chosse to end the subsidy, thus converting the low-income units to much higher market rate rents. California is extimated to have 1,400 projects totalling about 100,000 assisted units becoming eligible to convert to the private sector over the next 20 years. A high percentage of projects eligible to prepay or opt-out of contracts are expected to do so in California because the state's lucrative rental market will make many conversions highly profitable. These units will be lost from the low-income housing stock.

IV. How the Programs Have Performed

A. Dollar Volume of MRBs and MCCs in California

As shown in Exhibit 6, the dollar volume of MRBs issued in California increased from $2.76 billion in 1982 to $7.76 billion in 1985. In fact, the 1985 activity was inflated by the record volume of tax-exempt bonds which were sold by local agencies in late 1985 in anticipation of the enactment of the new tax law in 1986.

EXHIBIT 6
Historical MRB Volumes in California
(in millions of dollars)

	STATE-ISSUED			LOCAL-ISSUED			STATE/LOCAL
Calendar Year	Single Family	Multi-Family	Total	Single Family	Multi-Family	Total	Combined Total
1982	$ 345	$ 277	$ 622	$1,690	$ 448	$2,138	$2,760
1983	359	86	445	1,128	831	1,959	2,404
1984	421	90	511	1,870	1,036	2,906	3,417
1985	499	158	657	1,504	5,597	7,101	7,758
1986	739	-	739	252	306	558	1,297
1987	178	12	190	374	361	735	925

Source: California Debt Advisory Commission

From 1982 until 1985 the volume of MRBs was limited by law to 9 percent of the average annual principal amount of mortgage originated during the preceding three year period of $200 million, whichever was greater. The federal Tax Reform Act of 1986 imposed major changes on the issuance of all housing bonds. One such change was to bring the majority of multi- and single-family housing bonds under a "unified volume cap." As a result, housing projects must now compete for a portion of the state allocation with a number of other types of "non-governmental" bonds. The 1987 ceiling for the issuance of private activity bonds in California was $1.977 billion -- $75 per capita as set by the new federal law.

In 1987 California exhausted its $1.98 billion ceiling for private activity bonds. Of this amount state and local housing programs were allotted $908.6 million, or 46 percent of the state ceiling. Single-family MRBs accounted for $337 million, (17 percent of the ceiling) and $71.8 million (4 percent) was used for local multi-family housing issues. (These figures differ slightly from those cited in Exhibit 6 because Exhibit 6 includes bonds which were transitioned under the old tax law and one government purpose bond which does not require an allocation).

B. Use of Single-Family MRB Financing in California

California's Debt Advisory Commission (CDAC) is required by law to compile and summarize information on the use of locally-issued housing bond proceeds. CDAC's latest report, (Annual Summary 1987 -- The Use of Housing Revenue Bond Proceeds), provides some valuable information as to the benefits of MRB financed loans to California home buyers. For example, the report, which covers January 1985 through June 1987, shows that almost 88 percent of the single-family loans made were used to purchase a home priced under $125,000--well below the median price of an existing home in California which stood at $139,000 in 1987. Additionally, the majority of the loans made were to households with incomes ranging from 81 percent to 120 percent of the median.

Fifteen percent of the loans made enabled first-time home buyers to hold their monthly mortgage payment below $600 and 35.6 percent had monthly payments between $600 and $800. Just over 30 percent had monthly payments between $800 and $1,000 and only 19.3 percent had payments over that amount. In comparison, C.A.R. had calculated that to buy the median priced home in the state last year, with a 20 percent downpayment, the monthly payment (not including taxes and insurance) would have been $922.

C. Multi-Family Housing Bond Usage in California

The CDAC report summarizes the usage of locally-issued multi-family housing bonds in California from January 1985 through June 1987. During that period local agencies reported almost $3.3 billion of multi-family issuances which have provided funds for the construction of 57,991 units in 281 projects throughout the state.

Almost 38,000 of the units are occupied with 7,835 units or 20.8 percent of targeted for lower-income households. Of the targeted units which are occupied, almost 24 percent are rented to tenants with incomes at 50 percent or below the area median income. Almost 6 percent of the units have occupants between 50 and 60 percent of area median income and 70.5 percent of the units are occupied with tenant with incomes between 60 and 80 percent of median. The units are to remain targeted for a period ranging from 10 to 75 years.

D. Use of MCCs in California

Sacramento County was the first local government to use the MCC program. Over 1,500 MCCs were issued or pending in roughly the first year of operation in Sacramento. Santa Clara County also has an MCC program and over 300 households have benefitted in the first few months of operation. Programs are also being developed in Marin County, the city of Fairfield, Riverside County, and in Santa Cruz and Monterey counties.

In 1987, almost $500 million, or 25 percent of the state ceiling, was made available to local agencies for single-family MCC programs. This means that about $125 million in MCCs can be issued by the localities. Under the Tax Reform Act of 1986 the aggregate amount of MCCs issued can not exceed 25 percent of the volume of mortgage bond authority exchanged.

V. Conclusion

The California Association of REALTORS® appreciates being given this opportunity to comment on the issues before the Subcommittee on Taxation and Debt Management. Because housing affordability continues to be an issue of concern, both in California and many other areas of the nation, and because federal housing dollars are dwindling, it is critical that the Mortgage Revenue Bond and Mortgage Credit Certificate programs be continued. These programs have demonstrated effectiveness in providing affordable housing at a time when low-cost housing alternatives are increasingly hard to find.

The National Housing Task Force, which was established in September 1987, as part of a congressional effort to re-examine America's housing policy, has recommended the continuation of MRB and MCC programs for first-time homebuyers. Furthermore, the task force recommended that the availability of tax-exempt financing for low-income rental housing should be expanded by removing these bonds from the statewide volume caps and easing some of the technical restrictions imposed on these bonds by the Tax Reform Act of 1986. The importance of the MRB and MCC programs cannot be overstated. Please support the continuation of these programs so that all Americans will be able to live in decent and affordable housing.

THE COLORADO BAR ASSOCIATION

1900 GRANT STREET SUITE 950 · DENVER, COLORADO 80203-4309 (303) 860-1112 · WATS 1-800-332-6736

April 5, 1988

Mr. Edward Mihalski
Minority Chief of Staff
SH-203 Hart Office Building
Washington, D.C. 20510

Laura Wilcox, Hearing Administrator
205 Dirkson Office Building
Washington, D.C. 20510

Dear Mr. Mihalski and Ms. Wilcox:

The Tax Section of the Colorado Bar Association would like to express its support for substantial revision of the civil penalty provisions of the Internal Revenue Code of 1986, and would like this written statement included in the printed record of the hearing held on tax penalties by the Senate Finance Subcommittee on private pension plans and oversight of the Internal Revenue Service on March 14, 1988.

As tax practitioners who are involved in day-to-day issues on which the penalty provisions often have effect, we criticize the existing penalty provisions of the Code on the grounds of their multiplicity and complexity. In the course of addressing the "audit lottery" and other problems, a flood of penalty provisions ensued. However, while Congress was enacting penalty provisions in an incremental manner, little attention appears to have been given to the internal coherence of the penalty system. The system is disjointed and confused.

Specifically, we believe that the principal problems with the existing penalty system are the following:

1. Multiplicity. There are too many penalty provisions in effect. It is difficult for the taxpayer or the practitioner to recognize all the various penalties which can affect a specific transaction or tax return decision.

2. Complexity. Although complexity has become endemic in the tax laws in recent years, we believe that a number of the recently enacted penalties are too complex for taxpayers to comprehend. The complexity of the penalty provisions can lead to different treatment for virtually identical behavior, and, therefore, tends to cause inequity in the tax system.

3. Overlaps. Under the current penalty system, there are many cases where taxpayers can be subject to more than one penalty for the same behavior. As practitioners, we frequently find the IRS (or more typically the IRS' computers) asserting multiple penalties with respect to a single taxpayer action. This overlap creates the possibility that unexpectedly large penalties will be imposed. In fact, we sometimes find that taxpayer error triggers penalties which exceed the amount of the tax owed.

4. Inadequate Guidance. The IRS has provided inadequate guidance concerning the application of the penalty provisions.

We believe that this is especially the case with respect to the section 6661 "substantial understatement" penalty.

An example of the confused operation of the penalties is found in the recent increase in the section 6661 penalty. The Tax Reform Act of 1986 "increased" that penalty to 20%. One day earlier, the Omnibus Budget Reconciliation Act of 1986 increased the section 6661 penalty to 25%. Thus, the issue was whether the penalty was the first increase to 25% or the second "increase" to 20%. Although technical corrections presumably will provide that the penalty is and has been 25%, the situation certainly does not give one confidence in the tax legislative process.

We believe that these problem areas raise fundamental concerns regarding the administration of the penalty provisions and regarding taxpayer compliance with the tax laws. When taxpayer confusion is created with respect to penalties, it seems likely that the deterrent force of the sanctions is reduced. Further, the confusion in the penalty system causes administration problems in that field personnel of the IRS have relatively free rein to impose penalties on the taxpayer in order to encourage the settlement of outstanding issues in favor of the government.

Finally, we encourage that Congress make it clear that the principal goal of the penalty provisions is to deter objectionable taxpayer behavior, rather than to raise revenue. We believe that the use of penalties to raise revenue would encourage the IRS to seek application of penalties in all cases in which they might arguably apply, albeit tenuously, and would, by impeding the proper settlement of tax cases, have a negative effect on the administration of the tax laws.

Again, we encourage a continued study of the problems with the existing tax penalty structure, with a goal that there be a coherent penalty system which is much less complex to understand, follow and administer.

Very truly yours,

Susan Goddard

Susan Goddard
Chair, Tax Section of the
Colorado Bar Association

Consortium for Citizens with Developmental Disabilities

April 21, 1988

The Honorable Max Baucus
Chairman
Subcommittee on Taxation and Debt Management
Senate Finance Committee
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Baucus:

The following members of the Employment Task Force of the Consortium for Citizens with Developmental Disabilities urge you to pass legislation permanently authorizing the Targeted Jobs Tax Credit (S. 684). This particular tax incentive has been effectively used in employing people with disabilities who have historically been excluded from the labor market. Unemployment is disproportionately high among the 36 million Americans with disabilities.

A 1986 Lou Harris and Associates survey of 1,000 individuals with disabilities found that 66 percent of people were not working, 24 percent were working full time and 10 percent part time. Of those individuals not working, over two-thirds stated that they want to work.

Congress and the Federal Government support a variety of rehabilitation and training programs for people with disabilities to help alleviate this high unemployment. People with disabilities want to work and become independent tax-paying citizens. The tax credit is a cost effective method of assisting people in moving from Federal disability programs to competitive employment. In 1985, over 43,000 people with disabilities used the tax credit.

We therefore urge you to take expeditious action in permanently authorizing the TJTC as presently constructed. Prompt action will ensure continuity in this important program and avoid the disruptions that occurred in 1986 when the program lapsed for nearly a year. Thousands of jobs for people with disabilities are potentially at risk if prompt action is not taken.

STATEMENT FOR THE RECORD

ON

S.684 EXTENSION OF

THE TARGETED JOB TAX CREDIT PROGRAM

SUBMITTED BY:

DISPLACED HOMEMAKERS NETWORK

There are 11.5 million displaced homemakers who are struggling to become and remain economically self-sufficient. These are primarily mid-life and older women who because of the death, disability or long-term unemployment of their husbands, separation, divorce or loss of public assistance have lost their primary source of income. They have worked primarily in the home, some for as many as forty years or more, and now need to find paid employment. Their lack of recent paid work experience sometimes makes it almost impossible to find an employer willing to hire them. Displaced homemakers need the assistance that the Targeted Job Tax Credit Program gives other disadvantaged Americans. The Displaced Homemakers Network urges this Subcommittee to include displaced homemakers in your reauthorization of the Targeted Job Tax Credit Program (TJTC).

Presently, displaced homemakers are not included in the TJTC. As with many other federal assistance programs, displaced homemakers fall through the cracks of the TJTC. Though significantly disadvantaged, displaced homemakers often do not fit the eligibility requirements of specific programs that should be able to help them. A recent Network study of Census data found that 75% of displaced homemakers are 45 years and older. It is no surprise then that only one in four displaced homemakers still has dependent children. This means that the majority are not eligible for Aid to Families With Dependent

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Children (AFDC), a program whose recipients are already included in the TJTC.

Displaced homemakers are also frequently too young for Social Security, and many may never qualify because they are divorced from the family wage earner. Those that are under 55 still will not qualify for TJTC even if present efforts to add older workers to the program are successful. They cannot collect unemployment insurance because they have been engaged in unpaid labor in the home. They need every advantage available to assist them in getting that first job.

There are many barriers facing displaced homemakers seeking paid employment. They are older women in a youth-oriented society. For many, their educational training is obsolete and their skills are rusty. For the one in four displaced homemakers who are minority women, their opportunities for education and training were limited when they were young by racism and sexism. Now, all too often, these displaced homemakers are faced with the additional barrier of ageism when trying to find a decent job. In addition, most displaced homemakers do not know how to translate the skills developed in their careers as homemakers into those appropriate for the paid workforce. At the same time, most employers do not readily accept homemaking skills as experience for the paid labor force. Too often this situation is interpreted by the woman as personal failure.

Approximately 350,000 displaced homemakers each year find help from local displaced homemaker programs in overcoming these barriers. Currently there are over 1,000 programs that comprise the Displaced Homemakers Network. These programs, found in every state, have a track record of providing women with the education and employment and training services needed to achieve long-term economic self-sufficiency. But even with the benefit of these services, displaced homemakers and programs still find that employers are often unwilling to take a chance on someone without recent paid work experience.

The TJTC was established to improve the employment opportunities of disadvantaged job seekers. By any definition, displaced homemakers are disadvantaged. Their loss of income, combined with the barriers preventing them from easily finding paid employment, leaves most displaced homemakers poor. The Network study also showed that three in five are living at or below 150% of the poverty level. For too many, the prospects of moving significantly beyond that level are slim. A combination of increased services for women and incentives for employers will improve those prospects.

Some members of Congress have already recognized the plight of displaced homemakers. Currently, there is a bill pending in the House of Representatives that would add displaced homemakers to the TJTC program. H.R. 1064, introduced by Congressman Michael Bilirakis from Florida, will be taken under consideration as the House continues their work on the reauthorization of the TJTC. Eleven and a half million women are too many to ignore. Just like others already included in the TJTC, they need only the opportunity to become participants in the labor market and begin to achieve economic self-sufficiency. It is imperative that this Subcommittee add displaced homemakers to the Targeted Job Tax Credit Program at this time. The alternative is the continued ballooning of government expenditures on these women as they become part of the elderly poor.

TESTIMONY OF THE FACE LEARNING CENTER

BEFORE THE

SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

MARCH 28, 1988

TESTIMONY
TARGETED JOB TAX CREDIT
DISPLACED HOMEMAKER

There are well over 50,000 displaced homemakers in Pinellas County. Of those who are abandoned, divorced, widowed, married to a disabled spouse, or struggling as a single parent - often with more than one of those conditions imposed simultaneously - the most universal need is for access to the employment market.

Displaced homemakers often fall through the cracks of the so-called welfare system. In Florida, we do not have welfare. We have Aid to Dependent Children. Sometimes it takes up to three months even for women with children to qualify and receive any benefits.

Direct access to worthwhile, steady, fair-paying employment would considerably ease the transition to self-sufficiency or enhance it to the greatest degree. Direct access would probably prevent homelessness, mental breakdowns, behavior problems in children steming from family anxiety over lack of food, clothing, shelter, and medical care. It is not just the benefits that some women receive temporarily through AFDC that society would save. It is the enormous hidden bill that no one has ever tabulated resulting from the chain of events in that downward spiral from stability to instability, financial, mental, emotional, and social.

But displaced homemakers are at a disadvantage in the job market. Many are at a disadvantage because they lack recent job experience. Many do not have the resources to carry out a smooth transition from total or partial dependency for basic needs to self-sufficiency. These deficiencies in resources can create a less favorable appearance as a potential employee. The employment market is not friendly to those who are our nations caretakers and must work for considerably less wages than males and who lack spousal support. Displaced homemakers are set up in a vulnerable way for over-exploitation. They have to search harder for positions because their problematic situations exclude them from many situations due to hours, transportation, child care, caretaking of older adults, high stress, etc. They have more caution about changing employment.There is no buffer for them economically.

We can alleviate this situation by supporting the Targeted Jobs Tax Credit inclusion of displaced homemakers as a targeted group.

We can help break down some of the barriers to access to stable employment situations by giving the employer an economic incentive to hire and train displaced homemakers. We have to help business see - but they will not even look until we can show them something they will pay attention to. We have to encourage business to accept the responsibility of on-the-job training without creating a self-serving training bureaucracy that consistently has rejected and not served displaced homemakers, such as has been done with the latest government programs.

The tricklkdown effect has not worked. Job training programs that are outdated before they conclude have not worked. The targeted tax credits might pave the way for a far more productive relationship between training institutions and business and job training might mean more than an exchange of monies without impacting on the present skills gap in our labor market. Because when we talk about displaced homemakers we are talking about our entire social system, not just a bandaid here and there. We will begin to get to the nexus of social chaos.

People said that if social welfare benefits were reduced the divorce rate would change, people would not have children without means of support, people would be less likely to suffer family breakup's. There has been no significant change. As a nation we are implementing a program of pauperization, not motivation.

Every day at FACE LEARNING CENTER, we see women and children without. Without medical or dental care. Without money. Without housing. Without food. Without transportation. There are many who may have some of these things, but are rapidly losing them because of the disadvantages they experience in the job market. If they don't get hired, or if the only jobs available are seasonal, part-time, low-paying and unskilled, they rapidly find their situation and their family's situation deteriating to the point of pauperization.

FACE LEARNING CENTER Inc.
12945 Seminole Boulevard
Largo Florida 34648

813/585-8155

March 17, 1988

The Big Sky Country

MONTANA HOUSE OF REPRESENTATIVES

REPRESENTATIVE R. BUDD GOULD
DISTRICT NO. 61
HOME ADDRESS:
2205 SO. 5TH STREET WEST
MISSOULA, MONTANA 59801
PHONE: (406) 549-4236

COMMITTEES:
VICE CHAIRMAN
HUMAN SERVICES & AGING
JUDICIARY

March 25, 1988

Senator Max Baucus
706 Hart Senate Office Building
Washington, D.C. 20510

Dear Max,

Thank you for conducting a hearing to include the Targeted Jobs Tax Credit program. I would like to have you enter my support for extension of the program into the written record.

I have been heavily involved, as you well know, in programs for the handicapped since becoming blind in my adult life. My former membership on the National Council for the Handicapped and as a present member of the National Council on Health Professions Education has brought me into contact with extensive numbers of disabled persons' groups supporting rehabilitation activities. These groups, without exception, support programs like T.J.T.C. that will enhance employment of the handicapped. This segment of our population display a strong desire to be given the opportunity to be in the active work force and they relish self sufficiency.

Employers do need incentives like T.J.T.C. to encourage hiring of the handicapped, or other monetary off-sets to modify work areas to assist the accommodation of speciality needs. In my twelve years as a Representative in the state of Montana House of Representatives, I have been an advocate for the handicapped and disabled. I will continue this endeavor as the current Chairman of the Human Services Committee.

Max, you know of the tremendous budget crunch in the state of Montana and of our escalating welfare costs in the last few years which have gone "out of sight". Whatever the Federal government can do, such as extending T.J.T.C., to reduce welfare costs in the state will be greatly appreciated ~~by not~~ only elected officials, but by taxpayers as well.

Thank you for your support and leadership at the National level to extend the T.J.T.C. program past the December 31, 1988 expiration date. We will be most grateful for the continuation of this very vital program.

Sincerely,

R Budd Gould

R. Budd Gould
Montana House of
Representatives

RBG/jt

TESTIMONY OF

DR. ROY LITTLEFIELD

EXECUTIVE DIRECTOR

GREATER WASHINGTON/MARYLAND SERVICE STATION

AND AUTOMOTIVE REPAIR ASSOCIATION

IN SUPPORT OF

S. 684

MARCH 28, 1988

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to submit testimony in support of S. 684. The proposed legislation would make permanent the current targeted jobs tax credit.

My name is Roy Littlefield and I serve as Executive Director of the Greater Washington/Maryland Service Station and Automotive Repair Association. GWMSSARA is a regional, nonprofit trade association representing over 1,500 small business members who operate in the State of Maryland and in the District of Columbia.

A targeted jobs tax credit (Code section 51) was enacted in the Revenue Act of 1978 (Public Law 95-600) to replace the expiring credit for increased employment (the "new jobs credit"). As originally enacted, the targeted jobs credit was available for wages paid before 1982. The availability of the credit was successively extended by the Economic Recovery Act of 1981 (Public Law 97-34), the Tax Equity and Fiscal Responsibility Tax Act of 1981 (Public Law 98-248), and the Deficit Reduction Act of 1984 (Public Law 98-369). Following a lapse in early 1986, the credit was again extended until December 31, 1988.

Targeted jobs tax credits are available on an elective basis for hiring individuals from one or more of nine targeted groups. Those groups include: (1) vocational rehabilitation referrals; (2) economically disadvantaged youths; (3) economically disadvantaged Vietnam-era veterans; (4) supplemental security income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7)

economically disadvantaged former convicts; (8) Aid to Families with Dependent Children (AFDC) recipients and Work Incentive Program (WIN) recipients; and (9) economically disadvantaged summer youth employees.

While the pending House Bill, H.R. 3719, would extend the credit to the economically disadvantaged elderly, the Senate bill simply makes permanent the existing credit.

Currently the program provides for a tax credit of 40 percent of the first $6,000 in wages paid to targeted employees. For economically disadvantaged youths between the ages of 16 and 18, a credit of 85 percent of the first $3,000 in wages is available during the summer months.

In 1985, 625,000 people were employed under this program. Those individuals were employed at an average cost of one-tenth of what it would have cost to employ a Comprehensive Employment Training (CETA) worker. The Job Training Partnership Act (JPTA) provides needed training for the jobless, but the targeted jobs tax credit is important in securing employment.

This type legislation is expecially beneficial to small businesses in the service sector. Small businesses furnish 2 out of 3 workers with their first job. Many of these first-time positions are in the service sector, the traditional doorway to the job market for the young, minority, and unskilled workers, approximately the same number of workers in the manufacturing sector.

Between 1980 and 1982, 59.2 percent of total new jobs occurred in small firms, employing 50 persons or less. Yet times have been cruel to small firms.

In 1982, 11,948 small firms closed while 32,419 filed for bankruptcy; in 1983, 13,134 failed and 32,951 filed for bankruptcy. Those occurrences put 11,171,493 people out of work and represented the highest yearly total of bankruptcies since the 1921 yearly total.

Because the targeted jobs tax credit is a positive incentive to the small business owner in the service sector and because the current credit is scheduled to expire by year's end, GWMSSARA supports S. 684 and urges timely consideration and prompt favorable consideration.

STATEMENT
OF
GENE R. STALIANS

PRESIDENT OF THE
INTERNATIONAL TAXICAB ASSOCIATION

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

CONCERNING THE EXPIRING FUEL EXCISE TAX
REBATE FOR CERTAIN TAXICABS (I.R.C. §6427(e))

The International Taxicab Association, an association representing over 600 taxicab companies located in every major metropolitan area in the United States, as well as in many rural counties and municipalities, strongly supports the extension of the fuel excise tax rebate for certain qualifying taxicabs.

Background

Licensed taxicab companies and drivers currently pay the 9 cent per gallon federal excise tax on gasoline they purchase (and the 15 cent per gallon tax on diesel fuel), and are entitled to obtain a rebate of 4 cents per gallon, provided the following conditions are satisfied:

1. Shared riding is not prohibited.
2. They are the ultimate purchaser of the fuel.
3. The vehicle was manufactured after 1977.
4. The vehicle satisfies the average fuel economy standard for its model year.

This rebate provision was originally enacted in 1978, as a two-year experiment. As its gasoline conservation and pollution reduction benefits have been demonstrated over the years, the rebate was extended in 1980, 1982, 1984, and 1986. It is presently scheduled to expire with the gasoline and diesel fuel taxes on September 30, 1988.

In light of the energy savings obtained through shared riding in newer, fuel-efficient taxicabs, the taxicab industry supports legislation which would make the rebate permanent, and avoid the need for recurring extensions. ITA does not propose to change the requirements that must be satisfied in order to qualify for the rebate.

In addition, taxicabs compete with local bus systems, operated by state and local governments, and by private operators. Section 6427(b) of the Internal Revenue Code effectively exempts fuel used in these buses from any excise tax, thus affording such operators a tax-related competitive advantage over taxicabs. To not extend or make permanent the fuel tax rebate for qualified taxicabs would only increase this advantage.

ITA also wishes to point out that the Treasury Department does not disclose the assumptions underlying its estimate that the $2 million in refunds and credits claimed represents less than 10 percent of the estimated $21 million in exemptions available to potentially qualified taxicabs. As we have already pointed out, not all taxicabs are eligible for the rebate, and thus the $21 million figure is suspect. For example, in New York City, the largest metropolitan area, taxicab companies and drivers are ineligible for the credit because a city ordinance prohibits shared riding. Thus, the credit is more widely used than the Treasury Department suggests.

The fuel tax rebate continues to encourage the operation and maintenance of taxicabs that conserve our national fuel resources and reduce air pollution by lowering the cost of operations, and should therefore be extended with the fuel excise taxes or made permanent.

ITA thanks the Subcommittee for the opportunity to present its views on this important issue. Should you or your staff have any questions about the fuel tax rebate, please do not hesitate to contact our Executive Vice President, Mr. Alfred B. LaGasse III, at 3849 Farragut Avenue, Kensington, Maryland 20852, (301) 946-5700.

March 28, 1988

Statement of

International Union, United Automobile, Aerospace
& Agricultural Implement Workers
of America (UAW)

on the subject of

EXPIRING TAX PROVISIONS --

This Statement is submitted on behalf of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW) in connection with the hearing being conducted by the Subcommittee on Taxation and Debt Management on March 28, 1988 on expiring tax provisions. The UAW is particularly concerned about Sections 127 and 120 of the Internal Revenue Code, which exempt employer-provided educational assistance and group legal services benefits from taxation. These two provisions both expired at the end of 1987. The UAW strongly urges the Finance Committee to approve the bill which has been introduced by Sen. Moynihan (S. 39), and the bill which was introduced by Senators Moynihan and Heinz (S. 2119) to restore permanently the tax exempt status of these two worker benefits.

The UAW previously submitted a statement concerning the tax exemption for employer-provided educational assistance benefits (Section 127 of the Internal Revenue Code) in connection with a hearing conducted by the Finance Committee on March 15, 1988. A copy of that statement is attached heretoa we respectfully request that it also be included in the record of this hearing on expiring tax provisions. Since we have previously set forth in detail our views on educational assistance benefits, this statement will focus on the tax exemption for employer-provided group legal services benefits (Section 120 of the Internal Revenue Code).

The UAW has long been a supporter of group legal services plans.. In our view, they represent the best means of making quality, low cost legal sevices available to middle class working men and women. Legal services have traditionally been available only to the top and bottom segments of society. Wealthy individuals and corporations can afford to hire the best law firms. And the poor have been provided free representation through legal aid offices. Middle class Americans, however, have been left out in the cold. Too well off to qualify for legal aid programs, but with too little resources to be able to afford representation on their own, the typical worker has simply gone without any legal services.

This situation began to change because of a number of developments in the late 1960s and 1970s. The Supreme Court struck down various restrictions on group legal practice. And the Taft-Hartley Act was amended to permit group legal services plans to be collectively bargained. Most importantly, Section 120 was added to the Internal Revenue Code in 1976, making it clear that employer contributions to and services provided under qualified group legal service plans do not constitute taxable income to employees.

As a result of these developments, labor unions increasingly began to take an interest in negotiating group legal service plans as a means of assuring that their members have access to quality, low cost legal representation. The UAW is proud of the fact that it has been in the forefront of this effort.

The UAW established its first group legal service plan as a pilot program at Chrysler Corporation in 1978, in order to determine whether high quality, low cost legal services could be provided to active and retired workers through an HMO type delivery mechanism. With the success of this program, the UAW quickly moved to establish similar programs at the other major automobile companies.

Today the UAW has negotiated group legal services plans covering the active, laid-off and retired workers at Chrysler Corp., General Motors Corp., Ford Motor Company, American Motors and Navistar. In all, these plans cover about one million active, laid-off and retired workers, plus their spouses and dependent children.

These group legal services plans cover most personal legal matters which are not work-related. Benefits which are fully covered by these plans include contract, consumer, debtor, real estate, wills and trusts, adoption, guardianship and probate matters. Limited benefits are also provided for less serious criminal matters, traffic matters, divorces, nonsupport matters and personal injury claims. The group legal services plans typically exclude labor relations matters, worker compensation matters, or other disputes with the employer, as well as serious criminal matters.

In 1987, over 244,000 new cases were opened under the group legal services plans negotiated with the auto companies. The types of legal problems handled under these plans break down as follows:

Wills & Trusts	12%
Probate	3%
Family Law	15%
Real Estate	29%
Consumer & Debtor	21%

UAW collective bargaining agreements typically provide for employer funding of the entire cost of the group legal services plans. The employers generally contribute a specified amount for each hour worked by employees. The employer contribution in 1987 was about $85-$90 for each active worker. However, this contribution covers the cost of benefits for laid-off and retired workers, as well as the active employees.

The group legal services plans negotiated with the automobile companies are each directed by a Board of Trustees, composed of equal numbers of employer and union representatives and an Independent Chair. These group legal services plans have decided to deliver their benefits through a common delivery mechanism which is based on an HMO model. These programs currently have 90 law offices in 20 states, staffed by 500 attorneys who work fulltime to provide benefits under the plans. In addition, these programs have contracted with about 3,500 attorneys in private practice who have agreed to handle cases referred to them according to a pre-determined schedule of fees.

In our judgment, the group legal services plans negotiated by the UAW have been an unqualified success. The response of our membership to these programs has been enthusiastic. Our members have expressed satisfaction with the quality of the legal services, and have indicated that they consider group legal services to be an important and valuable fringe benefit. Thus, the UAW submits that group legal services plans are fulfilling their intended objectives: that is, making high quality, low cost legal services available to thousands of middle class workers and their families.

Unfortunately, under the Tax Reform Act of 1986, Section 120 of the Internal Revenue Code was scheduled to expire at the end of 1987. Although legislation was introduced in the House last year to extend Section 120, the House and Senate were not able to consider this issue during the 1st Session of the 100th Congress. Accordingly, employer-provided group legal services benefits became taxable beginning January 1, 1988.

The UAW is deeply concerned that the taxation of employer-provided group legal services benefits will have a detrimental impact on the continued growth and development of group legal services plans. The taxation of group legal services benefits will result in a tax increase for thousands of workers. This may undermine support for these programs among workers, who may perceive the imposition of taxes on a non-cash fringe benefit as being fundamentally unfair. In addition, the administrative burdens associated with the taxation of group legal services benefits may discourage employers from providing this valuable benefit.

Senators Moynihan and Heinz have introduced legislation (S. 2119) which would reinstate and make permanent the tax exemption for employer-provided group legal services benefit. The revenue loss associated with this legislation is minimal (about $75 million each year). We believe this is a small price to pay for providing middle class Americans with access to quality legal services. Accordingly, the UAW strongly supports S. 2119, and urges the Members of the Finance Committee to give this legislation favorable consideration.

The UAW appreciates the opportunity to set forth our views on two expiring tax provisions -- Sections 127 and 120 of the Internal Revenue Code -- which exempt employer-provided educational assistance and group legal services benefits from taxation. Your consideration of our views on these important issues will be appreciated. Thank you.

MAPI

1200 Eighteenth Street, N.W. Washington, D.C. 20036 Telephone (202) 331-8430 • FAX (202) 331-7160

April 20, 1988

Senator Max S. Baucus
Chairman
Subcommittee on Taxation & Debt Management
Committee on Finance
United States Senate
205 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Expiring Tax Provisions

Dear Senator Baucus:

MAPI is pleased to submit the enclosed "MAPI Proposals for Reinstatement and Modification of Internal Revenue Code Section 127" in connection with the Subcommittee's public hearings on expiring tax provisions. Our statement focuses on the individual income tax exclusion for educational assistance paid for, reimbursed, or provided under an employer-sponsored plan.

<u>MAPI proposal</u>.--MAPI's statement strongly urges Congress to reinstate the Section 127 exclusion for employer-provided educational assistance as a permanent feature of the tax law. We also suggest the possibility that Section 127 could be modified to target the exclusion more specifically to training and education which meets three fundamental purposes of this type of investment by employers in their employees' human capital. We identify these purposes as: (1) to enhance employees' performance and productivity in their current positions; (2) to enable employees to adapt to new or redefined jobs resulting from technological advances; and (3) to prepare employers to take on increased responsibilities in higher value-added jobs within the organization. These purposes are joined by the common goal of ensuring that the U.S. workforce contributes to technological progress and U.S. industries can retain and increase their competitive positions in global and domestic markets.

We hope that the MAPI proposal for the reinstatement of Section 127, as stated in the attached testimony, will prove useful to the Subcommittee.

Cordially,

Ken McLennan
President

MAPI promotes the technological and economic progress of the United States through studies and seminars on changing economic, legal, and regulatory conditions affecting industry.

MAPI Statement

to the

Subcommittee on Taxation and Debt Management

Committee on Finance United States Senate

in Connection With

Public Hearings on

Expiring Tax Provisions

MAPI welcomes the opportunity to express its support for the permanent reinstatement of the Internal Revenue Code Section 127 exclusion from taxable income for employer-provided educational assistance--one of the expired or expiring tax provisions which are the subject of the subcommittee hearings--and we ask that our submission be included in its entirety in the hearing record. The Section 127 exclusion was added to the Code by the Revenue Act of 1978 effective for taxable years beginning after December 31, 1978 and before January 1, 1984. In late 1984, the exclusion was extended but it expired for years beginning after December 31, 1987.

MAPI is a policy research institute whose 500 member companies are drawn from a broad spectrum of industrial corporations. Our membership is comprised of leading companies and trade organizations, including ones engaged in heavy industry, electronics, precision instruments, telecommunications, chemicals and aerospace, and related services. The Institute conducts original research in economics, law, and management and provides professional analyses of issues critical to the economic performance of the private sector. The Institute also acts as a national spokesman for its member companies concerning itself with policies that stimulate technological advancement and economic growth for the benefit of U.S. industry and the public interest.

MAPI is interested in these proceedings because our member companies provide educational programs for their employees as a necessary investment in maintaining and improving the ability of the workforce to adapt to the fast-paced technological change confronting virtually every sector of U.S. industry. In our view, Section 127 should be reinstated, either as proposed in S. 39 or in a more targeted fashion, as suggest by MAPI herein.

MAPI Commentary

The Importance of Investment in Training and Education

As the Subcommittee may know, employers invest in training and education for their employees for three fundamental reasons:

-- To improve employees' performances in their current jobs and thereby increase the efficiency of operations and overall competitiveness of the firm.

-- To enable employees to adapt to new skill requirements as technological innovations transform the workplace and product markets.

-- To increase the upward mobility of workers to higher value-added jobs so that the firm can continue to improve its competitive position and raise the real income of its employees.

Clearly, the public interest--in all of its components--would be served by a tax code that directly recognizes and facilitates business investment in training and education to meet all three goals mentioned above--greater employee efficiency in existing jobs, adjustment to the new skill requirements of changing technology, and employee mobility to higher skill levels associated with productivity improvement.

Broadly stated, MAPI's mission is to promote the technological advancement and economic progress of U.S. industry. The Institute's analyses of the sources of economic progress have led us to conclude that if the United States is to retain its leadership position in the global economy, industry must increase not only its rate of investment in physical capital--plant and equipment--but also in its "human capital" (i.e., increasing its commitment to training and educating the workforce).

Failure To Reinstate Section 127 Is Likely To Discourage Investment in Human Capital

Tax treatment under Section 127.--As already noted, employers train and educate employees to improve existing skills used in current jobs; to provide for the new skills required by technological change; and to achieve upward mobility toward higher skill levels. What is at issue is the tax treatment of these expenditures for the employee. From 1979 through 1987, employer-provided educational assistance was not included in employee income, with a cap of $5,250 per employee, if the education and training opportunities were provided under a program that satisfied the statutory requirements of Section 127./1

The result was highly desirable. Employers were permitted to encourage employees to invest the time and effort to improve their efficiency and prepare for continuous economic change. Employees were not subject to income tax with respect to educational assistance provided under a Section 127 program. And, neither the employer nor the employee was burdened by having to determine the proper tax treatment of the assistance under the income tax, withholding tax, or employment tax rules.

Tax treatment absent Section 127.--All of this has now changed. Beginning in 1988--in the absence of legislation to extend Section 127--some part of employer expenditures for educational assistance is likely to be taxable to employees as compensation because employer-provided educational assistance is now largely governed by Code Section 162 and Treasury Regulation Section 1.162-5. Specifically, educational expenditures incurred by an individual are deductible as miscellaneous itemized deductions only if they are "job related." Regulation 1.162-5 describes job-related education as education that:

(1) maintains or improves skills required by the employee in his employment (or other trade or business); or

(2) meets the express requirements of the individual's employer (or applicable law or regulation) imposed as a condition to the individual's retention of an

established employment relationship, status or rate of compensation.

As a general rule, if an employee's education is paid for (whether directly or by reimbursement) or is provided by his employer, the employee is treated as having received taxable compensation. However, expenses paid on behalf of, or reimbursed to, an employee for education that satisfies the Section 162 "job related" standard may be excluded (under administrative guidelines) from the employee's wages for purposes of employment taxes and income tax withholding.

The application of the Section 162 "job related" standard may be considered consistent with the goal of improving worker efficiency in existing jobs insofar as it concerns educational expenses incurred by individual employees. However, it both lessens the ability of workers to prepare themselves for new technologies and expands the administrative burdens and costs of the employer. In brief, the lapse of Section 127 increases employer and employee costs of training and education at a time when national priorities would seem to direct otherwise.

The "Job Related" Standard Is Inadequate

The "job related" standard set forth in Treasury regulation 1.162-5 was devised to guide individual taxpayers in distinguishing between deductible, business-related education expenses and non-deductible, personal education expenses. The standard, as applied to individuals, has had a checkered history, spawning in its wake a host of often-inconsistent court decisions.

Applied to employer-provided employee education, the "job related" standard presents difficulties because it does not adequately address the ordinary and necessary expenses incurred by an employer in providing for the education of its employees. For example, an employer may hire entry-level employees with the expectation that they will be given training and then advance to more senior positions. Similarly, many employers, including the Internal Revenue Service and other federal agencies, have special programs for identifying people who might be good managers and providing them with special training or additional education. Such programs may result in taxable compensation to employees because of the many cases in which deductibility has been disallowed for education that qualifies individuals for promotion or increased pay.

Another type of employer-sponsored or employer-funded program which is not likely to satisfy the Section 162 job-related litmus test is the job "retraining" program, undertaken to equip with new skills employees whose job skills have been made obsolete or whose jobs could be displaced by advancing technology. The tax treatment under Section 162 of employer training programs directed at preparing employees for new positions also is uncertain.

The virtue of Section 127 was that it did encompass education that prepared employees for advancement and the development of new skills as well as that which enhances existing ones. MAPI does not object per se to limitations on the type of education that may be provided under an educational assistance program but strongly opposes restrictions on educational programs that develop new, as well as improved, capabilities. We think employer-provided training and educational assistance is good business policy and sound tax policy.

Reinstatement of Section 127
Will Encourage Training and
Education of U.S. Workforce

In explaining the Revenue Act of 1978, the staff of the Joint Committee on Taxation described the reasons underlying the addition of Section 127 to the Code by noting that Congress believed that the Section 1.162-5 treatment of employer-provided educational assistance resulted in unnecessary uncertainty and complexity for the IRS, employees and employers. Further, it was viewed as a disincentive to upward mobility.

That congressional reasoning ten years ago is as cogent today as it was then. The issues have not changed. Case-by-case application of the "job related" standard by taxpayers, courts, and IRS personnel has produced, and will continue to produce, varying results. Reinstatement of Section 127 would eliminate this inconsistency for assistance provided under qualified programs.

More importantly in the context of employer-provided educational assistance, Section 127 succeeded for nine years in relieving employers of the burden of determining what amounts of assistance must be treated as compensation and subjected to employment and withholding taxes and what amounts may be excluded. Further, the employer was properly relieved of the administrative effort of justifying on audit a determination that a particular amount of educational assistance was properly excludible from an employee's compensation.

Section 127 also ensured that educational assistance was open to a broad range of employees. This would be even more true if the exclusion were to be made permanent subject to certain of the new Section 89 nondiscrimination rules, as indeed was contemplated by the Tax Reform Act of 1986. It may even be desirable to impose more specific requirements on the type of education that could be provided under a Section 127 educational assistance program. As pointed out above, however, our view is that such limitations should allow for education and training which will permit employees to gain new skills to adapt to the requirements of changing technology and/or to acquire sufficient knowledge to qualify for different positions with greater responsibilites within the organization.

Conclusion

MAPI recommends the permanent reinstatement of the Section 127 exclusion for employer-provided educational and training assistance. In our view, the exclusion effectively addresses issues which are unique to the employer-employee relationship and which are not well governed by the administrative extension of the Section 162 standard to employer-provided educational assistance.

Employers should be encouraged to invest in preparing employees to adjust to technological advances and to develop the knowledge and abilities that will permit them to contribute to improvement in the productivity performance of industry. The application of the Section 162 "job related" standard to employer investment in education and training for employees will not achieve this goal. In contrast, Section 127, as modified by the MAPI recommendations, is clearly in the interest of both employees and employers, and in fact the general welfare. Education and continuous retraining are the sources of technological excellence which in turn is the key to U.S. competitiveness.

1/ Under Section 127, an educational assistance program is a separate, written plan that benefits employees who qualify under an employer classification that is nondiscriminatory and that does not allow employees to choose between education and other renumeration includible in gross income. The Tax Reform Act of 1986 modified Section 127 in several respects, including subjecting an educational assistance program to the nondiscrimination requirements of Section 89(k). The modifications would become effective but for the section's expiration.

STATEMENT

BY

HAROLD P. ROY

COMMISSIONER

MICHIGAN EMPLOYMENT SECURITY COMMISSION

MONDAY, MARCH 28, 1988

Mr. Chairman, members of the Subcommittee, my name is Harold P. Roy. I am a Commissioner of the Michigan Employment Security Commission representing the employer community. I wish to thank you for the opportunity to testify in support of reauthorization of the Targeted Jobs Tax Credit (TJTC) Program.

Michigan is, and always has been, one of the States which has taken full advantage of the TJTC Program. We were handicapped by the recent gap between reauthorizations due to a lack of administrative money, but the program is now operating fully. This program is well received and utilized by the employer community throughout Michigan. Michigan is one of the larger industrial States, and we participate extensively in the employment and training arena utilizing Wagner Peyser resources, the Job Training Partnership Act (JTPA) and Trade Readjustment Assistance (TRA) under the Trade Act. However, it is our contention that TJTC serves a purpose that none of these other programs provide. Termination of TJTC would ignore the problems of the segments of society for which it has been designed. Those groups which have barriers to employment, such as economically disadvantaged youth, ex-offenders, welfare recipients, handicapped individuals and Vietnam Era Veterans, need the special incentives TJTC provides.

One key advantage to TJTC is that persons may be fully qualified for the jobs they apply for, needing no additional training. However, they are categorized differently from the mainstream of applicants. TJTC provides an incentive for employers to give these people a chance to demonstrate their capabilities.

Michigan is taking advantage of all the training resources available to put people into jobs. In spite of our efforts, it remains a sad fact that our young people in particular are still underserved. In February 1988, Michigan's statewide youth unemployment rate exceeded 19%. Black youth statewide unemployment exceeded 51%. This is not acceptable. Since TJTC was reauthorized in 1986, 51% of the people vouchered in Michigan were youth. Translating this percentage, 5,289 tax credits were issued - 5,289 young people got a job - 5,289 young people started paying taxes - 5,289 young people started to support themselves. This opportunity to become self-sufficient should not be stopped.

You, no doubt, will receive testimony from employer groups, labor groups and members of the various target groups in support of this program. One could conclude from this wide support that, indeed, there are no losers with TJTC. Since 1984, over 50,000 people in Michigan became wage earners, taxpayers, as a result of the TJTC program. Projecting that impact nationally, you can see the value to employers and local communities of these additional workers.

I totally support reauthorization of TJTC. This reauthorization must include adequate administrative funding for the State Employment Security Agencies (SESA's). In times past this has not been the case. SESA's have been unable to properly operate the program, because Wagner Peyser funds have not been available in sufficient amounts to cover the administrative costs of programs not contained in their primary mission.

I mentioned earlier that I represent Michigan's employers on the Commission of the Michigan Employment Security Commission. Let me assure you Michigan's labor representatives on the Commission join me in support of this testimony. My employer (Gallmeyer & Livingston Company in Grand Rapids, Michigan) manufactures machine tools for the metal working industries. We have suffered through the depression of our industry for several years now. Finally we are beginning to see a glimmer of light at the end of a long tunnel. When we begin to expand our workforce, we want to have TJTC available to us. We want to offer good people an opportunity to enter the mainstream of society. We will be able to afford offering such opportunities more readily if the tax incentives of TJTC remain available.

You have made a good investment in economic development through the establishment of the Targeted Jobs Tax Credit program. I have heard comments by some legislators that it is a very expensive program, but I don't buy those comments. People employed through the program begin to pay federal, state and local taxes. They spend their income in the local area. This creates the need for additional goods and services, ultimately leading to increased employment opportunities. Equally important, they leave income support programs. We in industry realize the importance of investing money to improve profitability. Your investment in TJTC offers the same potential for improvement. Working people pay taxes. Converting tax recipients to taxpayers is what you have to have to reduce our country's continuing deficit balances.

TJTC is a good program that produces positive results. It needs to be continued. Thank you for the opportunity to present my views today on this most important program. I will be pleased to respond to any questions you might have.

TESTIMONY OF

GOVERNOR EDWARD D. DIPRETE
NATIONAL GOVERNORS' ASSOCIATION

Mr. Chairman:

On behalf of the National Governors' Association, I would like to express our appreciation for the opportunity to state our support for the continuation of the exempt treatment of mortgage revenue bonds and the targeted job tax credit. The authorizations for these programs expire on December 31, 1988, without further action by Congress. We urge you to provide permanent extensions of these programs.

It is good public policy to encourage home ownership. In helping first-time home buyers achieve the American dream, governments receive the benefits from having families with significant ties to the community. Those families are likely to vote more often, be employed more regularly, pay more in taxes, and contribute more to their neighborhood and community. We want to encourage these social outcomes.

Yet since 1980, this nation has been going backward. Until 1980 home ownership rates had increased steadily for 35 years. Yet, since the beginning of this decade, these rates have fallen every year. Most bothersome is that young households are suffering the greatest declines. Between 1980 and 1987, home ownership rates declined 25 percent for those under 25 years of age; 17 percent in the 25-29 age group; by 13 percent among those 30-34; and 10 percent among households headed by those 35 to 39 years old. According to a new report from the Joint Center for Housing Studies of Harvard University, the decline in home ownership is remarkable for several reasons.

> First, it occurred during one of the most sustained and vigorous housing recoveries on record. Second, it has reduced the home ownershp rate to its lowest level in over 15 years. Third, lower home ownershp rates for young adults are found in all regions of the country, not just the high-cost Northeast or West.

Total annual median home owner costs stood at $6,006 last year -- well above the average for the past 20 years. According to the Joint Center report, "[t]here is little reason to expect a marked improvement in home ownership costs in the years ahead. The median price of the representative first home in 1987 approached $67,000, up more than 92 percent from the $34,800 figure for 1975." The data seem to indicate it is not just the high after-tax cost of housing relative to income that is proving to be a barrier. It is the increasing downpayment costs and reduced ability to accumulate savings as a result of growing rental payments and other cost-of-living increases that particularly affect the low- and moderate-income first-time home buyer. As the Governor of Rhode Island, I am especially concerned because house prices in the Northeast have increased three times faster than the national average.

The National Governors' Association has concluded that mortgage revenue bonds are an effective and essential tool to prevent the home ownership rate from falling even more precipitously. Since the inception of the mortgage revenue bond program, states have helped finance more than 900,000 homes for predominantly first-time home buyers. In Rhode Island over the past 14 years, almost 34,000 families and individuals have been able to purchase a home under the mortgage revenue bond program. In our most recent mortgage program, 53 percent of the mortgages processed have been for people earning less than $23,000 annually. According to accepted underwriting standards, only 14 percent of these home buyers would have been able to purchase their homes with a conventional loan. The average income of the households we have helped buy a home is $24,686, well below the statewide median income of $31,200.

We urge you to provide a permanent authorization for the mortgage revenue bond program. If this is not possible, you should enact S. 1522, which extends the program for four more years. The mortgage revenue bond program is a proven vehicle for assisting first-time home buyers. There is no adequate and less costly substitute. In fact, reauthorizing mortgage revenue bonds should not result in federal revenue losses because these bonds are only one of several private activity bonds issued under very limited state bond volume caps. If mortgage revenue bonds are not continued, other permitted kinds of high priority bond financed projects will likely be used to reach the bond ceiling.

The Mortgage Subsidy Bond Tax Act of 1980, the Deficit Reduction Act of 1984, and the Tax Reform Act of 1986 placed significant restrictions on the program. There is no need to further restrict the program, and every reason to provide it with some stability.

Another expiring provision the nation's Governors encourage you to extend is the targeted job tax credit (TJTC). Set to expire on December 31, 1988, this tax credit provides an important incentive for hiring targeted groups of disadvantaged workers.

The National Governors' Association reaffirmed its commitment to reform of the nation's welfare programs by recommending the creation of a system that encourages independence rather than continuing dependence. The Governors believe that employment remains the most effective route to economic self sufficiency. NGA is actively advocating comprehensive welfare reform legislation, and continuation of the targeted job tax credit is one component in the effort toward meaningful welfare reform.

Enhanced education and training programs constitute the centerpiece of welfare reform efforts. More and more frequently, states are directing increased resources toward providing the economically disadvantaged with the education and training they need to be competitive in the economic mainstream. The enhanced efforts, however, are meaningless if employment is not available. The targeted job tax credit provides a valuable tool to encourage employers to alter hiring practices and provide the economically disadvantaged with greatly needed jobs.

Individuals targeted for services under welfare-to-work programs frequently lack job experience as well as needed education and training. Government can help provide the education and training, but the private sector must provide the jobs. The tax credit is a way to level the playing field for these people who lack sufficient job experience to become top-notch private sector job candidates.

State experience with the tax credit indicates that it works to get veterans, ex-offenders, youth, disabled citizens, and economically disadvantaged individuals into the private jobs that make the difference between a life of dependence and a self-sufficient existence. It provides a needed complement to other government employment initiatives, such as veterans employment programs, the Job Training Partnership Act, and welfare-to-work programs.

The evidence indicates that the tax incentive approach of the targeted job tax credit program is economically efficient. Statistics indicate that the true cost of program certification is approximately $550 per certificate. The cost of a one-year extension of the credit is $337 million for 600,000 jobs. This cost is particularly small when one considers the savings to federal, state, and local governments from public assistance clients leaving the welfare rolls. The economics of the credit warrant its reauthorization, and the social value of helping these targeted populations get jobs is further justification for extension.

As a nation, we must marshall all available resources in our effort to make every citizen economically self-sufficient. Government and the private sector must become partners in this effort. Extension of the targeted job tax credit creates an opportunity to continue a program that works to further the important economic and social goal of self sufficiency for our citizens.

Mr. Chairman, there is one related matter that I bring to your attention, even though it is not an expiring tax provision. In 1978, Congress enacted legislation which allowed state and local governments to establish non-qualified deferred compensation retirement plans (Section 457 plans). A recent Internal Revenue Service (IRS) interpretation (IRS Notice 87-13) of Section 457 will cause state and local workers to be taxed on their accruals of bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay and death benefit plans, contrary to the legislative intent of the 1978 law and the Tax Reform Act of 1986. On behalf of the National Governors' Association, I ask that you pass legislative language clarifying that only elective, but not non-elective, benefits provided by state and local governments to their employees are subject to Section 457. Extending Section 457 to all non-elective deferred compensation will have several very undesirable effects on state and local governments and their workers. First, it will require workers to pay taxes on a current basis on benefits they have not or may never receive. Second, to avoid taxation workers are likely to reduce their retirement savings or use leave time inefficiently to limit the amount of compensation subject to the cap. Third state and local governments will be saddled with overwhelming tracking, computation and reporting problems trying to value these benefits.

Mr. Chairman and members of the committee, thank you for your attention, and I look forward to responding to your questions.

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
before
SENATE FINANCE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

March 28, 1988

INTRODUCTION

On behalf of more than 800,000 members of the NATIONAL ASSOCIATION OF REALTORS®, we appreciate the opportunity to present our views in support of legislation, S. 1522, to extend the mortgage revenue bond program and the mortgage credit certificate program until 1992. We thank the Subcommittee for holding this hearing and the 65 members of the U.S. Senate, including 13 members of the Finance Committee, who have cosponsored this legislation. We also appreciate Senator Riegle's efforts in coordinating the introduction of S. 1522.

We generally encourage proposals which increase homeownership opportunities, particularly opportunities for those discouraged from the market by high interest rates and high downpayments. This Association strongly supports S. 1522 because we believe the mortgage revenue bond and mortgage credit certificate programs provide many first time homebuyers with their only opportunity toward overcoming these obstacles to housing affordability.

Homeownership is a cornerstone of a democratic society and a strong market economy. Over the years the federal government, through a variety of programs and policies, has actively encouraged homeownership, and until the 1980's, these efforts have enabled more and more Americans to own their own home. Since 1980 though, the rate of homeownership has fallen noticeably, particularly among younger households. We recognize that Congress must address a number of tax provisions scheduled to expire at the end of 1988. However, we are very concerned that if the mortgage revenue bond and the mortgage credit certificate programs are allowed to expire, or even languish, as the MRB program did in 1983, than the current depressed homeownership rate among young first-time homebuyers in the United States will be exacerbated even further.

It is our strong conviction that the need for the mortgage revenue bond and the mortgage credit certificate programs continues. Both programs are effective in accomplishing their goals. In our testimony we will show that:

- o The mortgage revenue bond program consistently serves a first-time homebuying public which would otherwise be unable to purchase;
  - -- Homes purchased with mortgage revenue bonds are typically 30 percent less expensive than are the homes financed through conventional loans;
  - -- Homebuyers using MRB's have average incomes which are 20 percent below the incomes of homebuyers who qualify for conventional loans;
  - -- Homebuyers using MRB financing make downpayments which average about 57 percent lower than downpayments required with conventional financing;
- o The major obstacles to homeownership for millions of American families are high downpayment requirements and cash flow problems brought about by high mortgage interest rates;
- o The segment of the American population which suffers from the worst homeownership rate decline since 1980 are those under 25 years old and those in the prime homebuying ages of 25 to 34. This is also the

segment of the population which receives the greatest benefit from the MRB/MCC program;

- The mortgage revenue bond program acts as a countercyclical measure against economic recession and sustains the housing market in times of high interest rates;

- Between the mortgage credit certificate program and the mortgage revenue bond program, states are afforded efficient options to choose from in assisting first-time homebuyers;

THE BENEFITS OF HOMEOWNERSHIP

Mr. Chairman, we believe that owning a home not only benefits the individual homeowner, but that society and the economy at large also stand to profit greatly from a government which promotes homeownership through its policies. Policymakers for years have rightly understood that homeownership is the thread which binds society together by cultivating community pride, social participation, and political stability. In addition, it provides national economic benefits by contributing to total economic output and to savings.

In our National Homeownership Survey (for details on methodology, see Appendix II), we found that 87 percent of the Americans surveyed listed homeownership as a part of the things that make up a "good life". The goal of homeownership was also the overwhelming reason why owners bought their homes. Almost nine out of every ten owners said that living in their own home, rather than renting, motivated them to buy.

Our survey also indicated that homeownership is a key part of the "good life" even for those who do not yet own. Most renters we surveyed (55 percent) said they would very much like to own their own home, and a total of 82 percent had positive feelings about owning. And the vast majority of renters (67 percent) still expect to buy their next home.

An active housing market also contributes to the nation's gross national product (GNP) and encourages personal savings. The NATIONAL ASSOCIATION OF REALTORS® estimates that each existing single-family home sold in 1987 contributed nearly $21,000, and each single-family new home sold contributed $127,000, to GNP. Overall, 1987 single-family home sales activity directly and indirectly generated economic activity totaling $222 billion, or about 5 percent of GNP (See Appendix I, Table 4).

Homeowners save more of their personal income than renters, and for different reasons. In the University of Michigan Panel Survey on Income Dynamics (1976 to 1979), a positive relationship was established between homeownership and savings. Perhaps the best explanation for this is the homebuying process itself. Every monthly payment made by a homeowner automatically increases the equity value of the property. At the end of the mortgage period, the home is fully owned, and the entire value represents "savings" which would not have been accumulated had those same monthly payments gone towards rent.

The fact that homeownership is valued so highly by those who have not yet attained that goal, combined with the societal and economic benefits attributed to homeownership constitutes a compelling case for continuing Federal governmental efforts to assist those families who consistently strive for homeownership but are denied that goal because of market conditions. A positive demonstration of this continuing effort in this area is to extend the MRB/MCC program now, by enacting S. 1522.

THE PROBLEM OF HOUSING AFFORDABILITY IN AMERICA

Since World War II, more and more Americans have chosen to own their homes. Recently, however, the homeownership rate (the percentage of Americans owning their homes) has trended downward. As Table 1 on page 6 indicates, the homeownership rate in America slowly but steadily declined between 1980 and

1986 after climbing consistently since the end of World War II, the first sustained decline since the Great Depression. Even in 1986, when interest rates declined dramatically, the homeownership rate did not improve.

While it is too early to tell if this downward trend has reversed, U.S. Census figures placed the homeownership rate in the third quarter of 1987 at 64.2 percent. This represents the first rise in the rate since 1980. It may very well be that homeownership dreams are being realized by a larger segment of Americans, however, one observation is not enough evidence to prove that a new trend has developed.

Table 1
U.S. HOMEOWNERSHIP RATE
(Percentages)

Year		Year	
1930	47.8	1981	65.4
1940	43.6	1982	64.8
1950	55.0	1983	64.6
1960	64.2	1984	64.5
1970	64.6	1985	63.9
1975	65.6	1986	63.8
1980	65.6	1987#	64.2

Third Quarter
Source: U.S. Bureau of the Census

What is most disturbing from our point of view are the declining homeownership rates among certain segments of the population. As indicated by Table 2 on page 7, between 1980 and 1986, all segments of the population demonstrated declining homeownership rates, some more than others. The largest decreases were exhibited by those under 25 years old and those in the prime homebuying ages of 25 to 34. The combined homeownership rate of these two age groups shrunk by about 15 percent during this six year period.

Table 2
HOMEOWNERSHIP RATE BY SELECTED HOUSEHOLD CHARACTERISTICS: 1980-1986
(Percentage Distributions)

	1980	1983	1986	Percent Change 1980-1986
All Households	65.6	64.6	63.6	-2.9
Household Segments:				
Age of Head				
Under 25	26.4	19.3	21.6	-18.2
25-34	55.0	47.0	45.4	-17.2
35-44	74.4	70.4	66.4	-10.8
45-64	80.7	78.8	78.3	-3.0
65 and over	74.1	74.8	74.7	-1.0
Income				
Under $5,000	49.4	43.3	39.5	-20.0
$5,000-$9,999	56.8	50.3	48.6	-14.4
$10,000-$14,999	59.1	55.8	52.7	-13.9
$15,000-$19,999	66.5	59.7	57.6	-13.4
$20,000-$24,999	73.7	65.7	61.4	-16 7
$25,000-$34,999	82.0	74.1	68.0	-17.0
$35,000-$49,999	88.5	81.6	77.6	-12.3
$50,000+	91.9	89.1	86.9	-5.4

Sources: All household data from U.S. Bureau of the Census, Current Housing Reports, Series H-111, Vacancy Rates and Characteristics of Housing in the United States, Nos. 76-5 through 86-5; Age data from U.S. Bureau of the Census, Current Population Reports, Series P-20; Income data from the U.S. Bureau of the Census, Current Population Reports, Series P-60; Tabulations by the Economics and Research Division, NATIONAL ASSOCIATION OF REALTORS®.

According to our Homeownership Survey and the U.S. Bureau of Labor Statistic's Consumer Expenditure Surveys, housing affordability directly influences the level of homeownership in this country. Based on the Homeownership Survey, four out of five top reasons why people said they were renting at that time were affordability related. The primary affordability problems listed were the lack of an adequate downpayment and an inability to service a high monthly mortgage payment created by high interest rates. As explained in the following section, the MRB/MCC programs effectively address these problems.

THE CASE FOR MORTGAGE REVENUE BONDS

The most burdensome hurdles first-time homebuyers have to overcome are high downpayments and high interest rates. The single-family mortgage revenue bond program helps lower the cost of home mortgages for low- and moderate-income Americans by providing below market financing in the form of fixed-rate, level payment mortgages. The most direct benefit of the program for first-time homebuyers is its ability to increase the buyer's cash flow by lowering the monthly payments. Additionally, as demonstrated below, MRB homebuyers are allowed to put a lower amount of money down in order to secure the loan. These aspects of the MRB program ease homeownership affordibility problems.

Contrary to the conclusions drawn by the General Accounting Office (GAO) in its report to the Joint Committee on Taxation, entitled, "Homeownership: Mortgage Bonds Are Costly and Provide Little Assistance to Those in Need" (RCED-88-111), mortgage revenue bonds have served the lowest possible income segment of home purchasers, with incomes well below those of homebuyers who have obtained other types of financing, such as conventional, FHA-insured, and VA loans. Data released in the summer of 1987 from the NATIONAL ASSOCIATION OF REALTORS® Residential Mortgage Finance Panel Surveys* demonstrates that when compared separately to conventional mortgages, both fixed and adjustable rate, mortgage revenue bond loans consistently served a lower income, slightly younger, segment of the population. According to our survey, these MRB loan recipients made lower downpayments and, not surprisingly, paid lower interest rates.

* The NATIONAL ASSOCIATION OF REALTORS® Residential Mortgage Finance Panel Surveys provides the most comprehensive data on home financing transactions available to the public. Since 1984, the NATIONAL ASSOCIATION OF REALTORS® has collected information three times each year on transactions reported by approximately 2,000 REALTOR® brokers residing in the larger metropolitan areas around most of the country.

Do MRB's Really Serve A Conventional Market?

One of the principal conclusions the GAO has drawn is that mortgage revenue bonds serve a portion of the first-time homebuying public that is no different from the portion that does not receive assistance, i.e., the conventional market. We could not disagree more with this contention. In fact, the findings we have received from our survey support just the opposite conclusion. There is a pronounced difference between the income and age of first-time homebuyers using conventional loans and those using mortgage revenue bond-financing. Additionally, homes purchased with MRB's are much less expensive than the average home purchased with conventional financing.

From the survey data we collected between 1984 and 1986 among first-time homebuyers (compared with GAO's base data derived from the 1983 American

Housing Survey)(See Table 3 on page 9), we found that the average purchase price of a home financed with a fixed rate conventional loan was $76,378. From the same survey data, we found that the average purchase price of a home financed by a mortgage revenue bond issuance was $55,694, almost <u>30 percent lower</u> than conventionals. When we compared downpayments between conventional loans and MRB loans, the difference was just as clear: the average downpayment for conventional financing was $11,023 while the average downpayment for MRB financing was $4,545, about a <u>57 percent difference</u>. Yet another indication that MRB's uniquely serve a lower income homebuyer was the income differential between conventional loans and MRB loans: the average income for a homebuyer who financed with a conventional loan was $40,700; the average income for the MRB homebuyer was $32,700, <u>about 20 percent lower</u> than conventionals. And while the difference in the average age of a homebuyer with a conventional loan (31.2) and a homebuyer with a mortgage revenue bond loan (29.2) is slight, the latter finding does indicate that the MRB program does indeed serve the segment of the homebuying public it is intended to serve.

Table 3
1984 - 1986 First-Time Homebuyer Comparison
MRBs vs. Conventional

Loan Type	Down-payment	Purchase price	Borrowers Income	Borrowers Age
MRB	$4,545	$55,694	$32,700	29.2
Conventional	$11,023	$76,378	$40,700	31.2

SOURCE: NATIONAL ASSOCIATION OF REALTORS® Residential Mortgage Finance Panel Surveys

<u>Targeting and Eligibility Requirements</u>

The new targeting and eligibility requirements for MRB receipients, enacted in the 1986 Tax Reform Act blunt the time-worn criticism that bond-financed, below-market mortgages are being handed out to affluent homebuyers who could well afford higher, conventional rates. These new requirements require 95 percent of the net proceeds of a bond issue be used to finance homes for first-time homebuyers. Additionally, the purchase price limitations now restrict the acquisition cost of a home financed with MRB's to not exceed 90 percent (110 percent in targeted areas). And under the new income limitations, MRB's may now only be used to finance families whose incomes exceed no more than 115 percent of the higher of (1) the median family income for the areas in which the residence is located, or (2) the statewide median family income. We do not support any additional targeting of the MRB/MCC programs primarily because we believe that the 1986 targeting rules are working as intended.

<u>Revenue Estimates of the MRB Program</u>

Mr. Chairman, as with GAO's faulty analysis on the effectiveness of the MRB program, we also question the accuracy of the Joint Taxation Committee's revenue estimate on tax-exempt single-family bonds. The estimated cost of extending the MRB program is dramatically overstated. In 1986, Congress, concerned with the increasing volume of tax-exempt bonds issued under prior law, voted to place an overall volume limit on states' issuances of tax-exempt bonds to finance so-called private purpose activities, including low- and moderate-income mortgage revenue bonds. Despite this state by state volume cap, the method which the Joint Tax Committee uses to calculate the revenue loss from tax-exempt bonds assumes that states will use only a portion of their allocated issuing authority in a fiscal year. Therefore, according to Joint Tax methodology, the actual tax expenditure for tax-exempt bonds is not reflected in the total national bond cap but in total bond issues by states and local governments. The Joint Tax Committee staff argues that if a state issuing authority has more options available to issue tax-exempt bonds, such as mortgage revenue bonds, then it will use up more of the allocated bond cap bond authority. This reasoning increases the estimated revenue loss from the program even though the state could never exceed the cap approved by Congress in 1986. The Committee therefore bases their revenue estimate for a particular tax-exempt bond program on the presumption that if that program is allowed to continue, the revenue estimates will increase by a certain amount. We do not agree with this method of revenue estimating. We believe when Congress agreed to a certain cap, it agreed to a certain level of revenue loss for all private activity bonds. Extending the MRB program only provides states with an option as to how their cap will be allocated. It is unfair to say that by extending the mortgage revenue bond program, or any other tax-exempt bond program for that matter, state and local governments are necessarily tempted to spend more of their bond authority than they would without that option.

Sustaining A Depressed Housing Market

An especially important attribute of the mortgage revenue bond program is its ability to act as a countercyclical measure to sustain the housing market in times of high interest rates. In the early 80's the housing industry endured devastatingly high interest rates. In 1982, when rates were around 17 percent, mortgage revenue bonds financed the purchase of approximately 80,000 new and 100,000 existing single family homes. This home sale activity resulted in nearly 100,000 new jobs and $800 million in additional tax revenue.

Without a doubt, the countercyclical capability of the program will come into play in the future. While the homeownership rate has stabilized in the recent past and interest rates have been held down below 11 percent, there are signals on the horizon, led by the stock market instability which began in October 1987, that the ever growing federal deficit, and the declining value of the dollar abroad, may lead to an economic downturn in the near future. Some experts, and many consumers, worry that the interaction of these factors may throw this country into a recession that will hinder any further gains in homeownership. In this scenario, the role of tax-exempt bonds and the tax credit program will become crucial in stimulating what surely would be a depressed housing market. When faced with these possibilities, we believe it would be myopic to allow the mortgage revenue bond program to expire when the nation's economic future is so uncertain.

MORTGAGE CREDIT CERTIFICATES

The mortgage credit certificate program (MCC) was enacted by Congress in 1983 to complement the MRB program in assisting first-time homebuyers. Like the MRB program, MCC's are issued by State and local housing agencies to provide financial assistance to first-time homebuyers. States can trade in all or a portion of their MRB authority for authority to issue MCC's. With an MCC, a homeowner may take a credit each year against his or her tax liability for a portion of the mortgage interest. Lenders view this credit as additional income and are therefore able to lower the income level required for a borrower to qualify for a home.

Mr. Chairman, we fully support the extension of the MCC program, as contained in S. 1522. Since the program was enacted in 1984, many states, led by Michigan, Texas, Washington, and Rhode Island, as well as several cities, Corpus Christi, Texas and Sacramento, California, have had an opportunity to experiment with MCC's. As it was originally set up to achieve, the MCC program gives housing finance agencies much flexibility in determining the best method to use in assisting first-time homebuyers. While MCC's do not create the loan funds needed to purchase a home that the MRB program does, the program gives the homebuyer the extra income needed to qualify for a conventional loan.

Mr. Chairman, technically, the MCC program is already out of business. The genesis of its demise began with the enactment of the Tax Reform Act of 1986. With the best of intentions, Congress supposedly had extended both the MRB and MCC programs until the end of 1988 with the passage of the Act. Unfortunately, it was discovered afterward that because of an omission, only the MRB program was extended and, again, because of the omission, the MCC program was sunsetted at the end of last year. The technical corrections legislation in both the

House and Senate would have corrected this error, but, as you know, that legislation was dropped late in the session from the 1987 budget reconciliation bill.

Mr. Chairman, we fully realize that it has been your intent since late last session to ensure that the technical corrections legislation be considered in the Senate as soon as possible. We also understand that, because of scheduling constraints, full Congressional action on technical corrections is unlikely to come soon. Consequently, there could very well be little or no authority at all for states and local housing agencies to issue mortgage credit certificates in 1988. Recognizing that it could be some time before this issue is resolved <u>we strongly recommend that a statement be released by the Department of Treasury acknowledging that the unintended expiration of the MCC program at the end of 1987 was truly a technical error and that the Department will allow housing finance agencies' continued authority to issue credits through 1988.</u> We note that O. Donaldson Chapoton, Treasury Assistant Secretary for Tax Policy, in an statement to House Ways and Means Committee Chairman Rostenkowski, has declared the Department's intent to consider issuing an announcement acknowledging that they (the Department) will recognize certain provisions in the technical corrections legislation of 1987 as if enacted by Congress. We believe it would be appropriate and entirely consistent with the intent of the technical corrections legislation to include the extension of the mortgage credit certificate program within the meaning of Mr. Chapoton's statement.

<u>SUMMARY</u>

Mortgage revenue bonds have been a major tool for states and local governments in opening up homeownership opportunities for low- and moderate-income first-time homebuyers who would otherwise be unable to purchase. Our evaluation of the program has shown MRB's to be an effective way to provide assistance to households largely unserved by the conventional market. Tax-exempt bonds meet these needs by lowering the buyer's monthly payments which, in turn, increase his or her cash flow. The MRB companion program, mortgage credit certificates, also helps meet these needs by lowering a homebuyer's tax liability through a credit (viewed as additional income by the lender), thus allowing him or her to qualify for a conventional loan. In addition, mortgage revenue bonds benefit the economy as a whole by contributing to the nation's economic output, encouraging personal savings, and sustaining the housing market in times of high interest rates. If the declining homeownership rate among those Americans in the prime homebuying ages of between 25 and 34 is to be reversed, the tax exemption on mortgage revenue bonds and the authority to issue mortgage credit certificates must be extended.

APPENDIX I

Table 4
CONTRIBUTION OF SINGLE-FAMILY RESALES AND CONSTRUCTION TO GNP

	1987 Resales	1987 New
	P	P
Average Home Sales price	$105,400	$126,900
Construction	--------	77,409
Expenditures before resale	1,054	--------
Expenditures at time of sale	10,013	6,725
Expenditures after sale	2,108	2,411
Lenders' income net of cost of funds	632	1,776
Mortgage insurers' income	11	51
Subtotal	13,818	88,703
Multiplier effects	6,909	44,351
Total	$20,727	$133,054
1986 Home Sales Volume (units)	3.2 million	1.119 million
Total GNP Contribution	$72.9 billion	$148.9 billion
Contribution as a % of GNP	1.6%	3.3%

P = Preliminary

Source: NATIONAL ASSOCIATION OF REALTORS®,
Economics and Research Division
Forecasting and Policy Analysis Division

APPENDIX II

The NATIONAL ASSOCIATION OF REALTORS® National Homeownership Survey was conducted in late 1986 by Market Facts, Inc. Market Facts selected a representative sample (4,800) of the U.S. population from their Consumer Mail Panel, a demographically balanced group who have agreed to answer periodic surveys. An equal number of questionnaires were sent to owners and renters to ensure that enough renter questionnaires would be returned for meaningful comparisons. Despite the oversample of renters, the results for all respondents are consistent with a 64 percent homeownership rate and other national demographic aggregates. More than 68 percent (3,254) of the recipients returned a completed questionnaire.

Testimony on The Targeted Jobs Tax Credit submitted by the
National Rehabilitation Counseling Association
633 South Washington Street
Alexandria, VA 22314

The National Rehabilitation Counseling Association (NRCA) is pleased to provide the Senate Finance Subcommittee on Taxation and Debt Management with comments in support of the permanent extension of the Targeted Jobs Tax Credit (TJTC).

The National Rehabilitation Counseling Association, located in Alexandria, Virginia, is the largest association of rehabilitation counselors in the United States. NRCA is dedicated to the professional development of all persons involved in the practice of rehabilitation counseling and to the advance member of individuals with disabilities.

One of the goals of NRCA is to act as an advocate for the needs of persons with disabilities in our society. It is with this goal in mind that we present our justification as to why the Targeted Jobs Tax Credit should be made permanent. We are aware that on the surface this seems to be an unreasonable request in these times of high deficits and the need to generate more tax revenue for our country. We submit, however, that TJTC is really a revenue enhancer. The money lost in income tax from companies that avail themselves of the Targeted Jobs Tax Credit is more than made up by the income taxes paid by the individual employee with a disability who obtained a job through the Targeted Jobs Tax Credit, and the money saved when they leave the welfare, Social Security Supplemental Income (SSI) or Social Security the economy and creates profit which will generate tax revenue for our country. This in itself should be reason enough to extend TJTC. However, we have additional data which we feel is important to consider as valid reasons for TJTC being made permanent.

In the National Council on the Handicapped's 1986 Report to the President and to the Congress of the United States entitled "Toward Independence," they recommend that "Congress should extend and expand the Targeted Jobs Tax Credit Program." This program is seen as, and is, an excellent method to overcome the 66% unemployment rate of working age individuals with disabilities. This federal tax credit program, since its enactment in the Revenue Act of 1978, has been a real boost to the hiring of persons with disabilities. We applaud the members of Congress for putting forth such a measure. It is an excellent tool for the rehabilitation counselor to use in the job placement of qualified job seekers with disabilities. Persons with disabilities have the weakest links with the labor market and thus need some form of assistance to encourage employers to hire them. TJTC helps employers overcome the myths, fears, and misconceptions regarding persons with disabilities as workers and gives them the push needed to take a chance and hire them.

TJTC simply stated has become a major marketing tool for rehabilitation counselors. It has helped them change attitudes of employers toward hiring persons with disabilities. TJTC has and must continue to be an added inducement for the private sector employer to "try" the worker with a disability (and other targeted groups) on a job. TJTC has allowed the employer to learn to utilize qualified job seekers with disabilities and become less resistant to hiring persons with disabilities. This tax credit program was designed to provide the private sector with an incentive to change their hiring practices and seek out the structurally unemployed. It is accomplishing its purpose and must be continued until the job is completed. A 66% unemployment rate for working age persons with disabilities is an outrage and must be turned around.

TJTC has truly fostered a positive private sector initiative that is proving itself on a daily basis throughout the United States. A recent study which was conducted by the Maryland Targeted Jobs Tax Credit Unit of the Maryland State Department of Employment and Training showed that persons with disabilities in Maryland (who were clients of the Maryland Division of Vocational Rehabilitation) who were placed in employment using TJTC earned significantly more wages over a two-year period than those not hired under TJTC. This data showed that the TJTC group remained on the job longer than the non-TJTC group studied. In addition, the TJTC sample wages were $4,608 higher per person than those not hired under TJTC.

The membership of the National Rehabilitation Counseling Association spend a great deal of time talking with employers. What has come through loud and clear from these talks is that the rehabilitation community must speak the employers' language and use their approaches, thus we must market the qualified disabled job applicant. TJTC is the best marketing strategy we have. Much time, money and energy has been spent in preparing the person with a disability for the labor market. TJTC brings the finished product to the buying public's attention. It uses what business uses. When business wants to introduce a new product (an unknown) to the buying public, they use techniques like free samples and cents-off coupons, feeling that once the customer tries the product, they will keep on buying it. The Targeted Jobs Tax Credit is the qualified job seeker with a disability's cents-off coupon. It enables the employer to try it and get over their doubts and apprehensions.

The Targeted Jobs Tax Credit provides an ideal situation for all involved. The person with a disability gets the edge they need to compete successfully in the job market; the employer gets that extra incentive to try the unknown quantity they have some doubts about; and the federal government gains added revenue since the employee with a disability becomes a taxpayer rather than a tax TAKER.

Permanent extension of TJTC is a golden opportunity for Congress to let everyone win. The National Rehabilitation Counseling Association hopes you will take this opportunity to make it happen.

Thank you for your kind attention to our views.

Statement of

William A. Bolger
on behalf of the
NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES

on the subject of

S.2119 - TAXATION OF GROUP LEGAL SERVICES PLANS

March 28, 1988

The National Resource Center for Consumers of Legal Services is a non-profit research and education organization working to improve the legal system. Our primary focus is on legal services plans. We were founded in 1972 by consumer and labor groups and for 16 years have closely followed the development of legal services plans.

We strongly support I.R.C. section 120 and urge the passage of S.2119. Legal services plans have clearly proven their value and section 120 has successfully assisted the development of comprehensive employer-paid plans at minimal cost. It is time to stop extending and reenacting this provision every year or two. Congress should reenact section 120 without an expiration date.

Employer-paid legal services plans have so clearly proven their value that no one opposes them. Everyone agrees they're a good idea and that they work. The only excuse for letting section 120 expire is that the government needs the $75 million in revenue loss attributed to section 120 in 1987. Accordingly, after briefly reviewing why employer-paid plans are so valuable and work so well, we will demonstrate why the government will realize only a small fraction of $75 million in additional revenue by failing to preserve equal tax treatment for these valuable, cost-effective plans.

Plans Solve Problems.

As you know, the legal services plan tax provision excludes from an employee's gross income amounts contributed by his employer to a qualified legal services plan. These plans provide advance arrangements for meeting personal legal needs, especially for legal services that prevent or settle disputes. Legal services plans:

- promote individual happiness and family harmony by preventing or resolving serious legal problems

- increase the quality of justice by making legal advice more available to the average citizen

- improve economic productivity, because an employee distracted by legal difficulties isn't fully effective.

Legal services plans enjoy broad, strong support from labor, consumer, bar and insurance groups. There is no opposition to legal services plans. Plans are in the best American tradition of pragmatic, voluntary group action to meet common needs.

Section 120 puts legal services plans on an equal footing with other statutory fringe benefits. Legal services plans benefit primarily middle and working class Americans and are especially popular with union members. Even the most comprehensive plans seldom cost more than $150 per family per year.

Plans members receive mainly preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. Thus, group legal plans tend to preserve employee morale and productivity and assist in unblocking our overburdened judicial system.

Why Plans Work.

What is it about legal plans that creates "win-win" situations, where everybody benefits? Basically, it is that transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements dramatically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises. Thus people covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice, about more matters, but matters are handled at lower cost and in a way that minimizes disputes and litigation.

Revenue Loss.

So legal services plans are great, but can we afford to give them equal treatment as a statutory fringe benefit? Yes. Officially, the revenue loss attributable to section 120 was $75 million in 1987, but even that modest amount greatly overstates what the government will receive if it doesn't continue section 120. Why? Because much, if not most, of the employer contributions going to legal services will be directed to other exempt benefits.

The $75 million revenue loss figure comes from OMB. (To our knowledge, the Joint Tax Committee has not made any recent estimate.) The figure is about right, and can be arrived at this way:

a. number of employees for whom contributions are being made: 2.5 million

b. average contribution: $85/year

c. income tax rate on this amount: 19%

d. payroll tax on this amount: 15% (employer and employee shares)

total ab(c+d) = $72.25 million

Although most plans cover spouses and dependents, contributions are made on a per employee basis. Thus 6 - 6.5 million people are eligible for services, but contributions are only being made on behalf of 2.5 million employees. This figure may be overstated because some plans (including the UAW plans, the country's largest) cover retirees but don't have separate contributions made for them. If the plan includes the retirees as plan members but doesn't adjust the contribution per member figure, their product will be too high.

The average contribution of $85 may also be somewhat high. A study some years ago done by the National Resource Center for the Department of Labor found the average to be $87 per year; but the study pre-dated the UAW plans, which account for over a third of all people covered by employer-paid plans. UAW contributions range from $40-80 per employee per year and these amount cover over 300,000 retirees as well. A more recent survey by the National Resource Center yielded a median annual contribution of $89 per employee per year. This figure gave all plans the same weight. On a weighted basis the average contribution would have been significantly lower because of the UAW plans. Plan costs have shown little tendency to rise because benefits dollars have been scarce and competition within the legal profession is increasing.

Most plan members are in the 15% tax bracket now. Remember that employer-paid legal services plans primarily benefit union members. Legal services is not a benefit for executives or wealthy professionals. This is a benefit for average Americans, the 70% of the population underserved by lawyers. Our blended tax rate of 19% assumes about 30% of plan households are at the 28% marginal tax rate. That percentage is probably high.

In sum, the $75 million revenue loss figure is probably somewhat high, but is "in the ballpark." **That does not, however, mean that the government will receive $75 million if Congress does not reenact section 120.** Far from it. Instead, employer contributions are likely to be directed to other statutory fringe benefits, specifically, enhancements to medical, dental, prescription drug and optical plans. Employers will prefer to make non-taxable contributions to avoid paying the employer share of social security. Unions will want to assure that contributions go for benefits rather than taxes. They will also shy away from continuing or negotiating benefits that result in withholding taxes to their members on money those members never see.

Remember that 90% of the employees covered by employer-paid plans are union members. Non-union employees with the benefit are likely to have elected the coverage through a cafeteria plan. Without section 120 their benefit dollars will also flow to other exempt benefits. Thus, so long as the present system of fringe benefits taxation remains, the federal government will not actually receive much of that theoretical $75 million.

Plans are About Access to Justice.

Lest all this focus on numbers and dollar flows obscure the main point--that legal services plans promote the access to justice so fundamental to our free society--we've attached a statement by a plan member who testified before the Finance Committee four years ago. Joseph Ruth described how his wife's membership in a legal services plan prevented their house from being stolen from them through fraud. It is an intriguing and unusual story. Without the legal plan, they probably would have lost their house even if they had found a lawyer and won the case, because they would have had to sell the house to pay their lawyer.

Mr. Ruth's case is not typical in its facts, but is typical in that having ready access to legal assistance enabled justice to be done. Please enact S.2119 so that we do not undo 15 years of work and progress toward making preventive legal services readily and inexpensively available to working Americans.

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STATEMENT OF JOSEPH RUTH, WASHINGTON, DC

1. Through the legal services plan of Local 25 of the Hotel and Restaurant Workers Union I was able to obtain a lawyer and prevent my house from being stolen from me through fraud.

2. Without the plan I would probably have lost the house even if I had won the case, because I would have had to sell the house to pay the lawyer.

3. Legal services plans are a great thing and you should make sure they can continue.

Mr. Chairman, I am Joseph Ruth. I live at 1449 S St., N.W., Washington, D.C. I was asked to appear today as a sort of representative of the 10 to 12 million Americans who are covered by a legal services plan. My own case was rather unusual, but I think it illustrates just how valuable these legal services plans can be.

About eight years before my mother died, that would have been about 1970, my wife and children and I moved in with my elderly mother into her house on S St., the one where we now live, in order to care for her. She was beginning to be unable to keep up the house and it was unsafe for her to live alone. We gave up our own place in Southwest.

Mother got cancer in about 1974 and grew increasingly sick until she died in 1978. For the last two years she required constant care, which was provided solely by me, and by my wife and daughter. Mother was very disappointed that my 4 brothers and 8 sisters had so little contact with her even though most remain in the area. They almost never visited her, especially after she became ill. She told them that she intended to leave the house to me so that we could continue to live there, and she made a will saying so.

Within a few days of her death my brother Luther produced a typewritten will, dated later than the one I had, that left the house to him on the understanding that it should be sold and the proceeds distributed among all her children. I was shocked. The signature looked like hers, but I was sure it was not her genuine will. It was contrary to everything she had told my wife and me. To our knowledge my brother had not even visited her during the period when the will was made. (He later claimed to have visited her, with the witnesses, while we were all out.) I consulted a couple of lawyers and came away dismayed. They wanted a big deposit before they would do anything, bigger than we could obtain. They explained that contesting a will was expensive. It was hard to prove and would take considerable time. The worst part was that even if we won we probably would have had to sell the house to pay the fee. You see, the house was about all my mother had, and my wife and I are not wealthy. I work in the kitchen at the Capitol Holiday Inn and my wife is a member of Local 25 of the Hotel & Restaurant Workers Union.

That saved us! My wife remembered that they had legal help available and inquired about it. In December 1978 we met with attorney Paul Regan of Robert Ades and Associates. We found that the legal services plan would cover my case and would pay the legal fees. You can imagine how relieved we were. We knew we were right, but were afraid we would lose our place to live anyway.

Once Mr. Regan got started on the case we felt good about it. He was great. He interviewed lots of people, got a handwriting expert, and everything. It took quite a while before the trial, but Mr. Regan always knew just what to do. I thought the others would give up, but they didn't. One brother refused to join in the fraud, but the others did.

It's very hard to explain just how painful it was to hear my own brothers and sisters lying like they did. It was one of the worst days of my life. It would have been worse if they had gotten away with it. We won the case, and I haven't spoken to most of my siblings in the two years since. No criminal charges were brought against them.

Thanks to the legal services plan of Local 25 and the excellent work of Mr. Paul Regan, we're still in our house, my mother's wishes were followed, and justice was done. Without the plan we probably would have lost the house even if we had fought against the fraud. At the very least we would be paying off a big loan secured by the house.

As I said earlier, I know my case was very unusual, but I know there must be many, many other people who would be spared much heartache and money by having a lawyer to represent them. I hope you will continue the law that makes legal service plans like Local 25's possible.

Thank you very much for inviting and listening to me.

STATEMENT TO THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT, COMMITTEE ON FINANCE, UNITED STATES SENATE

ON

THE TARGETED JOBS TAX CREDIT PROGRAM, 1986-88: FACTS, EFFECTIVENESS, MYTHS AND REALITIES

Dr. Richard A. Lacey
Senior Vice President, Hearth Management Group,
Vice President, National Association of Targeted Jobs Consultants
Director, National TJTC Clearinghouse

April 20, 1988

INTRODUCTION

Thank you for the opportunity to clarify several fundamental concepts about the federal Targeted Jobs Tax Credit (TJTC) program. These understandings are based upon extensive experience with the program since 1979, when I worked on the Mondale Task Force on Youth Employment. Subsequently I monitored TJTC as a policy analyst in youth employment and public-private partnerships, and for the past four years I have focused on TJTC as a management consultant assisting employers, community based organizations, foundations, and government agencies.

Currently I am senior vice president of Hearth Management Group, a management consulting firm in Chester, Connecticut, and vice president of the National Association of Targeted Jobs Consultants. In collaboration with two organizations of employers and not-for-profit community-based organizations -- the Committee for Employment Opportunities and the TJTC Coalition -- I also administer a national clearinghouse on information about TJTC and continue to promote TJTC through newsletters and other publications.

Studies of TJTC since 1980 have produced varied reviews of the effectiveness, usage, costs and benefits of the program. Many studies and discussions in the policy community reveal a fundamental misunderstanding of the purpose of TJTC. In the following discussion I will summarize basic background facts about TJTC, explain why TJTC is an effective and needed program, and review fundamental myths and realities surrounding TJTC.

BACKGROUND FACTS

Congress first enacted the Targeted Jobs Tax Credit (TJTC) in 1978 to provide employers with a tax incentive to hire disadvantaged and handicapped workers, targeting groups whose unemployment rates were disproportionately high. After extending and modifying the law three times, Congress included TJTC in the 1986 Tax Reform Act; TJTC is scheduled to expire December 31, 1988.

TJTC grants a credit of 40 percent of the first $6,000 of qualified first-year wages (i.e., a maximum of $2400 gross credit, or a net corporate tax credit of $1584 for 1988 and thereafter) of workers certified by the Job Service, provided they remain employed 90 days or 120 hours. Most certifications are for individuals in "economically disadvantaged" groups, whose six-month family income is 70 percent or less of the BLS lower living standard -- currently about $95 per week for individuals, $263 per week for a family of four. These groups include youth aged 18-24, 16-18 year-old youth hired in summer jobs, and 16-19 year-old youth in cooperative education; Vietnam-era veterans; and ex-offenders. Other targeted groups are physically/mentally handicapped persons; recipients of AFDC, general assistance, and SSI; and WIN registrants.

In 1985, there were 627,088 certifications distributed in the following way: Youth: 50%, AFDC: 16%, Handicapped: 7%, and ex-offenders, summer youth, general assistance and veterans: each 4%; SSI 1%. State data for 1987 are being gathered for analysis in early 1988. TJTC was not in effect from January-October of 1986, but data are not yet available to domonstrate the precise impact of this hiatus on hiring from targeted groups.

The best estimates of usage for FY '87 are based on state figures -- a total of 383,000. This figure is unofficial, however, because the U.S. Department of Labor has not yet gathered and published the data.

TJTC is complementary to the Job Training and Partnership Act, and Congressional efforts to enact Welfare Reform. Training people for jobs and requiring them to go to work will succeed only if the private sector has an incentive to hire individuals with poor work history and from groups that are traditionally unrealiable. The TJTC incentive gives workers a second and third break as they settle into the world of work.

WHY TJTC IS AN EFFECTIVE AND NEEDED PROGRAM

The conventional wisdom that "a rising economic tide lifts all boats" does not apply to in inner city and rural American communities where unemployment still remains three to four times the national average. TJTC is an extremely effective tool for reaching out to the hard-to-employ and putting them to work.

Groups representing veterans, ex-offenders, and disabled people, and community-based organizations that serve hard-to-employ youth (e.g., in trouble with gangs or drugs) say TJTC is one of the most effective programs for job placement.

Many employers realize it is good business to hire the structurally unemployed and provide incentives to their managers for hiring TJTC-eligible applicants. The program is used widely in furniture, food service, retail and manufacturing industries.

Program continuity is essential. TJTC lapsed between January-October, 1986. When Tax Reform was enacted, it took months to revive employers' confidence in the program and begin to seek out structurally unemployed workers again.

In New York State, the largest TJTC user, 57,550 people were hired in FY 85. But in the last six months of 1987, only 18,073 were hired, indicating a 37% drop in utilization. New York City's summer jobs program, the largest in the U.S., uses TJTC to place youth.

The 10-month program hiatus in 1986 eroded employer confidence because the job service network to certify workers was dismantled. It is now running smoothly because Congress appropriated nearly $43 million ($15 million in the FY 87 Supplemental and $23.7 million in the FY 88 Continuing Resolution) for administration through FY 88.

If we face a recession in the next two or three years, we need a jobs program in place. If TJTC expires in 1988, too many people will be out of work before Congress can react and pass jobs legislation.

We should learn from previous training programs that didn't have a real job waiting for those who were trained. Welfare Reform would require massive federal and state spending to train recipients -- but training programs without hiring incentives will surely fail.

TJTC provides an essential incentive to get employers to hire newly-trained workers.

Past criticism of TJTC reflected the perception that the credit could be a windfall for companies to save taxes on high-turnover employees. This perception persists. Under the '86 Tax Reform law, however, employees must work 90 days or 120 hours before they qualify for TJTC. As a result, today the leading users of TJTC are manufacturers and retailers who provide long-term jobs.

Would TJTC workers have been hired without TJTC? When TJTC began in 1978, many hires were a tax windfall to the employer. But employers began to realize TJTC provides the incentive needed to cover added costs of training and supervision of disadvantaged workers, who proved they could do the job.

As a result, companies have changed their hiring practices to reach out to veterans, disabled, welfare and church groups as well as community based organizations who work with the structurally unemployed.

This has effectively expanded the work force. With today's levels of unemployment, if TJTC expires, employers would hire the first desirable applicants who walk in the door -- members of the active labor force. With TJTC, however, employers will continue to expand the work force by seeking out and hiring the structurally unemployed.

MYTHS AND REALITIES ABOUT TJTC

Myth: There is no proof that TJTC generates new jobs for the disadvantaged.

Reality: TJTC was not intended to create new jobs. Instead, it was designed to increase job opportunities for those with severe barriers to employment. Employers are encouraged through financial rewards to fill existing job openings with people from targeted groups.

Myth: Companies would often hire TJTC workers anyway.

Reality: It has always been extraordinarily difficult to persuade managers in business and industry to hire disadvantaged and handicapped workers. The labor market is always tight for "structurally unemployed" people. Increasing skill requirements of entry level jobs further limit access to employment of disadvantaged groups, such as minority inner city youth and others with limited work experience and marketable skills, or who face prejudicial barriers.

In the absence of the credit, employers instinctively prefer experienced and initially more capable workers rather than handicapped and disadvantaged applicants. Studies show that TJTC does help disadvantaged and handicapped workers get jobs (e.g., a GAO study showed that the penetration rate for economically disadvantaged youth increased during recessions in FY 80 and FY 82).

As companies discover that members of targeted groups are in fact productive workers, hiring managers change their attitudes and practices. They are now seeking out TJTC-eligible employees, requesting them on job orders -- especially when their company pays them a bonus for doing so.

Examples: (1) The Chicago Jobs Council study shows that a quarter of firms surveyed deliberately tried to hire TJTC-eligible workers, and nearly three-fourths changed their methods of seeking job referrals by going to non-traditional sources and Job Service offices. (2) The Congressional Budget Office study found that TJTC affects the hiring decision of firms: 34% of firms said that TJTC had significant influence on the decision, and another 22% said that there was a small effect.

Myth: TJTC primarily benefits corporations rather than individual disadvantaged workers.

Reality: Research for the Maryland Department of Employment and Training and for the National Commission for Employment Policy found significant gains to individual TJTC participants. Congressional testimony and ongoing research also offer ample evidence from individuals and community-based organizations.

Myth: TJTC primarily benefits the fast-food and similar service industries with high turnover (100% and more), low average tenure (1-6 weeks), and high percentages of part-time workers and 16-17 year-olds.

Reality: TJTC can be taken only if an eligible employee works at least 90 days or 120 hours for a company. Since most fast food short-term employees leave in the first six weeks, no TJTC credit is available for most of these employees. Furthermore, few 16-17 year-olds are TJTC-eligible.

Myth: Companies exploit the program by "churning" employees -- that is, replacing them as soon as they earn the maximum TJTC credit.

<u>Reality</u>: Even though TJTC-eligible workers are initially less skilled and experienced than others, their average tenure is about the same as for all employees. The costs of employee turnover and retraining are so high that it is inconceivable that a company would benefit from such practices. The average net tax savings on a TJTC employee is $660, whereas the average cost of replacing an experienced employee is at least $600.

<u>Myth</u>: Management consulting firms that assist corporations in implementing and processing TJTC are unintended beneficiaries of the program.

<u>Reality</u>: All programs in the public or private sector require special expertise to implement properly. Specialists such as CPAs, lawyers, engineering specialists, pollution control experts, etc., market their skills to assist corporations. Each short-term extension of TJTC has encouraged companies to rely on consultants rather than internal staff to manage program regulations and technical details of screening job applicants and processing time-sensitive paperwork.

<u>Myth</u>: TJTC is a government revenue-loser.

<u>Reality</u>: The projected costs of TJTC, which are derived from the Joint Committee on Taxation's economic model, are a matter for separate technical analysis of the number of TJTC participants, their average wage and turnover, and the tax rules. Nonetheless, special cost-benefits of TJTC deserve attention because of TJTC's effects upon the documented, quantifiable social costs of unemployed disadvantaged workers.

There are direct social benefits and cost savings: TJTC employees are taken off welfare and government assistance rolls; unemployment compensation costs are reduced; and revenues from income taxes are increased. Indirect savings can be reasonably estimated as well: costs of crime drop sharply when ex-offenders are employed; disabled and economically disadvantaged Vietnam-era veterans enter the economic mainstream, reducing costs of dependency on general assistance and related social costs of unemployment; disadvantaged youth and welfare recipients are able to develop a record of work experience, earn income, and escape the poverty cycle of the structurally unemployed.

Analyses of the financial savings produced by employment of TJTC-certified individuals support the claim that TJTC yields a trade-off of quantifiable revenue savings to the government. For example, the Chicago

Jobs Council study found that in FY 85, TJTC-generated employment saved the Federal and State of Illinois governments $11.6 million in Chicago alone. That study is currently being updated.

IRS statistics show that the cost of TJTC to the government is much less than $1000 per certification used in previous Congressional estimates, when the credit was 50% of first-year wages to $6000, plus 25% of second-year wages. Accounting for reduction of the credit to 40% and the offset for the disallowed deduction on the $6000 wage base results in about $550 per certification.

Conclusion

I and the organizations I work with urge extension of TJTC during 1988 to assure program continuity and employer confidence. Managers of companies, and of the State Employment Service need to know that TJTC will survive so that they can plan.

I would welcome solid studies that would enable Congress to refine the administration of this program. While I have ample evidence in the form of success stories to demonstrate that TJTC is effective, I also believe that TJTC administration could be improved. TJTC administrators at every level have revealed numerous practical, cost-efficient refinements that could be and in some cases have been implemented quickly. Upon extension of TJTC, the organizations collaborating to promote TJTC would seek to help the U.S. Department of Labor and the State Employment Services to assess and implement several of these recommendations in order to increase the power of this program to accomplish what Congress intended.

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April 11, 1988

The Honorable David Pryor
Chairman
Subcommittee on Private Retirement Plans and
Oversight of the Internal Revenue Service
Committee on Finance
United States Senate
205 Dirksen Building
Washington, D.C. 20510

Dear Senator Pryor:

I am submitting this statement to your Subcommittee on behalf of the New York Clearing House Association* to bring to your attention a totally unprecedented retroactive civil penalty provision that was added to the Internal Revenue Code,** by the Omnibus Budget Reconciliation Act of 1986 (the "Act"). In amending Section 6656(a) to double the previous penalty for late payment of withholding tax deposits from 5% to 10%, the Act provided that the increased penalty applies to all penalties "assessed" after the date of enactment, which was October 21, 1986, and

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* The members of the New York Clearing House Association are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA and European American Bank.

** Unless otherwise noted, references to the "Code" and all section references are, respectively, to the Internal Revenue Code of 1986 and to sections thereof.

without regard to the tax years for which they were imposed. For the reasons discussed herein, I believe that the Subcommittee should recommend that this effective date provision be amended so that the penalty increase applies only prospectively.

The extent to which the retroactive doubling of this penalty is bad tax policy is demonstrated by describing how Section 6656 is applied. Section 6656 imposes a penalty (formerly 5% and now 10%) for a late deposit of employee and non-resident withholding taxes, unless the withholding agent is able to demonstrate that the late deposit is "due to reasonable cause and not due to willful neglect." Unless the "reasonable cause" exception applies, the penalty is due if the deposit is as much as one day late.* Yet, the penalty amount (10% of the overdue balance) is the same whether the deposit is one day late or several months late. Moreover, the Section 6656 penalty is in addition to the interest customarily imposed on late payments.

Insofar as the imposition of penalties is concerned, barring fraudulent concealment, the determinative date should be the date deposit was missed. The rate of penalty ought to be whatever it was when a taxpayer failed to make payment. Nevertheless, the Act provided that when such a penalty is "assessed" determines the effective date of an increase in its amount. This is particularly arbitrary because assessment is merely one step, albeit a formal one, in the collection process, which commences when an I.R.S. agent begins his audit.

Further, even though one might think the normal three year statute of limitations on assessments of taxes and penalties would be sufficient time for the I.R.S. to audit a tax return and for a taxpayer to exercise his rights to administrative review, this is usually not the case. As a matter of course, I.R.S. auditors request extensions of statutes of limitations, and taxpayers have no choice but to sign them if they wish to exercise their administrative review rights before a tax is assessed and paid. It is not unusual (particularly in the case of large corporations filing complex tax returns) for more than five years to elapse between the date a tax return is filed and

* Under fairly usual circumstances, deposits are due roughly once a week.

the date on which the tax or penalty is actually assessed. If the Section 6656 penalty is assessed after October 21, 1986, the 10% rate applies no matter how long before that date the tax return was filed.

If, for example, two taxpayers both fail on the same date to make a required $10,000 withholding payment, the penalty imposed on each should be the same whether the I.R.S. auditors act rapidly or slowly. A taxpayer should not suffer a different penalty merely because of how he chooses to exercise his appeal rights. It defies logic to apply a lower penalty to taxpayers who promptly agreed (particularly before October 21, 1986) to a penalty because they knew they did not have a "reasonable cause" defense but to impose the doubled penalty on taxpayers who contested the penalty because they believed they could demonstrate the requisite "reasonable cause" to excuse the late deposit.*

Nor is the imposition of a penalty that is retroactively doubled according to the timing of assessment justified by any traditional argument for tax penalties. Since the penalized behavior occurred prior to the increase in penalty rate, it is impossible for the increase to have served as a deterrent or to have encouraged the taxpayer's compliance. It would not be unreasonable to assume that those members of Congress who favored this provision thought it would apply only to those whose continued failure to remit deposits required deterrence and not retroactively to those whose tardy deposits were promptly remedied. The Staff Report at p. 21 suggests that this retroactivity may be justified on the basis that "the original penalty structure may have been unduly lenient ...". On that basis, it would be appropriate to retroactively double any penalty ranging all the way from parking violations to criminal activity solely because government officials change their minds as to what the proper penalty should have been at some earlier and even far distant past time. Such a doctrine is antithetical to concepts of civil and criminal justice that have been the foundation of our

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* The March 9, 1988 Joint Committee staff report on tax penalties (the "Staff Report") suggests at p. 21 that making the Section 6656 penalty increase retroactive will "punish violations more equitably". To the contrary, any law that discriminates against taxpayers because they pursue their legal remedies is unfair, not equitable.

legal and political structure. The Subcommittee should forthrightly reject it.

The retroactive doubling of the Section 6656 penalty is particularly offensive because there is no indication that it was intended to penalize prior taxpayer misconduct. At the time it was enacted, Congress was completing a mammoth, months-long overhaul of the tax laws. However, the amendment to Section 6656 was not a part of that legislation. Instead, it was included in legislation that was intended to provide funds to help balance the Federal budget. Although it may be difficult to properly fix responsibility for the increasing budgetary shortfalls that led to the passage of that law, it is clear that persons who deposited withholding taxes a few days late were not to blame for the Federal deficit. To retroactively penalize a person for his own inadvertent errors is bad enough, but to retroactively penalize him for the faults of others is unconscionable. Indeed, as the enclosed article prepared by John Corry demonstrates it is likely that the retroactive application of the doubling of the Section 6656 penalty is unconstitutional.

The Subcommittee need not, however, focus on whether a constitutional challenge to the doubled penalty provisions would likely prevail. Rather, the concern should be whether Congress will take this opportunity to accomplish substantial justice by ending the inescapable and unjust retroactive consequences of the increased penalty provisions.

Wholly apart from the foregoing, if Section 6656's retroactive penalty date is not totally changed, Congress should at a minimum limit it by extending the equitable principles of Section 6661 to Section 6656. Treas. Reg. § 1.6661-6(c) provides that the substantial underpayment penalty is automatically waived where the taxpayer pays the substantial underpayment and files an amended return before the I.R.S. first contacts him. Congress should authorize a similar equitable principle that would make the increase in the Section 6656 rate inapplicable where delays in deposits are brief and are corrected in good faith prior to the filing of the taxpayer's original or amended Form 1042. This is particularly appropriate since most underpayments are intentional whereas most delays in making deposits are administrative and inadvertent.

I therefore urge that Section 6656 be amended either to totally delete its retroactive application or at the very least to exempt from its retroactive effect any taxpayer that on or before the effective date of the Act and prior to the date that the penalty was first asserted by the I.R.S. made the tardy deposits that were the subject of the penalty.

Very truly yours,

Mikel M. Rollyson

OHIO BUREAU OF EMPLOYMENT SERVICES
145 SOUTH FRONT STREET P.O. BOX 1618
COLUMBUS, OHIO 43216

RICHARD F. CELESTE
Governor

DR. ROBERTA STEINBACHER
Administrator

JOB SERVICE OF OHIO

April 1, 1988

Ms. Laura Wilcox
Hearing Administrator
United States Senate
Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ms. Wilcox:

The Ohio Bureau of Employment Services on behalf of future Ohio workers who need help in finding employment and Ohio employers whose businesses utilize tax credits to increase profitability and expand employment, wishes to submit the following statements in support of TJTC as a viable program in Ohio:

Ohio Work Incentive (WIN) Program Statement

The TJTC program has been instrumental in enabling Ohio WIN to meet its goal of serving economically disadvantaged citizens while reducing welfare costs to taxpayers. For the past eight years, Ohio has ranked among the top three WIN programs in the nation for the number of people removed from public assistance and placed in jobs. In fiscal year 1987, nearly 9,000 Ohio recipients of Aid to Families with Dependent Children (AFDC) secured employment resulting in annualized welfare savings of $18.6 million.

Ohio WIN's experience has shown that employers respond extremely well to the opportunity to receive a valuable tax credit in addition to a qualified employee. For the WIN client, the TJTC program has often meant the difference between a long-term stay on the welfare rolls and an opportunity for self-sufficiency and self-determination.

General Statement and Proposal for Continuation

TJTC as it currently operates under the authority of the Tax Reform Act of 1986 has helped 26,394 Ohio residents find employment in 1987. This is a great help to these Ohioans and their employers who are receiving the tax credit. However, this level of certification for tax credit purposes falls significantly below the year 1985 when there were 32,030 certifications issued in Ohio and the tax credit was 50% of the first $6,000 in qualified wages vs the present level of 40%. Figures for 1986 are inconclusive since the TJTC program was not operational for about nine months of that year. With this evidentiary information, we recommend that the Congress reauthorize the TJTC program at essentially the levels that were in existence prior to the tax credit reductions initiated by the Tax Reform Act of 1986. This agency's rationale for proposing a return to the pre-1986 level of authorization is that a greater tax credit should encourage employers to hire more workers thus adding to the roles of tax payers from these target groups, and removing significant numbers of persons from welfare and other supportive processes that use tax money rather than utilizing it to promote jobs.

Thank you for including these statements in support of the Targeted Jobs Tax Credit program in the record of procedings for the Senate Finance Committee on Taxation and Debt Management.

Sincerely,

Grace A. Kilbane

Grace Kilbane, Acting Administrator
Ohio Bureau of Employment Services

GK:JRJ:ms

cc: E. Mihalski

U.S. DEPARTMENT OF LABOR
Employment and Training Administration

OMB Approval No. 1205-0058

ELIGIBILITY DETERMINATIONS BY TARGET GROUP AND PARTICIPATING AGENCY

TARGETED JOBS TAX CREDIT
Report No. 1

STATE: OHIO

PERIOD ENDING: September 30, 1987

LINE NO.	PARTICIPATING AGENCY	TARGETED GROUPS: ECONOMICALLY DISADVANTAGED: Youth	Vietnam-Era Veterans	Ex-Convicts	Coop. Education Youth	Summer Youth	HANDICAPPED	INVOLUNTARILY TERMINATED CETA EMPLOYEES	WELFARE: General Assistance	SSI	WIN Registrants/AFDC	TOTAL	ELIGIBILITY DETERMINATIONS: Original	Subsequent
	A	B	C	D	E	F	G	H	I	J	K	L	M	N
1	CETA Prime Sponsor													
2	ETA Grantees	10					2		1	1	2	16	12	4
3	Vocational Rehabilitation	8	2	3			1423		5	4	7	1452	979	473
4	Coop. Education School													
5	Welfare Offices	3		1					1			5	3	2
6	SSA District Office			1								1		1
7	Veterans Administration		1								1	2	2	
8	Job Service	27998	2862	2514	*65	1119	3065		9662	649	16,316	64185	35643	28542
9	Other	11		4		3	9		4		1	32	27	5
10	TOTAL	28030	2865	2523		1122	4499		9673	654	16327	65693	36666	29027
11	Invalidations													

NAME AND TITLE OF RESPONSIBLE OFFICIAL	SIGNATURE	DATE SIGNED
J. Robert JOnes, Deputy Director	J Robert Jones	10-7-87

*Memorandum notation. Not included in totals.

ETA 8471 (R-Aug. 1983)

U.S. DEPARTMENT OF LABOR
Employment and Training Administration

OMB Approval No. 1205 0058

TAX CREDITS AUTHORIZED

TARGETED JOBS TAX CREDIT
Report No. 2

STATE: OHIO

PERIOD ENDING: September 30, 1987

LINE NO.	PARTICIPATING AGENCY	TARGETED GROUPS: ECONOMICALLY DISADVANTAGED: Youth	Vietnam-Era Veterans	Ex-Convicts	Coop. Education Youth	Summer Youth	HANDI-CAPPED	INVOLUNTARILY TERMINATED CETA EMPLOYEES	WELFARE: General Assistance	SSI	WIN Registrants/AFDC	TOTAL
	A	B	C	D	E	F	G	H	I	J	K	L
1	CETA Prime Sponsors											
2	ETA Grantees	2					2		1	1	1	7
3	Vocational Rehabilitation	3	1				512		3	1	1	521
4	Coop. Education School											
5	Welfare Offices								1			2
6	SSA District Office											
7	Veterans Administration											
8	Job Service	12748	1094	549		500	1204		3768	263	5718	25844
9	Other	8		3		3	2		4			20
10	TOTAL	12762	1095	552		503	1720		3777	265	5720	26394
11	Invalidations	13									5	18

NAME AND TITLE OF RESPONSIBLE OFFICIAL	SIGNATURE	DATE SIGNED
J. Robert Jones, Deputy Director	J. Robert Jones	10-7-87

ETA 8472 (R Aug. 1983)

OMB Approval No. 1205-0058

U.S. DEPARTMENT OF LABOR • Employment and Training Administration
TARGETED JOBS TAX CREDIT *(Report No. 3)*

CHARACTERISTICS OF INDIVIDUALS ELIGIBLE AND FOR WHOM TAX CREDITS ARE AUTHORIZED

STATE: OHIO

PERIOD ENDING: September 30, 1987

LINE NO.	CHARACTERISTICS (A)		ELIGIBLE DETERMINATIONS (B)	TAX CREDITS AUTHORIZED (C)
1	TOTAL		36666	26394
2	(DO NOT USE)			
3				
4	AGE	16 - 18	2043	1261
5		19 - 24	14727	11866
6		25 - 34	13246	9729
7		35 and Over	6650	3538
8	(DO NOT USE)			
9				
10				
11				
12				
13				
14a	VETERAN	Total	4510	3068
14b		Disabled		282
15	WAGES	Under Federal Minimum Wage		845
16		Federal Minimum Wage to $3.99		18485
17		$4.00 - $4.99		3671
18		$5.00 - $5.99		1287
19		$6.00 and Over		2106
20	OCCUPATIONAL CATEGORY	Professional, Technical, Managerial		556
21		Clerical and Sales		7965
22		Service		11325
23		Farm, Forestry, Fishery		211
24		Processing		338
25		Machine Trades		1032
26		Bench Work		955
27		Structural		430
28		Miscellaneous		3582

NAME AND TITLE OF RESPONSIBLE OFFICIAL	SIGNATURE	DATE SIGNED (Mo., Day, Yr.)
J. Robert Jones, Deputy Director	J. Robert Jones	10-7-87

ETA 8473 (R-Aug. 1983)

Department of Human Resources
EMPLOYMENT DIVISION

Targeted Jobs Tax Credit Extension

Employers in the State of Oregon have esperienced an estimated $68.4 Million in tax savings from participation in TJTC since 1978. The tax savings has been shared by a broad range of companies both large and small.

Many employers indicate that TJTC has been the keystone that helped them survive the years of economic depression. When the business climate improved employers continued to use TJTC for a variety of reasons, most commonly they found TJTC eligible applicants to be good employees. They saved money and they had a system in place for using TJTC which was cost effective and user friendly.

168,000 unemployed Oregonians have been determined eligible for the program since 1979. These have included individuals from our highest unemployed group, youth 16 through 24 years of age. Additional groups served include welfare clients, ex-felons, Vietnam era veterans, and the handicapped. Nearly 67,000 of these individuals have been hired and certified to employers since 1979.

The State benefits when welfare clients become employed and are no longer receiving public assistance. Unemployed youth have been able to obtain jobs and learn a skill because of TJTC. Ex-felons with jobs are less likely to commit new crimes and thus remain out of prison. Oregon jails are already overflowing placing additional pressure on the public to find ex-felons work as rapidly as possible. TJTC is a tool they can use to find work.

The handicapped is another target group for which TJTC has opened the door to job opportunities.

The tax credit has been a very good tool for encouraging the hiring of target group members. Loss of TJTC will reduce employment opportunities for the people who need the help most and makes it more difficult for them to enter the labor force.

It is important that Congress take immediate action to extend the program. Lack of continuity has plagued employer use of TJTC since its conception.

I urge your approval of TJTC because of its value to both employers and the unemployed in Oregon.

Following is a yearly statistical summary of TJTC activity in the State of Oregon.

Statistics

Fiscal Year	No. Vouchered	No. Certified	Potential Tax Credit Savings (Millions)	Actual IRS Savings (Millions)
1979-80	13,988	5,069	$ 22.8	$ 5.7
1981	19,225	10,743	48.3	12.1
1982	13,242	2,948	13.3	3.3
1983	25,797	6,445	29.0	7.3
1984	32,529	13,074	58.8	14.7
1985	27,604	15,149	55.5	13.9
1986	6,637	3,565	16.0	4.0
1987	18,356	7,856	18.8*	4.7
1988	10,341	4,563	11.0*	2.8
TOTAL	167,719	69,412	$273.5	$68.4

Definition of Terms

Vouchered - Targeted group members determined eligible.
Certified - Targeted group members hired by employers and certified.
Potential tax credit savings - Number certified x $4500 - In Millions.
*Number certified x $2400 - In Millions.
IRS Actual - 25% of potential tax credit savings - In Millions.

TESTIMONY

by

SCOTT SKLAR
EXECUTIVE DIRECTOR
SOLAR ENERGY INDUSTRIES ASSOCIATION

INTRODUCTION

The Solar Energy Industries Association (SEIA), the national trade association of the solar thermal and photovoltaic manufacturers and component suppliers, urges the Committee to maintain the existing solar business tax credits through 1995.

The U.S. solar energy industry is on a slight rebound in the face of mounting competition from abroad. Already our international competitor nations have surpassed the U.S. in their federal research & development spending. Over the last five years, most of our competitor nations have surpassed the U.S. in government financing. The U.S. commercial tax incentives represent one of they key programs for the U.S. solar industry to remain competitive. Only through an increasing domestic market will our solar industries have the financial base to compete internationally.

Although U.S. solar sales dropped in 1985 due to low energy prices, expiration of residential tax credits and the phase down of commercial credits, and decreasing government support overall -- by 1988 sales have increased due to advances in technology, utility interconnection, and special market niches due to rising energy prices.

Extension of the solar commercial credits at the ten percent (10%) level, will send a message to the financial markets and our international competitors. A message that the United States wants to maintain our technical predominance in solar energy at a time when our petroleum imports are reaching the precipitous levels experienced during the 1973 oil embargo is essential.

Commercial solar electric (photovoltaic) sales in 1987 totalled not more than $30 million. Commercial solar hot water sales reached $25 million in 1987. Commercial solar thermal power sales reached $150 million in 1987. Revenue loss from such an extension will not exceed $20 million per year, and in fact, probably be far less.

Our competitors are anxiously waiting for the market void left by a U.S. retrenchment in support of the solar industry. The potential multibillion dollar overseas solar markets will be won not only by those with the best technologies but by the industries which have a strong domestic base in their host countries and coordinated government support to build market bridgeheads throughout the world. The U.S. commercial tax incentives represent a key component for the U.S. solar industries to ultimately build our international bridgeheads.

TAX CREDIT HISTORY

After the 1973 oil embargo, the U.S. goverment instituted a three track approach to encourage solar and renewable energy development. The first part of the triad was an aggressive solar energy research and development program through the Energy Research & Development Administration (ERDA) and then the Department of Energy (US/DOE).

The second part of the triad was energy assistance through the weatherization program, low-income energy assistance program, and the loan subsidy program through the Solar Energy & Energy Conservation Bank that is administered through the U.S. Department of Housing & Urban Development. The basis of this program was to assist low and lower income people in cutting their energy bills through grants and subsidized loans.

The third and final part of the triad was the creation of residential and business tax credits. The tax credits passed in 1978 and the Internal Revenue Service promulgated guidelines in 1980. The credits for residential applications were limited to solar hot water and solar space heating systems. Passive solar applications and solar pool heating were prohibited. The business credits at the ten percent (10%) level ranged from solar hot water heating for business to industrial process heat & steam to utility-sized solar applications.

In 1978, the United States had less than 100,000 solar hot water systems and less than a megawatt of solar thermal power and photovoltaics. By 1985, the United States had over one million residential solar hot water systems. By 1988, the United States had over 110 megawatts of solar thermal power generated electricity and over 15 megawatts of photovoltaic both on a utility -scale.

The large success of market penetration is due to the tax incentives which serves to buy down the risk of these new solar technologies. While the residential credits expired in 1985, the business credits will expire in 1989. Although the U.S. market penetration seems large, our experience is dwarfed by those of our international competitors. For example, during the last fifteen years while the United States installed over one million residential solar hot water systems nationwide, during the same period the Japanese have installed over one million solar hot water heaters in the City of Tokyo alone!

The utilization of market pulls of new technology has been successfully demonstrated as one of the best ways to establish a domestic high-technology industries. The use of massive military procurements directly gave rise to the semiconductor and computer industries in the

United States. Programs created access to capital have built the residential housing industries and the utility industries. Use of tax incentives has enlarged private home ownership, preserved historic building, and maintained a thriving oil industry for many years.

The establishment of business solar tax credits was in line with a bipartisan goal of providing market incentives to build the U.S. solar industry which would dominate world markets. The credits are a fundamental influence in attracting capital towards technology that is perceived as both new and futuristic. Although the technology has been proven in countless government-sponsored demonstrations, potential commercial and utility customers needed the tax incentives to lighten the risk. The solar business credits have worked exceedingly well without the fraud or problems experienced in other sectors.

According to economist Robert Nathan's 1985 study titled "The Development of Solar Energy and Federal Income Tax Credits, stated that the U.S. cannot count on continued expansion of solar energy use without an expanding market for solar energy adequate to attract the levels of capital necessary for construction of large-scale plants. In my view, if the U.S. does not maintain this market expansion, our domestic market will be overwhelmed by foreign imports within the decade.

THE CASE FOR TAX INCENTIVES

From an economic point of view, the greater the U.S. trade balance, the weaker the U.S. economy. Oil imports now rank as one of the key contributors to the U.S. trade deficit. At the same time, most of the Third World has increased their oil imports which not only causes increased loss of capital but increased inability to pay their debts.

The United States has become the world's largest debtor nation. The Third World's inability to pay its debt threatens the world's financial stability. The United States, our allies, and the developing countries must pursue policies to utilize domestic energy resources to their fullest or risk a wind down of the world economy and possible depression.

In the midst of this negative economic scenario, the petroleum resources worldwide are depleting. According to a March release by the U.S. Geological Survey, the United States has only eleven years of untapped oil resources. And while the U.S. fills the Strategic Petroleum Reserve, questions remain as to its usability and access to all sectors of the U.S. economy. Coal reserves are abundant but increased coal combustion causes acid rain and harms agricultural and forest productivity. There has not been a new order for nuclear power plants in the last decade.

At the same time over seven thousand megawatts of electric power have been produced by renewable energy resources in the last eight years due to a mix of federal R&D support, legislated interconnection rights, and varied tax incentives. Increased U.S. export assistance has expanded the world markets. Yet the U.S. government has cut renewable energy R&D support by over eighty percent, slashed or halted tax incentives, and threatened utility interconnection.

Our country's economic and energy policies have not kept up with the realities of finite energy resources, Middle East tensions, and very high trade imbalances. The best way to overcome these energy issues is to enhance market forces to promote domestic renewable resources, particularly solar energy. Tax credits have worked excellently to encourage market acceptance of this new technology. Maintainance of this support will quicken the market acceptance and broaden the utilization that could have real effect on offsetting energy imports.

Over the last few years a scientific consensus has developed on the global warming trend. The breakdown of the earth's protective ozone layer coupled with massive amounts of carbon dioxide pumped into the earth's atmosphere causing a "greenhouse effect" pose alarming problems for the world's peoples. The effects of global warming could radically alter world agricultural products and imperil major urban centers on the coastlines on all continents.

Acid rain has become a central political issue between the United States and Canada. Many experts predict that increased use of coal will adversely effect agricultural production and severely limit timber production. Negative health impacts from combustion emissions currently cost consumers billions of dollars. Added losses from acid smog and acid rain on building and automobiles cost government and industry billions of dollars. The U.S. Congress has approved billions of dollars for clean coal research and billions of dollars for nuclear waste storage and research.

Extension of business solar tax credits over the next seven years would not cost the American taxpayer more than $200 million dollars in aggregate. Solar thermal and photovoltaic energy does not pose serious negative environmental impacts and clearly can offset or mitigate environmental problems caused by conventional energy resources. Utilization of photovoltaics to displace diesel generation for remote electric generation could seriously limit pollutants from a widely dispersed and unregulated power source. Utilization of solar thermal power to displace peak power generators can displace higher cost energy from peak power plants that are usually older and less environmentally benign. Use of commercial solar hot water technology can levelize electricity demand and moderate the need for expanded power generation.

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The solar technologies can add to the energy mix effectively and substantially. However to maintain these market inroads, these market incentives must be sustained in light of temporarily lower petroleum prices, and government indifference. A diverse reliance on a myriad of energy resources both conventional and renewable offers utilities and consumers maximum flexibility and reliability.

As stated earlier, the U.S. solar energy industry in order to be competitive abroad, must have a secure and growing domestic market. Our international competitor nations have a wide range of incentives to build their domestic solar markets. At a time when the U.S. is about to realize their fifteen year investment in solar energy, and when we need domestic energy production the most, our country must maintain its support of the U.S. solar industry.

The solar energy industry is a microcosm of any high technology industry. And the industry is caught between contradictory government polcies both on the domestic and international fronts. The United States has pursued major government efforts to enhance high technology industries as a way to expand our exports and bring our country into the new technological age.

Most government policymakers have concerns about the monumental environmental problems regarding global warming and acid rain. And many people are concerned with the increasing trade deficit and the enlarging U.S. dependence on energy imports whether its petroleum from the Middle East or the Caribbean Basin, or electricity imports from Canada.

Yet these concerns do not translate into positive policies to promote solar energy. But the record is clear that the United States solar industry leads the world in solar thermal and photovoltaic technology. However, due to contradictory policies, the United States may lose its technological edge due to a shrinking market as a result of government indifference.

Tax credits have been demonstrated as an effective tool in enhancing technology in the market place. A ten percent tax credit is not large enough to overcome all the market risk but provide just enough incentive to bring down the investment risk to acceptable levels. The solar business credits, if extended through 1995, will set the stage for incorporation of solar energy technologies into every facet of American life. And as a result, the U.S. quality of life and security will greatly benefit.

CONCLUSION

In the myriad of requests for tax incentives that the Subcommittee has received, the solar energy industry, albeit small, deserves Congressional support.

The photovoltaics and solar thermal industries are less than twenty years old with most companies established after 1978. Over the last decade, the industry has topped one billion dollars in sales. And though the industry has retrenched abit due to circumstances beyond our control, the United States still maintains a technological lead.

The tax incentives for solar energy were established to increase market demand for solar energy. Tied to federal research & development and loan programs, they have been very effective in building a market for solar energy.

If the Congress fails to extend the solar business tax credits, a signal will be sent to financial markets that the U.S. government no longer supports the long term development of solar energy. As a result, our competitors will infuse more money into their solar industries to fill the market void.

Lack of a coherent federal policy to promote solar and renewable energy resources, will insure that the American public will be importing solar equipment at the turn of the century. To insure a viable and sustaining solar energy industry, the United States must continue its support of solar energy, particularly in light of ever increasing petroleum imports and tensions in the Middle East.

The U.S. solar thermal and photovtaics industry urges the continuance of a ten percent (10%) solar business tax credit through 1995. Thank you.

Written Statement to
Senate Committee on Finance,
Subcommittee on Taxation and Debt Management

Hearing on Expiring Tax Provisions
March 28, 1988
215 Senate Dirksen Building

Submitted by The Employee
Stock Ownership Association
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Washington, D.C. 20036
Contact: J. Michael Keeling

Mr. Chairman and members of the Taxation and Debt Management Subcommittee, this statement is submitted on behalf of the Employee Stock Ownership Association (the ESOP Association). The ESOP Association has approximately 1,200 members, with approximately 800 ESOP company members, 300 associate members who provide services to ESOPs, and the others representing academia, and companies considering an ESOP.

The ESOP Association offices are located at Suite 310, 1100 17th Street, N.W., Washington, D.C. 20036.

Michael Keeling (202-298-8660), General Counsel of the ESOP Association, is the prime author of this written statement.

Mr. Chairman, it is a pleasure for the ESOP Association to submit a statement regarding Code Section 4980(c)(3), or, as we say fondly in the ESOP world, the "Baucus" amendment.

The ESOP Association favors the extension of the Baucus amendment, which is scheduled to expire at the end of this year, 1988.

You recall that the Baucus amendment was adopted by a voice vote of the full Finance Committee during mark-up of the Tax Reform Act of 1986.

It was at that time that the Finance Committee decided to impose a 10% excise tax on the amount of assets reverting back to the employer upon termination of a defined benefit plan. This tax, now known as the asset reversion excise tax, was also included in the House version of the 1986 Tax Reform Act. The regular corporate income tax also applies to the reverted amounts, or the so-called "reversion."

The Baucus amendment exempts from this excise tax and the corporate income tax reversions transferred to an ESOP.

When you offered your amendment, Mr. Chairman, your basic argument was that a reversion transferred to the ESOP benefited the company's employees, and thus there was no need for the special excise tax or income tax. Of course, explicit in your amendment is the premise that ESOPs benefit employees - a premise the ESOP Association endorses and, one that we can prove over and over.

We are aware of the controversy surrounding reversions. We know that some, represented well by ERISA experts from organized labor, argue that the company sponsor has no equitable claim to a reversion, and that a reversion belongs 100% to the plan participants. We know, on the other hand, that some, represented equally well by ERISA experts from employer groups, argue that a reversion belongs completely to the plan sponsor because the reversion amount is not needed to pay for the agreed-upon defined benefit to any eligible plan participant.

The ESOP Association does not have a position on this swirling controversy. We do know that the issue of who the money belongs to was subject to sharp debate during the deliberations on the Pension Protection Act of 1987, which was included in the Omnibus Budget Reconciliation Act of 1987 (PL 100-203).

Those deliberations, despite varying interpretations by ERISA experts, left the law untouched with regard to reversions.

Little noted, except by ESOP advocates, is the fact that the Administration's original Pension Protection Act proposal recommended that the Baucus amendment be repealed one year early. This anti-Baucus amendment proposal was rejected by the House Ways and Means Committee, the Senate Labor Committee, and this committee, the Senate Finance Committee. The House Education and

Labor Committee adopted early repeal of the Baucus amendment, but their position on the Baucus amendment was discarded in conference.

Why extend the Baucus amendment?

When deciding whether to continue a tax law incentive, Congress has to answer several questions, such as:

1. Is the policy giving rise to the incentive sound public policy?
2. If the policy is sound, is the incentive encouraging the behavior intended; and
3. Is the incentive cost-effective, or does it lower revenues too much?

To answer each. Is it sound public policy to encourage the creation of more ESOPs? The answer is yes. Study after study show that ESOPs provide employees with an opportunity to accumulate a sizeable capital account to provide financial security. In fact, there is evidence that most mature ESOPs have made many employees rich. Secondly, the ESOP financing techniques enable companies to finance in a manner cutting the employees in on the "deal." As an outgrowth of ESOP creation, there is evidence of increased productivity and competitiveness of ESOP companies.

We of the ESOP Association acknowledge that there are studies disputing the above claims. Our retort is (1) these studies are fewer in number than those showing otherwise; and (2) the real-world experience of successful ESOP companies is more impressive than abstract studies, with all due respect to the world of academia.

(In support of the Association's position, see C. Rosen, "How Well Do ESOPs Reward Employees?" Pension World (February 1986) pp. 34-39; M. Quarrey, J. Blasi and C. Rosen, Taking Stock: Employee Ownership at Work (September 1985: Ballinger Publishing Company); C. Rosen, K. Klein, and K. Young, Employee Ownership in America: The Equity Solution (1985: Lexington Books).

Contained in each of these are extensive bibliographies citing further research on ESOPs.)

As to the second issue, whether the Baucus amendment resulted in more ESOPs, the answer is yes. And, particularly important, the Baucus amendment has created more ESOPs in a sector of the economy where ESOPs have traditionally been very few in number - big business.

Although we in the Association have no "scientific" research document on the Baucus amendment, we have carefully reviewed the financial and pension press since its enactment. This review proves that the Baucus amendment has opened the door to employee ownership, in a very significant way, in several of our nation's largest employers. A few examples are:

1. Enron
2. Ashland
3. Transco
4. Clark Equipment
5. American Standard
6. HealthTrust
7. Emery
8. Grand Lighty & Supply
9. Dyn Corp
10. Kerr Glass

The key point about the use of the Baucus amendment, in either a corporate recapitalization plan, or a leveraged buyout, is that without the Baucus amendment, the reversion would have been used for other corporate purposes.

But it is clear that the Baucus amendment has enabled thousands and thousands of employees to keep a claim on the reversion, whereas without the Baucus amendment they would have lost all claim to the reversion.

As to the third point, pertaining to the tax expenditures associated with the Baucus amendment, the fact is that the Baucus amendment has helped many thousands at a cost of less than $50 million per year, which is in line with the original estimates when you proposed your amendment. In a trillion dollar plus budget, an expenditure of no more than 5/1,000 of a percent cannot be termed extravagance.

Finally, the Baucus amendment, by encouraging the direct transfer of hard dollars into an ESOP, results in tremendous leverage for the employees. For example, it is reported that for a $50 million reversion in the American Standard LBO, the employees will obtain a $500 million stakehold in a $2.5 billion company -- an impressive indication of what the Baucus amendment can do.

In sum, the ESOP Association supports the extension of the Baucus amendment. We hope that the Congress will make it a permanent provision of the Internal Revenue Code of 1986.

SPECIAL REPORT

TAX ANALYSTS

RETROACTIVE PENALTIES RAISE CONSTITUTIONAL ISSUES

by John A. Corry

John A. Corry is with Davis Polk & Wardwell in New York City. This article arises from his practice, and his firm has clients who could be subject to penalties discussed in this article. *He acknowledges with thanks the helpful assistance of his associates, David C. Humphreys and Robert B. Stack.*

In this article, Corry argues that the 1986 increases in penalties assessable under sections 6656 and 6661 are unconstitutional as applied to activity which occurred before they were enacted. His argument is based on a discussion of retroactive tax legislation, noting that it has generally been permitted, although he believes that none of the retroactive legislation previously upheld presented a strong case for being overturned. The recently enacted penalty legislation is beyond the limits of constitutionally permissible retroactivity, in his view. First, they are penalty provisions, and the legislative history offers no explanation for why the increase was retroactive or why previously assessed penalties should be treated diffrently from unassessed penalties. Penalties are to deter conduct, and a retroactive penalty is imposed on action taken before the penalty existed. Certainly, it cannot deter. Furthermore, he finds no precedent for the retroactive increase of a penalty, which, until now, has been increased prospectively. Finally, the retroactive aspect of the increases derives from the distinction between penalties assessed before the date of enactment and penalties assessed after the date of enactment. The date of assessment, not the date of the conduct, determines the size of the penalty. There is no explanation of this treatment except the need to raise additional revenue. He doubts that the courts will tolerate this distinction and believes that the courts are likely to overturn the retroactive aspect of the increases.

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Introduction

Last fall, Congress passed and the President signed legislation that goes well beyond any precedents in imposing income tax penalties retroactively. Before counting on the extra revenue dollars that retroactivity provides, however, Federal budget estimators should bear in mind the significant possibility that the courts will declare the legislation's effective date provisions invalid on constitutional grounds.

These retroactive penalty increases were enacted as part of the Omnibus Buget Reconciliation Act of 1986 (the "Act"). Section 8001 of the Act provides for a doubling of the previously effective penalty for underpayments of tax deposits under section 6656 of the Code[1] from five percent to 10 percent. In addition, section 8002 of the Act increases from 10 percent to 25 percent the penalty for substantial underpayment of tax contained in section 6661. Both provisions apply to penalties *assessed* after the date of enactment, i.e., after October 21, 1986.

Penalties are, of course, assessed well after the taxpayer has filed his return, and thus these provisions permit the Internal Revenue Service to collect significantly increased penalties relating to tax periods for as many years back as are not barred by the statute of limitations.[2]

This retroactive legislation raises in particularly acute form questions of constitutional due process and equal

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[1]Unless otherwise noted, all section references are to sections of the Internal Revenue Code of 1986.

[2]The section 6661 penalty in fact was inadvertently repealed the next day. At the same time that Congress was passing the Act, it was enacting the Tax Reform Act of 1986 ("TRA 86"), which doubled to 20 percent the penalty for substantial underpayment of taxes, but effective only prospectively for returns filed after December 31, 1986. Because President Reagan signed TRA '86 the day after he signed the Act, rather than prior to signing the Act, the 20 percent prospective penalty rather than the 25 percent retroactive penalty is effective at present. However, according to the Joint Committee General Explanation of TRA, "Congress intended that the increase in this penalty provided by the Omnibus Budget Reconciliation Act supersede the increase provided by the Tax Reform Act, regardless of which was enacted first. A technical correction may be needed so that the statute reflects this intent." Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, 100th Cong., 1st Sess. 340 (May 4, 1987). Section 115(c) of the proposed Technical Corrections Act of 1987, S. 1350; H.R. 2636, 100th Cong., 1st Sess. (1987), contains this technical correction.

protection of the laws whose outer limits have not yet been tested. In this connection, two introductory considerations are relevant. The first is that this retroactive legislation relates to penalties rather than to taxes.[3] Second, since it is well established that the prohibition against *ex post facto* laws in Article I, Section 9 of the Constitution applies only to criminal statutes, it does not bar imposition of these increased penalties.

This retroactive legislation raises . . . questions of constitutional due process and equal protection of the laws. . . .

Retroactivity: General Principles

In part because all tax penalties previously enacted have been imposed only on a prospective basis, there is no judicial precedent involving the constitutionality of their retroactive application. Nevertheless, certain principles appear to be well established. First, it seems reasonably clear that a new tax may be imposed only on a prospective basis.[4] Second, limited retroactivity is allowed for changes in income tax rates. Indeed, it is fairly common for changes in tax laws that are enacted during a year to apply to that whole year and, in certain cases, to prior years.[5] Finally, the courts are particularly hesitant to overturn retroactive legislation which is enacted to reverse a result that was generally unexpected.[6]

[3]Although section 6661 by its terms refers to an addition to tax rather than a penalty, the Act's effective date provision specifically states that it "applies to *penalties* assessed after the date of enactment of this Act" (emphasis added).

[4]*Untermyer v. Anderson*, 276 U.S. 440 (1928).

[5]Thus, in *United States v. Darusmont*, 440 U.S. 292 (1981), the Court upheld the application of the retroactive application of an expanded minimum tax on tax preference items to gain from a sale effected on July 15, 1986, although the statutory amendment was not enacted until later in that calendar year. Probably the greatest degree of income tax retroactivity approved by the Court involved a Wisconsin revenue bill adopted in 1935 that taxed corporate dividends received in 1933. In *Welch v. Henry*, 305 U.S. 134 (1938), after referring to prior decisions that upheld tax legislation that was retroactive for only one year, the Court pointed out that in part since the Wisconsin legislature at that time met only every other year and because the tax legislation in question was intended to meet unprecedented emergency needs created by the Great Depression, it should be viewed as valid.

[6]A good example of this type of legislation was involved in *Wilgard Realty Co. v. Commissioner*, 127 F.2d 514 (2d Cir. 1942). *Wilgard Realty* upheld the constitutionality of 1939 legislation that retroactively repealed the unanticipated decision of the United States Supreme Court in *United States v. Hendler*, 303 U.S. 567 (1938), that the assumption of a transferor's indebtedness under a prior version of 1954 Code section 351 constituted the equivalent of "other property" or money. Had it not been legislatively overridden, *Hendler* would have provided transferees with stepped-up bases for property acquired in transactions that generally had been considered to provide carryover bases because they were thought to be nontaxable. In *Wilgard Realty*, the Second Circuit stated that retroactive income tax legislation will not be unconstitutional "if it is no more burdensome than the taxpayer should have expected it to be when he did the thing which created the tax liability." 127 F.2d at 517.

After a long drought of judicial decisions involving the constitutionality of retroactive tax legislation, the Supreme Court recently has addressed one retroactive tax statute and shortly will be called upon to consider another. In *United States v. Hemme*, ___ U.S. ___ (1986), 86-1 U.S.T.C. Para. 13,671, the Court upheld the constitutionality of a retroactive reduction in the unified credit that a taxpayer can apply to a decedent's estate or gift tax liability. The Court reiterated its earlier determination in *Welch v. Henry*, *supra*, that retroactive tax legislation will be declared unconstitutional only if "its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." 305 U.S. at 147. In *Hemme*, the Court denied the taxpayer's challenge, finding that the credit that had been reduced was not in the Internal Revenue Code at the time the taxpayer made the gift in question, that the taxpayer was no worse off than he would have been if the credit had never been enacted, and that in any event the taxpayer was out-of-pocket only a few thousand dollars as a result of the credit reduction. Thus, the Court held that the taxpayer was not sufficiently aggrieved to warrant setting the statute aside. On the other hand, by its close factual analysis in *Hemme*, the Court appears to have left open the possibility that it might reach a different result in a more egregious situation.

There is no judicial precedent involving the constitutionality of [retroactive penalties]. . . .

The Court will have the opportunity this fall to consider a case that might be viewed as falling in that category. In 1984, the District Court for the Northern District of Illinois held that certain short-term project notes issued by public housing agencies were exempted from Federal estate tax by the Housing Act of 1937, pursuant to which they were issued. *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984). With Judge Posner dissenting, the Seventh Circuit affirmed *per curiam*. 757 F.2d 920 (1985). In section 641 of the 1984 Tax Reform Act ("TRA 84"), Congress immediately reacted to the District Court decision in *Haffner* without waiting for the Seventh Circuit's ruling by specifically making such project notes taxable in the case of decedents dying and *inter vivos* gifts made on or after June 19, 1984, which appears to be the date on which the legislation was approved by the Conference Committee. Section 641(b)(2) also made this provision applicable to the estates of decedents dying, and to gifts made *prior* to June 19, 1984, "if at any time there was filed an estate or gift tax return showing such transfers as subject to Federal estate or gift tax." The statute further provided that no inference should be drawn from its enactment as to the taxability of transfers made prior to June 19, 1984.[7]

[7]Section 642 of TRA 84 required taxpayers to report all transfers of project notes occurring after December 31, 1983 and before June 19, 1984.

Therefore, the effect of these statutory provisions was to overturn the *Haffner* pro-taxpayer result prospectively, as well as to overturn *Haffner* retroactively in any case in which a taxpayer or his estate had filed a tax return reporting the project notes as subject to tax. The provisions did not apply to notes transferred before June 19, 1984, or to notes transferred by persons dying before that date where any tax return that was filed did not report the notes as subject to tax. This was true even if the tax return had disclosed the transfer of ownership but had taken the position that no tax was payable.

The District Court found that...'retroactive removal' of an...exemption was equivalent to... an entirely new tax....

As a result of this legislation, judicial proceedings have been instituted by a number of taxpayers, claiming that the retroactive aspects of the legislation violate both the due process and equal protection clauses of the Constitution. In a consolidated memorandum opinion applying to two of these cases, *Crocker National Bank v. United States* and *Rosenberg v. United States*, the District Court for the Central District of California invalidated the legislation on both grounds. 86-2 U.S.T.C. Para. 13,703. After agreeing with the *Haffner* court that the project notes were nontaxable, the District Court found that what it considered to be TRA 84's "retroactive removal" of an estate tax exemption was equivalent to the imposition of an entirely new tax and hence invalid under the rule of *Untermyer v. Anderson, supra*. It further found that the distinction between two otherwise identical estates which differed only in whether they had listed the project notes as taxable assets, had "absolutely no rational basis." The court did not deny that the evident purpose of the distinction was to prevent persons from joining "the bandwagon in the wake of *Haffner* in anticipation of a windfall." It found, however, that this legislative purpose was inadequate to justify the distinction because it was "impermissible" to "deny persons those windfalls based on speculation about the legal position that they have taken...."[8]

If the Supreme Court decides that *Haffner* was incorrectly decided as a matter of statutory construction, it will not have to address the constitutional issues. On the other hand, if it agrees with the Seventh Circuit that these project notes were not subject to estate tax, the taxpayer's attack on the constitutionality of TRA 84's retroactivity would appear to be somewhat weaker on the due process issue than on the equal protection of the laws ground. Although there may be some merit to the District Court's conclusion that this retroactive repeal of an exemption does not satisfy constitutional due process because it is a new tax, i.e., this is the first time that these notes have been subjected to tax, the government can argue convincingly that taxpayers should have recognized that there always had been some doubt as to the estate tax status of these notes. As the Solicitor General's Jurisdictional Statement in *Crocker* points out (p. 11):

> ...common sense suggests some implausibility in the *Haffner* courts' discovery, in the early 1980s, of an estate tax exemption that had gone unclaimed by taxpayers, unacknowledged by the IRS, and unrecognized by the courts for some 45 years. Generally speaking, tax exemptions of billion-dollar magnitude do not lay dormant for such extended periods of time, invisible to the ever-watchful eyes of the private tax bar.

And as the Jurisdictional Statement notes (p. 13):

> There is nothing 'harsh and oppressive' about a statute that merely holds a taxpayer to his own treatment of items on a tax return that he himself prepared.

The taxpayer's chances of success on the equal protection of the laws issue probably are stronger. Any experienced tax lawyer knows that a decision whether or not to report an asset as taxable often turns on procedural questions that have little to do with the perceived strength of the taxpayer's position. The most common example involves a situation in which the taxpayer expects to be challenged on audit and would rather be in a position to litigate the issue in a district court or the Claims Court instead of the Tax Court. Further, although taxpayers dying before the effective date of TRA 84 probably could not have predicted its enactment, TRA 86 creates a strong incentive for prompt payment of tax on doubtful items by making interest paid on deficiencies greater than interest on refunds and by making the interest paid on deficiencies nondeductible.[9]

A decision whether or not to report...often turns on procedural questions....

Accordingly, as a matter of tax policy, it is undesirable for a substantive tax result to turn upon a taxpayer's decision whether to report an asset or receipt as taxable or not to do so. In the case of the anti-*Haffner* provisions in TRA 84, the distinction is perhaps even more egregious because the executor of a taxpayer who died before its enactment might as a conservative matter have reported the obligation as taxable whereas on a subsequently filed

[8] In *Netsky v. United States*, 652 F. Supp. 783 (E.D. Pa. 1986), 58 A.F.T.R. 2d (PH) 86-3687, appeal pending to the Third Circuit, the court reached the same conclusion as the court in *Crocker*. On the other hand, in *Estate of Bradford v. United States*, 645 F. Supp. 476 (N.D. Cal. 1986), appeal pending to the Ninth Circuit, the court, after following *Haffner*, concluded that the retroactive 1984 legislation was constitutional. In *Shackelford v. United States*, 649 F. Supp. 1347 (E.D. Va. 1986), appeal pending to the Fourth Circuit, the court held that *Haffner* was wrongly decided and accordingly had no occasion to reach the constitutional question.

[9] Code section 163(h)(2)(E); and *compare* sections 6621(a)(1) and 6621(a)(2).

return an executor probably would have a fiduciary duty to refrain from reporting the obligation as a taxable asset regardless of his previous views concerning its taxation, since to do otherwise would result in the application of estate tax with no possibility of a refund.

Thus, there appears to be some basis for the Supreme Court to invalidate the retroactive anti-*Haffner* provision as not satisfying the equal protection of the laws requirement. In convincing the Court to do so, however, the taxpayer will have to overcome the truism that, all other things being equal, a taxpayer who is confident as to his position is more likely to treat an item as nontaxable than a taxpayer who is not. Indeed, if a taxpayer is sure that an asset is nontaxable, it is difficult to believe that he would report it as taxable. Thus, if Congress' purpose of limiting retroactivity was to deny windfalls to taxpayers who had already reported the project notes as taxable prior to *Haffner* because they had not appreciated that the contrary result was a possibility, that distinction probably satisfies the strong presumption that tax legislation is constitutional even though other taxpayers who reported the notes as taxable merely did so out of excess of caution with the expectation that they would seek refunds of the taxes in question.[10]

The retroactive penalty legislation . . . presents a far stronger case for invalidation on constitutional grounds.

Retroactivity: The Penalty Provisions

The retroactive penalty legislation that was enacted last year, however, presents a far stronger case for invalidation on constitutional grounds. The legislative history of these provisions offers no indication as to why they were made retroactive or why a distinction was drawn between assessed and unassessed penalties. One can surmise, from the nature of the legislation in which the retroactive increases are included, that some saw the possibility of significant increased revenue amounts by applying the penalties retroactively. The only apparent reason for the law's distinction between assessed and unassessed penalties appears to be that it is easier to collect a tax or penalty from a taxpayer who is still in audit than it is to collect from a taxpayer who is not. Nevertheless, if the statute of limitations for assessments has not yet run, there is no statutory bar to collection of penalties for previous years.

One reason why these retroactive penalties are subject to a more persuasive constitutional challenge than the anti-*Haffner* legislation is that they involve penalties rather than taxes. In this connection, it may be significant to note that invalidating a retroactive tax in *Welch v. Henry, supra*, the Supreme Court stated:

> Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. 305 U.S. at 146.

[10]The legislative history of the 1984 Act contains no explanation for the distinction.

Since the purpose of these penalties is to deter improper reporting or depositing, to increase them after the fact cannot influence a taxpayer's past conduct.[11] Further, although these are not new penalties, the extent of their increase (200 percent of the prior rate in one case and 250 percent in the other) is so great that an argument can be made that they are the equivalent of new penalties and hence invalid under the rule of *Untermyer v. Anderson, supra*.

I have found no cases in which penalties have been increased retroactively. . . .

An even stronger basis for challenge on due process grounds is the totally unexpected nature of the retroactive aspect of this legislation. I have found no cases in which penalties have been increased retroactively rather than prospectively. Thus, all previous amendments to section 6656, as well as sections 6656 and 6661, as originally enacted, applied prospectively only.[12] Indeed, as I have already noted, in the simultaneously enacted 1986 Tax Reform Act (which was the legislation to which tax practitioners were devoting their full attention) the substantial understatement penalty was being doubled on a prospective basis only.[13]

An equally strong equal protection clause attack can be mounted against the retroactive legislation on the basis that there are no rational grounds for distinguishing between taxpayers and depositors against whom penalties have been assessed and those against whom they have not been assessed. Although assessment is an important formal step in the tax collection process, the date of assessment is and should be acknowledged as irrelevant in determining the effective date of an increase in a tax or penalty. As anyone who regularly practices before the Internal Revenue Service knows, the date on which a tax is assessed will turn upon, *inter alia*, whether

[11]Thus, the section 6661 substantial understatement penalty was added to the law so that "taxpayers should be deterred from playing the audit lottery through the imposition of a penalty designed to deter the use of undisclosed questionable reporting positions." General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (p. 216); S. Rep. No. 494, 97th Cong., 2d Sess. 272-73.

[12]Prior to 1986, section 6661 never had been amended.

[13]In this context, the statement contained in footnote 14 at p. 1277 of the Joint Committee Explanation of TRA 86 that Congress intended the Omnibus Budget Reconciliation Act of 1986's 150 percent retroactive increase in the section 6651 penalty to apply, rather than the prospective 100 percent increase of that penalty in TRA 86, is somewhat suspect. If Congress truly had this intent, would not it have deleted the penalty increase from the TRA 86 prior to its enactment? The discrepancy, of course, demonstrates what all tax lawyers know about legislative intent, i.e., on narrow issues such as this, Congress often has no intent at all but merely automatically ratifies the myriad of decisions made by staffers. It seems likely that their interest in and concern over constitutional issues probably is negligible. A contention that such legislation should be presumed to be constitutional because it represents Congressional intent thus should be subject to serious question.

the taxpayer accedes to the agent's request to extend the statute of limitations (as the taxpayer usually does), the complexity of the issues being considered on audit, and the degree of lethargy of taxpayer's representatives and the IRS officials that are conducting the audit process. It is not unusual for more than five years to elapse between the date a tax return is filed and the date on which, either as a result of a compromise tax liability agreed upon by the Service and the taxpayer or as a result of a failure to agree, a tax or penalty actually is assessed.

The assessment date can be delayed further because of the taxpayer's decision whether to litigate an unagreed case in the Tax Court or in a district court or Claims Court. In the former case, the tax will not be assessed until the judicial process has been completed, which could be an additional period of several years following the date on which the taxpayer and IRS agree that settlement is impossible and the case must be litigated. On the other hand, if the taxpayer wishes to litigate an unagreed case in the Claims Court or a district court, he must first pay the tax by waiving the restrictions on assessment contained in section 6213. It subverts the administrative process to impose a penalty on a taxpayer that chooses to litigate an unagreed issue in the Tax Court but not on an identically placed taxpayer that seeks to litigate the same issue in a suit for refund. Similarly, it defies logic to apply this drastically increased penalty to taxpayers that have contested the lower penalty because they believe they can demonstrate reasonable cause for the late deposit or substantial authority for the underpayment[14] while imposing a lower penalty that previously existed on taxpayers who, because they believe they have no mitigation defense, have promptly agreed to pay the penalty at the lower rate.

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[14]Sections 6656(a) and 6661(a)(2)(B)(i), respectively, provide for mitigation of these penalties in the case of reasonable cause or substantial authority.

Conclusion

These retroactive penalties raise constitutional issues of a kind that the courts never have had to consider. It is hard to imagine retroactive legislation in the tax area that could be more egregious and unfair. If the retroactivity of this legislation is to be sustained, the IRS and Justice Department, as well as the Supreme Court, will have to consider carefully whether any penalty can be so "harsh and oppressive as to transgress the constitutional limitation"[15] and if so, what type of legislative penalty that would be if this is not it. It therefore seems likely that this issue will be litigated and it thus behooves all taxpayers faced with the issue to reserve their rights in this area. In addition, any Federal budget preparers who have been counting on increased revenue from these retroactive penalties would do well to consider the possibility that their anticipated revenue gain will not survive judicial challenge and hence will prove illusory.

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[15]*Welch v. Henry, supra*, 305 U.S. at 147.

PRIOR COVERAGE

Retroactivity has been discussed at some length in the following *Tax Notes* features:

"Effective Dates of Tax Reform Legislation," a special report by the New York State Bar Association Tax Section, March 3, 1986, p. 863.

"Recommendations for Proposed Tax Straddle Regulations Under Sections 1092 and 1256," a special report by the Committee on Commodities and Financial Futures of the New York State Bar Association Tax Section, May 28, 1984, p. 973.

Letter from Converse Murdoch to Commissioner Roscoe L. Egger, Jr., May 28, 1984, p. 993.

Statement of

UAW-CHRYSLER LEGAL SERVICES PLAN
UAW-FORD LEGAL SERVICES PLAN
UAW-GM LEGAL SERVICES PLAN

on the subject of

S.2119 - TAXATION OF GROUP LEGAL SERVICES PLANS

March 28, 1988

The UAW Legal Services Plans [UAW-Chrysler Legal Services Plan, UAW-Ford Legal Services Plan, and UAW-GM Legal Services Plan], appreciate the opportunity to submit written comments on S.2119.

Our Plans came into being, and have been allowed to grow, under the protective umbrella of Internal Revenue Code Section 120. This section enabled employers' prepaid legal service arrangements for their employees to be put on the same footing as older employee fringe benefits. Unfortunately, Section 120's income exclusion expired last December 31st.

On behalf of the worker and retiree families our Plans serve, we strongly urge the Finance Committee to approve the bill introduced by Senators Heinz and Moynihan [S.2119] to restore permanently the tax exempt status of this worker benefit.

Section 120's original sponsors believed that it would make quality, affordable legal service available to working families. The growth in group legal service plan coverage, from 25,000 to over 6.2 million people, signals its success.

Each of our Plans was negotiated by UAW after Section 120 was enacted. The existence of each is dependent upon Section 120's protection and encouragement. The parties who collectively bargained these legal service programs would not have done so without tax provisions placing legal service on a par with other, older fringe benefits.

This Subcommittee has already received testimony and statements from representatives of labor, the organized bar, and consumers in support of the reinstatement of Section 120. We associate ourselves with the statements of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America [UAW]; Laborers' International Union of North America, AFL-CIO; American Bar Association; and the National Resource Center for Consumers of Legal Services. These statements relate the history of Section 120, and describe the concerns leading each group to support Section 120's reinstatement.

Those statements also explore Section 120's tax revenue implications. In a nutshell, they show the anticipated revenue gains from Section 120's expiration are small and ephemeral. Yet the price of this questionable gain will be the loss of much of the Congress's goals in creating Section 120. Our statement tries to illustrate that loss by briefly relating what our Plans, as fairly representative full service plans, have done for Section 120's worker beneficiaries. Our experience suggests Section 120 achieved Congress's social purposes of simple equity in access to legal service and of peaceful dispute resolution, and deserves to be reinstated.

Now in the tenth year of operation, our Plans have opened over a million cases for the families of active, laid-off and retired autoworkers. In 1987 almost 850,000 families were covered by our Plans.

A hallmark of group legal service plans is prearrangement for lawyers. Operating across the country, through staff and private attorneys, we have seen what prearranged access to affordable legal service means to working families. Our experience has been that easy availability of legal advice tends to bring legal matters to professional attention early. The consequence is prevention of problems and timely resolution of disputes. Generally people want a helping hand, not a hired gun.

Time after time our autoworker families simply want information on their legal rights and duties, or assistance in routine matters rather than representation for contested litigation. As a result, even though our Plans provide fully paid litigation service in a wide range of proceedings, much of our litigation is actually in such fairly uncontested matters as probate of estates and bankruptcies. So in 1987, while our Plans were opening 245,633 new cases, only 5,505 resulted in covered contested litigation - barely 2%.

That resolution rather than conflict should flow from access to prearranged, affordable legal representation is hardly surprising. Typically, working families turn to lawyers only when they have to, e.g., for criminal proceedings and personal injury suits. Easy access to legal service brings planning concerns to the fore - real estate assistance and wills are perhaps most representative of this phenomenon - where the role of attorneys is to provide assurance and to facilitate the clients' wishes.

Similarly, having timely professional advice available allows families to take self-help steps to solve disputes without litigation, or to handle matters in appropriate forums without lawyers. This illustrates Section 120 plans' potential for reducing the burden on our courts and enhancing the confidence and skills of beneficiaries.

Of course, not all problems are subject to prevention or self-help. We also see cases involving complex issues and serious conflicts of rights and duties. Access to affordable legal services permits these cases to be confronted, where before they had to be wished away or left to fester. We cannot recount how many nagging disputes and potential battles - between neighbors over uncertain boundary lines, between family members over responsibilities for the care of aged or disabled parents or siblings, between homeowners and government agencies over assessments and condemnations, between owners and builders over home repairs, and between consumers and the sellers over the performance of products - have been resolved or successfully concluded through an attorney's patient analysis, discussion, and negotiation. Section 120 let beneficiaries of qualified group legal service plans get the professional time so frequently needed for in-depth analysis and judgment.

Finally, there are those situations which require litigation and Section 120 allowed families covered by qualified group legal service plans to obtain the aggressive representation that true access to justice requires. Our Plans, like many Section 120 plans, focus their litigation coverage on areas where previously representation was rarely obtained, e.g., consumer and real estate matters. Lack of money for litigation has not been allowed to permit workers' wages to be unfairly attached, or their cars to be improperly taken and sold, or their guaranteed mortgage rates to be lost through unreasonably short commitment periods, or their fire-damaged property to go unrestored because of dilatory insurers, or their homes to go unrepaired because they lacked the money to correct a builder's defective work.

Everyone associated with our Plans is proud of what we have achieved for our beneficiaries. Our experience demonstrates the value of tax exempt prepaid group legal service plans. Section 120 did work. Let its goal - simple equity in gaining access to justice for working people - continue to be realized. We urge you to enact S.2119 this session.

STATEMENT OF
VIETNAM VETERANS OF AMERICA, INC.

Submitted By

PAUL S. EGAN
LEGISLATIVE DIRECTOR

on

REAUTHORIZATION OF THE TARGETED JOBS TAX

CREDIT PROGRAM (TJTC)

MARCH 28, 1987

Mr. Chairman and members of the Subcommittee, the Vietnam Veterans of America, Inc. appreciates this opportunity to submit its views on extending the Targeted Jobs Tax Credit program (TJTC). This program has demonstrated its ability to assist several targeted groups of economically disadvantaged individuals in a most unique way. In essence, the TJTC program harnesses the productive energy of the private sector by offering tax incentives to businesses willing to employ economically disadvantaged individuals. In doing so, the TJTC program constitutes a model public-private sector partnership in which legitimate public policy goals are, and ought to continue to be, met.

For economically disadvantaged Vietnam era and disabled veterans, this program has been a genuine success. Many veterans, continuing to experience readjustment problems following military service, have been able to utilize the TJTC program as a way of developing good work habits enabling them to subsequently move into better paying positions. Often these veterans have, and continue to sustain, psychological readjustment problems stemming from combat in Vietnam. For many of these individuals, the TJTC program has stood as the only safety net offering protection against permanent structural unemployment.

We are fully aware of the fact that most of the jobs made available under the TJTC program are in service industries offering low paying wages.

Nevertheless, for the veterans using the program, jobs paying higher wages are often beyond their emotional stability level. The work habits gained in TJTC-provided jobs are just the preparation that these veterans need on a short term basis. In working at these jobs on a regular basis, these veterans often restore the self respect and stability needed to make practical career decisions for their futures.

At present approximately 20 percent of all TJTC-provided jobs are occupied by veterans. However, the pool of veterans needing this type of assistance may grow precipitously as the national economy continues its dramatic transformation from one based on heavy industry and manufacturing to a largely service-based economy. In this connection, we already know that while veterans represent a mere 14 percent of the work force, they constitute a rather bloated 26 percent of the population of dislocated workers. Yet another indicator of what is happening to veterans generally in the current economy is that veterans are estimated to constitute between 30-40 percent of the homeless population.

In our view there is an obvious connection between the disproportionate share of displaced workers who are veterans and the apparent increase in the numbers of homeless veterans. As a matter of factual economic history in the readjustment of Vietnam era veterans from military to civilian life, most Vietnam veterans were disadvantaged in the workplace by contrast with their similarly aged non-veteran peers. This is because veterans were serving in the military while their similarly aged non-veteran peers were getting trained, educated and employed. Veterans got their training later and necessarily entered the job market too late to compete on equal footing with non-veterans in the same age group. With the understanding that this particular generation (veterans and non-veterans combined) is known by demographers as the "pig in the python", it is relatively easy to understand the competitive economic dynamic that has made it more difficult for Vietnam era veterans to secure employment comparable to what was earlier available to similarly aged non-veterans who were trained and employed while veterans served.

The consequence of this phenomenon was a disproportionate concentration of over-qualified veterans, who received training after service, in the heavy industry and manufacturing sectors of the economy. As workers in these sectors have been increasingly laid off and as numerous plants have been shut down, veterans have been among the hardest hit of the various groups of workers having been displaced.

The period of time it takes to lose one's home, family, self respect and positive work habits is rather short when employment with comparable earnings cannot be found. The net result in our view, is record high VA home loan foreclosure rates, large infusions of new entrants to the homeless population and similarly large new infusions into the population of structurally unemployed. In each of these latter two categories, the TJTC program holds obvious potential as an important way to interrupt the downward spiral from self respecting, self supporting worker to unemployed homelessness.

The legislation to extend this program, S.684, would reauthorize the program for an additional year. In our view this program has earned the right to be made permanent with possible modifications in order to make it attractive to businesses offering training for more highly skilled, better paying jobs. Nevertheless, the program should be extended for at least another year and the Vietnam Veterans of America strongly encourages this subcommittee to do so.

DEPARTMENT OF EMPLOYMENT SECURITY
Charleston 25305-0112

Arch A. Moore, Jr.
Governor

Adna Irl Thomas
Commissioner

March 16, 1988

SENATE FINANCE SUBCOMMITTEE
ON TAXATION AND DEBT MANAGEMENT

The TJTC program has proven to be one of our best methods of encouraging employers to hire persons who normally have difficulty competing in the job market. The program is particularly effective when used in cooperation with other state agencies in finding suitable employment for AFDC recipients, the handicapped, and ex-offenders. Members of these groups have extraordinary difficulty in finding acceptance in the job market and the financial incentive offered by the TJTC program is often the critical factor in the decision to hire. We have had excellent results with this program and urge you to extend it again.

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Herbert R. Northrup, Director

Wharton

The Wharton School of the University of Pennsylvania

April 5, 1988

Dear Congressperson:

I am pleased to enclose herewith a copy of the Executive Summary of the forthcoming book, Wage Subsidies and Jobs for the Disadvantaged: Applying the Targeted Jobs Credit in an Operating Environment.

In line with its commitment to publish matters of vital interest in public policy, the Wharton School's Industrial Research Unit will issue this study later in 1988. It differs from most in that it is the story of how one company utilized TJTC to provide itself with a labor force while at the same time giving work and an introduction to industrial society to disadvantaged persons. We believe that it is a story worth telling, and one that should be heard as part of the information helpful to Congress in determining whether, in this era of difficult decisions in regard to public spending, the funding for the TJTC program should be continued as the author, Dr. Joseph W. Arwady, clearly believes. For this reason, we are issuing this executive summary prior to the publication of the book.

Dr. Joseph W. Arwady is uniquely qualified to make this study. He received his Ph.D. from Ohio State University, and directed the research center at Virginia State University before entering private industry. The author of thirty articles and one book, Dr. Arwady is now Director of Performance Management, Baker Industries, Inc., a subsidiary of Borg-Warner, Inc. In this post, Dr. Arwady has worked with the program which utilized the TJTC and observed the problems related thereto, which policies worked and which did not, and the values involved for the disadvantaged, for industry, and for society. Whether one agrees with his views, the information supplied is surely of general interest. Of course, as in all publications of the Industrial Research Unit, the author is solely responsible for the opinions expressed, and they should not be attributed to the University of Pennsylvania or any division thereof.

Cordially yours,

Herbert R. Northrup

Herbert R. Northrup
Professor of Industry

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MANPOWER AND HUMAN RESOURCES STUDIES
No. 12
(Executive Summary)

WAGE SUBSIDIES AND JOBS FOR THE DISADVANTAGED: APPLYING THE TARGETED JOBS TAX CREDIT IN AN OPERATING ENVIRONMENT

By Joseph W. Arwady, Ph.D.

University of Pennsylvania
The Wharton School
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INTRODUCTION

The Targeted Jobs Tax Credit (TJTC) has induced Borg-Warner Protective Services to favor disadvantaged workers in recruitment, hiring, pay, and retention. The process was evolutionary. It moved from difficult beginnings with field units showing apathy, bias, and resistance to a mature program with the organization obtaining 1 percent of all TJTC certifications issued nationwide in 1985, and a projected 1.5 percent of those issued in 1987.

While the operations may not be unique, as other employers have become large users of TJTC as well, the Borg-Warner program is noteworthy in its design, importance within the organization, and intensity of execution at the local level. In that regard, the study can make a contribution to broadening the general public's understanding of the program and, more specifically, provide legislative, research, and user groups with the first analysis of TJTC presented from an employer's perspective.

Background of TJTC Legislation

From a public policy perspective, the targeted employment subsidy is designed to stabilize and impact the unemployment rate of certain disadvantaged workers. By creating an "employment advantage" for blacks, youth, handicapped, and other targeted workers, the federal government is attempting to offset an historical imbalance in the distribution of the unemployment burden. TJTC is one of several programmatic efforts on the part of the federal government to induce private employers to hire economically disadvantaged workers. The Job Training Partnership Act (JTPA) and the Work Incentive (WIN) tax credit are other examples. During the program's eleven years, Congress has continued to redefine TJTC in order to boost employer utilization and improve the program's cost-to-benefit ratio.

1978 - 1981. The Revenue Act of 1978 provided employers with a wage subsidy to offset the cost of hiring disadvantaged workers. The subsidy was extended to seven target groups, including youth (16-18 years old) in cooperative education programs. Credits could be claimed retroactively for employees already hired, as well as for new hires, at 50% of wages up to $6,000 in the first year of employment and 25% of wages up to $6,000 in the second year of employment.

1981 - 1982. The Economic Recovery Tax Act of 1981 eliminated (1) credits for cooperative education participants who were not economically disadvantaged and (2) retroactive certifications, both aspects of the program that afforded tax credits for people who had already been hired or would have been hired in the absence of the credit. The 1981 Act also added AFDC and WIN recipients as two new target groups, dissolved the separate WIN program and extended the TJTC legislation through December 31, 1982.

1982 - 1984. The Tax Equity and Fiscal Responsibility Act added a new target group--economically disadvantaged summer youth--and extended the legislation through December 31, 1984.

1984 - 1985. The Deficit Reduction Act extended the program an additional twelve months through December 31, 1985.

1986 (first nine months) Congress did not pass the Tax Reform Act in 1985 and the TJTC legislation expired.

October, 1986 - 1988. The Tax Reform Act, passed in October, reinstated the TJTC program retroactively to January 1, 1986, and through December 31, 1988. Target groups remained the same but the second year credit was eliminated and the first year credit was reduced to 40% of the first $6,000 in wages. A new minimum work requirement was added that awarded credit only for certified employees who worked either 120 hours or 90 days.

Description of the Study

The B-WPS report is based on an ex post facto field study. The study was conducted to measure the impact of the company's employment operations on the recruitment, hiring, and retention of targeted workers during 1983, 1984, and 1985. No attempt was made to draw direct relationships between specific independent variables, i.e., program operations, and the three dependent variables selected for study. The dependent variables were assessed more in terms familiar to a businessperson than a researcher. The measures were descriptive and the conclusions regarding significance were based on practical standards for performance. The three dependent variables were hiring, pay, and retention of TJTC versus non-TJTC workers. The null assumption was that there had been no difference between the performance of the TJTC and non-TJTC groups on these measures, despite the company's efforts to recruit, select, and schedule workers in ways that would increase the number of eligibles and the wages they earned.

In terms of its generalizability, the study has implications for (1) large users who take steps to integrate TJTC into standard business operations, and (2) firms in the contract security or other decentralized service industries.

Borg-Warner Protective Services and the Contract Security Industry

Borg-Warner Protective Services is the largest provider of contract security services in the world. The company consists of five divisions including two large guard units--Burns International Security Services and Wells Fargo Guard Services--and three other units that provide other contractual security services. These are Wells Fargo Armored Service Corporation, Wells Fargo Alarm Service and Pony Express Courier Corporation. The two guard firms are the subject of the field study, although all five units are TJTC users.

In the United States, the contract security industry consists of approximately 11,000 firms that employ over 1.1 million guard employees. The industry is highly fragmented and overall entry barriers are low. The five largest firms control less than 20 percent of the market. Net profit margins average only 4-5 percent with wages typically accounting for 60 to 75 percent of the contract bid price.

Burns and WF Guard are wholly-owned independent business units. They function autonomously in more than 170 domestic locations. Field units in thirty large city markets, where both firms operate, compete as intensely with one another as with any other competitor. The internal competition between units characterizes the two division's TJTC operations as well. For this reason, the study describes Burns and WF Guard unit performance, as well as combined Borg-Warner Physical Security (B-WPS) performance.

The contract guard industry presents disadvantaged workers with skills and experiences that are fundamental to ~~productive~~ work and useful in obtaining better paying, higher skilled jobs. Most guard assignments require the worker to execute independently. The employee must arrive on time, maintain a log of activities and events, secure the premises on schedule, and stand ready to follow procedures in cases of emergency. Post assignments are wide-ranging in difficulty and importance. From highly sensitive nuclear facility protection to maintenance of computer switching centers to monitoring the perimeter of a construction site, each post assignment requires customized on-the-job training. Area or site supervisors provide initial training to new employees. Counseling and follow-up training are ongoing to ensure that each employee progresses to a point where he is able to manage job functions independently. More than most other entry level jobs, contract security ensures that employees meet standards for appearance, punctuality and individual accountability.

PREVIOUS RESEARCH

The practical value in conducting research on TJTC lies in the contribution it makes to understanding what is working and what is not, and how the TJTC program can be improved. Research findings on TJTC have been limited by the small number of investigations and the inconsistencies in design, intent, and focus of the studies that have been conducted. The most comprehensive study, financed by the Department of Labor and reported in 1986, presents a mixed review of the program's impact.[1] A 1987 summary of research findings, prepared by the Library of Congress' Congressional Research Service, points to inconsistencies and gaps in the TJTC evaluations completed thus far, but labels TJTC unsuccessful in light of available evidence.[2] A 1987 George Washington University report concentrates on both research findings and methodological limitations drawing the conclusion that wage subsidies may be effective in ameliorating work opportunities for the poor, but that the federal government needs to take a more active role in promoting TJTC.[3]

Of the three sources cited above, only the Labor Department study is based on original research. The lead researcher on this project and on TJTC in general is

John Bishop, who has written extensively on TJTC and on the general purposes and requirements of wage subsidies. Bishop tends to favor the use of wage subsidies as incentives to promote employment opportunities for certain groups of workers. He remains a proponent of TJTC in concept, given its potential to increase work opportunities for the poor, but believes changes in design and administration are necessary.[4]

Original research has also been conducted by Edward C. Lorenz who, as coordinator of the State of Maryland's TJTC program, studied income gains, retention and vouchering for population samples in Maryland and Missouri.[5] Gary Burtless of the Brookings Institute, participated in a controlled experiment to test the effectiveness of TJTC in Dayton, Ohio.[6] The Lorenz study reflected favorably on income gains and the effects of prevouchering as a job search assistance tool,[7] while Burtless found that the use of vouchers could place eligible workers at a disadvantage by creating a stigma and reducing their chances for employment.[8]

The federal government has not participated directly in assessing program effectiveness. A notable exception is Sandra Christensen's evaluation which she prepared as an employee of the Congressional Budget Office.[9]

Wage Subsidies and Jobs for the Disadvantaged includes a thorough review of previous research. In the aggregate, the research presents no clear conclusions on the program's effectiveness and often cites the general lack of research in explaining why so little is known about how well TJTC works. During TJTC's eleven years of existence, a period when numerous extensions and amendments have continued to redefine the program's direction and intent, the research has been sporadic and generally removed from firsthand evaluations of participants, employers, and effects. Wage Subsidies and Jobs for the Disadvantaged, for example, is the first study of the program in a single employer setting. Its findings are generally favorable and consistent with many of those presented by Lorenz and Bishop and Hollenbeck.

PROGRAM OPERATIONS

As is mentioned often in the B-WPS study, acceptance of TJTC was evolutionary. Prior to and during 1983, management spent its resources on overcoming bias, ignorance, and resistance among staff at field locations and among its own ranks as well. The guard business is a twenty-four hour per day, 365 days per year business. It is inherently hectic and to preferentially hire less capable workers made no sense to anyone. Of course, into 1983, no one had compared TJTC and non-TJTC workers on any performance measures. Neither had liability claims, call-off and no-show rates, or lost account data been analyzed to determine if eligibles presented a greater risk to the company's performance than non-eligibles. Much of the early sentiment against the program was based on the perception that the wage subsidy was available only because workers eligible for the subsidy could not get jobs without it. Managers reasoned that since subsidized workers would seldom meet the basic qualifications for security guard employment, the potential magnitude of the subsidy would also be small. In 1983, management's objective was to implement procedures for obtaining field compliance on basic employment screening and vouchering procedures. Plans for prescreening, recruiting, and retaining eligibles would evolve as the organization gained confidence in its ability to obtain benefits while controlling costs.

In 1984 and 1985, a series of management activities were progressively implemented to improve TJTC operations and raise performance. Primary among these in 1984 were: (1) assigning identical performance targets to both line and staff as a means to force people in different roles to work in support of common objectives; (2) introducing monetary incentives for field coordinators who managed local programs on a daily basis, managers who were accountable for TJTC operations and received a direct profit-and-loss contribution, and guards who were paid regular wages when they attended employment service vouchering interviews; (3) initiating weekly reporting on screening and vouchering results and a monthly key indicators report that tracked projected and lost income values for eligibles with vouchers pending and others who terminated before obtaining vouchers; and (4) designing strategies for establishing and maintaining productive relationships with local referral agencies, including award programs, hiring the hardest-to-place, and taking employment service staff to a working lunch.

Throughout 1985, the level of activity continued to increase, with new methods for driving performance that included: (1) forcing accountability for TJTC to field units where aggressive managers would compete with other employers for a finite number of subsidized workers in local markets; (2) placing emphasis or retention practices that included promotions, better pay, and on-the-job training and counseling for subsidized workers; (3) using "model performer" memorandums to communicate innovative approaches that high achievers used to recruit and retain eligibles; and (4) designing maintenance reporting for each subsidized worker that included weekly earnings, hours worked, vouchering status, tax credits generated, and corresponding incentive values.

RESULTS

Recruitment and Hiring

Perhaps the most troubling criticism of the targeted jobs credit is that it rewards employers for hiring workers they would have hired even without the inducement of an employment subsidy. This is a serious charge that undercuts the premise for the entire legislation, namely that employers will not hire targeted workers without a special incentive to do so. Without a special inducement to do otherwise though, employers have demonstrated that they will not readily hire black youth, welfare mothers, handicapped workers, ex-convicts, and other targeted workers. So the assertion that employers are hiring the same targeted workers they would have hired without the credit can only refer to a relatively small number of eligibles who happen to be hired as a function of employers' normal employment practices.

In 1983, B-WPS screened 2,783 eligibles out of 51,821 new hires. In 1984, the organization stepped up its recruitment of eligibles, establishing partnerships with local referral agencies throughout the country. These agencies are referenced in the study, but some of the more noteworthy were Goodwill, SER Jobs for Progress, Department of Social Services, the Urban League, and, of course, the Employment Service. The number of screened eligibles rose in 1984 to 4,779, an increase of 73 percent over 1983.

By 1985, both divisions had refined their recruitment operations to a point where field units maintained weekly contact with an average of ten local referral agencies. Work relationships with agency personnel had matured to a point where weekly referrals were routine. Notable exceptions, occurred where local unemployment rates were low, thereby preventing referrals of any workers, let alone TJTC eligibles. One of the elegant aspects of TJTC is that it works best where it is needed the most. Where eligibles have found employment, TJTC is unnecessary and unutilized. Despite persistently low unemployment, B-WPS pressed its referral sources for more eligible workers and hired 9,800 targeted workers in 1985, an improvement of more than 100 percent over 1984. The 9,800 eligibles screened and hired in 1985 represented 16.7 percent of the organization's work force, a significant proportion during a period when the annual unemployment rate was only 7.1 percent (see Figure 1).

It is difficult to estimate how many of the 1,636,729 targeted workers certified nationwide between 1983 and 1985 would have been hired in the absence of the jobs credit. The shift in the Burns field culture had not been as pronounced as in WF Guard, but prior to 1984, both divisions were resistant to hiring targeted workers. By 1985, the predominant attitude among field managers was that targeted workers were attractive commodities that should be pursued and hired. With a 6-8 percent rise in annual hiring between 1983 and 1985, the far more dramatic growth in TJTC hiring indicates that there was some ratio of preferential to nonpreferential hiring of eligibles that increasingly favored preferential hiring as the organization gained experience and confidence with the program (see Figure 2). The disparity between the number of eligibles screened and hired during 1983-85 and those certified by the Employment Service illustrates the difficulties B-WPS experienced in scheduling vouchering interviews. Employees were scattered at thousands of account sites and many had limited access to transportation. As Figure 2 shows, B-WPS was successful in coordinating vouchering/certification interviews for only about 60 percent of the eligibles it hired, with the others leaving the company before obtaining the necessary certification of eligibility.

Pay

One of the premises of the targeted wage subsidy has always been that the hardest-to-employ are less skilled and therefore, at least initially, less productive than less disadvantaged workers. If employers recognized their lower productivity, targeted workers would be expected to earn less per hour than nontargeted workers. Drawing from a 1980 employer survey, Bishop and Hollenbeck confirmed that TJTC-subsidized workers were 14 percent less productive initially, but only 3 percent less productive after they had gained experience on the job.[10] A 1984 NCRVE survey revealed that on average, TJTC workers were 7 percent less productive than non-TJTC workers.[11]

In testimony before the House Ways and Means Committee, Bishop reported again on the 1982 survey of 3,710 employers. Fully 26 percent of the employers who had heard of TJTC thought of eligibles as poor workers, either unskilled or unreliable. Another 23.2 percent did not use the Employment Service, presumably because of dissatisfaction with previous referrals.[12] Christensen reported similar results elsewhere during the same Congressional hearings.[13] Comparing data at thirty-three firms where eligibles and nonsubsidized workers were hired in the same job, Bishop and Hollenbeck found that eligibles were paid a statistically significant 8 percent less.[14]

The perception that subsidized workers are less productive than nonsubsidized workers was confirmed through the B-WPS wage data. The 1985 data placed subsidized workers at $.37 less per hour than nonsubsidized workers who worked at the same kinds of job sites (see Figure 3).

The B-WPS combined wage data for 1985 included workers who earned wages in 1985, but may have been hired the prior year. This was true for TJTC and non-TJTC workers. The average hourly wage paid to a TJTC worker in 1985 was $4.67, while the non-TJTC average hourly rate was $5.16. These were composite figures which included the higher paying Burns utility units. Without the utility figures, the pay rates dropped to $4.38 and $4.75 respectively. Burns paid a slightly higher wage than WF Guard, with an $.08 per hour differential for eligibles and a $.15 per hour differential for nonsubsidized workers. As a proportion of non-TJTC wage rates, eligibles earned nearly 93 percent as much as their less disadvantaged counterparts in WF Guard and 91.5 percent in Burns, excluding utility figures.

Even without the Burns utility wages, the $4.38 per hour wage rate was over a dollar more per hour than the $3.35 minimum wage in 1985. Critics of TJTC often claim it is a minimum wage program filled with dead-end jobs. The B-WPS figures challenge that assessment. B-WPS pays all workers at least minimum wage, and as the data indicate, generally much more. Although only 357 eligibles earned utility division wages in 1985, their average hourly wage was $8.41, a far cry from minimum wage.

The study compares hourly wage rates for TJTC and non-TJTC workers that Burns hired in 1983, 1984, and 1985. The data were cumulative, capturing employee earnings across calendar years and beyond the tax credit eligibility period. The purpose in tracking cumulative data was to avoid truncating the wage benefits that accrued to workers who found jobs and stayed with them for some time, building earnings and experience along the way. The pattern for cumulative earnings in the Burns industrial units showed that only a $.02 pay differential separated TJTC and non-TJTC workers who started work in 1983. The near identical pay rates show that TJTC eligibility was playing a minor role in determining who would be hired (see Figure 4).

During 1984, a period when B-WPS began to actively manage TJTC, the cumulative number of full-time TJTC workers grew to 1,498, a 243 percent increase, while full-time non-TJTC workers numbered 22,395, a 202 percent increase. Field units were under pressure to recruit and screen for eligibility. The financial implications of the wage subsidy were not lost on managers who increasingly "tested" TJTC workers in lower paying, routine jobs. Overtime assignments seldom went to eligibles who, on average, were less productive and less reliable than their nonsubsidized counterparts. Non-TJTC workers in 1984 enjoyed a wide $.22 per hour wage advantage.

Taking into account anyone working in 1985 who was hired during the entire three-year period, the TJTC wage disadvantage narrowed to $.06. With a 203 percent increase in the number of TJTC workers versus only a 158 percent increase for non-TJTC workers, 1985 was the first complete year for the B-WPS system. Managers who reluctantly hired subsidized workers in 1983, were aggressively pursuing and retaining them in 1985. The $.06 wage advantage enjoyed by nonsubsidized workers was largely a reflection of their more advantaged backgrounds and better job skills.

Figure 5 shows the contribution made by the Burns utility division which began utilizing TJTC in earnest before the industrial units. The trend in Figures 4 and 5 correspond as the higher paying utility units favored targeted workers and produced an overall pay advantage, except in 1984, where the industrial units preferentially hired eligibles but placed them initially at lower paying sites. In that year, subsidized workers maintained only a $.02 advantage over nonsubsidized workers ($5.41 versus $5.39).

Figure 6 includes wage data for full-time and part-time workers. It shows that TJTC part-time workers were the lowest paid in the organization. Conversely, full-time eligibles earned nearly as much as their nonsubsidized counterparts in 1985 ($4.96 versus $5.06). Obtaining full-time employment appears to be important in order for targeted workers to gain job experience and earn higher wages.

Retention

As is mentioned in the study, there is a strong tendency for observers to think of the jobs tax credit as a hiring instrument. No doubt, it is first and foremost a vehicle for disadvantaged workers to use in getting jobs. This primary purpose, however, is not its exclusive purpose. As soon as the targeted worker is hired, the employer must take steps to maximize the duration of employment and the corresponding size of the subsidy.

The B-WPS study provides some interesting insights into why targeted workers stay on the job. Although pay rate was a factor, it does not appear to have been overriding. While targeted workers experienced an upward trend in pay, especially into 1985, they remained at pay rates below those assigned to nonsubsidized workers. The interaction between pay and retention may have been based on the targeted worker's independent expectations of pay and the steps his superiors took to facilitate higher earnings.

Other factors were scheduling of both work hours and job location, quality of counseling and on-the-job training, and the amount of recognition provided by superiors. The results in Figure 7 show a length of service advantage of 1.1 months for full-time targeted workers and 1.4 months for all targeted workers, both full and part time. These represent work durations that were 15.7 and 21.2 percent longer than those achieved by nonsubsidized workers.

TJTC Program Costs

During its ten years of operation, there has been no clear accounting of TJTC program costs. The real dollar impact of TJTC on government revenues remains undetermined despite widespread concern over the federal budget deficit. Much of the difficulty in determining which cost factors to use in evaluating the jobs tax credit is a result of uncertainty over the savings or benefits attributable to the program.

The Congressional Budget Office is on record as placing the average revenue loss per TJTC participant at between $700 and $1,000.[15] Levitan and Gallo have reviewed the Treasury Department's revenue loss estimates and believe they have been overstated.[16] With the Labor Department reporting 563,381 certifications for FY 1984 and the IRS reporting $555,996,000 in credits, the average tax credit per participant figured to $987. There is, however, a difference between the size of the employer's tax credit and the government's revenue loss. Employers who claim TJTC credits must reduce the deduction they take for wages in an amount equal to the credit, thereby reducing the government's revenue loss proportionate to their individual employer tax rates. Applying an average 42 percent offset against FY 1984 credits, the total cost of the program and the cost per participant were reduced respectively to approximately $323 million and $572. This figure did not take into account the effects of increased tax revenues or reduced transfer payments.

In the case of B-WPS, between 1983 and 1985, the average certification had a gross credit value of $1,095. This was lowered to $591 after reducing the company's deduction against wages by an amount equal to the credit. The $591 per certification cost was the maximum average revenue loss incurred by the Treasury Department for B-WPS TJTC credits between January 1, 1983 and December 31, 1985. This figure was further reduced by $119 to $472 per participant based on increased tax payments from 1,493 eligible workers who had taxable income in excess of the zero bracket amount. This $472 figure, however, did not include the effects of reduced transfer payments for AFDC, SSI, general assistance, and unemployment insurance.

Based on information from the Department of Health and Human Services, targeted AFDC and general assistance recipients who obtained full-time employment with B-WPS were likely to have lost full or partial benefits. The resulting loss in benefits represents a potentially large reduction in the actual revenue loss attributable to tax credits claimed on wages earned by nearly 19 percent of the eligibles hired nationwide and approximately 14 percent of the eligibles that B-WPS hired between 1983 and 1985 who were receiving AFDC, SSI, and general assistance benefits when they were hired.

CONCLUSION

Among the conclusions reported in Wage Subsidies and Jobs for the Disadvantaged are the following:

1. The targeted jobs tax credit has worked and should be extended permanently. Employers like B-WPS have responded to the employment subsidy by installing effective employment practices to favor disadvantaged workers. Perhaps the strongest argument favoring a permanent extension is that the jobs tax credit works best where it is needed the most, and only functions where targeted workers are available. The employment subsidy is elegant in that its functioning is proportionate to the magnitude of the disadvantaged population it serves.

2. The standard procedures for vouchering eligible workers are difficult for some employers to use and should be expanded to permit alternatives to live, in-person vouchering at Employment Service offices. In B-WPS, eligible workers are posted at remote sites and, because they usually work alone, are unable to attend vouchering interviews. Besides mail vouchering, which three states have implemented, employers could be authorized to issue vouchers for the eligibles they recruit and hire. Employers like B-WPS are already performing most of the tasks associated with vouchering. Ninety percent of the eligibles that B-WPS screened and referred to the Employment Service during 1983-85 were vouchered on the first visit. As designated agents, employers could initiate the eligibility determination, with the Employment Service retaining its traditional authority to issue certifications.

3. There is strong evidence that suggests the employment subsidy may be less costly than current government estimates indicate. One factor with the potential to produce a considerable offset against the program's cost is the reduction in transfer payments for AFDC, SSI, general assistance, and unemployment insurance recipients who find employment through the TJTC program. Working with a representative sample of large users and state social service agencies, the Department of Health and Human Services and the Labor Department should provide estimates of transfer payment reductions for targeted workers who obtain and sustain employment through the program.

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2 Linda LeGrande, "The Targeted Jobs Tax Credit, 1978-1987," Congressional Research Service, The Library of Congress, July 14, 1987.

3 Sar A. Levitan and Frank Gallo, "The Targeted Jobs Tax Credit: An Uncertain and Unfinished Experiment," Labor Law Journal, Vol. 38, No. 10, (October 1987), pp. 641-649.

4 Author's telephone conversation with John Bishop, February 23, 1988.

5 Edward C. Lorenz, "The Targeted Jobs Tax Credit: An Assessment," (Washington, D.C.: National Commission for Employment Policy, August 1985).

6 Gary Burtless, "Are Targeted Wage Subsidies Harmful? Evidence from a Wage Voucher Experiment," Industrial and Labor Relations Review, Volume 39, No. 1 (October 1985), pp. 105-114.

7 Lorenz, "TJTC: An Assessment," p. 44.

8 Burtless, "Are Targeted Wage Subsidies Harmful?," p. 113.

9 Sandra Christensen, "The Targeted Jobs Tax Credit," Targeted Jobs Tax Credit Extension (Washington: Government Printing Office, 1984) testimony before U.S. Congress, House Committee on Select Revenue Measures, Serial 98-90, April 10, 1984, p. 64.

10 Bishop and Hollenbeck, "Final Report," p. v-12.

11 Ibid.

12 John Bishop, "The Targeted Jobs Tax Credit," Targeted Jobs Tax Credit Extension (Washington: Government Printing Office, 1984) testimony before U.S. Congress, House Committee on Select Revenue Measures, Serial 98-90, April 10, 1984, p. 126-127.

13 Christensen, "The TJTC," p. 64.

14 Bishop and Hollenbeck, "Final Report," p. V-16.

15 Nancy M. Gordon, "Extension of the Targeted Jobs Tax Credit." Hearing before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, House of Representatives, Ninety-fifth Congress, March 19, 1985, Serial 99-12.

16 Levitan and Gallo, "The TJTC," pp. 647-648.

Figure 1

B-WPS Targeted Hiring And Vouchering Rates Versus National Unemployment Rates

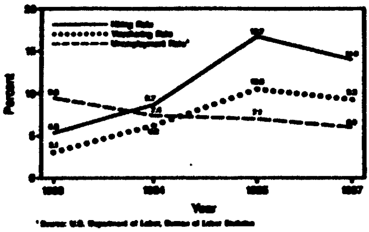


Figure 2

B-WPS Work Screened as TJTC Eligible, Hired and Certified as a Percent of All Employees Hired

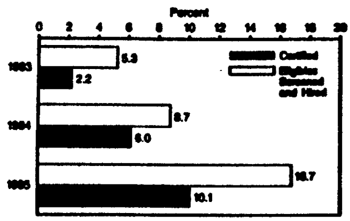


Figure 3

Average Hourly Pay for TJTC and Non-TJTC Employees Earning Wages at B-WPS in 1985

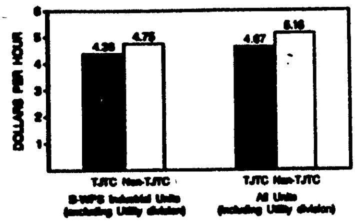


Figure 4

Average Hourly Wage Trend for TJTC and Non-TJTC Employees at Burns Industrial Units, 1983–1985

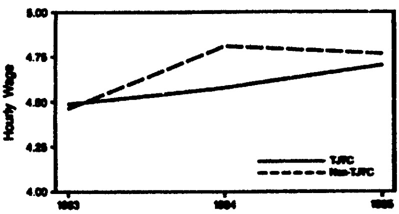


Figure 5

Average Hourly Wage Trend for TJTC and Non-TJTC Employees at Burns Industrial and Utility Units, 1983–1985

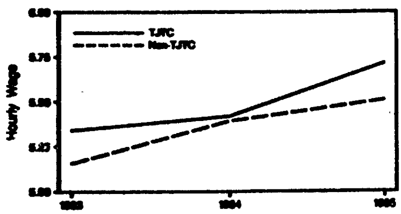


Figure 6

Burns Hourly Wage Trends for TJTC and Non-TJTC, Part-time and Fulltime Workers at Industrial Units (Excludes Utility Division), 1983–1985

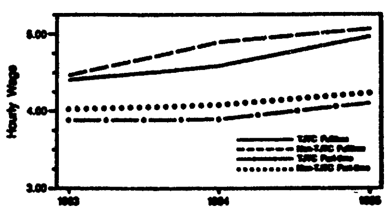
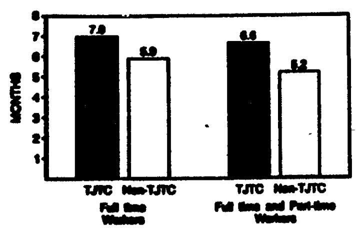


Figure 7

Months of Service at B-WPS for TJTC and Non-TJTC Employees With First Day Worked in 1985



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STATEMENT OF THE PUBLIC SECURITIES ASSOCIATION
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATE FINANCE COMMITTEE
MARCH 28, 1988

Mr. Chairman, the Public Securities Association (PSA) appreciates the opportunity to present testimony on the reauthorization of the mortgage revenue bond (MRB) program. PSA strongly supports the reauthorization of MRBs. Attached is a paper, prepared for PSA by Kurt van Kuller of Lebenthal & Co., Inc., which describes our arguments in defense of the MRB program.

Briefly, this paper offers evidence that the MRB program has been highly successful in targeting mortgage loans to low-income homebuyers. In addition, the record indicates that MRBs have been a potent tool for the redevelopment of economically disadvantaged areas. Besides providing this evidence in defense of MRBs, this paper also examines in some detail the report on MRBs recently released by the General Accounting Office (GAO). GAO's report severely criticizes the MRB program. The attached paper raises a number of concerns about GAO's analysis and concludes that questionable assumptions and methodology cast serious doubt on the reliability of GAO's conclusions. As such, we hope that GAO's report will not unduly affect the debate over the extension of mortgage revenue bonds.

In sum, PSA firmly believes that MRBs have been highly effective at fulfilling an essential goal of housing policy, namely, the provision of low-interest mortgage loans to first-time homebuyers of limited means. As the nation struggles to confront a housing crisis, we cannot afford to terminate the MRB program.

Again, we thank the Subcommittee on Taxation and Debt Management for the opportunity to submit testimony.

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THE CASE FOR REAUTHORIZATION OF THE SINGLE-FAMILY MORTGAGE REVENUE BOND PROGRAM

I. Introduction

Forty-eight states, as well as the District of Columbia, Puerto Rico, and the Virgin Islands, have established housing finance agencies since the creation of such agencies in the early 1960s. Since 1970, these state agencies have provided over 900,000 below-market mortgage loans, primarily to first-time homebuyers of limited means. In addition, scores of local housing agencies have arisen to provide approximately 200,000 more such targeted loans. The vehicle for this development has been the tax-exempt, mortgage revenue bond (MRB). Unfortunately, without Congressional action, tax-exempt status for mortgage revenue bonds will expire on December 31, 1988. Given the desperate need for affordable housing, failure to reauthorize the mortgage revenue bond program would be a grave mistake. The argument for reauthorization is really very simple: the program works.

This paper will examine our experience with mortgage revenue bonds. The evidence demonstrates that the program has fulfilled its goal -- it has made home ownership possible for thousands of low income families poorly served by the conventional mortgage market. Moreover, the mortgage revenue bond program has directed much-needed capital investment to low-income areas and boosted redevelopment efforts across the country.

Indeed, the MRB program offers a potent tool for targeted economic development and low-income housing finance. The program has fostered the development of an efficient and capable housing delivery system, centered around state and local housing agencies, that links developers, lenders, and real estate professionals to households of limited means that seek home ownership. In the midst of a housing crisis, the nation cannot afford to dismantle such a network.

II. The National Housing Crisis

Over the past two decades, the cost of owning a home has skyrocketed; family incomes have not kept pace. A suprising number of young families today simply cannot afford a decent home, and hence, for the first time since the Great Depression, national homeownership rates are on the decline. And there is no improvement in sight. Political, legal, economic, and financial developments portend a worsening crisis in the years ahead.

The facts are not in much dispute. Table 1 illustrates the steep decline in homeownership rates, both nationally and for young people, in the 1980s.

Table 1

Homeownership Rates

	1980	1987
Total National	65.6%	64.0%
Under 25 years	21.3%	16.1%
25-29	43.3%	35.9%
30-34	61.1%	53.2%
35-39	70.8%	63.8%
Northeast 25-29	35.9%	34.1%
Northeast 30-34	55.0%	51.3%
Midwest 25-29	50.5%	40.2%
Midwest 30-34	68.1%	58.6%
South 25-29	46.4%	39.4%
South 30-34	63.4%	55.2%
West 25-29	36.0%	27.0%
West 30-34	54.9%	45.4%

Source: HUD Annual Housing Survey

There is no mystery in this decline. According to the Joint Center for Housing Studies at Harvard University, the median price of a representative first home rose 92% between 1975 and 1987.[1] Family incomes have simply not kept pace with this rise. Statistics from the Harvard Joint Center show that the median income of all households headed by an individual under 25 dropped 28.7% (in constant 1986 dollars) between 1974 and 1987. Real incomes for households headed by individuals aged 25-34 fell 11.5% during the same period. In 1987, the after-tax cash cost burden of home-ownership for a representative first-time buyer "stood 50% above the levels averaged during the late 1960s and early 1970s."[2] According to the Federal National Mortgage Association, today's median-priced new home absorbs nearly twice the family income it did in 1973. Table 2 shows the homeownership cost burden for first-time homebuyers by region of the country.

Table 2

1987 Housing Cost Burden of First-Time Homebuyers
By Region

	<u>% of Income Required for Monthly Housing</u>
Northeast	34.5%
Midwest	31.1%
South	29.0%
West	34.4%
National Total	32.4%

Source: Harvard Joint Center for Housing Studies

The prospects of owning a home are not likely to improve for young persons in the near future. New housing development is being restricted by localities across the country in an effort to reduce stress on inadequate infrastructure. Serious threats of water-supply shortages in certain fast-growing regions will further restrict new housing construction, particularly on the West Coast, where the need for new housing is great. At the same time, as inflation remains relatively low, real interest rates continue at their historically high levels, increasing the burden of mortgage payments on homebuyers (see Figure 1). Finally, increasingly strict mortgage standards will make it more difficult for low-income households to obtain mortgage financing in the conventional market. Regular surveys by Standard & Poor's Credit Review demonstrate that mortgage insurers are substantially tightening underwriting standards, especially for low down-payment mortgages, most of which are obtained by first-time homebuyers with low to moderate incomes.

These developments promise no relief in housing prices, as supply is restricted; no relief on the total homeownership burden, as real interest rates remain high; and less access to mortgage credit for low income homebuyers, as underwriting standards tighten. The future for prospective homebuyers does not look bright.

III. <u>The Mortgage Revenue Bond Program</u>

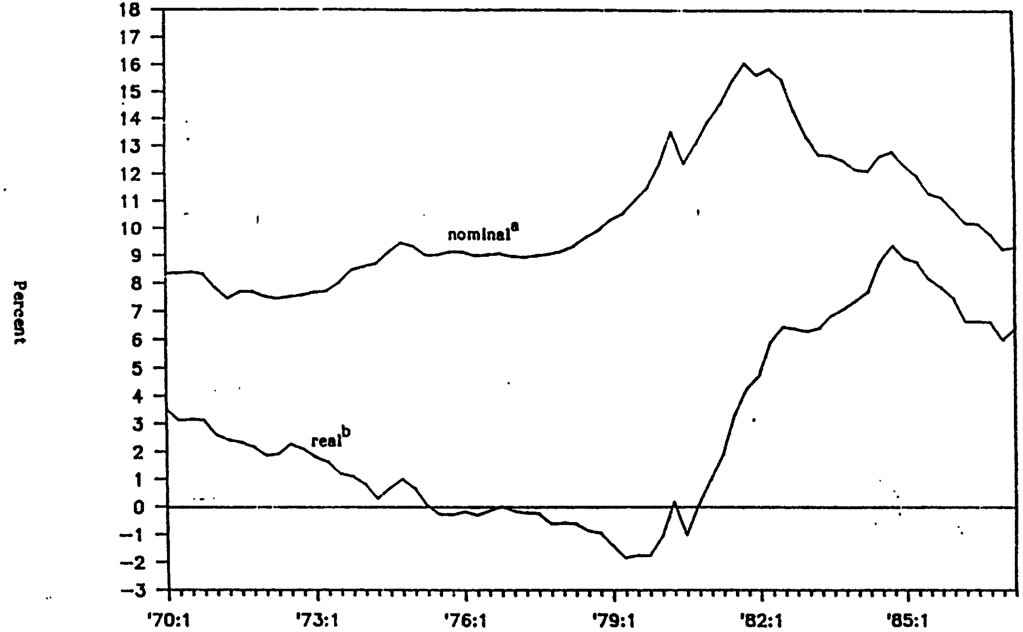
One method that state and local governments have used to help low-income families purchase homes has been the tax-exempt mortgage revenue bond. Low interest rates on tax-exempt MRBs allow states and localities to offer mortgage loans to homebuyers at below-market rates. State housing agencies began issuing MRBs for single-family mortgages in 1970; localities entered the MRB market in 1978. Since 1980, Congress has mandated strict eligibility requirements for families to qualify for MRB-subsidized loans. These targeting requirements were relaxed slightly in 1982 and then tightened in 1986. Table 3 lists the requirements established by the Mortgage Subsidy Bond Act of 1980 (as amended by the Tax Equity and Fiscal Responsbility Act of 1982) and the changes mandated by the Tax Reform Act of 1986 [TRA].

Even without the stiffer targeting requirements imposed by the TRA, the mortgage revenue bond program was well-targeted toward low-income households. The evidence, in fact, is impressive. In a recent report on the MRB program, the General Accounting Office found that 15 of the 25 housing agencies it visited used tighter eligibility standards than required by federal law.[3] According to data compiled by Dr. Margaret Wrightson of the Georgetown University Center for Public Policy, MRBs have assisted buyers with significiantly lower incomes than buyers who do not receive MRB loans. Table 4 shows that the average median family income of MRB-assisted homebuyers was $26,000 between 1984 and 1987. This compares to $36,000 for first-time homebuyers with conventional loans. In addition, other data from the National Association of Realtors Annual Housing Survey show an average median family income of $40,597 for first-time homebuyers using adjustable rate mortgages between 1984 and 1986. None of these figures are adjusted for inflation. These statistics demonstrate that the MRB program has been appropriately targeted to lower income homebuyers. This income targeting is particularly impressive when one considers that <u>no federal income eligibility standards existed for MRB borrowers prior to 1986</u>.

Figure 1

NOMINAL AND REAL MORTGAGE RATES

1970 to 1987 Q2



a - Effective Mortgage Rate on Conventional Loans Closed, Source: Federal Home Loan Bank Board

b - Nominal Mortgage Rate Less 3-Year Moving Average of Average Constant Quality Home Price, Source: Mortgage Bankers Association of America

Note: Average Constant Quality New Home Price obtained from the Bureau of the Census.

Table 3

Federal Limitations on the Mortgage Revenue Bond Program

Imposed by the Mortgage Subsidy Bond Act of 1980 (Amended by the Tax Equity and Fiscal Responsibility Act of 1982)	Imposed by the Tax Reform Act of 1986 on Mortgages Financed by MRBs Issued After August 15, 1986
Residence Requirement: Each of the premises financed must become the principal residence of the mortgagor after the financing is executed. In the case of two-to-four family residences, the mortgagor must occupy one unit and certify that the residence was first occupied at least five years ago.	Residence Requirement: Same.
First-Time Homebuyer Requirement: At least 90% of bond proceeds outside of targeted areas must be provided to mortgagors without an ownership interest in their residence for three years prior to execution of the loan.	First-Time Homebuyer Requirement: At least 95% of bond proceeds outside targeted areas must be provided to mortgagors witnout an ownership interest in their principal residence for three years prior to the execution of the loan
New Mortgage Requirement: No part of the proceeds may be used to acquire or refinance an existing loan.	New-Mortgage Requirement: Same.
Purchase Price Limitation: Price of the residence may not exceed 110% of average area purchase price applicable to such a residence, or 120% in targeted areas.	Purchase Price Limitation: Price of the residence may not exceed 90% of average area purchase price applicable to such a residence, or 110% in targeted areas.
Income Limits: None.	Income Limits: All mortgage loans, except in targeted areas, must be provided to borrowers whose income does not exceed 115% of applicable median *family* income. In targeted areas, two-thirds of the loans may be made to borrowers whose *family* income does not exceed 140% of the applicable median; one-third may be made without regard to income limits.
Assumptions: Allowed only if assuming party meets above requirements, otherwise "due on sale".	Assumptions: Assuming party must meet all of the new requirements.

Table 4

Median Incomes of First-Time Homebuyers[4]
According to Type of Financing
(Unadjusted for Inflation)

	MRB	FHA	VA	Conventional	MRB/Conv
1984	$27,000	$30,400	$32,500	$31,300	86.3%
1985	$26,000	$30,600	$32,600	$37,000	70.3%
1986	$26,000	$32,600	$33,000	$38,200	68.1%
1987	$27,000	$32,700	$35,000	$39,600	68.2%
Average	$26,000	$32,000	$33,100	$36,700	73.2%

Source: MRB data compiled from Georgetown Public Policy Program MRB beneficiary database. FHA, VA, and Conventional data compiled from the National Association of Realtors Residential Mortgage Panel Questionnaire, 1984, 1985, 1986, 1987.

Moreover, the MRB program has not been misused to subsidize high-priced homes. The evidence indicates that MRB borrowers have purchased fairly modest homes in comparison with home-buyers who borrowed from other sources. Table 5 shows that the average median purchase price of homes bought by MRB-assisted buyers was $55,000 between 1984 and 1987. This compares to $71,000 for first-time homebuyers with conventional mortgage loans. In addition, data from the National Association of Realtors show an average median purchase price of $77,498 for first-time homebuyers using adjustable rate mortgages between 1984 and 1986. Again, none of these figures is adjusted for inflation. These statistics show that MRB loans have been appropriately targeted to finance the purchase of less expensive homes than those purchased with other types of financing.

Table 5

Median Purchase Prices of Homes Bought by First-Time Homeowners[5]
According to Type of Financing
(Unadjusted for Inflation)

	MRB	FHA	VA	Conventional	MRB/Conv
1984	$56,000	$63,000	$68,500	$62,500	89.6%
1985	$54,000	$64,000	$69,000	$69,800	77.4%
1986	$56,000	$63,000	$68,400	$70,000	80.0%
1987	$62,000	$67,100	$70,300	$82,900	74.8%
Average	$55,000	$64,500	$69,000	$71,000	80.5%

Source: MRB data compiled from Georgetown Public Policy Program MRB beneficiary database. FHA, VA, and Conventional data compiled from the National Association of Realtors Residential Mortgage Panel Questionnaire, 1984, 1985, 1986, 1987.

It is important to review the success of the MRB program, because it has recently been the subject of some criticism. In particular, the General Accounting Office (GAO) released a report in March that questions the need for MRBs. The report, entitled "Homeownership: Mortgage Bonds are Costly and Provide Little Assistance to Those in Need," argues that MRBs assist families that could be adequately served by the private mortgage market and that MRBs finance homes almost as expensive as those purchased in the private market. Given the attention this report has received, it is worthwhile to examine it in some detail.

Based on various sources of data, GAO develops a profile of MRB-assisted and national first-time homebuyers. GAO estimates that national first-time homebuyers have a median family income of $27,000 and that the homes they buy have a median purchase price of $64,000. MRB-assisted homebuyers, by contrast, are found to have a median family income of $26,000 and to buy homes with a median purchase price of $58,000. On the basis of this data, GAO concludes that the MRB program has not been effective in serving a disadvantaged sector of the population. GAO's statistical analysis, however, contains some serious flaws. In the first place, in evaluating the MRB program, the relevant comparison is between MRB-assisted homebuyers and non-MRB, non-subsidized homebuyers. But, by GAO's own admission, its sample of all first-time homebuyers includes 5 to 10% of MRB-assisted purchases and 35% of VA- or FHA-assisted purchases. Since first-time homebuyers assisted by the MRB or FHA programs or by other subsidies have lower incomes, on average, and purchase less expensive homes than first-time buyers in the private market, the GAO's data on national homebuyers is biased toward lower incomes and lower purchase prices. In essence, by including MRB-assisted and other subsidized borrowers in its national sample, GAO makes national first-time homebuyers look more like MRB homebuyers. Given that other data portray quite a different picture of the national mortgage market, GAO's results appear to be questionable.

Furthermore, GAO's profile of MRB-assisted homebuyers is subject to sampling error. The 25 housing agencies GAO chose to study are located in some of the highest cost housing areas in the nation. According to an analysis of the National Council of State Housing Agencies, using data from Harvard's Joint Center for Housing Studies, incomes of potential first-time homebuyers in the areas included in GAO's study are 15-17% higher than those for the nation as a whole.[6] This sampling bias, of course, tends to inflate the incomes of MRB homebuyers, relative to the national sample, and the purchase prices of MRB-financed homes. This sampling bias clouds the reliability of GAO's profile of MRB-assisted buyers.

GAO's most serious criticism of the MRB program is its contention that 56% of the families served by the MRB program could have obtained conventional financing to buy a home of the same cost. In addition, GAO estimates that another 12% of MRB-assisted buyers could have obtained adjustable-rate mortgages. Given that the data discussed above (see page 4) demonstrate that homebuyers with conventional and adjustable-rate mortgages have significantly higher incomes than buyers with MRB loans, GAO's faith in the private mortgage market seems suspect. A closer look at GAO's methodology reveals a somewhat unrealistic view of the private mortgage market. GAO classifies an MRB-assisted homebuyer as eligible for conventional financing if the buyer's housing expenses do not exceed 28% of income. This simple test, however, overlooks a number of critical underwriting standards. Among the other factors that affect whether a buyer can obtain a conventional loan are: 1) the ratio of total debt payments to income (usually may not exceed 33-36%); 2) the location of the home (e.g, whether it is in a distressed area); 3) the net worth of the borrower; 4) the employment history of the borrower; 5) the credit history of the borrower; 6) the availability of lendable funds; 7) the size of the downpayment; 8) the availability of mortgage insurance; and 9) the "points" in the deal. These criteria add up to much more stringent conventional underwriting standards than GAO's simple housing expense to income test. In addition, as noted in the first section, mortgage underwriting standards are becoming much tighter, particularly in the area of mortgage insurance for first-time homebuyers. These points cast serious doubt on GAO's assertion that most MRB-assisted buyers could have obtained conventional financing. Anecdotal evidence supports this skepticism. A study by the Legislative Auditor General of the State of Utah found that 85% of mortgagors assisted by Utah MRBs in 1986 could not have obtained conventional financing.

Besides objecting to the need for the MRBs, GAO also questions whether the benefits of the program to individual homebuyers outweigh the program's costs. GAO assesses the benefits of the MRB program by calculating the mortgage interest subsidy to MRB homebuyers. Assuming for the moment that the mortgage subsidy accurately measures the entire benefits of the program, certain points about GAO's methodology need to be raised. In the first place, GAO calculates benefits for spreads between conventional mortgage and MRB rates of 50 to 150 basis points. According to GAO's calculations, however, the median spread achieved for MRB loans between 1983 and 1987(Q2) was 144 basis points. Obviously, a median spread of 144 suggests that spreads are often higher than 150, especially since GAO points out that housing agencies do their best to achieve a minimum spread of 150 basis points. In fact, spreads are often significantly higher than 150 basis points. Hence, the 50 to 150 range is skewed toward the low end of spreads achieved by MRBs. A more realistic range would include higher spreads, which would imply greater mortgage subsidies and greater program benefits.[7]

More important than these questions about methodology, however, are the assumptions about the scope of the program's benefits. GAO's definition of the benefits of the MRB program overlooks several points. First, since mortgage underwriting standards are much more complicated than the 28% test used by GAO, and often rely on qualitative judgments in addition to income and debt tests, MRB-assisted homebuyers may have simply been unable to obtain mortgage financing from other sources. If this is the case, then there is a qualitative benefit from the program beyond the imputed mortgage subsidy, namely, the opportunity to obtain a mortgage at all. Furthermore, the emphasis on benefits to individual borrowers overlooks one of the key features of the MRB program -- its ability to stimulate redevelopment. GAO estimates that 40% of MRB loans between 1983-87(Q2) were for newly-constructed homes. Given the significant eligibility limitations on MRB loans, this stimulus to new construction (as well as the significant stimulus to rehabilitation of existing homes) is directed at low and moderate income zones. These are precisely the regions that private industry is most reluctant to enter. Often, MRB loans are funneled to special projects. The State of New York Mortgage Agency, for example, has provided every mortgage loan under the Nehemiah redevelopment plan in New York City. Moreover, at least 20% of the lendable proceeds of MRBs must be set-aside for distressed areas for at least one year. This channelling of MRB funds to areas badly in need of assistance has helped to revitalize communities across the country. Examples include, among others, Atlantic City and Newark, New Jersey; Boston, Massachusetts; Denver and Pueblo, Colorado; and West Memphis, Arkansas.

The resources that can be tapped by MRBs are substantial. A study by the California Housing Finance Agency estimates that $640 million in construction activity was generated by just the new construction part of its MRB program between 1982-87. The Arkansas Development Finance Authority estimates that its MRB program created 13,196 construction jobs between 1978 and 1987. Other state housing agencies report similar results. Obviously, the capital and labor tapped by MRBs could be directed toward other economic purposes in the absence of a mortgage bond program. The point is that MRBs enable state and local governments to target these resources to low-income housing and to the redevelopment of distressed areas. While the free market would certainly create economic activity in the absence of MRBs, it would not direct this activity to serve these socially desirable goals. Active public policy is required to channel private resources toward national goals. MRBs have been a remarkably potent tool to channel mortgage and construction capital to the areas most in need.

In sum, all the evidence points in one direction: MRBs work. Housing agencies have used MRBs to provide a substantial number of below-market loans to low-income families poorly served by the private mortgage market. In addition, the MRB program has stimulated new housing supply and redevelopment in distressed areas nationwide. In the midst of a housing crisis, with private industry reluctant to enter distressed areas, and with banks, the traditional provider of mortgage finance, facing severe problems of their own, it makes little sense to dismantle a program with a proven record of success in delivering mortgage financing. The MRB program should be reauthorized.

IV. The Revenue Effect of Extending the MRB Program

Estimates of the revenue loss through "tax expenditures" on tax-exempt MRBs, and on tax-exempt bonds generally, play a critical role in the policy debate over municipal bonds. Hence, the methodology employed by the Joint Tax Committee to estimate revenue loss deserves a careful and rigorous scrutiny. For this reason, the Commission on Public Finance created by Congressman Beryl Anthony has asked one of its task forces to examine, in detail, the revenue estimating process. The results of this inquiry should be instructive. Even in the absence of a formal analysis, however, it is clear that estimates of the revenue loss from extending the MRB program rely on certain assumptions that can be questioned. Some of these assumptions are desribed below.

First, to dispense with a somewhat minor point, any revenue loss attributable to MRBs should be presented fairly. There is an important distinction between annual and present value costs. The GAO report, for example, cites evidence that every $1 billion of MRBs issued costs the Treasury $20-30 million annually, and calculates this loss "to be $150-200 million in present value terms." The present value calculation attempts to measure, in present dollars, the loss of revenue through tax-exempt interest paid over the entire life of the bond. In essence, 30 years of interest is crammed into one year. While the present value has a certain economic significance, it has no bearing on revenue lost in any one year. Moreover, as suggested above, the GAO calculation assumes that the life of mortgage revenue bonds is 30 years. MRBs, however, actually retire in a broad range from 3 to 20 years depending on the rate of prepayment of mortgages. According to GNMA and FHA statistics on mortgage prepayments, MRBs have an expected average maturity of 12-14 years. This adjustment would substantially reduce the present value measure of the revenue loss.

The estimates of annual revenue loss, which are more pertinent than present value estimates to concerns about the federal deficit, are based on the critical assumption that MRBs displace, on an even money basis, investment in taxable securities. It is not at all obvious that this assumption is true. A significant amount of money from former MRB investors could flow into many forms of currently existing tax shelters (e.g., oil and gas, profit-sharing plans, trust accounts, business, real estate) or into deductible investment in business (particularly by corporations formerly owning MRBs). Furthermore, to the extent that MRBs do displace taxable investment, estimates of revenue loss must account for the fact that any additional state and local taxes may be deducted from federal taxable income. In addition, the revenue estimates typically assume that a full year of tax-exempt interest is paid in the year that a tax-exempt bond is issued. Since bonds are issued throughout the year, the great majority of them generate tax-exempt income to investors for only a portion of the year. Assuming that all bonds generate a full-year of tax-exempt interest in the year of issue tends to make revenue losses look larger in the first fiscal year after issuance.

The other major assumption used in calculating the revenue loss of extending MRBs relates to the existing state caps on the volume of certain types of bonds. Under the Tax Reform Act of 1986, each state faces a ceiling on the volume of bonds it may issue, in aggregate, for certain purposes. Mortgage revenue bonds must compete with other types of "private activity" bonds for allocation under each state's volume cap. Estimates of revenue loss from extending the MRB program assume that states will not make full use of their volume caps if the MRB program is not extended.

It is true that volume caps were not fully used in 1987 (although a number of states appear to have approached their caps), but this can be attributed to the huge volume of projects funded in 1985-86, in anticipation of tax reform; the lingering confusion over the Tax Reform Act of 1986; and the lack of experience with the volume allocation process under the state caps. Given the scale of infrastructure problems the country faces, to assume that no states will reach their volume caps is somewhat cavalier, especially when one considers that one or two large projects can entirely consume a state's volume cap. Not every state will reach its volume cap in every year, but many states will find the caps restrictive in the next few years, and many will undoubtedly substitute, to some degree, other bonds for MRBs, if the MRB program is not extended. If the caps will be fully consumed without MRBs, then failure to extend the MRB program will not gain any revenue for the federal government, but will only allow states and localities less choice in the use of their tax-exempt bond authority. If the caps are not fully used in the absence of MRBs, but there is significant replacement of MRBs with other types of bonds, then the revenue gained from terminating the program will be less than currently estimated. Finally, it would be interesting to see the extent that revenue estimates prepared for the Tax Reform Act of 1986 assumed that volume caps would be used after the MRB program expired. A significant inconsistency would be worthy of discussion with the revenue estimators.

IV. CONCLUSION

America's housing crisis demands a national policy. Most policymakers and most Americans recognize the need for a federal role in housing. A survey by Information America in May, 1987, found that 79% of Americans support the role of the federal government in assuring that mortgage money is available at the best possible rates. A 1987 Yankelovich poll found that 54% favor increased spending for low and moderate-income housing.

At issue before the Congress is whether mortgage revenue bonds will continue to be a part of federal housing policy. Without Congressional action, the mortgage revenue bond program will expire on December 31, 1988. The program has a proven record of success in supplying mortgage financing to those in need, redeveloping economically distressed areas, and achieving Congressional targeting goals. In short, this program works. In the interest of national housing policy, it should be reauthorized.

NOTES

1. William C. Apgar, Jr., and H. James Brown, "The State of the Nation's Housing, 1988." Joint Center for Housing Studies of Harvard University. Data from this study is referenced in the text throughout the paper.

2. Apgar and Brown, p. 10.

3. See Home Ownership: Mortgage Bonds are Costly and Provide Little Assistance to Those in Need (GAO/RCED-88-111, March 28, 1988). This report is referenced in the text throughout the paper.

4. This data was compiled by Dr. Margaret Wrightson of the Georgetown University Center for Public Policy for a forthcoming paper on the mortgage revenue bond program. This table was reproduced from "A Referendum on the American Dream," a study prepared by the National Association of Home Builders, the National Association of Realtors, the National Council of State Housing Agencies, and the Association of Local Housing Finance Agencies. The data of MRB-assisted buyers comes from only 16 states; the data on private financing, however, comes from national surveys by the National Association of Realtors.

5. See footnote 4.

6. See "A Referendum on the American Dream," p. 5.

7. It appears that GAO calculated the mortgage subsidy by comparing the mortgage rate at the time of issue of a mortgage bond to the conventional mortgage rate at the time individual loans were closed. Since interest rates have been falling over the past several years, the spread will obviously narrow in the time between issuance of the bond and closing of the loan. If interest rates were rising, the spread would widen. Moreover, this method for calculating mortgage subsidy overlooks the fact that housing agencies attempt to compensate for falling interest rates and narrowing spreads through use of their reserve funds when individual loans are issued. By "buying down" the interest rate, housing agencies are able to widen the spread at the point when loans are issued.

ACKNOWLEDGMENTS

This paper was prepared for the Public Securities Association by Kurt van Kuller of Lebenthal & Co., Inc., who serves on PSA's Credit Research Committee and chairs the PSA's ad-hoc committee on mortgage revenue bonds. PSA would like to thank Jim Lebenthal and Joe Sack for allowing Mr. van Kuller to take time from his other duties to complete this project. In addition, PSA wishes to thank George Friedlander, Chairman of PSA's Market and Public Policy Analysis Committee, Sylvan Feldstein, Chairman of the Credit Research Committee, and the other members of the MRB committee (Nancy Granese, Kutak, Rock & Campbell; Tom Buckmeyer, Smith Barney, Harris Upham & Co., Inc.; and Bill de Sante, Moody's Investors Services) for their help in this endeavor. Finally, PSA is grateful to the following people for their assistance in the preparation of this report:

David Pinson, National Counsel of State Housing Agencies
Dr. Richard W. Peach, Mortgage Bankers Association of America
Mark Moore, Public Securities Association
Mary Kate Smith, Association of Local Housing Finance Agencies
David Ledford, National Association of Home Builders
Forrest Pafenberg, National Association of Realtors
Larry Pierzchalski, Mortgage Guaranty Insurance Corp. (MGIC)
Brian Broomfield, Mortgage Guaranty Insurance Corp. (MGIC)
Robert Kessler, Citicorp Investment Bank
Leon Karvelis, Jr., Municipal Bond Investors Assurance Corporation
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April 25, 1988

VIA MESSENGER

Committee on Finance
United States Senate
Room 205
Dirksen Office Building
Washington, D.C. 20510

Re: Extension of Section 368(a)(3) of the Internal Revenue Code of 1986 (the "Code") to Encompass Modified Conversions of Troubled Thrift Institutions

Attention: Ms. Wilcox and Mr. Mihalski

Ladies and Gentlemen:

In response to the request of the Committee in Press Release #H-10 for written statements concerning expiring tax provisions, and on behalf of several of our clients which are savings and loan associations and savings banks ("Thrift Institutions"), this is to present the reasons we believe Section 368(a)(3) of the Code should be amended to preserve the net operating loss carryforwards ("NOL Carryforwards") of troubled Thrift Institutions following their conversion to stock form in a "modified" conversion.

A modified conversion, as more fully described in Exhibit A hereto, enables certain weakly capitalized Thrift Institutions to raise funds through the sale of stock to depositors, borrowers,and to "Standby Purchasers" who guarantee the success of the stock offerings in return for being allowed to acquire control of Thrift Institutions. A modified conversion is frequently the only procedure a poorly capitalized Thrift Institution can use to raise capital. However, the current version of Section 368(a)(3) obstructs the ability of Thrift Institutions to complete modified conversions by requiring that a Thrift Institution lose the benefit of its net operating loss carryforwards ("NOL Carryforwards") following a modified conversion. In contrast, well capitalized institutions can convert to stock form pursuant to a "standard conversion" and insolvent institutions can convert to stock form pursuant to a voluntary supervisory (i.e. bankruptcy) reorganization and preserve their NOL Carryforwards. Due to this discrimination in the tax laws against modified conversions, many weakly capitalized, but solvent Thrift Institutions are unable to convert to stock form and are frequently forced into insolvency.

We respectfully submit that Congress should amend the current version of Section 368(a)(3) of the Code in order to aid troubled Thrift Institutions that are seeking to strengthen their capital base through the sale of stock. A specific proposed amendment is attached hereto as Exhibit B. Such an amended provision should remain in effect for the foreseeable future, and well beyond the December 31, 1988 expiration date of the current version of Section 368(a)(3).

A. <u>Policy Reasons For Congressional Support of Modified Conversions</u>.

1. <u>Congress Has An Interest In Supporting Private Recapitalization of Thrift Institutions</u>

Congress reaffirmed in Title IX of the Competitive Equality Banking Act of 1987, in a sense of Congress resolution, that deposits in Thrift Institutions and, ultimately the solvency of the savings and loan industry, are backed by the full faith and credit of the United States. Therefore, Congress has a strong interest in utilizing whatever prudent means are available to assist Thrift Institutions to remain solvent and financially secure.

Congress should not be misled by the short-sighted argument that it is not appropriate to amend the current version of Section 368(a)(3) because the tax laws should not be utilized to provide assistance to selected taxpayers. To the contrary, we submit that it would be a wise tax policy for Congress to facilitate the recapitalization of troubled Thrift Institutions through modified conversions which can be promoted at nominal cost to the United States Treasury. Troubled Thrift Institutions which have large NOL Carryforwards are, in fact, not paying substantial amounts of federal corporate taxes. If Section 368(a)(3) were not amended, many of such troubled Thrift Institutions which could successfully recapitalize pursuant to a modified conversion may fail. Such failures could ultimately become a liability of the Treasury if a "taxpayer bailout" of the savings and loan industry is necessitated.

2. <u>NOL Carryforwards Are An Effective Incentive for Private Investment In The Thrift Industry</u>

We are aware of several instances in which troubled Thrift Institutions could successfully raise capital and become viable entities through the sale of stock if such institutions were able to utilize their NOL Carryforwards following a "modified" conversion to stock form. In such cases, the availability of NOL Carryforwards would increase the return available to private investors and provide an important incentive for such investors to risk their capital by purchasing the stock of troubled Thrift Institutions.

With the loss of their ability to use their NOL Carryforwards without limitation following a "modified" conversion, however, Thrift Institutions may not generate a sufficiently profitable return for investors to consider the purchase of their stock. Accordingly, such troubled Thrift Institutions have been effectively prevented by the current version of Section 368(a)(3) from completing modified conversions to raise needed capital. Instead, these undercapitalized Thrift Institutions have been left in an extremely precarious position, unable to raise necessary capital to comply with applicable FHLBB regulations and very near to insolvency.

The foregoing situation would be greatly alleviated if a Thrift Institutions' NOL Carryforwards were fully available following their modified conversion. As described below, it appears that several hundred conversions of Thrift Institutions to stock form would be facilitated through the proposed amendment of Section 368 (a)(3).

3. <u>The FSLIC Cannot Afford Avoidable Failures of Thrift Institutions</u>

The General Accounting Office ("GAO") reported to Congress in May 1987 that the FSLIC was insolvent by $6.3 billion at the end of 1986. FSLIC's insolvency was due to the creation of loss reserves of $10.5 billion to cover future losses associated with troubled Thrift Institutions. Accordingly, the GAO testified to the House Committee on Banking, Finance and Urban Affairs that:

> FSLIC's reserves for dealing with such problems [increasing number of closed institutions, increasing cost of liquidation, increasing assistance to open troubled institutions] have steadily declined and, with the additional loss provision . . . , FSLIC will be in a deficit position. This decline coupled with FSLIC's sharply higher and increasingly expensive caseload, illustrates the urgent need to infuse new funds into the Corporation.

In the Competitive Equality Banking Act of 1987, Congress authorized the FSLIC to borrow $10.825 billion to finance its recapitalization. Many anticipate that this level of borrowing will be insufficient to cover FSLIC's estimated losses of up to $30 billion.

Against this background, there can be no dispute that the FSLIC cannot afford unnecessary failures of additional Thrift Institutions. Congress should amend the tax laws in the manner suggested herein to facilitate the private recapitalization of as many troubled Thrift Institutions as possible in order to alleviate the massive losses which the FSLIC will encounter in the coming years. Such an amendment of Section 368(a)(3) should reduce the number of insolvency receivership proceedings conducted by the Federal Home Loan Bank Board ("FHLBB"). In addition, we believe there would be a reduced cost to the FSLIC of providing financial assistance in connection with bankruptcy reorganizations of troubled Thrift Institutions. Certain bankruptcy reorganizations may be prevented altogether if troubled Thrift Institutions could successfully complete modified conversions. The early recapitalization of troubled Thrift Institutions through modified conversions in which NOL Carryforwards are preserved would be cost effective as compared with the larger costs which would otherwise be imposed on the FSLIC, and possibly on the U.S. Treasury, if more Thrift Institutions fail.

4. The Proposed Amendment Will Generate Increased Tax Revenue

The cost to the Treasury, in terms of lost revenue or "tax expenditure" which would result from creating an exception from the Section 382 limitation on NOL Carryforwards following a "modified" conversion would, we believe, be compensated for through increased tax revenue over a period of several years. The failing Thrift Institutions which have large NOL Carryovers are not currently paying significant federal corporate income taxes. Accordingly, there is no real tax expenditure involved if they are allowed to convert to stock form in a modified conversion. If a Thrift Institution is restored to profitability following its modified conversion, the only tax cost which may be involved is an opportunity cost resulting from its ability, under the proposal set forth herein, to utilize its own NOL Carryforwards. After a short number of years, however, any such opportunity cost would itself be eliminated since the NOL Carryforwards which existed at the time of a modified conversion would expire over a statutorily-prescribed schedule. Thereafter, a converted institution would be restored to being a tax-paying corporation and would broaden the federal tax base.

B. Why Modified Conversions are Currently Obstructed.

If a Thrift Institution completes a modified conversion, which typically involves the sale of a controlling interest in the company's stock to a single investor, the current version of Section 368(a)(3) provides that no exception from the generally applicable Section 382 limitation on NOL Carryforwards is available. This is because such a sale of control constitutes an "ownership change" within the meaning of Section 382 and the related Treasury Regulations.

Such an "ownership change" does not occur in the case of a conversion to stock form of a well-capitalized institution because a "standard" conversion prohibits any investor group from acquiring control of the institution. In the case of a "voluntary supervisory" (i.e. bankruptcy) conversion of an insolvent Thrift Institution which involves an ownership change of the institution, the current version of Section 368(a)(3) provides an exception from the Section 382 limitation on the use of NOL Carryforwards. However, a Thrift Institution may only qualify for a voluntary supervisory conversion and the exception from the Section 382 limitation if the Federal Savings and Loan Insurance Corporation ("FSLIC") is authorized to appoint a receiver for the company. A receivership may be imposed on a Thrift Institution only on the grounds of "insolvency, in that the assets of the association are less than its obligations", or if there has been a violation of applicable law, rules or regulations, or the institution is in an unsafe and unsound condition to transact business. See Sections 368 (a)(3)(ii)(III) and 382 (1)(5)(F)(iii) of the Code, and 12 U.S.C. §1464(d)(6)(A)(i), (ii) and (iii), attached hereto as Exhibit C.

Thus, the current version of Section 368 (a)(3) in effect requires that a troubled Thrift Institution must either be able to complete a standard conversion, which is unattainable for many solvent but under-capitalized institutions, or must actually become insolvent before it may be exempted from the generally applicable Section 382 limitation on the use of NOL Carryforwards following a conversion to stock form. For the policy reasons cited above, this state of the law is contrary to public policy, short-sighted and impractical and we believe Congress should amend Section 368(a)(3) to assist in preventing forced insolvencies of Thrift Institutions which may, in many cases, be prevented through the sale of stock in a modified conversion.

The ability of Thrift Institutions to recapitalize would be greatly increased if Section 368 (a)(3) were amended to provide that modified conversions of Thrift Institutions are exempted, as voluntary supervisory (i.e., bankruptcy) conversions already are, from the Section 382 limitation on the use of NOL Carryforwards following an "ownership change" as defined in Section 382 of the Code. We believe an exception from the Section 382 Limitation may be narrowly drawn in Section 368 (a)(3), as the proposed amendment to the section set forth in Exhibit B hereto demonstrates, by allowing a specific exception only for modified conversions of Thrift Institutions completed pursuant to Subpart D of Part 563b of the Rules and Regulations for FSLIC Insured Institutions, 12 C.F.R. §563b.34 et seq.

C. The Number of Thrift Institutions Likely to Complete Modified Conversions.

The pool of Thrift Institutions likely to complete modified conversions consists of those institutions which can demonstrate positive net worth of less than three percent of total liabilities after subtracting from their balance sheets such items as appraised equity capital, goodwill and deferred losses. Institutions which are reduced to negative net worth after these adjustments are probably not realistic candidates for a modified conversion. Based on our internal calculations using these criteria, we believe there would be forty-seven institutions with total assets of $32.8 billion eligible to complete modified conversions in the Southwest region of the country consisting of Arizona, New Mexico, Texas, and Oklahoma. Across the nation, we anticipate that there could be several hundred troubled Thrift Institutions which may be able to complete a modified conversion if their NOL Carryforwards were not subject to limitation following their sale of stock.

D. Conclusion

To the best of our knowledge, there were only five modified conversions of troubled Thrift Institutions completed during 1987. However, if NOL Carryforwards could be used without limitation following the modified conversion of a troubled Thrift Institution, it appears that several hundred weakly capitalized Thrift Institutions across the nation which are currently unable to complete standard conversions would be better able to raise needed capital through the sale of stock.

We believe the increased capitalization of the savings and loan industry which would result from the proposed amendment of Section 368(a)(3) would be attained at a relatively low cost to the United States Treasury. Without the proposed amendment, we submit that a much greater cost will be imposed on the FSLIC and, indirectly on the Treasury and all taxpayers, if marginally capitalized Thrift Institutions which could successfully raise capital through modified conversions instead founder and become insolvent.

Please feel free to call us if you have any questions regarding the foregoing or if we can supply you with any additional information.

Very truly yours,

Jeffrey A. Koeppel

Derek A. Bloom

cc: Senator Lloyd Bentsen
Sam Sessions, Esq.

Senator Bob Packwood
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Exhibit A

Modified Conversions of Thrift Institutions

In order to rebuild the capital base of Thrift Institutions, the FHLBB has developed three different programs to facilitate capital formation by means of the sale of stock. The voluntary supervisory form of conversion is not described below since it is available only for insolvent Thrift Institutions which may convert to stock form pursuant to Section 368(a)(1)(G) of the Code. The Section 382 limitation on the use of NOL Carryforwards is inapplicable to conversions which qualify as tax-free bankruptcy reorganizations pursuant to Section 368(a)(1)(G).

Standard Conversions

In a standard conversion, the stock of a Thrift Institution is sold to the general public at its appraised fair market value. Members of the Thrift Institution in its mutual form must be given nontransferable rights to subscribe to purchase stock sold in the conversion on a priority basis. The members' right to receive the residual net worth of the institution in the event of its liquidation is carried forward in a "liquidation account". Any stock not sold to members is sold to the general public either in an underwritten public offering or in a direct community offering.

Restraints are imposed by the FHLBB on the ability of any party or group to acquire control of a Thrift Institution converting to stock form in a standard conversion. Investors are limited to purchasing a maximum of 5% of the stock sold in a standard conversion, with the exception of certain employee benefit plans which may purchase up to 10%.

Procedurally, the primary elements in a standard conversion by a mutual Thrift Institution are: (1) adoption of a plan of conversion by a two-thirds vote of the institution's board of directors, (2) submission of an application for conversion (containing a plan of conversion, a proxy statement, and an appraisal) to the FHLBB, (3) holding a special meeting of members to vote on and approve the plan of conversion, (4) offering priority subscription rights to members to acquire the stock of the institution, and (5) sale of the remainder of the stock either in an underwritten public offering or in a direct community offering.

Modified Conversions

A modified conversion is generally available to a Thrift Institution which can demonstrate that a standard conversion would not raise sufficient capital to enable the institution to comply with applicable regulatory capital requirements of the FHLBB. The most important distinction between a standard and modified conversion, is that in a modified conversion it is permissible for an investor to acquire control of a Thrift Institution.

Modified conversions differ from standard conversions, procedurally, in the following respects:

(1) A majority of the board of directors of the converting Thrift Institution must approve the conversion, but approval of the institution's members is not required to authorize a modified conversion.

(2) A converting Thrift Institution must sell its stock at an aggregate price exceeding the estimated pro forma market value of the institution, including an appropriate control premium, based on an independent valuation. Under the FHLBB's regulations, a person or company acquiring control of a Thrift Institution during its modified conversion (a "Standby Purchaser") must provide sufficient capital to bring the regulatory capital of the institution up to the minimum required level on a generally accepted accounting principle ("GAAP") basis which is generally in the range of 3% of total liabilities. The required level of regulatory capital is being increased to 6% over a period of approximately 12 years.

For its investment in a Thrift Institution during its modified conversion, a Standby Purchaser would be able to acquire control of the institution at a favorable price to book ratio. The Standby Purchaser would be asked to enter into a Stock Purchase Agreement with the institution whereby it would agree to purchase all shares of stock which remain unsubscribed for in a subscription offering to the institution's members. In exchange for guaranteeing the minimum gross proceeds of the offering, the Standby Purchaser is granted a priority right to purchase a certain percentage of the offering based upon a formula described below and could acquire up to 100% of the shares offered depending on the amount of stock sold to members in a subscription offering.

(3) The subscription rights of members may be reduced in a modified conversion according to a formula based on the percentage of an institution's regulatory capital requirement which is satisfied based on calculations made in accordance with generally accepted accounting principles.

Exhibit B (Proposed additions are underlined.)

Proposed Amendment of Section 368(a)(3) of the Code

(3) ADDITIONAL RULES RELATING TO TITLE 11 AND SIMILAR CASES.

(A) TITLE 11 OR SIMILAR CASE DEFINED. for purposes of this part, the term "title 11 or similar case" means-

(i) a case under title 11 of the United States Code, or

(ii) a receivership, foreclosure, or similar proceeding in a Federal or State court, or

(iii) a transaction described in subpart (iii) of subparagraph (D) of paragraph (3).

(B) TRANSFER OF ASSETS IN A TITLE 11 OR SIMILAR CASE. In applying paragraph (1)(G), a transfer of the assets of a corporation shall be treated as made in a title 11 or similar case if and only if-

(i) any party to the reorganization is under the jurisdiction of the court in such case, and

(ii) the transfer is pursuant to a plan of reorganization approved by the court.

(C) REORGANIZATIONS QUALIFYING UNDER PARAGRAPH (1)(G) AND ANOTHER PROVISION. If a transaction would (but for this subparagraph) qualify both-

(i) under subparagraph (G) of paragraph (1), and

(ii) under any other subparagraph of paragraph (1) or under section 332 or 351,

then, for purposes of this subchapter (other than section 357(c)(1), such transaction shall be treated as qualifying only under subparagraph (G) of paragraph (1).

(D) AGENCY PROCEEDINGS WHICH INVOLVE FINANCIAL INSTITUTIONS.

(i) For purposes[s] of subparagraphs (A) and (B)-

(I) In the case of a receivership, foreclosure, or similar proceeding before a Federal or State agency involving a financial institution to which section 585 applies, the agency shall be treated as a court, and

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(II) In the case of a financial institution to which section 593 applies, the term "title 11 or similar case" means only a case in which the Board (which will be treated as the court in such case) makes the certification described in clause (ii) or (iii).

(ii) A transaction otherwise meeting the requirements of subparagraph (G) of paragraph (1), in which the transferor corporation is a financial institution to which section 593 applies, will not be disqualified as a reorganization if no stock or securities of the corporation to which the assets are transferred (transferee) are received or distributed, but only if all of the following conditions are met:

(I) the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met with respect to the acquisition of the assets,

(II) substantially all of the liabilities of the transferor immediately before the transfer become, as a result of the transfer, liabilities of the transferee, and

(III) the Board certifies that the grounds set forth in section 1454(d)(6)(i), (ii), or (iii) of tile 12, United States Code, exist with respect to the transferor or will exist in the near future in the absence of action by the Board.

(iii) A transaction meeting the requirements of subparagraph (F) of paragraph (1) in which the taxpayer is a financial institution to which section 593 applies and in which the Board certifies that the taxpayer is completing a modified conversion from the mutual to stock form of organization pursuant to Section 1464(i) or (o), or Section 1725(j) of title 12, United States Code.

(iv) For purpose[s] of this subparagraph, the "Board" means the Federal Home Loan Bank Board or the Federal Savings and Loan Insurance Corporation or, if neither has supervisory authority with respect to the transferor, the equivalent State authority.

NATIONAL REHABILITATION ASSOCIATION
TESTIMONY ON TARGETED JOBS TAX CREDIT
MARCH 28, 1988

CAROLYN B. THOMPSON, MS, CRC
PRESIDENT
JOB PLACEMENT DIVISION, NRA

Mr. Chairman and members of the subcommittee, The National Rehabilitation Association is pleased to come before you today to urge you to support Senate bill 684 which will amend the Internal Revenue Code of 1986 to make permanent the Targeted Jobs Tax Credit.

There are 37 million Americans with disabilities. A recent Harris Poll informed us that 67% of these Americans are unemployed and want to work. Who are these unemployed Americans with disabilities? They represent all races, sexes, creeds and disabilities. They have high school educations, college educations, Ph.D's. They have little or no work history or training and they have years of experience. They are trained as biologists, teachers, accountants, secretaries, janitors, chefs, bus boys, managers and computer technicians, to name a few. They live in Montana, Hawaii, Arkansas, Missouri, Delaware, Rhode Island, Wyoming, Washington D.C. Why are so many individuals with such different backgrounds in need of Targeted Jobs Tax Credit? They are disabled, and though the Rehabilitation Act protects people with disabilities from discrimination, the continuing lack of widespread experience by the business community with disabled employees prevents them from hiring. The increasing gap between the disabled worker's skills and the requirements of today's jobs, coupled with, quite often, little or no work history, only serves to increase the employer's concerns.

Targeted Jobs Tax Credit is designed to change hiring practices. It has a proven track record since its inception in 1979 in providing a substantial incentive to employers to hire not only workers with disabilities but workers from other targeted groups experiencing unusually high rates of unemployment. During FY 1984 563,381 TJTC participants were hired in all 50 states and the District of Columbia. About 11% of these were people with disabilities. Early in FY 1986 the credit expired and was not renewed until October of 1987. I am sure that you will not be surprised to learn that the year following the 9 month lapse, FY 1987, the number of TJTC participants hired was estimated to be only 400,000.

The program has never been fully utilized by either those job seekers qualifying in targeted groups or the business community, but great advances were being made. The Targeted Jobs Tax Credit has been up for renewal and extended four times, the most recent time in late 1986 only after a 9 month lapse. The time limited nature of past extensions of the Targeted Jobs Tax Credit and memory of the lapse has caused a significant drop in usage and a drop in hiring those job seekers most in need of assistance. The purpose in offering the Targeted Jobs Tax Credit to the employer is to provide an incentive to hire people with disabilities and others that because of their work history or lack of work history, skills, and/or education are considered too high risk to be hired. The Tax Credit provides the employer with the necessary incentive to take the risk and allow for a longer "break in" period. Making the Targeted Jobs Tax Credit permanent will provide the stability needed for the business community to become totally familiar with it, see its benefits and use it as part of their long range plans.

Many groups believe that we are recovering from the FY 1986 lapse and gaining the confidence of the business community once more. The Targeted Jobs Tax Credit Coalition, a group of employers, community groups and organizations representing disadvantaged workers, estimates that if Targeted Jobs Tax Credit is extended one year the number of jobs attained through this program in FY 1989 will be back up around 625,000 again (comparable to FY 1985). This number will increase dramatically when the provision is made permanent. Rehabilitation professionals and others have helped

employers to see that hiring people with disabilities is not only not the "risk" that it seems but in fact makes good business sense. Our task will be made easier if you make the Targeted Jobs Tax Credit permanent, creating the stability that the business community needs.

We have heard opponents of TJTC argue that it is unnecessary because employers would hire disabled and disadvantaged workers anyway, given the tightening labor markets for young workers, the traditional source of entry level workers. I believe that this is a false assumption. I believe that in the absence of TJTC, employers will prefer the ever increasing number of women entering the workforce, elderly workers and displaced workers to people with disabilities, veterans, ex-offenders and the other targeted groups. Let me point out to you again that the intent of the TJTC program is to change hiring practices. TJTC has been proven to be effective in doing this and should be continued as long as unemployment rates for people with disabilities and others that are disadvantaged remaim embarrasingly high.

Not only does the Targeted Jobs Tax Credit program help people with disabilities get a foot in the door at their local company and provide an incentive for employers to take a risk in hiring but it also saves government dollars. IN FY 1985 the total cost of TJTC was $364 million figured at $586 average cost per person. The FY 1985 savings on public assistance alone for those employed with the help of TJTC was $418 million. Other major savings were gained from SSI and SSDI, food stamps and unemployment compensation. This program helped to employ 622,848 hard to employ people in FY 1985 and saved the United States government in excess of $54 million. If TJTC is made permanent we can expect FY 1989 savings to exceed $54 million and increase each year. This program makes good business sense to both the private sector and the federal government.

I'd like to briefly share with you the life of a man, a life that would be entirely different today without the help of TJTC several years ago. Joe is a young man who can barely read the simplest of sentences and until three years ago was late to every job related event and had extremely low self esteem. After careful training and preparation with rehabilitation professionals to ready himself for the job search he set out with high hopes. Unfortunately his low self esteem and tardiness prevented him from even getting an interview. All attempts to solve these problems through counseling had failed and as I'm sure you can imagine all the weeks and months of turndowns did nothing for this man's self-esteem. Finally, in a brief discussion with the manager of a Mexican food chain, Joe remembered to show his TJTC certification. The manager called Joe's counselor for an explanation of both TJTC and the services that Joe was receiving that would help him be the quality of worker that this manager needed. The manager decided to take a risk. The risk paid off because Joe did become a loyal, timely and happy employee of that company. Of course there were problems in the beginning but the incentive of TJTC encouraged the manager to work along with Joe and his counselor to solve these problems.

Today, three years later, Joe has had his ups and downs. The company where he had his first job closed but another Mexican food chain hired him right away because of his experience, work history and reference and he has been a valued employee at his new company for two years. He recently has saved enough money and gained enough skills and confidence in himself to move out of the group residence he lived in for five years and into his own apartment. Without TJTC the first manager would not have hired him and the number of turndowns would eventually have led Joe to stop seeking competitive employment.

In conclusion, you must make decisions now that will insure that all the future Joe's of this country will have the opportunity for competitive employment and an independent life style. This is nothing more than we want and in fact demand for ourselves. I urge you to support Senate bill 684 to amend the Internal Revenue Code of 1986 to make the Targeted Jobs Tax Credit permanent. Permanency will stabilize the program which will increase its utilization thus decreasing the unemployment rate for people with disabilities and other targeted groups and providing a significant savings in public assistance and SSI, SSDI payments.

John F. Kennedy said "The cost of doing the job right is not more than we can afford. It may not be cheap or easy or popular - but we cannot afford to do less."

Statement of
The National Association of Rehabilitation Facilities

on
Extension of the Targeted Jobs Tax Credit
S.684

Before
Subcommittee on Taxation and Debt Management
Committe on Finance
United States Senate

March 28, 1988

The National Association of Rehabilitation Facilities wishes to express its support for extending the Targeted Jobs Tax Credit as proposed in S.684. Extension of this credit will provide a much needed incentive for employers to expand their employee base by hiring persons with disabilities and other persons with significant barriers to employment.

The National Association of Rehabilitation Facilities (NARF) is the national trade association of community-based organizations that provide vocational and medical rehabilitation services to persons with mental and/or physical disabilities. These facilities annually provide services to more than 400,000 persons with disabilities. A primary purpose of rehabilitation programs is to return disabled persons to work after an illness or injury or to given them their first opportunity to work. The persons served by rehabilitation facilities, and those who will benefit most from extension of TJTC, are those persons with the more severe disabilities. These are those persons who are mentally retarded, who have chronic mental illness, and those who have severe limitation of mobility or other major life function. Just a very few years ago, these persons were not considered employable. However, increasing public awareness and acceptance, improved technology, development of new programs such as supported employment, and the removal of some work disincentives have made employment a realistic goal for even the most severely disabled. The most serious barrier to employment remains employer reluctance to hire people that they believe or perceive less than fully productive. The Targeted Jobs Tax Credit has often proven to be an important factor in overcoming this barrier.

The Targeted Jobs Tax Credit benefits two groups served by vocational rehabilitation facilities. They are referrals from the state vocational rehabilitation program and recipients of Supplemental Security Income (SSI) under the Social Security Act. Most of the persons with disabilities served by these facilities are either receiving or are eligible for state V.R. services. Many of the disabled persons served by these facilities are also SSI recipients.

In 1985, Lou Harris Associates conducted a comprehensive poll of non-institutionalized disabled persons. The findings of the poll were dramatic. The Poll found:

> *Two-thirds of all disabled Americans ages 16 to 64 are not working. Only one in four work full-time and another 10 percent work part-time. No other demographic group under age 65 of any size has such a small proportion working. Only 29 percent of disabled persons say they have at least some college education compared to 48 percent of non-disabled persons. Forty percent of all disabled persons age 16 and over did not finish high school. This proportion is nearly three times that of the non-disabled population, where only 15 percent of adults age 18 and over have less than a high school education.*
>
> *Disabled Americans are much poorer than are non-disabled Americans. Half of all disabled persons age 16 and above had a household income in 1984 of $15,000 or less. Fully one in three disabled persons reports a household income of $7,500 a year or less. Six out of 10 elderly disabled persons report a household income of $15,000 or less.*
>
> *About three out of 10 disabled individuals say that a lack of accessible or affordable transportation is an important reason why they are not working. Of these disabled people, 38 percent say that under-education and the lack of marketable skills are important reasons why they are not working. And, 47*

percent of disabled persons who are not working at all say that employers won't recognize that they are capable of doing a job because of their disability.

One issue raised frequently in discussion of barriers which prevent disabled persons from working is fear of a loss of key benefits such as government health insurance. (emphasis added)

In 1987, Lou Harris conducted a second poll, this time on the attitudes of employers toward hiring persons with disabilities. Among the findings in that poll was that over 50% of the employers polled said that increased tax deductions and financial incentives would induce employers to train and employ more handicapped persons. (emphasis added) Of those employers polled who had participated in TJTC, 76% found it to be very or somewhat successful.

The statistics from the Harris Poll are born out by NARF's experience. Over the past year, NARF has been working with several national corporations to develop job opportunities for persons with severe disabilities. These efforts have resulted in thousands of letters to community employers from their corporate headquarters urging them to hire persons with disabilities. Manuals and video training tapes were developed to show the local employer how they could hire disabled workers. Information on TJTC was part of those manuals and tapes. These corporations include Coors, Kentucky Fried Chicken, and Taco Bell. All of these corporations have told NARF that while TJTC is not the sole reason to hire someone, it is a very important part of their corporate strategy. It does make them consider some groups such as persons with disabilities as potential employees when they might not have without the tax credit.

Most vocational rehabilitation facilities offer placement services. These programs match persons with disabilities with available jobs in the community. Overcoming employer reluctance to hiring persons with disabilities is a major factor for these placement programs. The availability of TJTC is an important factor in many businesses taking a pro-active posture in hiring persons with disabilities.

The Targeted Jobs Tax Credit is the only federal incentive for most employers to hire persons with disabilities. Non-discrimination and affirmative action laws regarding persons with disabilities only apply to federal contractors. Loss of TJTC would be a major blow to our efforts to increase employment opportunities for persons with disabilities.

While the loss in revenues to the Treasury occurs in one year, the payback in taxes and the savings to the SSI program and other welfare benefits will go on for many years. Many studies have shown that the savings of rehabilitating a person and putting them in a job saves the Federal government $10 for each dollar spent. TJTC is an important incentive to employers to give disabled persons a chance at a job. Studies have also shown that once they do have a job, disabled persons stay on the job. In many of the entry level jobs utilized in the TJTC program there has traditionally been high turnover. The Assistant Secretary of Education for Special Education and Rehabilitative Services recently said that the average tenure for severely disabled persons in supported employment (competitive jobs when special follow along services are provided to allow the disabled persons to maintain employment) was two to three times that for non-disabled employees in the same jobs.

In his statement to the Subcommittee on behalf of the Administration, Dana Trier, Acting Tax Legislative Counsel for the Department of the Treasury, said that the tax credit was not used in 97% of the jobs that economically disadvantaged youth got in 1981. This was the only evidence he cited that TJTC did not work. Many of these disadvantaged persons got their jobs without federal assistance and thus there was no cost the Federal government. What is important is how many persons did get jobs because of the tax credit. In 1986, TJTC provided jobs for 563,000 workers. Disabled workers got 43,000 jobs as a result of TJTC in 1986.

What we should be concerned about is how we can increase these numbers. Congress needs to renew TJTC for at least three years so that employers will continue to have an incentive to hire persons with special barriers to employment including persons with disabilities. Prompt action by this Subcommittee, the Finance Committee, the Senate, and the House of Representatives will ensure continuity in this important program. NARF also joins the efforts of members of the Employment Task Force of the Consortium for Citizens with Developmental Disabilities who have submitted a letter supporting the extension of TJTC. The staff of NARF is willing to help the Members and staff of the Subcommittee in any way to assist in the earliest consideration and passage of S. 684.

STATE OF NEW YORK
DEPARTMENT OF LABOR
GOVERNOR W. AVERELL HARRIMAN
STATE OFFICE BUILDING CAMPUS
ALBANY, NEW YORK 12240

THOMAS F. HARTNETT
COMMISSIONER OF LABOR

April 18, 1988

Ms Laura Wilcox
Hearing Administrator
United States Senate
Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ms Wilcox:

I am pleased to enclose testimony on the Targeted Jobs Tax Credit program to be included in the proceedings of the Subcommittee on Taxation and Debt Management.

Sincerely,

Thomas F. Hartnett

Thomas F. Hartnett

cc: Mr. Ed Mihalski

TESTIMONY

FOR

UNITED STATES SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON TAXATION AND

DEBT MANAGEMENT

TARGETED JOBS TAX CREDIT

PRESENTED BY

NEW YORK STATE DEPARTMENT OF LABOR

THOMAS F. HARTNETT
COMMISSIONER OF LABOR

APRIL, 1988

New York State has consistently been the nation's leader in employer use of the TJTC. This program has been well received in the business community, opens the job-market door for thousands of hard-to-place individuals, and is economically and socially cost efficient. For these reasons, the State of New York urges favorable action by your Committee and the full Senate on S. 684, to extend and make permanent this important employment program.

Your Committee has received testimony on the positive impact of the TJTC on a national scale. We will illustrate the importance of the TJTC to job seekers in New York State who face the most serious barriers to employment.

During the fiscal year ending in September 1987, the TJTC gave over 35,700 individuals a chance of permanent, productive employment, a chance which otherwise might not have occurred. The various characteristics of persons hired, as described below, affirm the effectiveness of the program in providing opportunities for our highest priority clients.

In Fiscal Year 1987, 78,280 persons were determined eligible and 35,731 hired as follows:

	Eligible	Hired
Disadvantaged Youth	34,703	21,632
Disadvantaged Vietnam Vets	1,566	638
Disadvantaged Ex-Felons	2,945	892
Handicapped	3,677	1,313
Co-op education students	30	30
Supplemental Security Benefits	360	139
Summer Youth	3,935	2,203
Public Assistance Recipients	31,064	8,884
Total	78,280	35,731

The entry of these disadvantaged persons into the productive work force means their entry into the economic mainstream. Thousands have left and will leave behind lifestyles of public dependence and despair. The TJTC hirings of 8,884 public assistance recipients in New York could generate potential welfare savings of as much as $4.6 million per month. This compares to a net cost of the federal tax credit attributable to the hiring of public assistance recipients, as estimated by the National TJTC coalition, of only $4.7 million, annually.

Substantial additional savings accrue as a result of the hiring of ex-felons who -- because of the job opportunities provided by the TJTC -- break the cycle of recidivism. For every ex-offender dissuaded from a return to a life of crime, the State will save at least $35,000 -- the estimated annual cost of incarceration in New York -- plus the immeasurable social costs of criminal activity. Thus, if only one quarter of the 892 ex-felon hirees last year had returned to prison because of the lack of the TJTC incentive, the corrections cost alone would have amounted to at least $7.8 million.

TJTC benefits also extend to disadvantaged young people excluded from the job market, either by hiring practices or by their own attitudes and perceptions, who may otherwise have been tempted to turn to a life of crime. While youths aged 16 through 19 comprise only 6 percent of New York's labor force, they represent 17 percent of all unemployed persons.

We estimate that the total annual payroll of the 35,731 New Yorkers hired under the TJTC in 1987 was in the range of $350 to $400 million, and that the ripple effect of economic activity resulting from this employment could be as much as $1 billion.

Declining unemployment rates in New York State and the nation are welcome signs, but general "averages" can be misleading. The unemployment rate in New York State for black youth is at an unacceptably high level of 25 percent. Experienced workers permanently displaced because of industrial changes in basic industries amount to between 157,000 and 263,000 in the State. We have over 1,158,000 public assistance recipients. Overall, an estimated 3.1 million New Yorkers are in need of employment and training assistance to help remove impediments to full participation in the job market. Current Job Training Partnership Act, Work Incentives and State-funded programs enable us to reach perhaps 149,000 --- less than five percent of those who need or can benefit from these services. Annual funding uncertainties for federal programs in the past several years have added to our challenges in serving the full universe of those in need.

TJTC is an important, innovative, and effective resource that opens up access to employers who might not otherwise be receptive to hiring persons in the targeted groups. It differs from other programs by providing a direct, though modest, incentive to employers.

As your Committee considers making this program permanent, we also urge the relevant committees to provide sufficient resources to administer the program. Our Department's budget, for example, amounts to less than one-half of the actual costs of administering the TJTC.

New York State appreciates this opportunity to testify on behalf of this important program and extends the gratitude of the tens of thousands of our citizens now in the productive work force because of the TJTC to Congressional supporters of the program. For almost every one of the 35,700 individuals who found work last year with the help of the TJTC, there is a success story, and we would like to share one with you.

Yolonda B. is an 18 year old school dropout who was living in a homeless youth shelter when she visited our Job Service office in Manhattan. She impressed the staff as genuinely wanting to escape the street environment, but just did not have the resources to do so. We eventually located an employer who would hire and train her, but could only hire her at $3.50 an hour - unfortunately not enough to enable Yolonda to become self-sufficient. Our office discussed the situation with the employer, and explaining that the TJTC would compensate for the additional cost, persuaded the employer to start Yolonda at $4.00 per hour. Several weeks later, Yolonda came back to visit us -- still on her new job, enjoying it, and well underway in learning new skills.

We believe that if we do not intervene now on behalf of individuals in the targeted groups, all of us will pay a higher price in the future, through lost opportunities, lower productivity, and additional social costs. We strongly urge your favorable action on S. 684 to enable the good work of the TJTC program to continue.

STATEMENT OF THE
NATIONAL COUNCIL OF SAVINGS INSTITUTIONS
ON EXPIRING TAX PROVISIONS

SUBMITTED TO THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
FOR A HEARING ON MARCH 28, 1988

The purpose of this Statement is to express the support of the National Council of Savings Institutions for extension of the provisions of the Internal Revenue Code (IRC) relating to reorganizations of financially troubled thrift institutions (Secs. 368(a)(3)(D) and 382(1)(F) and treatment of assistance received from the Federal Savings and Loan Insurance Corporation (FSLIC)(Sec. 597). The current provisions, which were originally adopted in 1981 and extended during consideration of the Tax Reform Act of 1986 (the Act), provide an exception to the general reorganization rules as they affect net operating losses (NOLs) and continue tax free treatment of FSLIC assistance through the end of 1988. In addition, the Council recommends that the application of the special reorganization rules to savings banks insured by the Federal Deposit Insurance (FDIC) be clarified and that the rules granting favorable tax treatment be extended to FDIC assistance.

The National Council is a trade association representing approximately 500 savings institutions nationwide. Our membership consists of savings banks and savings and loan associations which are insured by the FDIC and the FSLIC. Given the duality of our membership, we have been able to judge first hand the effect of the current rules regarding supervisory reorganizations and the tax treatment of assistance given in supervisory acquisitions. The evidence shows that the special treatment of supervisory reorganizations and the consequent survival of tax attributes such as NOLs have been extremely valuable to the insuring agencies as they have dealt with problem institutions since 1981. The rules which provide for tax free treatment of FSLIC assistance have allowed FSLIC to preserve its resources and to deal with a broader range of problems than would otherwise have been possible.

Extend the Supervisory Merger Provisions Through 1991

While we would like to be able to tell the Subcommittee members that all of the problems facing the FSLIC and the FDIC are currently solved and that it will not be necessary to extend the tax provisions, such a recommendation is not possible at this time. Although Council member institutions generally are healthy and profitable, it is readily apparent to us that more time is needed to solve the problems facing the savings industry as a whole. The enactment of a $10.825 billion recapitalization of FSLIC by the Congress last year is a step in the long term solution to problems, but this program alone will not allow FSLIC to complete the job that needs to be done. If the failing institutions are to be successfully merged and if appropriate acquirors are to be found, all resources must be used. Repeal of the special tax provisions affecting supervisory mergers would require FSLIC to spend more dollars on each merger and would be counter productive. This fact was recognized by the Treasury Department during the tax reform process. "Treasury I" recommended extension of the assistance to 1991. Given this fact and the continuing economic problems facing a segment of the industry, the National Council recommends that the tax provisions be extended through 1991 to coincide with the period of the FSLIC recapitalization provided by the Competitive Equality Banking Act (CEBA) last year.

Grant Similar Treatment to FDIC

Given the fact that the Council represents savings banks insured by FDIC as well as savings and loans insured by FSLIC, we have been able to observe directly the impact of the special reorganization rules on FDIC. We believe the current treatment has been favorable, but that clarification is needed regarding the coverage of supervisory mergers of FDIC. In addition, the Council asks that parity of treatment be given by extending the favorable treatment currently available only to FSLIC asistance to that given by the FDIC. Such treatment would allow FDIC to stretch its resources at a critical time and would reduce the dollar outlays of the FDIC. Further, the confusion inherent in the current situation would be eliminated.

Make Needed Technical Changes

There are a number of technical problems relating to the drafting of section 382 which need to be addressed if the rules for supervisory mergers of thrift institutions are to work properly. The Council is pleased that the Internal Revenue Service has taken steps to address the "Double G" Reorganization problem for interim control of savings and loan institutions in the Management Consignment Program. We urge that IRS grant similar treatment to use of "bridge banks" by the FDIC.

The Council also urges the Congress to clarify that the proportionate "scaled down" use of NOLs for institutions not meeting the 20% continuity of ownership test continues to be available under section 382. This provision of previous law was not included in section 382 as rewritten in the Tax Reform Act.

There are numerous other technical problems that appear to be cropping up as institutions begin to work through conversions, mergers and acquisitions following enactment of the Tax Reform Act of 1986. We hope that the members of the Subcommittee will monitor the effect of the new 382 changes on these activities to assure that normal activity is not unduly restricted. While we at the Council recognize the need for public policy goals which protect tax revenue, we do not believe such provisions should be so cumbersome as to stand in the way of activities which have a true economic basis or, a broader, more pervasive public policy goal. We are concerned that this may happen with provisions of section 382 as currently structured.

The Council appreciates the opportunity to submit this statement to the Subcommittee on Taxation and Debt Management. We will be pleased to work with the Subcommittee on this and other issues affecting the savings industry. For further information on this issue, please contact Beth Neese, Director of Tax Legislation at the National Council of Savings Institutions, 1101 15th Street, Washington, D.C. 20005, (202) 857-3100.

Statement of

CHRISTINE A. FLYNN

PRESIDENT AND CHIEF EXECUTIVE OFFICER

STATE OF NEW YORK MORTGAGE AGENCY

for the record

Hearing on Expiring Provisions of the Tax Code

Monday, March 28, 1988

INTRODUCTION

Mr. Chairman, I am Christine A. Flynn, President and Chief Executive Officer of the State of New York Mortgage Agency, which is known informally as SONYMA. I appreciate the opportunity to appear before you today to endorse the extension of the single family mortgage revenue bond (MRB) program for four years. I also wish to explain a problem which has been inadvertently created by the way in which income limits have been established by the Tax Reform Act of 1986.

Our agency was created in 1970. Since its creation, SONYMA has made more than 60,000 loans to households throughout New York State. We are proud of our program and of its many successes. I have appended to this statement several tables outlining the SONYMA program and I ask permission that they be incorporated in the hearing record at the conclusion of my testimony.

In New York State, MRB-financed mortgages play a crucial role in enabling first-time homebuyers to realize their dream of owning their own homes. By providing assistance to prospective homeowners in financing the purchase of reasonably priced housing, MRBs have helped many low and moderate income New Yorkers purchase their first home.

The Congress has examined this program nearly every year since 1979. And despite severe criticism, Congress has seen fit to continue the program -- albeit with fine tuning -- because it recognizes that MRBs are a fundamental tool of U.S. housing policy -- a policy that seeks to ensure affordable, decent housing for all its citizens.

MRBs fill a gap in U.S. housing policy which neglects the needs of low and moderate income families. The program is crucial in the efforts of state and local agencies like SONYMA to help such families qualify for affordable financing by providing state and local housing authorities with flexibility to meet housing needs in specific markets. MRBs may be used to finance new construction or to purchase existing housing. States may combine MRB subsidized mortgages with other forms of assistance or impose additional restrictions on the homebuyer, the home, the lending institution and the location of the home to ensure that only the lowest income residents and most critical areas are assisted.

For instance, SONYMA has created a $10 million very low interest rate program (4%), with income and purchase price limits below those in the federal law. Under this program, households with incomes averaging $17,500 are able to purchase homes. This flexibility is essential in stimulating and complementing state and local housing initiatives. It is responsible for a large part of the program's success.

The following discussion of MRBs will highlight the reasons we believe justify extension of this worthwhile program.

THE CRISIS IN HOUSING AFFORDABILITY

The difficulties facing first-time home buyers today, particularly those with low and moderate incomes, are well documented and have contributed to the first drop in home-ownership in this country since the 1930's. Rising real housing costs, declining real renter incomes, high interest rates, and the significant up-front costs incurred when purchasing a house have combined to make home-ownership a possibility only for the relatively well-to-do.

Rising housing costs

Real estate prices, especially for single-family homes, continue to rise dramatically. Concurrent with increasing home-ownership costs, rents have risen as well, in part caused by a dramatic increase in real estate prices. These factors have combined to decrease the ability of renters to purchase homes because it has become more difficult to save for increased downpayments and closing costs associated with the purchase of increasingly expensive homes.

Since the early 1970's, real home-ownership costs have increased 14% simultaneous with a 27% increase in real rent burdens. According to the U.S. Department of Commerce, new homes priced at or below $70,000 comprised only 23% of all new home sales in 1986. In some areas of the country, prices have skyrocketed even more than the national average.

High interest rates

While interest rates have fallen considerably from the record levels of the early 1980's, interest rates still hover at the double digit range. Interest rates today remain significantly higher than the rates prevalent during the early to mid-1970's. High interest rates significantly diminish the buyer's ability to pay for housing. As a result, homebuyers in the low and moderate income brackets still encounter difficulties in qualifying for conventional mortgages, and are particularly benefitted by the lower rates offered by MRB programs.

Moreover, it is important to recognize that a decline in interest rates usually leads to an increase in housing prices. Because housing prices have continued to increase, the benefits of 'lower' interest rates are almost eliminated.

Up-front costs

The up-front costs incurred when purchasing a home are prohibitive for many low and moderate income buyers. Private lenders traditionally require a downpayment of at 10% to 20% of the purchase price of the house. Most lenders charge fees (commonly called points) for originating and processing a loan. In addition, there are transfer fees, local and state taxes, and settlement costs on top of the downpayment of 10% to 20%.

In total, these costs have tripled, in current dollars, as home prices have tripled, since the 1970's. These expenses can easily increase the loan amount by up to 5% to 7%. At today's housing prices, this translates into thousands of dollars.

The large sum of money needed up front when purchasing a home poses particular problems for first-time homebuyers who have no cushion from the sale of a previous home to help pay for the downpayment and closing costs. MRB programs address this by requiring downpayments of only 5%, and many states and localities provide assistance with closing costs as well.

Decline in personal income growth

Further adding to the difficulties facing low and moderate income home buyers, is the fact that personal income growth has not kept pace with housing costs. Since the mid-1970's, renter real incomes have fallen 9%. Because more money must be spent on rent, many families find it virtually impossible to save the large sums of money necessary to purchase a home. This is critical because first-time homebuyers ordinarily have incomes that are significantly lower than families who have already owned at least one home.

THE GAO REPORT

In its recently released study on mortgage revenue bonds, the General Accounting Office (GAO) asserts that family income is likely to rise over time. Today, most low and moderate income families are caught in a vicious cycle of rapidly rising housing costs and laggardly rising incomes that are increasing at a disproportionate rate. Rather than saving money, many families are finding it difficult to 'break even' or avoid going into debt.

The GAO study contends that two-thirds of the families receiving assistance under the MRB program could qualify for conventional mortgages. As one of the agencies which was surveyed for that study, I strongly object to the findings of the report as they apply to the SONYMA programs.

The report argues that conventional mortgage instruments, including adjustable rate mortgages and graduated payment mortgages, could be utilized by many participants in the MRB program. The GAO report overlooks the fact that many low and moderate income families are unable to meet the standards imposed by these lenders in the application process.

Families who have difficulty obtaining a conventional mortgage are also likely to experience difficulty in obtaining an adjustable rate mortgage (ARMs). ARMs are suitable for families with rising incomes but for many low and moderate income families, significant increases in income are unlikely. The low initial interest rate increases in subsequent years and lenders, to reduce their risk, employ strict underwriting criteria before approving such loans. Consequently, ARMs and graduated payment mortgages cannot serve as a true substitute for MRB financed mortgages as GAO argues.

Targeted benefits

Federal restrictions on MRBs target the benefits of the program to those most in need of assistance. Borrowers under the MRB program face income limits and restrictions on the price of the house they purchase. Personal income may not exceed 115% of state or area median and home prices may not exceed 90% of the average area purchase price. These restrictions ensure that only lower income families benefit from the program.

In this regard, the criticisms levelled by the GAO report regarding the income profile of MRB recipients is spurious because of the data upon which the GAO study is based. That data relates largely to programs conducted between 1983 and 1986, a time period during which there were no federal limits on the household income of MRB-financed mortgages. Only the first 6 months under the 1986 limits were studied, a time period when virtually no mortgage revenue bonds were issued as housing authorities grappled with the complexities of the new law.

Although the GAO report asserts that this lack of post tax reform data is irrelevant, that is definitely not true in analyzing New York State's experience. SONYMA has implemented many changes resulting in a program which is better targetted than ever. In 1987, average SONYMA borrower incomes dropped 15% and the number of low-income borrowers (below 80% of the median) doubled. Low-income households now constitute the majority of borrowers in many regions of the State.

MOYNIHAN AMENDMENT ON INCOME LIMITS

At this point, I would like to take a few minutes to describe a problem that New York and several other states face under the income limits currently in effect for the MRB program and to seek your support for a proposal which would remedy that problem. The proposal was offered by Senator Moynihan and adopted by the Finance Committee last fall as part of Title III of the Omnibus Budget Reconciliation Act of 1987 (Sec. 6781).

We are proud of our success in targeting SONYMA loans to families of lesser means. However, the 1986 Act's income limits, when combined with the housing purchase price limits which have long been in effect, pose a special problem in downstate New York. New York City and its suburbs to the east and north of the city limits,* have more expensive housing prices compared to the median incomes in their respective Metropolitan Statistical Areas (MSAs) than is the case in the rest of the State.

The New York MSA contains 48% of the state population, including one of the highest concentrations of low-income families in the country. As a result, the MSA's median income, upon which the MRB income limits are based, is much lower than necessary to finance modestly priced housing.

Because of this, many New York families which have incomes sufficiently within the federal income guidelines frequently cannot find a home to buy. Even with SONYMA's assistance, the available housing stock -- and even that under construction -- is often too expensive for these families. For example, in New York City in 1988, the highest allowable income for MRB-financed home purchases in New York City is $39,100. The highest priced house purchasable at that income in New York under current interest rates is approximately $95,000, a price at which single family houses, condominiums or cooperative apartments are virtually unavailable.

Without the Moynihan amendment, 40% of SONYMA's downstate market will be ineligible for MRB-assisted mortgages. Ironically, many of those households could qualify for MRB assistance in other communities where housing costs are lower than those in the New York and Long Island MSAs because the area median incomes are higher in those communities, resulting in proportionally greater income limits under the MRB program.

As adopted by the Finance Committee, Senator Moynihan's amendment would create a special rule for MRB applicants in high cost areas. Section 6781 would establish standards defining high cost areas and would create alternative income limits for areas which meet those standards. The amendment is designed to provide equity for communities which are saddled with high land and construction costs for housing, even though area incomes may be low. In fact, that is precisely the premise upon which Senator Moynihan's 1987 amendment was based. I quote from the Finance Committee report:

> The committee recognizes that the existing income targeting limits may be difficult to apply in areas where the costs of building, operating, and maintaining housing are substantially higher than the national average. The committee feels that this problem is narrow in scope, but wants to provide some relief for those few areas where it does arise.

The proposal is not designed to enable "wealthy" families to purchase expensive homes in high income areas, nor will it have that effect. The amendment simply permits purchasers in high-cost areas a chance for MRB mortgages. It does not increase the purchase price limits for MRB-financeable homes. It only raises the income limits in a limited fashion in a few areas to permit purchase of homes within the current MRB limits.

This amendment preserves Congress' intent of targeting MRB financing to moderate and lower income households. It simply deals with the reality that a decent home in one part of the country may cost vastly more in another, where land, labor and materials -- not to mention the ordinary cost of living -- are more expensive. It would ensure that low and moderate income homebuyers in all parts of the country can use MRB financing.

Since last fall, we have participated in extensive conversations with the staff of the Joint Committee on Taxation to determine the whether a more equitable formula can be developed. SONYMA would support any formula which ensures that the average first-time homebuyer in New York has the same opportunity to buy a home as the average first-time homebuyer in any other part of the United States.

MRBs VS DIRECT FEDERAL SUBSIDIES

Some critics of the MRB program argue that tax exempt financing should be replaced with a direct federal subsidy to first-time home buyers because such a system would be less costly and more efficient. A direct federal subsidy would undoubtedly foster the creation of a new bureaucracy to administer the subsidy and enforce targetting guidelines. It would be an impractical substitute for a program which has worked successfully for more than fifteen years.

This plan overlooks the fact that an effective program structure now exists in every state and that there are established procedures and programs in place to provide MRBs. It is a program that is run with minimal bureaucracy because of the public/private partnership with the network of private lenders. Moreover, neither this Congress nor the next is likely to create a multimillion federally-financed program to assist first-time homebuyer. This program works and it is all we have -- and all we are likely to have.

[requires minimal bureaucracy due to partnership with existing networks with private lenders who participate in the program]

EXTENSION OF MRBs WOULD NOT RESULT IN NEW REVENUE LOSS

The staff of the Joint Committee on Taxation (JCT) contends that delaying the MRB sunset would result in a revenue loss of $900 million over 5 years even though the bonds will be subject to a state volume cap of the greater of $50 per capita or $150 million. Thus, the exact amount of tax revenue "lost" is clearly subject to debate.

Projections of revenue loss are incorrect

The JCT assumption is based on the mistaken premise that every dollar that might be invested in a tax-exempt mortgage revenue bond will be invested instead in a taxable instrument if MRBs are unavailable. This dollar-for-dollar equation, however, does not take into account the highly individual nature of investment behavior. Investors will seek alternative means of sheltering income. The investor's dollar may be invested in other tax-exempt bonds or other assets which may represent an even larger revenue loss to the federal government.

MRBs generate revenue in other areas

Nor does the Joint Committee on Taxation estimate take into account the tax revenues generated through the increased economic activity spurred by a rise in new housing construction. The existence of MRBs has had a strengthening effect on the nation's housing supply, on the economy, and on credit availability. Thus, the "revenue losing" nature of tax-exempt MRBs is open to question. At the very least, the "cost" to the federal government is offset by increased revenue in other areas.

MRBs MEET AN IMPORTANT NATIONAL OBJECTIVE

Private lenders, developers, and participants in the MRB program are in agreement that MRBs complement, rather than compete with, the conventional mortgage market. MRB-financed loans are roughly two points below conventional rates, in addition to having downpayment requirements which are two to four times smaller. These two factors are critical to making homes affordable to low and moderate income homebuyers. By enabling low and moderate income families to purchase reasonably priced homes they would otherwise be unable to afford, MRBs serve a niche in the housing market. As a result, MRBs actually increase home-ownership.

Since World War II, U.S. housing policy has been directed toward ensuring that all American citizens have access to safe, decent housing. A corollary of this policy has been the promotion of home ownership for all Americans. The primacy of this objective and the broad base of support this policy enjoys are the fundamental reasons it has become an integral part of the "American dream."

Unfortunately, in recent years, home ownership, rather than becoming easier, has become more and more difficult for American citizens, especially low and moderate income families. By targeting families that most need assistance in purchasing a home, MRBs ensure that home ownership does not become only a dream for low and moderate income Americans.

AVERAGE INCOME OF HOMEBUYERS: 1987

Statewide (est.)	$45,000
SONYMA regular	$31,000
Modest Means	$17,000

SONYMA BORROWER INCOME DISTRIBUTION: 1987-1988

Less than $20,000	10.3%
$20,000 - $30,000	40.6%
$30,000 - $40,000	30.8%
More than $40,000	18.2%

*The New York City MSA includes the five boroughs of New York City -- Kings (Brooklyn), Queens, Staten Island, Manhattan and the Bronx -- and Westchester, Putnam and Dutchess counties, north of the city. The Long Island counties of Nassau and Suffolk constitute a separate MSA.

Statement of the

NATIONAL RETAIL MERCHANTS ASSOCIATION

Senate Finance Committee

Subcommittee on Taxation and Debt Management

on the Targeted Jobs Tax Credit

April 22, 1988

The National Retail Merchants Association (or "NRMA") is the nation's largest trade association for the general merchandise retail industry. Its members operate approximately 40,000 leading department, chain, independent and specialty stores in the United States. Annual sales by NRMA members exceed $150 billion and member firms employ more than three million workers. Accordingly, changes in the tax law which affect U.S. businesses in general and the employer-employee relationship in particular are of major importance to NRMA and its members.

The targeted jobs tax credit (or "TJTC") was enacted in 1978 to provide an incentive to employers to hire persons from targeted groups experiencing high unemployment rates or other special employment needs. At present, the TJTC is available on an elective basis for hiring individuals from one or more of nine targeted groups.

Over the years, as employers have become more aware of the TJTC program, the TJTC has demonstrated its ability to create jobs for members of the targeted groups and contribute to the nation's economic growth. Despite the facts that employment growth nationwide during the early years of the program was uneven and changes in the program have restricted the employees who could qualify, the program has grown from 202,000 certifications of employees in 1982 to 445,000 certifications of employees in 1987. The growth of the program within the retail industry appears to be even more dramatic.

The TJTC is scheduled to expire at the end of 1988. In the Senate, Senator John Heinz (R-PA) has introduced S. 684, a bill which would make permanent the TJTC, while Congressman Charles Rangel (D-NY) has offered a companion bill (H.R. 3719), a measure which would extend the TJTC for three years and make other refinements. NRMA and its members, many of whom have hired employees under the TJTC program, support both proposals and believe that the TJTC program should be continued for the following reasons:

1. TJTC is the Most Cost-Effective Federal Employment Program for the Economically Disadvantaged

Studies indicate that the TJTC has been the most cost-effective federal employment program for the economically disadvantaged, working more efficiently than direct spending programs designed to achieve the same goal. For example, a Congressional Research Service ("CRS") report determined that it cost $1,000 in fiscal year 1984 to create a job under the TJTC program while the Comprehensive Employment and Training Act ("CETA") program spent $4,600 to create the same job in the public sector in fiscal year 1981. The CRS report confirms earlier studies that indicated that the average cost per employee in the TJTC program was significantly less than the cost per employee in CETA or its successor, the Job Training Partnership Act ("JTPA"). In addition, many retailers participating in the TJTC program have found it to be the least bureaucratic of the programs designed to provide jobs for the disadvantaged.

2. TJTC is Best Suited to Help the More Seriously Disadvantaged Worker

By targeting persons from groups which face particularly high unemployment or special barriers to employment, the TJTC program allocates resources to those workers most in need of employment and training assistance. Other programs, such as the Job Training Partnership Act, are designed to aid all of the nation's unemployed workers; a significant amount of this aid goes to nondisadvantaged workers. TJTC, by focusing on those disadvantaged workers who might not receive aid under other programs, addresses the nation's structural unemployment by providing assistance to those most in need. Thus, TJTC should be a critical part of any strategy for fighting structural unemployment.

3. TJTC is Accomplishing the Goals Envisioned by Congress

Independent studies of the TJTC program demonstrate that the program is providing jobs for the disadvantaged worker. Despite uneven growth in employment during the early years of the program and changes in the structure of the program which restricted its availability (since 1982, retroactive certification, as well as eligibility for nondisadvantaged cooperative students, have been prohibited), there has been impressive overall growth in the number of employees obtaining jobs under the TJTC program. Within the retail industry, employer awareness of the TJTC is growing, as evidenced by the dramatic increase in the number of certified retail employees participating in the program. Many retailers believe that if there were certainty that the program would continue, there would be further expansion of both the number of retailers involved in the program and the number of employees benefitting from it.

4. TJTC Contributes to the Nation's Growing Economy

By providing entry-level positions in the economy, TJTC helps reduce dependence on welfare and related programs. Workers in the TJTC program are given a foothold in the labor market, with the opportunity for advancement within the company. Retailers report many instances of employees who began in the TJTC program and who have subsequently been promoted to other full-time jobs within the company. Moreover, the program helps satisfy the growing need for unskilled labor, particularly in the retail industry. These goals are accomplished, in major part, by the private sector. Finally, there is no evidence that either the turnover or dismissal rates for employees in the program is significantly greater than the turnover or dismissal rate for employees in general. On the contrary, most retailers have had positive experiences with the TJTC program and have expressed interest in expanding their use of the program.

Conclusion

NRMA and its members believe that the TJTC program should be continued without interruption to avoid many of the start-up costs and administrative problems which result when an authorized program is terminated and subsequently reauthorized.. Retailers have found the TJTC to be a cost-efficient program which contributes to the nation's economy and offers direct assistance to the nation's most disadvantaged workers, who otherwise might require federal assistance. For these reasons, NRMA and its members support efforts to extend the TJTC.

News from Senator John Heinz

Release March 9, 1988

Contact Bob Ferri (202) 224-7753

HEINZ PUSHES FOR MORTGAGE BONDS FOR MIDDLE- AND LOW-INCOME HOMEBUYERS

WASHINGTON -- Sen. John Heinz (R-PA.) today announced he is backing legislation to reauthorize Mortgage Revenue Bonds, which have helped 40,000 Pennsylvanians become homeowners.

"Mortgage Revenue Bonds allow a great many Americans to realize the dream of owning their own home," Heinz said. "The program is a model of public-private partnership, with federal, state and local officials of all political stripes working closely with the housing industry. These bonds create the jobs and wages needed for economic growth. They are an investment that must not be frittered away. Congress should act quickly to reauthorize this critically needed housing program."

Heinz is a member of the Senate Finance Committee, which will take up the Mortgage Revenue Bond reauthorization in the next few weeks. Without Congressional action, authority to issue the bonds will expire at the end of this year.

Mortgage Revenue Bonds are issued by state and local governments to provide funds for home mortgages at rates about two percentage points below the market rate. The program has helped 40,000 Pennsylvania families buy homes since the State Legislature passed legislation encouraging use of the bonds in 1982. Home purchases resulting from the bond issues account for about $20 million a year in local tax revenues in the Keystone State, according to the Pennsylvania Housing Finance Agency. Nationwide, the bonds have helped finance more than 700,000 new homes and 1 million existing ones.

To be eligible for the program in Pennsylvania, prospective homebuyers must have an annual household income not exceeding a level between $30,360 and $37,000, depending on their county of residence. The maximum price of an eligible home must not exceed a level between $57,960 and $111,100 for a new home and between $50,310 and $91,190 for an existing one -- again, depending on the county.

Bills in both the Senate and House would reauthorize the Mortgage Revenue Bond program through 1992. Heinz urged his colleagues in both chambers to make sure differences over 1988 tax legislation do not prevent renewal of the housing program.

Real Estate

THE FRESNO BEE Sunday, February 28, 1988

Loan program that aids first-time home buyers finds itself threatened

By WANDA COYLE
Bee business writer

For Kim and Vincent Cunningham, there were "just no prospects for a home of our own" for most of the first five years of their marriage.

Things changed, though, and the Cunninghams' fifth anniversary this month was celebrated in their own home, a three-bedroom, two-bath house in Kesterson Development Co.'s Somerset subdivision west of Freeway 99.

What made it possible was the California Home Finance Agency, which offers low-down-payment, low-interest loans to people precisely like the Cunninghams — those who are hoping to be first-time homeowners.

Kim Cunningham knew little about CHFA loans, even though she is employed by a mortgage company. But she and her husband, a delivery driver for a truck company, realized the opportunity the loans offer when they found a home they wanted to buy and learned that they qualified for the program.

What she found, she said, is that, "It's a nice bridge — somebody meets you half-way."

It made a nice bridge, too, for a fellow employee of Cunningham's at All Valley Mortgage Co., Renee Yurkin, and her husband, Barry. And for Ernest Valdez, a school relations specialist at Kings River Community College.

The Yurkins, married three years and expecting their first child in June, moved into their new home in the Brentwood Estates subdivision in Clovis this month. Valdez, who is single, is a neighbor of theirs — he has lived in Brentwood for seven months.

Valdez said if it hadn't been for CHFA he would have lost the deposit he put down on his 1,460-

Bee file photo

KARNEY HODGE — CHFA head

square-foot home in January 1987. That's just about the time that interest rates began to climb, he noted. Higher rates would have disqualified him, with his single income of under $30,000, for a regular mortgage loan.

CHFA came to the rescue, as it did for a total of 582 first-time home buyers in Fresno County last year.

But the program for low- and moderate-income buyers is threatened. Unless Congress acts this year, the mortgage revenue bond program that makes it possible will expire on Dec. 31.

Karney Hodge, the Fresnan who heads the California Housing Finance Agency, said the "sunsetting" of the bond program is "a major, major, major concern" to everyone interested in affordable housing.

It was the topic he most wanted to talk about on a recent swing through his home town. And he said it is the focus of the year's effort by the National Council of State Housing Agencies, of which he is vice president.

In the past, he said, extension of the mortgage revenue bond program was "rather automatic," but with housing now low on the priority list of the Reagan administration, there are serious fears that the program will die.

It would mean the loss of "one of the few housing programs left that helps the segment of the population having one tough time getting a mortgage under conventional lending programs."

Hodge said he is worried not only because of what the loss would mean to potential loan recipients but because of the effect it would have on the state's economy in general.

"I don't know of any industry that has such an immediate effect on local economy as home building," he said. He called "mind-boggling" the ripples created to various economic segments — building trades, landscapers, carpet and furniture suppliers — the list goes on.

Figures prepared by CHFA show that in Fresno County last year the agency's home loans totaled $36 million and its new-construction loans, $22.6 million. When the multiplier effect is considered, those funds generated 909 jobs with wages of over $17 million, and federal, state and local taxes of more than $7 million.

Hodge said although CHFA has programs for rental housing that help lower-income people, the home loans financed by revenue bonds go principally to people whose incomes won't meet the qualifications for conventional

See CHFA, Page F5

Continued from Page F1

mortgage programs. They also are directed almost exclusively to people who are buying a home for the first time.

CHFA loans allow for low down payments — frequently under 5 percent — and offer interest rates about 2 percent below the market. The Fresnans mentioned earlier each paid about 3 percent down and got interest rates at 8.4 percent.

Hodge said CHFA acts generally as a savings and loan for the state and "there is no tax money whatsoever in our agency."

He thinks it will take a grass-roots movement, with local organizations and individuals lobbying their congressional representatives, to save the mortgage revenue bond program that finances the housing loans.

But in contrast to the federal administration's indifference or hostility toward housing programs, he said, Gov. Deukmejian — who appointed Hodge to his state post in 1983 — has been "very, very supportive" of the agency.

HOUSING WATCH

New Home Sales in the Pits

by David Rush

Sales of new homes slowed again in January, to an annual rate of 535,000 units, reports the U.S. Department of Commerce. The 9 percent decline marked the third straight month that new, single-family home sales have fallen, and pushed the level of activity in that segment of the industry to its lowest point since the end of the recession in 1982. The Commerce Department says January sales were 25 percent below where they stood a year ago.

Except for the West, sales during the winter period have been much weaker than industry analysts had expected. The biggest decline in January was posted by the Southern region, which takes in economically hard hit agricultural and oil-producing areas.

The slowdown followed setbacks of 6.8 percent in December and 3.4 percent in November, as the housing industry staggers under the effects of October's stock market crash. Other facets of the industry, such as new home construction and sales of existing single-family homes, have also posted steep declines in the wake of the market crash. Analysts believe the 508-point, blue-chip loss in October has consumers worried about the future, and they have simply stopped looking for new homes.

Despite the weaknesses, officials of the National Association of Home Builders (NAHB) and economist James Christian, of the U.S. League of Savings Institutions, believe that "with mortgage rates moving in the right direction," sales for all of this year should rebound. Although most analysts agree that a lot of pent-up demand has been satisfied, Dale Stuard, president of the NAHB, expects the housing numbers will move back to the plus side this spring. He says, "Mortgage rates declined in February, and talk about a recession [in 1988] appears to be receding."

The combination of lower interest rates and greater confidence in the overall economy "should spark renewed interest in the housing market in the months ahead," Stuard says.

January's 9 percent decline was the steepest one-month fall by new home sales since May 1987, when interest rates jumped through the 11 percent barrier. The sales drop was accompanied by soaring prices. The median price of a new home rose nearly 10 percent, to $120,000. The Government says the average price was more than 10.5 percent higher at $149,000, although many industry officials contend there really is no benchmark for the average price of a new home, because of different styles, sizes, and amenities.

In a separate report, a trade group says January's housing affordability index fell to a five-month low, but maintained a high level. The index, compiled by the National Association of Realtors, was 112.5 percent. That means a family earning the median income of $31,242 had 112.5 percent of the income needed to qualify for a conventional home loan, covering 80 percent of the median price for an existing single-family home. Since the median in January was $87,900, that family would have sufficient income to qualify for a home costing $98,900.

MORTGAGE WATCH*
[illegible]

City	30 Year Fixed	15 Year Fixed	1 Year ARM
Atlanta	9.66% + 3.09 pts.	9.49% + 2.53 pts.	7.36% + 3.04 pts. 1-6% caps
Boston	9.08% + 1.94 pts.	9.59% + 1.89 pts.	7.62% + 1.96 pts. 2-6% caps
Chicago	9.79% + 2.46 pts.	9.48% + 2.54 pts.	7.46% + 2.52 pts. 2-7% caps
Dallas	9.77% + 2.41 pts.	9.32% + 2.33 pts.	7.52% + 2.48 pts. 1-6% caps
Denver	9.83% + 2.05 pts.	9.52% + 1.71 pts.	7.31% + 2.75 pts. 2-6% caps
Detroit	9.86% + 2.23 pts.	9.53% + 2.17 pts.	7.27% + 2.43 pts. 2-7.5% caps
Indianapolis	9.79% + 2.32 pts.	9.48% + 2.1 pts.	7.7% + 2.19 pts. 1-6% caps
Kansas City	9.85% + 2.46 pts.	9.56% + 2.21 pts.	7.25% + 2.31 pts. 2-6% caps
Los Angeles	9.84% + 2.05 pts.	9.49% + 2.01 pts.	7.98% + 2.19 pts. 1.5-6% caps
Minneapolis	9.74% + 2.86 pts.	9.43% + 1.99 pts.	7.53% + 2.2 pts. 1-6% caps
New York	9.98% + 2.21 pts.	9.61% + 2.19 pts.	7.63% + 2.3 pts. 1-6.5% caps
Orlando	9.77% + 2.42 pts.	9.42% + 2.36 pts.	7.19% + 2.5 pts. 1-6% caps
San Francisco	9.85% + 2.1 pts.	9.56% + 1.96 pts.	7.26% + 2.32 pts. 1.75-6% caps
Washington, D.C.	9.7% + 2.56 pts.	9.32% + 2.46 pts.	7.21% + 2.73 pts. 1-7% caps
All Cities	30-Year FHA/VA - 9.5% + 3.25 pts.		

* Rates are representative of 90 percent financing. Points shown include origination and discount fees.

Source: Mortgage Watch, compiled by ERA Real Estate © 1988.

Bentsen Predicts Mortgage Bond Tax Exemption Will Continue

By Joan Pryde

WASHINGTON, March 17 — Senate Finance Committee chairman Lloyd Bentsen said today he is optimistic Congress will vote to continue the tax exemption for single-family mortgage revenue bonds, but cautioned he is unsure of how to generate the revenues to pay for it.

"I think we have a pretty good chance" of extending the exemption beyond its Dec. 31, 1988, termination date, the Texas Democrat told a conference of the National Association of State Treasurers. "But I've got to find the revenues... I've never seen the [budget] constraints we have now," Mr. Bentsen said.

The Joint Tax Committee estimates that continuing the mortgage bond exemption for five more years would cost the federal government between $800 million and $900 million.

In view of the costs involved, municipal finance lobbyists are worried that if the tax committees decide to approve an extension of the mortgage bond exemption, they will increase restrictions elsewhere in the bond area to cover losses from the mortgage bond exemption.

Meanwhile, housing finance officials this week criticized the General Accounting Office for employing lax underwriting standards and other faulty data in developing a study on the efficiency of the mortgage bond tax exemption.

The criticisms were made by the National Council of State Housing Agencies and the Association of Lo-

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Housing

Continued from front page

cal Housing Finance Agencies in letters sent to the GAO. The GAO is scheduled to release the study later this month.

Proponents of the mortgage bond tax exemption have said the report's findings are likely to be a divisive element in the congressional debate this year over whether to extend the exemption.

GAO staffers briefed congressional aides and housing finance officials on its findings last week. The GAO found that 67% of the 178,000 loans examined were made to people who could have afforded the same house on the same day with either a conventional fixed-rate mortgage or an adjustable-rate mortgage, according to a congressional aide briefed by the GAO.

Of the remaining 33%, the GAO found that many borrowers were younger than the average first-time home buyer, the aide said. In addition, many of these younger borrowers could have financed homes costing only 10% less than the properties they bought with conventional instruments, according to the GAO.

The GAO's only criterion for making that determination appeared to be whether the home buyer's monthly mortgage payments were no more than 28% of their monthly income, said John C. Murphy, the executive director of the local housing association, in a letter to the GAO.

"This simplified qualifying procedure reflects the GAO's failure to perform reality testing on its conclusions," Mr. Murphy said. "Regretfully, it appears that the study group made little or no effort to learn the program content or context in the individual localities."

Similarly, F. Lynn Luallen, president of the state housing council, said in his letter to the GAO that the study's method "presents a very distorted picture." The 28% standard applied by the GAO "doesn't consider taxes and insurance, or the debt of the individuals, [and it] assumes that mortgage capital would be readily available in the first place, or that mortgage insurance would be available."

The housing associations said the GAO also used faulty data in comparing loans made from mortgage bond proceeds with other types of loans. The GAO studied 178,000 loans in 32 states made between 1983 and 1986. The study compared those loan recipients with a "general universe" of first-time home buyers who used conventional financing. But the associations said the control group included loans receiving other forms of subsidies.

"By comparing MRB loans with a sample . . . that contains MRBs and other subsidized or assisted loans, [GAO] ensured that the results would show the two samples to have similarities," Mr. Riedy said, adding that GAO inferred that it is comparing MRBs against conventional loans for first-time homebuyers."

Meanwhile, Harvard University researchers released a study today on home-ownership trends in the Unite States that said elimination of the tax exemption for single-family mortgage would be a "worrisome" development, especially at a time when home ownership rates are declining.

Harvard's Joint Center for Housing Studies also found that while a majority of U.S. citizens have adequate housing, the number of people unable to afford decent housing "is growing at an alarming rate."

The study shows that the number of home owners aged 25 to 34 have fallen most sharply, despite "measurable reductions" in inflation-adjusted homeownership costs since the early 1980s, when interest rates were higher.

H. James Brown, a co-author of the study, said in a press briefing today that forms of financial assistance such as the mortgage bond tax exemption need to be continued to stem the decline in homeownership. He said the elimination of the mortgage bond exemption would be an imminment cause for concern.

Futures Markets

Corporate Bond Index

Del. Mo.	High	Low	Settle	Change
Mar. 88			91-28	+22
June 88				
Sept 88				

Estimated number of contracts traded 0
Number of contracts traded on 3/16 0
Open interest on 3/16 15, unch

The CBOT-Bond Buyer Corporate Bond Index futures contracts, quoted in points and 32ds of principal value, trade on the Chicago Board of Trade. The unit value of each contract is $100,000, and a one-32d change in price represents $31.25

O'Neill says state's low mortgages in jeopardy

New Haven 2/24 P.

By Brian McGrory
Register Staff

WASHINGTON — Connecticut officials would have to kill a state program that extends below-market mortgages to low- and middle-income homebuyers if Congress does not continue a federal tax-break program, Gov. William A. O'Neill said Tuesday.

Without these loans, thousands of qualified families would be unable to buy their first homes in the increasingly expensive Connecticut housing market, O'Neill said. The Connecticut Housing Finance Authority has financed nearly $565 million in mortgages for about 8,600 low- and moderate-income families since 1985.

"In the midst of all of the concern and activity addressed to the housing problem or crisis we face in Connecticut, it seems almost inconceivable to me that we are in real danger of losing this program in the Congress in 1988," O'Neill said.

O'Neill made his remarks Tuesday afternoon in testimony to the housing and community development subcommittee of the Banking, Finance and Urban Affairs Committee of the House. The testimony followed O'Neill's involvement in the annual, three-day National Governor's Association winter meeting.

"To lose this program would really be more than adding insult to injury," said O'Neill. "It would be adding injury to injury. The efforts of all of us to re-invigorate the housing agenda cannot cope with this damage at this critical time."

At issue are federal tax laws that currently grant states the ability to issue tax-exempt mortgage revenue bonds. State officials then use the capital from the bonds

Turn to Mortgages, Page 13

Mortgages: State's program is in danger

Continued from Page 1

to issue below-market-rate mortgages that benefit low- and middle-income families, usually buying their first home. Officials can also use the bond capital to subsidize low-income housing.

The states' ability to issue mortgage revenue bonds expires Dec. 31, and without congressional action the Connecticut home mortgage program will end at the same time, O'Neill said. A bill that would extend the program is pending before the House Ways and Means tax-writing committee, with 208 sponsors.

O'Neill said his fear is that the bill will not be pushed out of the committee and onto the floor of the House for a full vote before the program expires in December. Because this is an election year, Congress isn't expected to convene as often as it would in a non-election year.

He urged subcommittee members to co-sponsor the bill and to prod their colleagues on the Ways and Means Committee.

O'Neill told the panel, which included U.S. Rep. Bruce Morrison, D-3, that Connecticut is by most measures an affluent state.

"However, I fear many people are being left behind," O'Neill said. "Homeownership is becoming an increasingly solid dividing line between the 'haves' and the 'have nots.' It is becoming an increasingly improbable aspiration for many young households in our state.

"Most cannot afford to live in the communities in which they were raised — and neither could their parents if they were forced to purchase their home now under current market conditions with their present level of income," O'Neill said.

NEW HAVEN REGISTER

Februart 2, 1988

Connecticut

O'Neill pushes mortgage help

Gov. William O'Neill

WASHINGTON (AP) — Eliminating the ability of states to issue affordable mortgages to low- and moderate-income people would devastate the American dream of home ownership, Connecticut Gov. William A. O'Neill warned Congress yesterday.

"To lose this program would be more than adding insult to injury. It would be adding injury to injury," O'Neill told the House Banking, Finance and Urban Affairs subcommittee on housing and community development.

The federal mortgage revenue bond program, which allows states to issue tax-exempt bonds and use the proceeds for affordable mortgages, is scheduled to be eliminated Dec. 31. Legislation to extend the program is pending in the House Ways and Means Committee.

O'Neill pointed to drastic cuts in federal housing subsidies under the Reagan administration and the growing inability of people to purchase homes.

"We're a wealthy state, but there's only so much we can do," the governor said. "In the midst of all of the concern and activity addressed in the housing problem or crisis we face in Connecticut, it seems almost inconceivable to me that we are in real danger of losing this program in the Congress in 1988.

"I must tell you, that as a governor who is a strong believer in the need for state government to address housing issues, and as a strong believer in state government responsibilities, ... I find this situation wholly unacceptable and intolerable."

The National Governors' Association said in a letter to House and Senate leaders that the mortgage revenue bond program "represents one of the last housing programs that allow Americans of modest income to realize the American dream of owning their own homes."

Nationally, the federal program has helped finance more than 700,000 new homes and more than 1 million existing homes. The average household income of recipients is $26,700.

In Connecticut, the Connecticut Housing Finance Authority has raised more than $2 billion to help more than 46,000 households through the bond program, O'Neill said. The majority of them were first-time homebuyers.

O'Neill defends mortgage aid plan

WASHINGTON (AP) — Eliminating the ability of states to issue affordable mortgages to low- and moderate-income people would devastate the American dream of home ownership, Connecticut Gov. William A. O'Neill warned Congress yesterday.

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Norwich 2/24

Will More Buyers Be Locked Out of the Market?

The nation's housing bond program is up for sunset review. What does that mean for Florida's home buyers?

by Caroline Chambliss

On Dec. 31, 1988, a major government home-ownership program is scheduled to be eliminated. Without positive legislative intervention, the single-family mortgage revenue bond program will end — with consequences for home buyers and housing-related industries.

The single-family mortgage revenue bond (MRB) program uses the proceeds from tax-exempt mortgage revenue bonds to offer below market interest rate mortgage loans to first-time home buyers. The loans are originated through individual private lenders that are invited to participate in the program.

The program now offers thousands of first-time home buyers reduced mortgage interest rates, relaxed credit underwriting standards and lower closing costs.

As one part of the Tax Reform Act of 1986, the MRB program is scheduled to sunset or terminate on Dec. 31, 1988. If it is not reinstated, state and local governments will no longer have the ability to sell tax-exempt bonds to finance purchases by first-time home buyers.

The elimination of the program would have obvious consequences for many buyers. Across the nation and throughout Florida, eager first-time home buyers are shocked to find that they are not able to buy their own homes. More and more families, beginning professionals and even the elderly are now permanent renters. Today, nationally, home ownership is at its lowest level in over a decade. At the same time, changes in federal housing policy have eliminated many and propose to eliminate even more critical governmental incentive programs.

> **"Home, in one form or another, is the great object of life."**
> **J. G. Holland**

Barriers to home ownership exist today that did not exist 10 years ago. The sale price of the average home is rising faster than family income. Credit underwriting standards are much more stringent. Also, higher rents deplete the family budget. A prospective home buyer may find it virtually impossible to establish the savings and credit history necessary to buy a home. But the most often-cited prohibition to first-time home buyers is the up-front costs needed to close the loan.

A recent poll taken by the National Association of REALTORS and published by the *Chicago Tribune* revealed that 70 percent of the renters surveyed do not buy their own homes because they simply do not have the necessary down payment. Only 47 percent blamed the high price of a home; only 30 percent responded that they could not afford the monthly costs associated with owning their own home. If current trends remain unchanged, prohibitions to home ownership threaten to undermine the prosperity of Florida's home-building and real estate industries.

It is also apparent that without any government assistance or incentives, the private sector cannot fulfill the growing, complex housing needs of the nation. Working together with private industry, however, the public sector can increase existing market opportunities for home ownership. Unfortunately, over the last 10 years the federal government has been moving steadily away from the housing industry, leaving the responsibility to the individual states. The elimination of the MRB program could eliminate one of the most effective home ownership programs now available to the states.

How Does the Program Work?

Qualified applicants under the program are limited to first-time home buyers of low and moderate income. Low income is defined as a household income between 50 and 80 percent of the state median household income. Moderate income is between 80 and 120 percent of that median. Florida's statewide median income for 1987 was $27,800. Federal Housing Administration (FHA) insurance is available under the program. Once they have been approved for the following criteria, the loans are purchased from private lenders by the Housing Finance Agency; in Florida, by the Florida Housing Finance Agency (FHFA). To be eligible, the applicant must:

- Be a first-time home buyer
- Have an income less than the limit stated for each program
- Purchase a home with a sale price less than the limit applied to each program
- Have a good, established credit history and be approved for credit by a participating lender

The stated purpose of the MRB program is to provide a stable source of affordable mortgages for low-, moderate- and middle-income home buyers who have never owned their own home. According to federal targeting requirements, mortgage revenue bonds are only available to households with a total income that is not above 115 percent of the state or the area median. The purchase price of eligible houses under the program is limited to 90 percent of the area median.

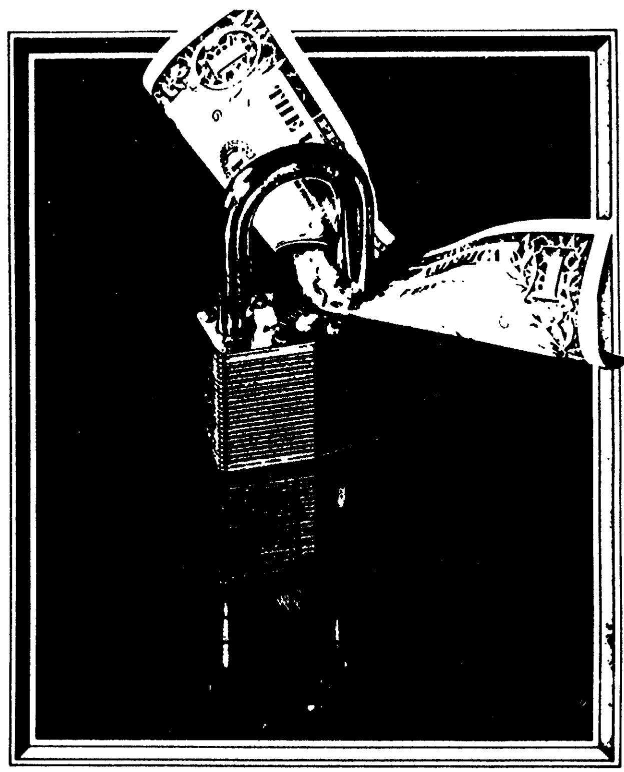
The inception of the MRB program has made it possible for a great many home buyers to buy a home – home buyers who previously had no hope of being able to afford a home of their own. Nationwide, from 1980 through 1986, state housing finance agencies have issued $58.4 billion in mortgage revenue bonds. Those funds have been used to finance 723,339 new homes and 1,084,177 existing homes. And, according to the National Council of State Housing Agencies, the national average household income of a home buyer under the program is $26,000. This figure confirms that the program does benefit its intended constituents: low- and moderate-income home buyers.

Florida's Program

Florida's MRB program has been highly successful. Since 1980, the Florida Housing Finance Agency has financed a total of $718.1 million worth of mortgages that were subsequently used to purchase 14,659 homes. In Florida, the average household income of the buyer is $25,101 – only 90 percent of the state median income and below the national average. Additionally, local housing finance agencies statewide have financed over $1 billion of mortgages.

A recent FHFA review of the home ownership bond program uncovered even more about the character of the average Floridian participating in the MRB program. For example, a full 20.7 percent of participating home buyers earn less than $20,000; the average family size is 2.08. The average home buyers are not generally young professionals with the potential to earn significant salary increases. **The number one male profession of the home buyer is that of laborer. The number one female profession is clerical.**

The MRB program is beneficial to both the home buyer and to the housing industry for a number of reasons. Aside from lowering mortgage interest rates, the program dces offer lower up-front costs, previously recognized as a major barrier to the purchase of a home.



Dominick Connotello

The Florida Housing Finance Agency is willing to buy loans requiring lower down payments than conventional financing. The use of the Federal Housing Administration financing lowers down payment requirements, allows for much more liberal credit underwriting and offers a mortgageable insurance premium.

Builders often offer to pay up-front costs on behalf of the buyer. The Agency can also lower closing costs by charging origination fees to the builder without allowing any to pass through to the buyer.

Sunset

The possibility that the MRB program will not be reinstated has prompted housing-related industry groups nationwide to support legislation extending the MRB program until 1992. Rep. Brian Donnelly (D-Mass.) introduced a bill on June 9 containing the extension.

As of January 1988, 36 senators and 180 representatives in Congress have signed on as co-sponsors of the bill. The key congressional committees that will hear testimony on the extension are the House Ways Committee and the Senate Finance Committee.

The most often-stated argument against the extension of the program is that the amount of tax revenue forgone is simply not worth it, particularly in light of federal deficit discussions and the recent Wall Street crash. Industry groups respond by pointing to the benefits that the program delivers for a comparatively small investment. In Utah, for example, the State Auditor General conducted an extensive survey and found that out of all of the participants, 95 percent could not and would not have purchased a home without the benefits of the MRB program.

In actuality, the extension is revenue neutral; there is already an existing cap on the number of revenue bonds that a state can issue in any given year. That cap cannot be exceeded. The extension of the MRB program would simply allow each state to choose to dedicate a percentage of its annual allocation to home ownership bonds, rather than to rental housing or to industrial development.

The National Association of REALTORS, along with the National Homebuilders Association, Mortgage Bankers and the Council of State Housing Agencies are working together to organize support for the extension of the MRB program. Here in Florida, the Housing Finance Agency has met with representatives of all three of the industry groups to introduce the issue and will hold a political strategy session with those groups in the future.

The extension of the MRB program would simply allow each state to choose to dedicate a percentage of its annual allocation to home ownership bonds, rather than to rental housing or to industrial development.

Without public sector assistance of some kind, the chance to own a home will continue to move further and further from the capability of most first-time home buyers. The MRB program has proved to be a successful, cost-effective mechanism to stimulate the purchase of homes both nationally and here in Florida. If the program is not extended, both the industry and Florida's home buyers will lose a program that not only stimulates the industry but also makes it possible for a large number of Florida residents to own their own home. □

Caroline Chambliss is community assistance specialist for the Florida Housing Finance Agency in Tallahassee.

Couple finds 5% down is not easy financing

Second of five parts.

By JAMES KINSELLA
BUSINESS EDITOR

THROUGH THE MORTGAGE MAZE

For Tom and Judy Smith, getting a mortgage from a bank would have been a lot easier if they had had more money in the first place.

But the Smiths — not their real name — had only $8,000 to $9,000 to bring to the table. And they intended to use $3,000 to $4,000 to cover closing costs and fees, leaving them with a down payment of about $5,000.

When they began saving for a house, the Smiths tried to accumulate more money for a down payment. But they found that housing prices leapt ahead even as they sought to save.

So they decided to obtain 95 percent financing. After finding a condominium in a Lower Cape town and agreeing on a price with the New Jersey-based owners, the Smiths went seeking a mortgage.

There they ran into their first roadblock. Because the Smiths had such a relatively small down payment, they needed to obtain private mortgage insurance.

But the first two banks they went to on the Cape told them that they couldn't obtain private mortgage insurance.

One problem was that the insurers wanted Tom to have been employed at least two years in a job he had just begun.

Then, the proportion of investor-owned condominiums in the development where the Smiths wanted to buy was too high for the private mortgage insurers, the banks said. The theory behind the private insurers' position was that the lack of owner-residents could lead to a deterioration of the property.

Discouraged, the Smiths went to Bea Tilga, the real estate agent who had arranged the sale of the condo, and told her they wanted their deposit back.

Ms. Tilga had other ideas. "She was determined that we would have this place," Judy said. "She was more determined than we were to get us in."

The real estate agent called Don DeLude, director of secondary mortgage operations at the Cape Cod Five Cents Savings Bank. She called the Smiths back and said, "Cape Cod Five thinks they can do it."

DeLude told them that they could obtain private mortgage insurance after all. Because the condominium development had been in the hands of a homeowners association and had been well kept up, he said, private insurers would accept a "spot loan" in the condominium complex.

But the Smiths ran up against yet another roadblock: the private mortgage insurers required an initiation fee and six months of mortgage payments up front — another $7,000 to $9,000, on top of the down payment and closing costs.

The Smiths exploded and their pent-up frustration poured out. They didn't have the extra money. That's why they were seeking 95 percent financing in the first place.

Once again they had come up short.

Judy was disgusted by the whole experience, and left it to Tom to go back to Ms. Tilga once again and ask for their money back.

"Let me try one more thing," Ms. Tilga told Tom. If the private mortgage company was the roadblock to the mortgage, she said, let's try to get them out of the picture.

She asked the condominium owners if they would take back a note on the property. "I never thought they'd say yes," Tom said. But they did.

Between the approximately $5,000 the Smiths had and the $15,000 or so provided by the previous owners, the Smiths had 20 percent of the purchase price. Private mortgage insurance no longer was needed.

The Cape Cod Five now needed to decide whether it would loan them the other 80 percent.

The bank also had to determine whether it would keep the mortgage within its portfolio, or sell it in the secondary market.

Because the Smiths did not have enough of their own money to cover at least 20 percent of the condo's cost, they couldn't go after a secondary mortgage but had to pursue a loan within the bank's own portfolio.

The reason is that the secondary market mortgages negotiated by a bank are "bundled" into securities, which are then sold to investors. To protect the investment, certain ground rules are established for these mortgages. They include minimum down payments of 20 percent, because the default rate increases in instances when buyers have put down less than 20 percent.

According to DeLude, secondary market mortgages offer long-term, fixed rate loans. DeLude said local banks essentially have abandoned these kinds of loans. They don't want to get caught, as they did in the 1970s, with low-paying mortgage loans in their portfolios and the need to borrow high-cost money.

The secondary markets also can offer adjustable mortgage rates that sometimes are more competitive than those offered by local banks, DeLude said. The rates on these loans move up and down at set periods — most often every one or three years. The rates are linked to financial market benchmarks, such as what one- or three-year Treasury securities are paying at any given time.

Portfolio loans, on the other hand, can offer increased flexibility, albeit on usually less favorable financial terms. But, as in the Smiths' case, a portfolio mortgage can make the difference between a loan or no loan.

Secondary market mortgages are a relatively recent addition to the New England banking market, according to DeLude, who said they first began five to 10 years ago.

In 1987 at the Cape Cod Five, 30 percent of the mortgage loans were secondary and 70 percent were portfolio. But the percentage of secondary loans in the bank's overall mortgage activity is growing, DeLude said.

Cape Cod banks have needed to turn to the secondary market because they don't have enough money themselves to support the volume of lending activity on the Cape. Real estate lending activity has skyrocketed in recent years, which DeLude attributes to the increased value and volume of property sales.

Tomorrow: The bank reviews the Smiths' finances.

CAPE
COD TIMES
March 2, 1988

THE NEWS TRIBUNE

Move afoot to rescue subsidy program

By CHRISTIAN WIHTOL
Special to The News Tribune

A federal subsidy program that has helped thousands of low- and moderate-income families buy homes faces extinction unless a congressional bid to extend the program succeeds, state officials say.

The program lets state and local housing agencies around the nation issue tax-exempt bonds to raise money that is passed on to first-time and urban home buyers in the form of below-market-rate mortgages.

Under the Tax Reform Act of 1986, the bonds will lose their tax-exempt status by the end of 1988. That will make it impossible for housing agencies to raise low-cost mortgage money.

A bill sponsored by Rep. Brian J. Donnelly, D-Mass., and cosponsored by at least nine members of New Jersey's congressional delegation, would extend the program until 1992.

"This program has been very important in offering home ownership to people who otherwise would not be able to afford it," said James Logue III, executive director of the New Jersey Housing and Mortgage Finance Agency, which administers the state's mortgage revenue bond program.

"I think it was an egregious mistake to sunset (end) the mortgage revenue program, and this should be corrected as soon as possible," said Rep. Marge Roukema, R-Ridgewood, one of the bill's cosponsors.

Since 1977, the program has funneled mortgages to 22,500 New Jersey home buyers, said the NJHMFA.

Using mortgage revenue bonds, the NJHMFA currently offers 30-year, fixed-rate loans at 8.55 percent, compared with a rate of around 10.5 percent on the private market. The NJHMFA charges two points and requires a 5-percent down payment. Private lenders often charge three points and require down payments of 10 percent or more. Points are processing fees; each point equals 1 percent of the amount borrowed.

The average income of families that used the program last year was $30,000, said the NJHMFA. The majority buy homes in the state's largest cities, including Newark, Jersey City, and Paterson, where prices are lower than in the suburbs, said Logue.

The fate of Donnelly's bill remains uncertain, in part because it is unclear how much it would cost to extend the program.

The U.S. Treasury Department estimates that mortgage revenue bonds will cost the federal government $1.57 billion in lost taxes during the 12 months ending Sept. 30. They cost an estimated $1.54 billion in the 12 months before that, said a Treasury spokesman.

The bonds are a drain on federal coffers because bondholders do not pay taxes on the interf they receive. In the Tax Reform Act, Congress cut back sharply on many forms of tax-exempt bonds, citing their cost to the federal government.

Thomas Barker, legislative counsel to Donnelly, asserted that extending the mortgage revenue bond program won't cost a dime.

That, he said, is because, in addition to issuing mortgage revenue bonds, states are permitted to issue tax-exempt bonds to pay for projects such as sewage treatment plants, resource recovery plants, and industrial parks. The federal government caps the total amount of tax-exempt bonds each state can issue — in New Jersey, it's $550 million this year — but states are free to choose which categories of bonds they issue.

Supporters hope that the bill, which is before the House Ways and Means Committee, will be debated this fall and approved as part of the so-called Reconciliation Bill. That legislation seeks to make a $40-billion dent in the federal government's huge deficit, which last year hit $240 billion.

ASBURY PARK PRESS

First-home loans may be in danger

By DOROTHY HINCHCLIFFE
Press Business Writer

Many people could be shut out from buying their first homes in New Jersey if Congress does not continue a federal tax-exempt bond program that states use to finance mortgages for first-time and urban home buyers, says the head of the New Jersey Housing & Mortgage Finance Agency.

Executive Director James L. Logue III said the agency issues mortgage revenue bonds to provide financing for qualified first-time and urban home buyers at interest rates below those for conventional mortgages. However, under the 1986 Tax Reform Act, state housing agencies won't be able to issue the bonds after Dec. 31, 1988.

The agency can offer below-market mortgage rates because its interest costs are cheaper with tax-free bonds than with taxable ones. Investors accept a lower interest rate on tax-free bonds since they generally do not have to pay federal income taxes, and in many cases state income taxes, on the earnings.

The agency could issue taxable bonds, but then it could not afford to offer the lower mortgage rates, Logue said.

"If this program ends, it could prove to be devastating for New Jersey and the other 49 states," Logue said. "Not only have mortgage revenue bonds provided opportunities for families who could not otherwise think of home ownership, they have also helped to strengthen urban and other municipal economies by expanding their tax bases."

Congress has acted to limit tax-exempt bonds because they cost the federal government through lost tax dollars. The original purpose of the tax-exempt status was to help municipal and state governments to finance traditional public projects. But the concept of "public purpose" has been greatly expanded over the years and critics contend many tax-exempt bonds are helping finance projects that are not really public in nature.

However, a national effort is underway to prevent mortgage revenue bonds from being terminated. The Council of State Housing Agencies (of which the New Jersey Housing & Mortgage Finance Agency is a member), the National Association of Realtors and the National Association of Home Builders are supporting a congressional bill that would extend the termination date for mortgage revenue bonds to December 1992.

The bill, co-sponsored by Frank J. Guarini, D-N.J., a member of the House Ways and Means Committee, was introduced by Massachusetts Democrat Brian Donnelly.

"It is crucial that this extension be made, because if it (the mortgage revenue bond program) is discontinued, it will drastically affect the ability of first-time home buyers to get their share of the American dream," Guarini said.

To qualify as a first-time home buyer under the program, an individual cannot have owned a home in the previous three years and must meet certain income requirements, depending on the county in which the purchase is.

See MORTGAGE, page D5

Mortgages

From page D1

Ocean counties,the buyer's income must be $39,675 or less.

Anyone purchasing in one of the agency's urban target areas can qualify for a mortgage through the program regardless of income. Sections of Asbury Park,Keansburg,Lakewood,Neptune and Red Bank are among the target areas.

The agency also offers some financing for multi-family homes.

Logue said the program has helped expand the conventional housing market by bringing more consumers into it and has helped stimulate the state's economy.

Since 1977,the New Jersey agency's Single Family Division has provided more than $1 billion in mortgages to more than 23,000 first-time home buyers in the state. Nationwide,the number of first-time buyers who have benefited from the low-interest program exceeds 900,000.

The average price of a home in the state now is $143,000, according to agency figures. The average purchase price of homes through the program is $66,860, with an average mortgage of $57,307.

The program's present interest rate for urban and first-time home buyers is 8.55 percent, which compares with mortgages in the 10½ to 11 percent range in the normal financial markets.

Elimination of mortgage revenue bonds would make it particularly hard for many people in New Jersey to buy their first homes since housing costs are so high, Logue said.

"It would be a terrible circumstance because there is such a high demand in New Jersey for housing and the only break a first time home buyer can get now is on the interest rate (through the program)," he said.

Logue also noted that 60 to 70 percent of those receiving mortgages through the state program have bought homes in urban areas.

Whether the legislation will be passed to continue mortgage revenue bonds is unclear,Logue said. If the problems first-time home buyers have in purchasing homes continue to be considered a national issue,there is a greater chance the "sunset" on the bonds will be extended,he said.

'MRB's— Is There A Future?

REALTOR MAGAZINE

by Trisha K. Morris

Two summers ago, David and Carol Puckett of Newport News, Virginia, jumped at the chance to buy their first home using a mortgage with a 9.53 percent interest rate.

At the time, conventional loans as well as those guaranteed by the Veterans Administration or insured by the Federal Housing Administration were offered at interest rates ranging between 11 percent and 12 percent.

The Pucketts got their rate—and the chance to become homeowners—from Virginia Housing. "Without this program, it might have been another five years before we could afford to buy a house," Mrs. Puckett said.

For scores of modest- to low-income Americans, the difference between renting and owning a home is the ability to get a loan with funds derived from the sale of mortgage revenue bonds. Since 1980, when Congress codified the states' authority to issue mortgage revenue bonds, nearly 1.8 million existing and new homes have been financed with loans funded by mortgage revenue bonds.

But the program is under scrutiny by federal officials, some of whom believe Uncle Sam is losing too much tax revenue on tax-exempt bonds. The Tax Reform Act of 1986 which reflects this concern contains a provision to eliminate state authority to issue mortgage revenue bonds by the end of December, 1988. There are proposals, however, underway in Congress to extend the expiration date. Rep. Brian J. Donnelly (D-Mass.), a member of the House Ways and Means Committee, has introduced a bill to stretch the mortgage revenue bond-authority through December, 1992.

"He (Donnelly) feels the program is a viable way for home buyers with modest incomes to buy houses," said Tom Barker, assistant legislative analyst in Donnelly's office.

For scores of modest- to low-income Americans, the difference between renting and owning a home is the ability to get a loan with funds derived from the sale of mortgage revenue bonds.

Carl W. Riedy, Jr., executive vice president of the Council of State Housing Agencies in Washington said CSHA is seeking similar action toward an extension to be made soon in the Senate.

John Ritchie, Jr., executive director of Virginia Housing, said there is no alternative method states can use to raise mortgage capital to provide below-market mortgage financing for home buyers which does not have serious disadvantages. "We've explored all avenues, and there just isn't any other way," he said.

"It all comes down to what investors are willing to pay for the bonds. They are making a decision based on economic self-interest. Without the tax-exempt feature, they are going to want a higher return. Nothing else we have come up with would provide us as low a cost of capital for loans for these home buyers."

Mr. Ritchie pointed out that in the past, Virginia Housing has had "no trouble" attracting investors for the tax-exempt bonds. "They are generally well-established in the marketplace as a respected security." One of the reasons the bonds enjoy a good rating and remain attractive is that Virginia Housing is careful in underwriting the loans that serve as security for the bonds.

Tess Van Curen, vice president of Lomas & Nettleton Co. in Newport News, said she "salutes" the homeownership opportunities provided by Virginia Housing and the agency's insistence on by-the-book underwriting standards. "Their program is designed around people who need it. But the people who get VHDA loans are not the type to walk away from those houses. VHDA protects that bond money to the nth degree." In confirmation of that, the figure for Virginia Housing's foreclosure rate in 1986 was .24 percent, compared with the national average for the same time period of .92 percent for all foreclosed properties.

Tax reform has imposed new limits on the amount of tax-exempt bond capital states can generate from the sale of bond issues to investors. The 1986 Act placed a collective volume cap on the bond issues allotted for each state. Prior to tax reform, states worked under separate volume ceilings for issuance of industrial revenue bonds, mortgage revenue bonds and other types of bond issuances. Now, the total dollar volume of bond issuances is lumped together under one total ceiling of $75 per capita or $250 million, whichever is greater. In 1988, the ceiling drops to $50 per capita or $150 million.

"Instead of wiping it (bond issuance authority) out completely, the federal government has chipped away at it with these volume caps," Mr. Riedy said.

The Tax Reform Act of 1986 imposed new guidelines for home prices and borrower incomes. The federal regulations limit applicants' income to 115 percent of the area median or the state median whichever is higher and limit home prices to 90 percent of the average area price. Requirements are less strict for "targeted" high-cost areas.

Additionally, the federally set income limits would bar applicants with incomes just over those limits who rely on mortgage revenue bond financing during times of higher interest rates. "This would botch the program's counter-cyclical role in the mortgage market," said Mr. Riedy. "There is always the debate, 'Does the program serve low-income people, or is it counter-cyclical?' It ought to be able to do both," he said. Mr. Ritchie agreed. "We are able to reach below and serve those with lower incomes than the conventional market can serve. When rates go down, we serve those with lower incomes. When rates are up, we serve those whose incomes are a little higher. But always we serve families with incomes lower than the conventional market can serve at the time." Over the past decade, Virginia Housing's rates have ranged from a low of 7 percent to a high of over 13 percent.

Another counter-cyclical feature of the mortgage revenue bond program is that the capital it generates is used more during times of high interest rates, Mr. Riedy explained. "It impacts lenders, Realtors and builders who are trying to move stagnant product. Lenders love our money when rates are up."

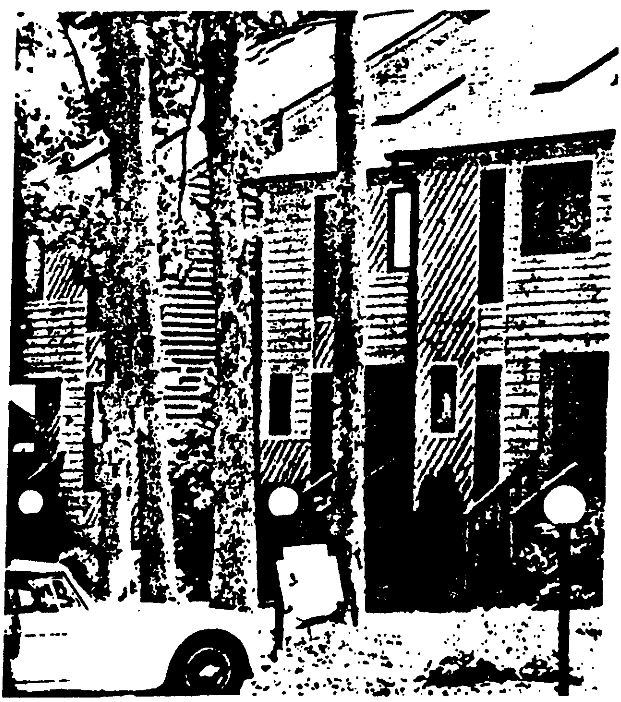
"In today's market, there is so much mortgage capital now and so much demand for housing that some lenders are not interested in mortgage revenue loans. They have money to lend coming in from other sources," said Mr. Riedy, "and if they can make one loan for $300,000, they'd rather do that than make six for $50,000 from mortgage revenue bond capital."

"There is also a question of competition for investors," he continued. "Some people feel the program is drawing away investors from the private market. But mortgage revenue bond financing is done with a public-private partnership. On the private side is the lender, who is the conduit for the money. On the public side is the participation of the federal, state and local governments. As long as we are achieving a public purpose, to help people buy homes who could not otherwise buy them, we are not competing with the private sector."

"The national decline in homeownership among young people," added Mr. Riedy, "justifies mortgage revenue bond programs. Since 1978, the percentage of homeowners aged 25-34 has slipped from about 53 percent to about 46 percent in 1986. A congressional decision to retain or eliminate mortgage revenue bonds could make the difference in reversing or continuing that trend. This needs to be approached not as a tax issue or a federal deficit issue. It is a housing issue."

Trisha Morris is a free-lance writer and a staff writer for the National Association of Realtors.

The MRB Program helps many become first-time-homebuyers



Is the American Dream Out of Reach?

The key to the future health of the housing market depends upon keeping homes within the financial grasp of potential buyers.

The demand for affordable housing in Florida has begun to outstrip the available supply. Florida's population growth of four times the national average has had a serious impact on housing, affecting both availability and affordability. The percentage of Floridians who can afford to purchase or rent safe and sanitary housing has declined precipitously in the last five years — following rather significant progress made in the 1960s and early 1970s. Housing costs have risen sharply, whereas income has increased at a much slower pace. Hardest hit are the low- and moderate-income families who must pay a prohibitively high portion of their incomes for decent shelter.

This growing problem in housing affordability is the result of the rising costs of land, construction and financing, an extreme reduction in federal funding, stricter underwriting criteria and added land use restrictions, coupled with phenomenal growth. These factors have combined to raise the cost of housing to a level that is no longer affordable for many Floridians. *(continued on page 42)*

by Caroline Chambliss

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American Dream

(continued from page 14)

What is Affordable?

The standard definition of affordable as it applies to housing is that not more than 30 percent of household income is spent on housing costs, including mortgage or rental payments, taxes, insurance, and utilities. As stated previously, problems of affordability are most severe for low- and moderate-income households in both rental and owner-occupied categories. State housing programs use the following definitions of those categories:

- Moderate Income – household income between 80 percent and 120 percent of the state median household income.
- Low Income – household income between 50 percent and 80 percent of median.
- Very Low Income – household income below 50 percent of median.

The statewide median family income issued by the U.S. Department of Housing and Urban Development for fiscal year 1987 is $27,800. For an example of how to determine affordability, assume a low-income household with an annual income of $15,290. To be affordable, housing costs can be no more than $4,487 annually or $382 per month. For a very low income household earning $11,120 annually and $927 per month, affordable housing can cost no more than $3,336 annually or $278 per month. .

Changes at both the state and national levels as well as certain general financial trends have made affordable housing much less attainable than it once was.

The Florida Housing Finance Agency (FHFA) and the Florida Department of Community Affairs (DCA) estimate that over two million Florida residents are experiencing critical housing problems, meaning that they are paying a disproportionate share of their income for housing, or that they are living in substandard conditions. It is also estimated that 84 percent of the low-income households in Florida spend over 30 percent of their income on housing.

The shortage of affordable housing extends to both the home-ownership and rental markets. It is estimated that 406,997 very low- and low-income persons and families need affordable rental units. According to an analysis of 1980 census data prepared by the National Low Income Housing Coalition, only seven states report a greater per capita need for low income rental units than Florida. They are: California, Colorado, Michigan, Nevada, New Jersey, New York and Oregon. A series of market studies prepared for the Florida Housing Finance Agency in 1985 surveyed the need for moderate-income rental housing in 17 of Florida's largest counties. The result:

34,974 additional units per year, for the next five years, would have to be built to meet the demand.

The affordability crisis can be attributed to several factors. Changes at both the state and national levels as well as certain general financial trends have made affordable housing much less attainable than it once was.

Underwriting Guidelines, Credit and Affordability

Although interest rates have declined significantly in the last five years, stricter underwriting standards have all but eliminated the benefits of lower rates to first-time home buyers. For example, some eligible and generally credit worthy applicants to the Florida Housing Finance Agency's first-time home buyer loan program are unable to participate in the loan program due to the requirements that are now needed to close a loan. The cost of private mortgage insurance has risen markedly along with the minimum required downpayment. In response to increased foreclosures, mortgage insurers have tightened their underwriting standards and the five-percent-downpayment, conventional loan has effectively disappeared.

In response to increased foreclosures, mortgage insurers have tightened their underwriting standards and the five-percent-downpayment, conventional loan has effectively disappeared.

The debt-to-income ratio allowed by mortgage insurers has decreased in the last five years from 33 percent monthly and 38 percent total debt, to the current ratio of 25 percent monthly and 33 percent total debt. Many first-time home buyers no longer qualify under the new guidelines since young, first-time home buyers are often more dependent on credit than they once were. Therefore, the average debt-to-income ratio of home buyers is higher now than it was five years ago.

Housing costs have also risen at a significantly higher rate than real income. In effect, five years ago a typical first-time home buyer with an annual income of $20,000 could afford a $44,000 mortgage (13 percent mortgage rate). Using today's insurance underwriting guidelines, and a 10 percent mortgage rate, that same family could still only afford a $44,000 mortgage (with a likely downpayment of 10 percent, as opposed to the previously available 5 percent). Therefore, the benefits of the significant drop in interest rates have been negated by the tighter credit underwriting standards.

Generally, the new standards restrict the purchase of insurance to individual savings, eliminating gifts and financial assistance. Additionally, the potential home owners must prove that they will still have the equivalent of a minimum of two months in housing costs after the closing. Contributions such as build-

It is evident that if affordable housing is to be constructed in Florida, certain concessions and even incentives must be built into the development regulatory framework.

er buy-downs are now limited to 2 percent and much stricter definitions of earnings are being applied.

Changes in standards for condominium sales have had a dramatic effect in Florida. Mortgage insurance companies generally will no longer insure condominium loans with less than a 10 percent down payment. On condominium construction projects, they will only risk a 30 percent exposure whereas five years ago the amount was generally unlimited. Prior to these changes, condominiums were often the lowest cost, most attractive option for first-time home buyers in Florida.

Unanticipated Consequence of Managing Growth

Florida's enormous surge in population has prompted a new environmental awareness and concern for managing growth that culminated in the passage of far-reaching growth management laws. The Omnibus Growth Management Act of 1985 was specifically drafted to strengthen the requirement that all land development regulations and orders be consistent with local comprehensive plans. It also limited local plan amendments to twice a year and guaranteed citizen standing to challenge specific plan and development regulation consistency.

The intent of the legislation, stated quite simply, was to standardize development regulations to best accommodate the 300,000 or more residents that move to Florida annually, while maintaining the state's natural beauty and integrity. One unforeseen consequence has been to hinder the production of affordable housing. The more land that is preserved, lessens the amount of land that can be developed. Competition for the remaining land increases the cost of that land.

Developers throughout the state have made it clear that growth management controls, in many instances, encourage them to develop lower-density, higher-priced units to realize a reasonable return on their investment. Growth management regulations have made it more costly to develop. As reported by HUD Final Report of the Task Force on Housing Costs:

"...local governments are steadily transferring, from the community-at-large to the developer, and thence to the housing consumer, a greater share of the public capital costs of growth."

Regulation is costly for a developer. Delays in construction require higher carrying charges, increased taxes and payrolls. These losses must be made up on each one of the units that are built. It is also true that the fewer units allowed, the less land available, the more expensive each unit will be. It is evident that if affordable housing is to be constructed in Florida, certain concessions and even incentives must be built into the development regulatory framework.

The New Role of The State

Since 1981, the budget of the Department of Housing and Urban Development has been cut by over 65 percent. Budget authority for all low-income housing programs within HUD has decreased from $32.2 billion in 1981 to $1.39 billion in 1986. These reductions have effectively eliminated all federally subsidized construction. The current administration has consistently advocated and implemented massive cutbacks in funds for housing programs. The responsibility for the provision of housing has been turned back to the individual states.

In Florida, the Florida Housing Finance Agency was created in 1980 to sell tax-exempt bonds and use the proceeds to finance mortgages for first-time home buyers and loans to developers of low-, moderate-, and middle-income rental housing. Participants in Florida Housing Finance Agency programs, both first-time home buyers and developers of multi-family rental housing must meet certain eligibility requirements to guarantee that the housing that is financed does increase the availability of affordable housing for low-, moderate- and middle-income persons. Both the first-time home buyer and the multi-family rental programs have been extremely productive. In six years the Agency has sold over $2 billion in bonds to finance housing for over 82,000 Floridians. That productivity has been threatened by the Tax Reform Act of 1986, however, which has limited the tax-exempt bonding authority of the state and added additional targeting requirements that have made it virtually impossible for developers to participate in the program.

Alternative solutions to the state's acute affordable housing shortage are being analyzed by the Affordable Housing Study Commission that was created by the Affordable Housing Act of 1986. Specific issues that the Commission was directed to address are:

- Offering low-interest and zero-interest loans for the development or rehabilitation of housing.
- Use of publicly owned lands and buildings as affordable sites.
- Creating a state mortgage insurance fund.
- Streamlining the various state, regional and local regulations governing the housing industry.

The committee has submitted an interim report and is charged with submitting the final report to the Governor by December 31, 1987. The report is expected to contain substantive recommendations.

As Florida moves into its place as the fourth largest state in the nation, this critical shortage of affordable housing must be addressed. Affordable housing is not a luxury; it is essential to the health of an expanding economy. The solution will require a public-private partnership removing many of the negative factors and creating incentives for the private sector to develop affordable housing.

You Can Help

The National Association of REALTORS Task Force on Housing for the Poor and Disadvantaged is in the process of devising a comprehensive set of recommendations on how Realtors on a national, state and local level may get involved in housing issues.

The Task Force would like to know specific examples of where Realtors are actively participating in providing creative solutions to the low-income housing problem in their communities. To produce a comprehensive policy on the housing needs of the poor, NAR must hear from you.

Any local Board having any knowledge of any of these types of programs, please contact Peter Morgan or John Butts, Government Affairs Division, NAR, 777 14th St., N.W., Washington, D.C. 20005; (202) 383-1233.

Caroline Chambliss is community assistance specialist for the Florida Housing Finance Agency in Tallahassee. This article represents conclusions drawn by the author, and does not necessarily reflect the official position of the Board of the Florida Housing Finance Agency.

Suburbs

From 1C

kind of apartheid that now exists in America. "The downside is a division based on class and race, a clear social division. And I am one who believes separation is not healthy."

The bright side of this new economic base is more money for more programs. "The advantages outrule the disadvantages," says Delta Clerk Barrett. "We have a tremendous park program."

Barrett, who moved to Delta Township 33 years ago because the land was cheaper and her house was out in the country on a large lot full of trees, says only the large lot full of trees still exists. "But we haven't been hurt by having neighbors. It balances off, the disadvantages and the advantages."

Barrett is a big booster of suburban life.

"Suburbia is a place where it's five minutes to church, five minutes to work, five minutes to a shopping place, with not a worry about getting a parking place," she says. "Suburbia does answer all the qualities of life people are seeking — school, church, work, shopping."

Another suburbia booster is Meridian Township Clerk Virginia White, who moved to Meridian 19 years ago, looking for good schools and open space. Her children are grown, and the two vacant lots that bordered her property have been developed. But still she likes life in the township, likes being close to the stores, the restaurants, the libraries, and the recreation opportunities.

Only two new quirks bother her: the lack of energetic people in their 30s and 40s to serve on township boards, and the lack of time to meet all the new neighbors.

Instead of being a bedroom community, suburbs have a new role, she says.

"It's moving into a family room community," she says. "Now it's diversified. More people are being employed in suburbia, in the mall shops and more and more working in their home."

Richard Harlow, director of development control in Meridian, still considers the township to be a bedroom community, about 80 percent residential. But more service-oriented businesses, such as doctor's offices, are opening, he says.

Meridian Township has an estimated population of 34,747. Meijer is the single biggest employer with 468 jobs. Delta Dental has 225. "The majority of people who live here work elsewhere," Harlow says.

The needs of the population are changing, Harlow admits. "We see a need for additional housing and activities for senior citizens," he says.

Classified

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A 4-line ad for 7 days is $6 for items priced $1,000 or less; additional lines are $1.50 each. For items priced $1,001 to $5,000, a 4-line ad for 7 days is $12, additional lines are $3 each. For items priced $5001 to $25,000, a 4-line ad for 10 days is $18, additional lines are $4.50 each. Easy Money ads also appear in People Plus mailed to non-subscribers. Non-commercial advertisers only, please.

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Display ads are 4 column-inches (56 lines) or larger. Rate per line per day is $1.47 weekday, $1.60 Sunday; size discounts apply to ads 27½ column-inches or larger. Repeat discount of 25% applies to display ads repeated within seven days.

Classified Index

011 Lost and Found

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438

state's home-ownership market.

Most of these households are headed by people under 40 and working in police or fire departments, schools and other essential municipal or business services. "This is bad news for families and bad news for our cities," he said.

WHILE both houses of Congress are gearing up for new housing legislation next year, there have been few specific proposals other than one that would extend the right of states to float tax-exempt bonds for subsidized mortgages. The housing industry and its think tanks, however, are taking the opportunity to lobby for favorite causes.

At the Joint Center for Housing Studies of the Massachusetts Institute of Technology and Harvard University, in Cambridge, Mass., staff members are preparing a major study on housing affordability to present to Congress.

"A key thing is that we need to work more on the down-payment problem and less on the long-term payment problem," said William C. Apgar, associate director of the center.

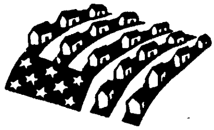
Too many state programs, he said, are geared to reducing mortgage interest costs over 30 years — a very long subsidy period for homeowners who may not need it.

"We need to provide more subsidy up front to help first-time buyers," said Mr. Apgar, "and more flexible assistance in helping the buyers with the long-term cash-flow burden." As an example, he cited a program of the Kentucky Mountain Housing Corporation that provides both substantial down-payment subsidies and, over the term of the mortgage, a subsidy of the mortgage interest based entirely on need.

Other housing groups want Congress to permit first-time buyers to use pretax savings for making down payments.

High housing prices have stretched both family and extended-family resources to the limit by depleting savings to use for down payments and by absorbing 30 to 35 percent of family income for housing payments, according to a 1986 report by the joint housing center. The tax advantages of home ownership, moreover, reduced costs by only 9 percent for all households in 1985, and that subsidy is further reduced under the new tax laws, according to Mr. Apgar.

Not surprisingly, high housing costs and declining home appreciation rates have contributed to a record number of mortgage defaults and delinquencies across the country.



Moderate-income homeowners, particularly those in the Northeast, have managed to trade up to better homes with the profits they obtained from the sale of homes that had sharply appreciated in value in the last decade.

Illustrations by Nancy Doniger

As a result, mortgage lenders and insurers have made it much more difficult for young, first-time home buyers to obtain mortgages. Lenders and insurers have tightened their underwriting standards by limiting housing costs to 25 percent of income — from 33 percent of income two years ago — and by limiting the source of down payments to personal savings, thus eliminating gifts and financial assistance from friends and family.

There are several ways of measuring housing affordability, and some show that median-priced houses have become more affordable to median-income families — those who earn about $28,000 a year.

MANY moderate-income homeowners, particularly those living in the Northeast, have managed to trade up to better homes with the profits they obtained from the sale of homes that had sharply appreciated in value during the past decade. But for many other median-income home buyers, this measure of affordability means that only the better-paid half of the nation's households can afford to purchase homes.

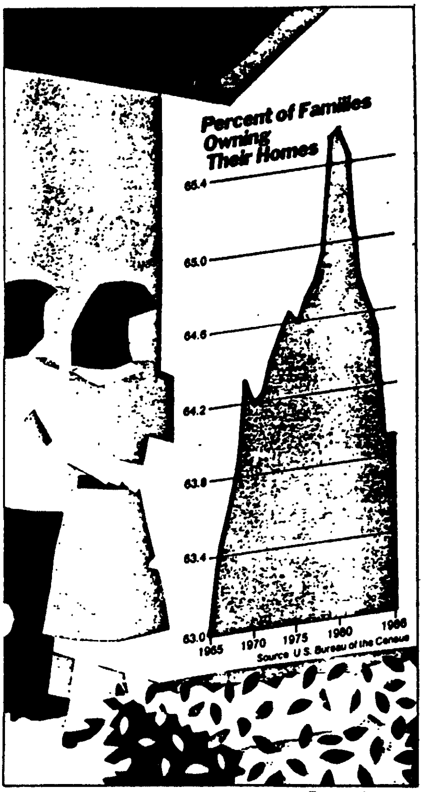
These national indexes also fail to take note of the distribution problem: there are many more lower-income people who live in higher-priced urban areas. In places like metropolitan New York, for example, the median income is only half the income required to qualify for purchasing a median-priced home.

HOUSING experts, moreover, are concerned about the declining percentage of families who own their own homes. This home-ownership rate rose from 43.6 percent in 1940 to 65.6 percent in 1980. The rate declined during each of the following six years and is now at 63.8 percent.

Had the home-ownership rate remained at its 1980 level, 1.5 million more families would be living in their own homes today, according to the National Association of Realtors. The fundamental reason for the decline is that national income has risen only 7 percent while home prices increased 32 percent — both figures adjusted for inflation — during the last six years.

Heads of families under the age of 35 actually experienced declines in their inflation-adjusted income. As a result the home-ownership rate for couples in the 30-to-34 age group fell 5 percent and the rate for couples in the 25-to-29 age group fell 7 percent — decreases that were two to three times the national decrease of 2.7 percent. The overall decline would have been greater if there had not been an increase in older people staying in their homes.

"In the 1970's, a record number of



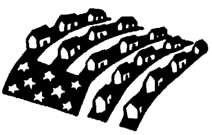
Americans born following World War II began flooding the housing and job markets," said James M. Fischer Jr., a Nashville home builder and a spokesman for the National Association of Homebuilders, "creating a situation where there were upward pressures on prices and downward pressures on wage rates."

SINCE 1979, nearly every economic trend has hurt the rate of home-ownership, according to the home builders.

The association cites record high interest rates that were followed by

According to a Census Bureau index for the last seven years, prices for similar housing almost doubled in the Northeast, but increased only by about 16 to 25 percent in the Midwest, South and West.

When the prices of all new homes are considered, however, there has been a more substantial increase because homes are being built larger and with more amenities. The average new home sold for $76,400 in 1980 and $111,800 in 1986, according to the Census Bureau. The increased price reflects the fact that builders are constructing larger and more expensive homes for the older homeowners



Prices rose in the Northeast, but the demand has been so great that it was the only region in the country that experienced an increase in the home ownership rate last year, from 60.8 percent to 61.4 percent.

high unemployment and slow income growth among younger households. New house prices continued to be high, and when interest rates started falling, so did appreciation rates.

The home-builders' group, however, says that prices for homes of similar size and amenities have not increased very much since 1980. But this fact provides little comfort to most home buyers because, over the years, builders have been selling larger, better equipped homes that cost a lot more than the average home built seven years ago. Builders, then, have largely given up starter homes and have increasingly focused on the trade-up market.

When houses with similar amenities and size are compared, the average price was $74,200 in 1980 and $95,300 in 1986, according to the Census Bureau.

This change, say the builders, represented a smaller increase than inflation in general.

"New house prices in most areas have not gone up faster than inflation, when equivalent houses are compared," said Michael S. Carliner, a senior economist with the home-builders' association.

"In the West, the real or inflation-adjusted prices have actually declined since 1979; the only region with an increase, and it's been tremendous, has been the Northeast area right down to Washington, D.C., and northern Virginia."

who are trading up.

Prices rose in the Northeast, but the demand has been so great that it was the only region in the country that experienced an increase in the home-ownership rate last year, from 60.8 percent to 61.4 percent. This increase, in the face of higher prices, shows the complicated relationship between price and home-ownership rate, according to Mr. Carliner. "Instead of buyers saying, 'Look how expensive houses are,'" Mr. Carliner said, "they have said, 'We'd better buy now because houses will be more expensive next year.' Of course, that was the rationale for people who could afford to make that choice."

The index that real-estate agents use for resales of existing homes indicates that median-income households were unable to afford median-priced homes from 1980 through 1985.

Only since June 1986 have median-income buyers been able to purchase median-priced homes; the real estate agents predict that this level of affordability will continue throughout this year.

This year, the index has been hovering around 110, down from a height of 150 in 1972. When the index is at 100, it means that a family with a median income of $29,742 — and the ability to make a 20 percent down payment on a home — can just qualify for a mortgage on an existing house that sells for the median price of $85,400. ■

Perspective

Lansing State Journal ■ Sunday, Jan. 10, 1988

C SECTION

America is no longer a land of city dwellers. Almost half of the country's population lives in suburbs.

But even suburbs are changing; they are no longer sleepy bedroom communities. The number of Americans working in suburbs is almost equal to the number working in cities. The jobs are there, says one researcher, because businesses and industry wanted to get away from the higher taxes and problems of the cities.

Clerk Barbara Barrett says Delta Township has 28,500 residents and an estimated 35,000 jobs. Industry has joined the fast-food restaurants, doctors' offices and shopping centers to make satellite cities.

Jill Fredel

Jill Fredel
News Editor

THE SUBURBS

They aren't sleepy towns any more

Soaring home prices squeezing out young buyers

By WILLIAM DUNN
Gannett News Service

LEVITTOWN, N.Y. — This Long Island suburb is choking on its own success — skyrocketing home prices that make it tough for the children of Levittown to buy here.

Expanded and renovated homes — built for the masses and selling for $7,990 in 1947 — now command $150,000 to $200,000.

"The young people unfortunately don't have a Mr. Levitt," said Daphne Kus, 58, secretary of the homeowners association. "The price of housing is putting it out of the reach of many young people. A lot are forced to leave the area."

"Seventy-five percent of the people of the United States that need and want housing cannot afford a house in Levittown today," said original developer William Levitt.

In response, parents approaching retirement occasionally sell homes to their children for reduced prices and easy terms.

Still other families have added "mother-daughter apartments" to their homes. It's legal in Levittown to rent to relatives but it is illegal to rent to outsiders — a restriction that is frequently ignored.

Failing those options, many young couples head farther out on the island to less costly towns, where they face lengthy commutes into New York City.

"We have to address this. It may be through financing, to work with banks in an effort to see that we can get young marrieds to move in," says Levitt resident Joseph Mondello, presiding supervisor in Hempstead.

Some 56,000 people live in Levittown.

The housing cost dilemma has triggered a critical shortage of young workers for local businesses. It also has led to absentee landlords, who are illegally turning private homes into boarding houses.

Non-whites were once barred from buying homes in Levittown.

"We were private builders, private enterprise. We had to build for profit. If we were to sell, at that stage of the game, 40 years ago, to black people, whites would not buy. Which was perfectly all right with us, provided there be enough blacks to buy our houses.

"The interesting part, and I was right, I said the day the government passes any kind of legislation against discrimination, we will be the first to implement it, and we were," he said.

Lansing State Journal

Suburbs

From 1C

kind of apartheid that now exists in America. "The downside is a division based on class and race, a clear social division. And I am one who believes separation is not healthy."

The bright side of this new economic base is more money for more programs. "The advantages outrule the disadvantages," says Delta Clerk Barrett. "We have a tremendous park program."

Barrett, who moved to Delta Township 33 years ago because the land was cheaper and her house was out in the country on a large lot full of trees, says only the large lot full of trees still exists. "But we haven't been hurt by having neighbors. It balances off, the disadvantages and the advantages."

Barrett is a big booster of suburban life.

"Suburbia is a place where it's five minutes to church, five minutes to work, five minutes to a shopping place, with not a worry about getting a parking place," she says. "Suburbia does answer all the qualities of life people are seeking — school, church, work, shopping."

Another suburbia booster is Meridian Township Clerk Virginia White, who moved to Meridian 19 years ago, looking for good schools and open space. Her children are grown, and the two vacant lots that bordered her property have been developed. But still she likes life in the township, likes being close to the stores, the restaurants, the libraries, and the recreation opportunities.

Only two new quirks bother her: the lack of energetic people in their 30s and 40s to serve on township boards, and the lack of time to meet all the new neighbors.

Instead of being a bedroom community, suburbs have a new role, she says.

"It's moving into a family room community," she says. "Now it's diversified. More people are being employed in suburbia, in the mall shops and more and more working in their home."

Richard Harlow, director of development control in Meridian, still considers the township to be a bedroom community, about 80 percent residential. But more service-oriented businesses, such as doctor's offices, are opening, he says.

Meridian Township has an estimated population of 34,747. Meijer is the single biggest employer with 400 jobs. Delta Dental has 225. "The majority of people who live here work elsewhere," Harlow says.

The needs of the population are changing, Harlow admits. "We see a need for additional housing and activities for senior citizens," he says.

The New York Times

Founded in 1851

ADOLPH S. OCHS, Publisher 1896-1935
ARTHUR HAYS SULZBERGER, Publisher 1935-1961
ORVIL E. DRYFOOS, Publisher 1961-1963

To Help Families, Help Housing

In his State of the Union Message, President Reagan urged Congress to rally behind family values. Meanwhile, hard-pressed American families are finding out the truth of December's grim statistics: Total housing starts dropped 18 percent below November. Apartments are what home-starved city families need; families already combing the streets for vacancies know that apartment-house starts dropped a mammoth 33 percent. If Washington wants to help families, it should stimulate, not block, construction of housing.

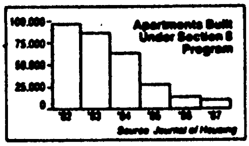
•

The nation's builders, emerging from the recession of the early 80's, added significantly to the housing supply in the last five years. Higher employment bolstered demand. A more effective but costly stimulus came from tax policies, and from tenant subsidies linked to new construction. This program is called "Section 8 Certificates for New Construction," and it has helped to produce 860,000 low-rent units nationwide. Money still in the pipeline stimulated new construction even after the Reagan Administration refused to ask for new money.

Before 1987, the Internal Revenue Code encouraged builders and equity investors by letting them deduct paper losses, created by super-fast depreciation, from other taxable income. These stimulants were taken away by the 1987 tax reform. Builders can be stimulated at lower cost by other methods, as low-interest mortgage loans from the Federal Housing Administration proved after World War II. But one way or another, some stimulus is required to speed construction of low-rent projects that offer only modest returns at perversely high risk.

To make apartments available to low-income families without Section 8 inducements, Washington tried less generous "existing housing" certificates and a new rent voucher program. Both programs supplement the income of poorer families; neither program encourages investors or mortgage lenders to increase the *supply* of housing.

In some regions, notably the Southwest, recession has hit hard. Many recently completed homes stand vacant. Other areas are experiencing strong housing demand and few vacancies. Fears of rent gouging, racial change and overdevelopment have prompted laws that perversely make building more costly than it should be. And local programs to finance housing via tax-exempt bonds are hampered by 1987 tax-law changes.



There are no panaceas for these housing afflictions. But Washington's first priority must be to energize builders and owners of rental apartments — private, public and community-based. They must be assisted in assembling the capital that is needed, particularly in cities with low vacancy rates.

Additional subsidies, in one form or another, will be needed to supplement tenants' incomes so they can afford the homes being produced. And the cost of those new homes can be brought down by streamlining local standards and regulations. Excessive land-use restrictions and the threat of permanent rent regulation also discourage builders. The Federal Government can play a constructive role in persuading local governments to review and change obstructive procedures.

There is no single housing problem; there are many partial remedies. They will all take work, and leadership. More than President Reagan's airy generalizations about Washington's interest in family values, American families need housing.

MONEY MATTERS

DOWN BUT NOT OUT

The effectiveness of the Minnesota Housing Finance Agency's Mortgage Loan Program has taken a serious blow.

Many of you are aware of the reductions in maximum purchase price limits which went into effect on November 25, 1987 for some Greater Minnesota homes financed under the Minnesota Housing Finance Agency's (MHFA) Single Family Mortgage Loan Program. However, some of you may not know the history behind the reductions . . the outlook for the future. We w. . y to address both of those topics, briefly, in this letter.

In particular, we would like to make it crystal clear that MHFA had no discretion in the matter, that MHFA strenuously opposed the Congressional initiatives which mandated the reductions, and that MHFA is doing everything it can to reverse the changes.

MHFA mortgage loans are financed with the proceeds of tax-exempt mortgage revenue bonds (MRBs). The tax-exempt status of the bonds enables MHFA to provide loans at below-market interest rates. The U.S. Congress established the conditions under which we can issue the bonds and make the loans to ensure that the funds are used to achieve important public policy objectives.

Unfortunately, in October 1987, the U.S. House Ways and Means Committee passed a "technical corrections" bill which ostensibly merely clarified ambiguous items in the Tax Reform Act. In reality, it made significant policy changes in regard to refunding bonds, and imposed them retroactively. This "technical correction" subjected loans from uncommitted proceeds of all of MHFA's 1987 bond issues to the new home purchase price limits.

For the eight "designated" outstate counties with a large urban center, this meant an immediate drop in the purchase price limit for new homes from $67,000 to $64,890 and for existing homes from $57,000 to $47,070. For the rest of Greater Minnesota, it meant a drop in purchase price limits for existing homes from $50,000 to $47,070. No changes were necessary for any limits in the Twin Cities metropolitan area.

MHFA has commissioned a study of house prices throughout Greater Minnesota, including the eight designated counties, which we hope will justify increases in the current limits. If so, MHFA will submit the data to the U.S. Department of the Treasury, which could then raise Minnesota's limits through a private letter ruling. This should occur early in 1988.

MHFA is also working with members of the Minnesota Congressional delegation and representatives of the National council of State Housing Agencies to delete the refunding "corrections" from the technical corrections bill. However, Congress is not likely to pass a final bill until the end of 1988. Even more importantly, the federal law authorizing MHFA to issue MRBs "sunsets" on Dec. 31, 1988. It is crucial to our future ability to deliver affordable housing financing for first-time homebuyers in Minnesota that Congress extend the sunset on MRBs.

If you believe the "technical correction" and/or the MRB sunset will hurt your clients and your community, the most effective thing you can do is to call or write your U.S. Congressman and both U.S. Senators. Encourage your current and former clients to write to Congress as well. The letters can be very brief. Be specific and, where possible, give concrete examples of individuals who have benefited from MRBs or been hurt by the purchase price reductions.

It will take a concerted effect for the next twelve month by *EVERYONE* concerned about affordable housing if we are to have any hope at all of extending the sunset on MRBs. We will be fighting an uphill battle against massive pressures to reduce the federal deficit. We will need your help. We must start now.

Thank you for helping make ownership a reality for thousands of first time homebuyers.

REALTOR MINNESOTA

Winter 1988

EDITORIALS

THE TENNESSEAN

Housing bill too modest

THE housing legislation that President Reagan has signed was called a substantial achievement by the White House, but the fact of the matter is that it falls far short of the nation's housing needs.

It is the first major housing legislation passed during his administration. In signing it, the President said it "will efficiently and effectively meet the challenge of America's changing housing needs."

The measure provides $15 billion for housing and community development in the fiscal year beginning Oct. 1 and $15.6 billion in the succeeding year. It provides $7 billion annually for low-income housing assistance, $1.5 billion for public housing operating subsidies, $2 billion for rural housing, $3 billion for urban development grants. It also contains permanent insuring authority for the Federal Housing Administration's home mortgage insurance program.

That appears to be a lot of money and it is. But the problem is massive. Most cities are struggling, and have been for years over housing for the poor. Many have public housing that has deteriorated over time, with little or no money to replace it or build new housing.

Waiting lines are long. Families are forced to double up or go homeless. In some cities there is a crisis. So, it is encouraging that some relief is in sight, but it is not the kind of relief that makes up for a kind of benign neglect of housing needs over the years.

For the young, owning a home has become a frustrating goal and for most a dream delayed. Housing prices have climbed far more rapidly than incomes. Although fixed mortage rates have dropped lately, requirements for low down payment have grown tighter, making it harder for middle income persons to qualify for mortgage loans, or else reducing the size of a loan a buyer can get.

Young families are caught in a Catch-22 situtation. Rents are rising faster than inflation, which makes it difficult for them to save enough to meet the down payment on a home of their own. The home ownership rate for those under 35 has dropped steadily from more than 60% in 1974 to slightly over 53% last year.

Whether the permanent insuring authority of the FHA can help the situation very much is speculative. It should help some, but again that help is far from enough.

There is the old saying that half a loaf is better than none, and in that view the housing bill is welcome. But it still means that for millions of the poor and more millions of the middle income-group, there will be no loaf at all. ■

Many Are Forced to Pay More For Worse Housing, Study Says

By Ann Mariano
Washington Post Staff Writer

The number of Americans who can afford to own homes is plunging, while the number of low-income families is rising and their families are being forced to pay more than ever for poorer quality housing, according to a Harvard University study.

H. James Brown, director of the Joint Center for Housing Studies at Harvard, said the study depicts "an America divided into two nations of haves and have-nots."

The majority of Americans "are very well housed," but others face problems that range from "the frustrations of young couples unable to qualify for a home loan to the desperation of families with young children who cannot obtain any housing at all."

Because the housing industry has been booming in recent years, national attention has been deflected "from the critical problems of first-time homebuyers, disadvantaged renters and homeless families and individuals," the study concluded. Brown and William C. Apgar Jr., associate director of the center, said housing problems faced by these groups are "interconnected" and solutions must be found for all such problems.

Single parents, whose numbers have nearly doubled since 1974, pay an average of 58 percent of their income in rent. At the same time, the median income of single parents, after adjustment for inflation, has fallen from $10,965 in 1974 to $7,271 in 1987.

As a percentage of income, rent also has increased sharply for most other types of households during the last 20 years, the study said. The mounting rent burden is "a major factor in the increase of homeless families," Brown said.

Only one in four Americans living at or below the poverty level lives in public housing or receives housing subsidies, the study said. In addition, nearly 10 million households are in substandard homes, many of them located in inner city neighborhoods and rural areas.

Apartment construction has been brisk for the past five years and vacancy rates have risen, but "the supply of low-cost rental housing continues to shrink as units are lost to abandonment or are upgraded for higher-income occupants," the study said. As a result, more people are competing for a dwindling supply of low-cost housing, it said.

Rents have risen dramatically in the 1980s, increasing at a pace 14 percent faster than overall inflation. Vacancies also have increased because more apartments have been built, but most of the available units are beyond the reach of poor Americans. The study said vacancies doubled between 1981 and 1986, but nearly 90 percent of the empty apartments rent for more than $300 a month.

"There is an enormous mismatch between the income of households and the cost of housing," said Apgar. "A vacant apartment in Houston does little good" for a tenant whose "rent increase is in Boston."

The costs of owning a home peaked in the early 1980s, but are still high by historical standards, according to the study.

In 1982, the after-tax cash costs borne by home owners was $9,599 a year—in real, or inflation-adjusted, dollars. Last year those costs had dropped to $7,449 in real terms. Nevertheless, that is still higher than the average ownership costs in the 1960s and 1970s, according to the study. After-tax cash costs are determined by subtracting income-tax savings from the outlay for mortgage interest, fuel and utilities, maintenance and repairs, real estate taxes and insurance.

The study said it found "little reason to expect a marked improvement in homeownership costs in the years ahead."

The study said that "the prices of land and labor are largely responsible for long-term geographic differences in housing prices." The study quoted an Urban Land Institute survey showing that a San Jose, Calif., lot costing $70,000 in 1985 could be purchased in Charlotte, N.C., for $13,000.

WASHINGTON POST

March 18, 1988

Cityscape

The Urban Legacy of James Rouse

By Benjamin Forgey
Washington Post Staff Writer

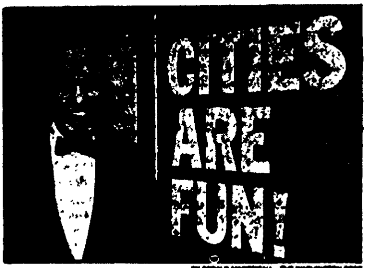
As one can see in an exhibition devoted to his lifework opening today at the National Building Museum, there is a certain grand pattern to the career of James W. Rouse, the country's most famous real estate developer.

In each of four postwar decades he has seized upon an idea and made it more or less his own, and in the process has helped greatly to change the look and feel of America's suburbs and cities.

During the surburbanizing 1950s he made his money as one of the pioneers of the shopping mall. In the 1960s Rouse, a city lover at heart, combined his interests and fathered the new town of Columbia, Md. In the 1970s he inaugurated a new phase of urban development by inventing the center-city festival marketplace. And most improbably, in the 1980s Rouse, now 73, has devoted his superabundant energy to one of the nation's most pressing social needs—housing the poor.

Rouse was in Washington last night to open the exhibition and to accept the museum's second annual Honor Award, presented by former Maryland senator Charles McC. Mathias, a longtime friend, at a black-

See CITYSCAPE, C14, Col. 1



James Rouse at the National Building Museum last night.

WASHINGTON POST

, March 24, 1988

Four Decades of James Rouse

CITYSCAPE, From C1

tie dinner in the fabulous central court of the Pension Building, occupied by the Building Museum since 1985.

In his, well, rousing speech, Rouse chastised most of those present—"leaders in business, banking, government, the managers of our wealth and our institutions"—for ignorance of the way "millions and millions of people in our country live."

This, he said, is "the city of people who are struggling to survive in miserably unfit housing, in wretched, disorderly neighborhoods with too little food, too little health care . . . too little happiness, too little hope."

He called for a $200 million "new partnership" among the federal government, local governments and "business, charitable, religious and civic resources" to "forge a new America with fit and affordable housing for all who seek it."

About half of the exhibition, organized by curator Mina Wright, is devoted to the most quixotic and most challenging of Rouse's endeavors—he's become a lightning rod for ideas about how to solve housing problems in an era of greatly reduced federal housing expenditures. What he proposes, with his nonprofit Enterprise Foundation and its for-profit subsidiary, the Enterprise Development Co., is to use real estate profits to help finance a wide variety of low-income housing programs nationwide. The philosophic thrust of the far-reaching, but still relatively small-scale, enterprise is to imbue raw capitalism with humanistic values.

Rouse's interest in low-income housing is nothing new. In her research Wright uncovered evidence of his earlier involvements. The most touching manifestation is a Rouse Co. Christmas card from the early 1950s touting the company's collaboration with Brotherhood Services Inc., a church-inspired group, in the renovation of a dingy Baltimore row house.

A more ironic piece is a 1953 photograph of a smiling Rouse in a group with President Eisenhower—Rouse chaired a subcommittee of a presidential housing task force and is credited, in an accompanying label, with having coined the phrase "urban renewal." It's an astonishing time warp. Those optimistic words came to stand for everything wrong-headed about our attempts to throw money at city problems, especially housing.

Not incidentally, they also stand in direct opposition to the pragmatic, incremental, cooperative approaches currently advanced by Rouse's new enterprises. It will be fascinating to see what Rouse and colleagues come up with in the way of recommendations for a new housing policy, as he is chairman of a 26-member National Housing Task Force created last fall with congressional support. The report will be released on Monday.

The Rouse Co., the nation's largest publicly held real estate development firm and Rouse's business masterpiece (though he severed formal ties with it in 1981), also is credited with first use of the word "mall" to describe the "suburban substitute for downtown" that began to proliferate in the '50s. Here again there's a certain irony—the man and the company whose greatest fame derives from the "urban visionary" marketplaces in the '70s and '80s clearly were suburban realists.

And they were suburban visionaries. Columbia was Rouse's imaginative response to the related problems of center-city decay and suburban sprawl—a planned community intended to combine the best of both worlds; that is, to introduce communal facilities so lacking in the malls he was building, to bring some sense of urban order and variety to the placeless suburban landscape and to provide former city dwellers with green suburban amenities. It was 20 years old last year and it has worked—although low-income housing goals haven't been met, Columbia is well on the way to becoming a commodious middle-sized city.

It is easy today to underestimate the impact of the festival marketplaces because they're practically ubiquitous and because, with time, their limitations have become all too apparent. But one simply has to make the effort to recall how dismal center-city prospects appeared in the early 1970s, before Rouse came along with his big idea, combining some of the marketing strategies learned in the malls with aspects of traditional urban commercial clusters. Neither conventional developers nor financial institutions were at all interested in mixed-use downtown projects until Rouse's Faneuil Hall in Boston (1976) and then his Harborplace in Baltimore (1980) turned the situation around.

This psychological turnabout is perhaps the most important contribution of the festival marketplace—it engendered a new sense of the benign possibilities of traditional city centers, as well as providing jobs and stimulating, in places, huge related investments. Of course today, amid voluminous evidence that once you've seen one such marketplace you've seen them all, it's justifiable to conclude we've been overmarketplaced as well as overmalled.

Furthermore, the formula has been indiscriminately applied. Rouse and others have been learning that it works best in big cities with significant regional and tourist markets to draw upon. Rouse's EDC, for instance, apparently is negotiating a withdrawal from Richmond's 6th Street Marketplace, opened with fanfare and high hopes just three years ago. And even the successful marketplaces have done little to solve more intransigent city problems, such as housing, education and social services for the less fortunate.

Which is where Rouse's personal turnabout comes into play—since 1981 he's combined his Christian social conscience and his business brilliance in a heroic attempt to fashion new ways of dealing with the nation's housing crisis.

The genesis of this effort occurred in Washington, during the 1970s, when Rouse would meet with members of the Church of the Saviour and other interested parties at the Potter's House café in Adams-Morgan. The result of this collaborative venture (with Rouse supplying essential financial support) was Jubilee Housing, an organization that has produced impressive results not only in housing the poor in Adams-Morgan but also in supplying crucial support services.

Modeling its programs after those of Jubilee, Rouse's Enterprise Foundation has set up a nationwide network of more than 90 self-help housing groups to which it provides grants, information and technical expertise. It has developed innovative, though simple, techniques to cut drastically the cost of renovations and equally inventive means of increasing the pool of capital available for low-income housing.

Could this holistic approach, combining enlightened capitalism, sophisticated local government involvement, volunteerism and broad-based community support, be a model for a revived nationwide crusade to provide decent housing for all citizens, as Rouse believes? The obstacles, obviously, are immense. But Rouse deserves great honor for trying and, as many were saying last night, the man has a track record.

Allegheny County
Residential Finance
Authority

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445 Fort Pitt Boulevard
Pittsburgh, PA 15219

412/644-1065

George Arendas
Executive Director

Administered by the
Allegheny County
Department of Development
Joseph M. Hohman, Director

Tom Foerster, Chairman
Pete Flaherty, Commissioner
Barbara Hafer, Commissioner

March 10, 1988

The Honorable Max Baucus, Chairman
Senate Finance Subcommitte on Taxation
and Debt Management
Committee On Finance
United States Senate
205 Dirksen Building
Washington, DC 20510

Dear Senator Baucus:

As your subcommittee meets to discuss expiring tax provisions, I suggest that you consider extending the sunset date on Mortgage Revenue Bond authority. I would imagine that Allegheny County is no different than other parts of this great country. Our residents share the dreams of their countrymen--a home to call their own and the ability to maintain and upgrade their domicile. The greatest tool we have to make this dream a reality is our ability to issue Mortgage Revenue Bonds.

Almost 3,500 families in Allegheny County have been able to purchase a home since the inception of our Single Family Mortgage program just five years ago. The below market financing rate was in many cases the only available option to enable the purchase. The average income of the participants of our program is $33,549.

The Improvement Program of Allegheny County (IMPAC) is also financed by Mortgage Revenue Bonds. Through this program our home owners are able to afford to make the improvements necessary to maintaining their health and safety. Code violations can be corrected because of the affordable below market interest rates. Ninety-four hundred families are living in better environments because of Mortgage Revenue Bonds. The average income of the participants in this program is just $23,855.

I thank you for your time and consideration and hope you will find the extension of Mortgage Revenue Bond authority a cause which you may support.

Very truly yours,

George Arendas

George Arendas
Executive Director

GA/med
cc: Ed Mihalski, Minority Chief of Staff

STEVE COWPER
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 23, 1988

The Honorable Max Baucus
Chairman
Taxation and Debt Management
Subcommittee
United States Senate
Room 215
Senate Dirksen Building
Washington, DC 20510

Dear Mr. Chairman:

The State of Alaska appreciates the opportunity to comment on the importance of continuing the qualified mortgage revenue bond program. As you may be aware, the cost of housing in Alaska continues to be among the highest in the country. At the same time, Alaska has the youngest population in the nation, and many of these young people, along with other citizens in the state, are seeking affordable ways of becoming first-time homeowners. The mortgage revenue bond program has proven to be extremely helpful to these first-time Alaskan homeowners.

Since 1983, 8,262 Alaskans have been able to purchase homes financed through the qualified mortgage bond program for a total of more than $700 million in housing loans. Although Alaska is currently going through an economic recession that is affecting all segments of the real estate industry, the state is still able to take advantage of the mortgage revenue bond program. The Alaska Housing Finance Corporation (AHFC) in November 1987 issued $50 million in tax-exempt bonds to provide mortgage loans for first-time home buyers in Alaska. Through the qualified mortgage revenue bond program, AHFC has provided loans at a 9 percent interest rate to first-time home buyers. The 9 percent The interest rate is about 2.125 percent lower than the conventional home loan interest rate in Alaska.

Recently, even during the economic recession in Alaska, it has been noted that the most stable real estate market has been in single family houses. Although the value of almost all real estate has declined, single family houses have held their value the best. Providing low interest rates to new homeowners should have a ripple effect, helping the entire home real estate market.

In Alaska, we have witnessed a painful process where many homeowners have not been able to keep up with their mortgage payments. The state has developed programs so that most of these homeowners affected by the recent recession will not lose their houses. What is noteworthy is that the struggle of these borrowers to keep their homes is not solely an economic decision. They also have a sense of pride and attachment to their communities, a belonging in large part created through homeownership.

I urge Congress to recognize the important value of home ownership to all our communities and to reauthorize the qualified mortgage revenue bond program.

Sincerely,

Steve Cowper
Governor

THE STATE OF THE NATION'S HOUSING 1988

SUMMARY

America is increasingly becoming a nation of housing haves and have-nots. While the majority of American homeowners are well housed and have significant equity in their homes, the prosperity of these homeowners does not reflect the plight of the nation's growing number of low- and moderate-income households. Continuing high housing costs limit the ability of low- and moderate-income households to improve their standard of living as many households struggle to secure even minimally adequate housing.

Homeownership costs have eased somewhat since the early 1980s but remain high by historical standards. Young households find purchasing a first home especially difficult, as housing costs remain high relative to income. Unable to secure a home of their own, these persons remain renters and bid up the price of rental housing.

Despite five years of strong construction activity and rising vacancies, the supply of low-cost rental housing continues to shrink as units are lost to abandonment or are upgraded for higher-income occupants. Having lagged inflation in the 1970s, real rents (measured in constant 1986 dollars) have moved up sharply since 1981 and now stand at their highest level in over two decades. Rising rents have led to an increasing share of households paying 30, 40, or even 50 percent of their incomes for rents, if they can secure housing at all.

For decades, improving housing conditions has been an important component in the upward mobility of American families and individuals. For many, moving from renter to owner occupied housing is a key step on the path to financial security. For those without sufficient income to become homeowners, obtaining good-quality, affordable rental housing has ~~been an~~ equally worthy goal. And for those with the lowest incomes, publicly assisted units have served as the foundation upon which to build a better future for themselves and their families.

The growing number of housing have-nots suggest that this housing progress has stalled in recent years. The problems of the housing have-nots come in many forms, ranging from the frustration of a young couple unable to qualify for a home loan, to the desperation of low-income families with children who cannot secure any housing at all. This State of the Nation's Housing report seeks to document these diverse housing problems and provide a sound empirical foundation for the emerging national housing policy debate.

Exhibit 1

Key Findings

- The After-Tax Cash Cost of Homeownership, Although Down From Its Recent Peak, Remains High By Historical Standards
- The Homeownership Rate Has Declined Steadily Since 1980, Particularly Among Young Households
- Despite Rising Rental Vacancies, Inflation-Adjusted Gross Rents Now Stand At Their Highest Level In Two Decades
- The Supply of Low-Cost Rental Housing Continues To Shrink As Units Are Lost To Abandonment Or Are Upgraded For Higher-Income Occupants
- For The Growing Number of Low-Income Families, Rents Have Increased Sharply As A Percent Of Income
- Only One In Four Renter Households With Incomes At Or Below The Poverty Level Lives In Public Or Other Subsidized Housing
- The Growing Rental Payments Burden, Particularly Among Single-Parent Families, Has Contributed To The Rise In Homelessness

TRENDS IN HOUSING COSTS

The costs of housing and other basic needs are key determinants of the standard of living for any family or individual. Changes in housing costs thus affect not only the ability to secure decent housing, but also the amount of income available for other necessities.

Because housing consists of many attributes, obtaining reliable price profiles proves difficult. This section presents a series of indexes that trace the changes in prices over the period 1967 to 1987 of representative owner and renter housing units with fixed characteristics. These indexes help to distinguish between changes in housing expenditures that result from changes in the type of housing consumed and those that reflect increases or decreases in the price of a housing unit of given characteristics (see Appendix Table 1 for a more complete description of the data used to form these price indexes).

HOMEOWNER COSTS

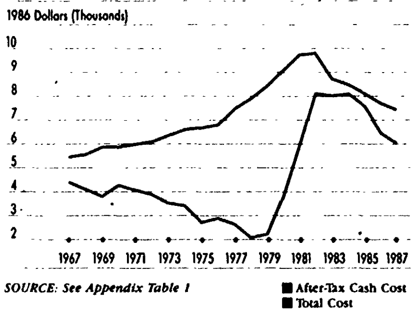
A complete homeownership cost index must incorporate indirect costs and savings as well as the more readily observable cash outlays and tax benefits. The after-tax cash cost of homeownership is the sum of several ongoing expenses (including outlays for mortgage interest payments, fuel and utility costs, maintenance and repairs, real estate taxes, and insurance) less the income-tax savings associated with owning a home. The total homeownership cost also includes the indirect cost of earnings foregone on funds used as a downpayment less the indirect savings from house price appreciation and the resulting equity buildup.

Exhibit 2 depicts how both the cash and total costs of owning and operating a modest single-family home during the first year of occupancy have changed over the last 20 years. In these calculations, a modest home is defined as the median-valued house purchased in 1977 by a first-time buyer aged 25 to 29. All costs are expressed in constant 1986 dollars.

After rising steadily for 15 years, the after-tax cash cost of homeownership reached a peak of $9,599 in 1982. Although it fell to $7,449 last year, the after-tax cash cost is still higher than the average recorded in the 1960s and the early 1970s. By comparison, the total cost of homeownership (including the foregone earnings on homeowner's equity and an allowance for price appreciation) remained at or below $4,500 from 1967 to 1979; indeed, for much of the period, total annual costs were less than $3,500. After 1979, though, total costs began to move up sharply; by 1982, higher home prices, interest rates, and utility costs—together with smaller gains from appreciation—had boosted the total costs of owning a home to $7,904. Though falling from this peak, total homeowner costs stood at $6,006

Exhibit 2

Homeowner Costs (In 1986 Dollars)



SOURCE: See Appendix Table 1

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last year—still well above the average for the past 20 years.

There is little reason to expect a marked improvement in homeownership costs in the years ahead. The median price of the representative first home in 1987 approached $67,000, up more than 92 percent from the $34,800 figure for 1975. Rising prices are a double-edged sword: while they make homeownership a good investment for those who already own, they also force young first-time buyers to make larger downpayments and/or larger monthly mortgage payments. The legacy of the rapid home price inflation of the 1960s and 1970s is the continuing high home prices, and the high after-tax cash costs of homeownership.

REGIONAL HOMEOWNER COSTS

Since the costs of building materials and financing vary little from one region to the next, the prices of land and labor are largely responsible for long-term geographic differences in housing prices. According to a recent survey by the Urban Land Institute, a lot that sold in 1985 for $70,000 in San Jose, California, could be purchased for only $13,000 in Charlotte, North Carolina. Although detailed data that separate total home purchase prices from underlying land costs are not available, land cost is undoubtedly the major determinant of variation in home prices.

During the 1970s, home price appreciation in the West, and particularly in California, outpaced that in all other regions (Exhibit 3). Although house price inflation slowed considerably after 1982, the median price for the representative first home in the West last year was $82,285, still 23 percent above the national median.

In the Midwest and the South, housing prices increased less dramatically. In 1967, a first-time buyer could purchase a home in the Midwest for $180 less than the national average; in 1987, this home sold for $10,324 less. Home price inflation in the South has also lagged behind the national average: in 1967, a modest home sold for $1,324 less than the national average; by 1987, it sold for $11,744 less.

Price trends in the Northeast have been decidedly more volatile. During much of the

Exhibit 3

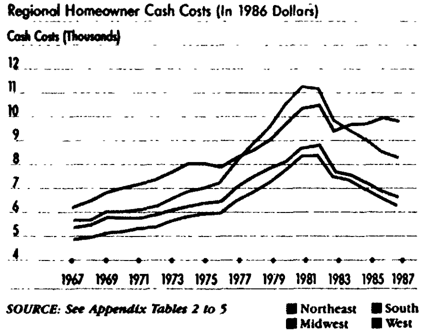
House Prices by Region

Region	1967	1972	1977	1982	1987
Northeast	$17,797	$26,048	$37,000	$58,201	$93,844
Midwest	16,350	20,993	32,700	50,162	56,562
South	15,206	19,958	29,700	48,975	55,142
West	18,318	22,780	42,900	71,386	82,285
All	16,530	21,611	34,800	56,202	66,886

SOURCE: Joint Center calculations based on 1977 Annual Housing Survey data indexed by Department of Commerce Constant Quality Home Price Index.

Exhibit 4

Regional Homeowner Cash Costs (In 1986 Dollars)



SOURCE: See Appendix Tables 2 to 5

1970s, house price inflation lagged behind national rates; since 1982, however, house prices in the Northeast have increased three times faster than the national average.

The real after-tax cash costs of homeownership also rose almost steadily in each region from 1967 to 1981 (Exhibit 4), but declining mortgage interest rates and a slowdown in house price appreciation have helped to lower these costs since then. Real after-tax cash costs dropped most rapidly in the West, although significant declines occurred in the Midwest and South as well. In the Northeast, however, rapidly rising home prices partially offset the effect of declining mortgage interest rates. Despite this regional variation, after-tax cash costs in all regions remain well above levels recorded in the 1960s and 1970s.

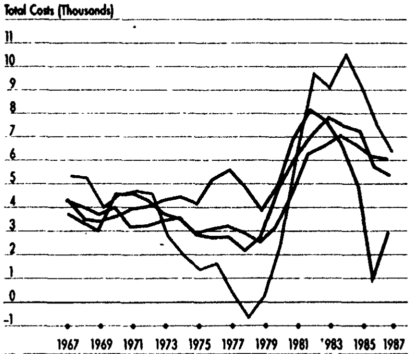
High home price levels and low current price appreciation combine to give the West the highest total homeowner costs in the country (Exhibit 5). Although down from the peak levels of the early 1980s, total costs in the Midwest and South remain above the levels recorded for much of the 1970s. In the Northeast, home price appreciation reduced total homeowner costs in 1986 to their lowest level in two decades; with slower house price inflation, however, the equity buildup in the Northeast also slowed and total homeownership costs in the region increased again in 1987.

RENTER COSTS

Unlike trends in homeowner costs, the recent growth in real rents has received little attention. Exhibit 6 presents estimates of real gross and contract rents for a representative unit with the characteristics of the median-priced rental unit in 1977. Contract rent is the monthly payment to the property owner for housing services; gross rent includes not only contract rent but also payments for fuel, water, sewerage, and other utilities.

Exhibit 5

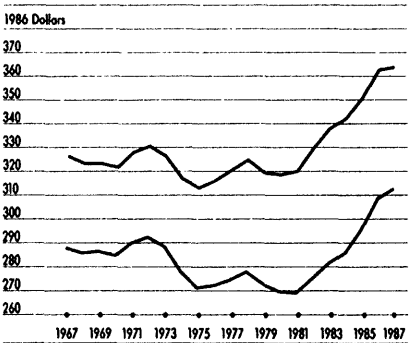
Regional Homeowner Total Costs (In 1986 Dollars)



SOURCE: See Appendix Tables 2 to 5

Exhibit 6

Rental Costs



SOURCE: See Appendix Table 1

Real rents (that is, adjusted for inflation in other goods and services) tend to move with the business cycle, falling during cyclical downturns and rising during expansions. Despite a sharp jump in rental vacancies, contract rents have moved up steadily since 1981 and now stand at their highest levels in more than two decades. In 1987, the contract rent for the representative unit was $312—an increase of 16 percent from the 1981 low of $269.

Gross rents have moved up as well, but somewhat more modestly because of the slowdown in energy price inflation. Nevertheless, the rise in gross rents is still pronounced: up 14 percent between 1981 to 1987, bringing the level to $364.

Gross rent is seemingly the more comprehensive measure, but changes in contract rent have considerable analytical significance. Gross rent can change as a result of shifting energy prices or other factors that have little to do with the long-run cost of housing capital. Policy analysts should note, however, that the persistent increase in contract rent during a period of substantial new construction suggests that there has been a long-term increase in the rental price of housing capital. Unlike a runup of energy costs, such a long-term trend is not quickly reversed. Over the past six years, the cost of supplying rental housing appears to have drifted upward, a movement that can only point to continued high rent levels in the years ahead.

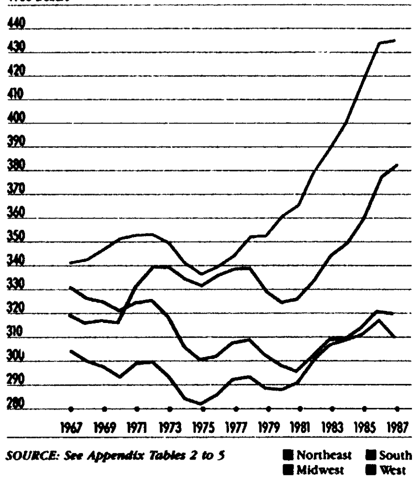
REGIONAL RENT TRENDS

The Northeast and the West, areas of vigorous economic expansion, have witnessed the sharpest rent hikes during the decade (Exhibit 7). From 1981 to 1987, real gross rents in the West increased by nearly 19 percent, while those in the Northeast rose approximately 17 percent. More modest rent increases occurred in the Midwest. Only in the South, a region with substantial overbuilding, do gross rents appear to have peaked.

Exhibit 7

Regional Gross Rental Costs

1986 Dollars



SOURCE: See Appendix Tables 2 to 5

The rapid growth of rents seems inconsistent with the recent increase in residential vacancies. From 1981 to 1986, the number of vacant rental units nationwide expanded from 1.54 million to 2.66 million. In part, the reason for this phenomenon of growing vacancies and rising rents is that housing consists of many distinct submarkets defined by the location and the quality of the dwelling unit. Obviously, the increase of vacant rental apartments in Houston does little to check rent increases in San Francisco or Boston.

Even within a given housing market, vacancies at one quality level will not necessarily result in lower rents for housing of a different quality. It appears that over the past six years, many newly constructed, better quality rental apartments have remained on the market at relatively high rents. Indeed, units leasing for more than $300 in real terms account for 90 percent of the rise in rental vacancies during the past six years. While the rising vacancy rate may have resulted in some moderation in rents for luxury apartments, it has not limited rent increases of more modest apartments.

That rents are increasing fastest at the low end of the market is perfectly understandable. During the 1970s, an excess supply of housing, in part the result of a rapid buildup of subsidized housing in selected urban neighborhoods, depressed rents in some markets; even in 1986, many housing units still rented for $100 to $300. Yet in many areas, such low rents are inadequate to cover property owners' costs for utilities, property taxes, and debt service, let alone the costs of maintaining the buildings in good condition.

As a result, the number of units renting for less than $300 per month dropped by nearly one million between 1974 and 1983; the number of units with rents above $400, in contrast, increased by 4.5 million to 10.2 million (Exhibit 8). The loss of low-rent units involved two distinct dynamics: some fell into disrepair and were removed from the stock; others—especially those located in the stronger housing markets of the Northeast and West—were upgraded to attract higher-income tenants. High-rent units were thus added both by new construction and by rehabilitation of existing inventory.

Estimating the exact number of low-rent units lost to abandonment as opposed to revitalization is difficult. Recent data suggest, however, that investment in existing rental structures has been significant: after showing virtually no real growth from 1970 to 1982, expenditures for maintaining and upgrading rental units more than doubled from 1982 to 1986. While this trend is observable throughout the country, the investment increases in the Northeast and the West are particularly notable. Apparently, the recent rise in real rents has made investment in existing properties profitable again in many metropolitan areas—investment that will further diminish the supply of low-cost rental housing in the years ahead.

Exhibit 8

Monthly Gross Rent (Thousands of Units)

Gross Rent In 1986 Dollars	1974	1983	Change
<100	1,064	957	-107
100-200	4,197	3,408	-789
200-300	6,264	6,181	-83
300-400	5,846	7,034	+1,188
400+	5,748	10,233	+4,485
No Cash Rent	1,173	1,401	+228
TOTAL	24,291	29,214	+4,923

SOURCE: Joint Center tabulations of U.S. Department of Housing and Urban Development, Annual Housing Survey, 1974 and 1983

THE HOUSING COST BURDEN

The rise in housing costs comes at a time when low-income households are particularly vulnerable. Since 1974, the number of low-income households has increased markedly. This trend reflects cutbacks in federal funding for various income-support programs, as well as the growing number of individuals with few marketable skills and limited income-earning capacity. The shrinking supply of low-cost housing, then, will most certainly result in increased housing payments relative to income for an ever larger number of low-income households.

INCREASES IN LOW-INCOME HOUSEHOLDS

Over the past 20 years, low-income households have suffered sharp declines in income during economic downturns—declines that were not made up for during subsequent recoveries. The result is a long-term increase in the number of low-income households. Since 1974, the total number of households increased by 26.3 percent. At the same time, the number of households with real incomes of less than $5,000 (measured in 1986 dollars) surged from 4.7 million to 7.2 million, an increase of 55.1 percent (Exhibit 9).

The profile of the nation's low- and moderate-income households has changed over the past 20 years due to a complex series of demographic, social, and economic changes. Rapid growth of the young adult population in the 1970s put a squeeze on wage growth for many entry-level jobs. Rising divorce rates and increases in teenage pregnancies have also added to the number of economically disadvantaged single-parent households. The high inflation of the 1970s further eroded the real incomes of those with limited earning power and has continued to outpace the growth of income transfer programs.

Exhibit 9

Household Income and Homeownership

Thousands of 1986 Dollars	Number of Households (In Thousands)		Percent Homeowner	
	1974	1987	1974	1987
Under 5	4,705	7,204	42.8	36.7
5 to 10	8,755	10,984	48.7	45.9
10 to 17.5	11,436	15,326	53.8	51.9
17.5 to 25	11,152	13,063	58.7	60.0
25 to 35	13,277	14,636	69.3	68.3
35 to 50	11,638	14,177	78.6	79.3
50 +	9,891	14,089	86.2	89.1
Total	70,854	89,478	64.7	64.0

SOURCE: Joint Center tabulations of data from the Annual Housing Survey, 1974, and Current Population Survey, 1987.

Measured in real terms, today's young households have lower incomes than their counterparts of 1974. Over this period, the median income of all households remained virtually constant in real terms, but the income of households with heads aged less than 25 fell by 28.7 percent from $18,248 to $13,011, while the income of households with heads aged 25 to 34 fell from $27,366 to $24,230. By contrast, incomes of somewhat older households continued to advance, with the sharpest gains recorded by households with heads aged 65 or older.

The drop in income for young households is largely the result of the alarming situation of single-parent families with children. These households constitute both a growing share of young households and a growing share of the nation's poverty population. Over the past decade and a half, the number of single-parent households with heads aged 25 to 34 more than tripled. In 1987, the median income for households in this group was a meager $9,621—23 percent below the figure recorded for similar households in 1974. For single-parent households with heads aged less than 25, median income in 1987 was $4,688 (see Appendix Tables 6 and 7 for more detailed data on household income by age and family type).

CHARACTERISTICS OF OWNER AND RENTER HOUSEHOLDS

Rental housing is increasingly the home of the nation's lower-income households, while higher-income households increasingly choose to own a home. Since 1974, the homeownership rate fell for households with incomes of less than $10,000 (measured in 1986 dollars). By comparison, the number of homeowners with real incomes above $50,000 grew by 4 million over this period and the homeownership rate increased from 86.2 to 89.1 percent (Exhibit 9).

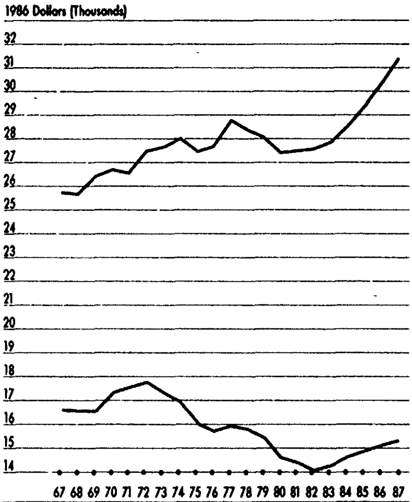
The growth in the number of low-income renter households has widened the income gap between owners and renters. Between 1972 and 1982, the median income of renters fell by 21 percent, from $18,000 to $14,000 (Exhibit 10). With the economic expansion of the mid-1980s, the median renter income did improve slightly, but not enough to reduce poverty among renter households. From 1983 to 1987, the number of poverty-level renter households increased by 300,000 to 7.5 million. By contrast, the number of poverty-level owner households fell by 500,000 to 4.5 million. Thus, by 1987, 63 percent of all poverty-level households lived in rental housing.

As a group, renter households are younger and poorer than homeowners. Since 1974, the median income of renter households aged 25 to 34 fell by 18.5 percent (Exhibit 11), while the median income of renters aged 25 or younger was 25.8 percent lower than real incomes of young renters in the mid-1970s.

Rental housing is also increasingly the home of the nation's children. Between 1974 and 1987, the number of renter households with children grew more than four times faster than the rate for all households. In contrast, the number of young homeowners with children actually fell over the past decade and a half (see Appendix Table 7 for detailed data on households by tenure, age and type).

Exhibit 10

Household Income (In 1986 Dollars)



SOURCE: Median household income indexed by Bureau of Labor Statistics Consumer Price Index (CPI-UX) for All Items. See Appendix I.

Exhibit 11

Households and Household Income By Age And Tenure

Age and Tenure	Number of Households (In Thousands) 1974	1987	Percent Change	Median Income (1986 Dollars) 1974	1987	Percent Change
Owner						
Under 25	1,377	833	39.5%	$23,419	$18,934	-19.2%
25 to 34	7,630	9,237	21.1	31,220	32,006	2.5
35 to 44	8,653	12,507	44.5	35,284	38,044	7.8
45 to 64	18,590	20,404	9.8	30,965	33,218	17.5
65 +	9,593	14,272	48.8	12,730	14,962	17.5
Renter						
Under 25	4,666	4,364	-6.4%	$15,828	$11,737	-25.8%
25 to 34	7,042	11,266	60.0	22,340	18,199	-18.5
35 to 44	3,412	6,196	81.6	21,963	20,357	-8.3
45 to 64	5,731	5,673	-1.1	18,216	15,732	-13.6
65 +	4,160	4,727	13.6	8,485	8,336	-1.7

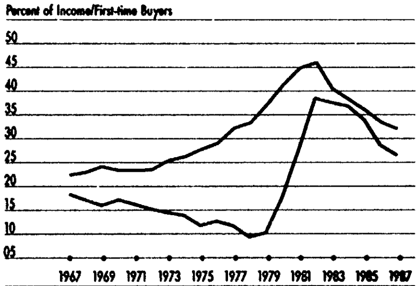
NOTE: Income data as of prior year

SOURCE: Appendix Table 7

Exhibit 12

Homeowner Cost Burden

Percent of Income/First-time Buyers



SOURCE: See Appendix Table 1

■ After-Tax Cash Cost Burden
■ Total Cost Burden

INCOME AND HOUSING COSTS

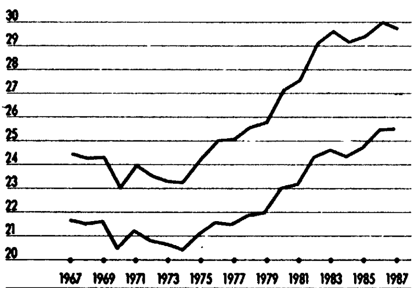
The relatively low incomes of renter households have important implications for housing in America. Low incomes not only limit the ability of many households to secure adequate and affordable housing in the non-subsidized private marketplace, they also shrink the pool of potential first-time home-buyers. With the incomes of young renter households failing to keep pace with inflation, the construction and sales of housing targeted to first-time buyers will suffer.

Exhibits 12 and 13 present estimates of owner and renter cost burdens, i.e., the annual cost of a representative unit as a percent of household income. Again, the representative unit for owners has the characteristics of the median-valued home purchased by a first-time buyer in 1977; the representative unit for renters has the characteristics of the median-priced rental unit in 1977.

Exhibit 13

Rental Cost Burden

Percent of Income/All Renters



SOURCE: See Appendix Table 1

■ Contract Rent Burden
■ Gross Rent Burden

Nationwide, the cash cost of owning the representative home was $7,720 last year, or 32.4 percent of the estimated median income of potential first-time homebuyers (proxied here by the income of married-couple renter households aged 25 to 29). For all renters, the median gross rent of the representative unit was $4,368 annually (or $364 per month). While this rent is only 18.3 percent of the median income of married-couple renters aged 25 to 29, it represents almost 30 percent of the median income of all renters.

Although young married-couple renters earn more than other renters, their incomes have not kept pace with homeownership costs. For the representative first-time buyer, the after-tax cash cost of homeownership rose steadily from 23 percent of income in 1970 to 45 percent in 1982. The cash cost burden has declined since 1982, but last year still stood 50 percent above the levels averaged during the late 1960s and early 1970s. Total homeownership costs as a percent of income have also fallen since 1982 but remain high by historical standards.

As might be expected, the cash cost burden of homeownership is highest in the Northeast and West (Exhibit 14). In the Northeast, the incomes of first-time buyers are 24 percent higher than the national average, but the cash cost is 32 percent higher. Household incomes in the West are also above the national average, but above-average cash costs leave potential first-time buyers in the West little better off than their counterparts in the Northeast. Cash cost burdens in the Midwest and South are below average, with lower housing costs more than offsetting lower incomes. Nevertheless, the cash cost burden in each region remains above 1970s levels (see Appendix Tables 2 to 5).

Housing affordability is, of course, a relative concept. Whether housing is affordable or not in 1987 depends on one's point of view. In the face of higher housing costs, households may choose to purchase a smaller home or one with fewer amenities. The figures in Exhibit 12 simply suggest that young households are less able to purchase a home of given standards today than 15 or 20 years ago.

The constant quality rental cost burden —measured as either annual gross rent or contract rent for the representative unit as a percent of median renter income—also remains relatively high (Exhibit 13). The gross rent burden fell slightly from 1967 to 1974, but has moved up sharply since that time. What is striking is that the strong economic recovery that began in 1982 did nothing to alleviate the renter cost burden: increases in real rents have steadily outpaced growth in real income.

Like the homeownership cost burden, the renter cost burden varies geographically. Renters in the West face the largest burden; although the median renter income is above the national average, so too are gross rents. In the Northeast, rents are also above the national average, but relatively high incomes help to reduce the burden. By contrast, rents in the South and Midwest take a somewhat smaller bite out of renter income.

Exhibit 14

Housing Cost Burden By Region: 1987

Region	Income First-time Buyer	Homeowner Cash Cost	Cash Cost Burden	Income All Renters	Gross Rent	Gross Rent Burden
Northeast	$29,600	$10,223	34.5%	$17,000	$397	28.0%
Midwest	22,300	6,929	31.1	14,700	332	27.1
South	22,600	6,581	29.1	15,300	322	25.2
West	25,200	8,680	34.4	17,400	450	31.0
National Total	23,800	7,720	32.4	15,200	377	29.7

SOURCE: Appendix Tables 2 to 5

THE OUTLOOK FOR HOUSEHOLD FORMATION AND HOMEOWNERSHIP

Despite some slowdown, the strong housing demand of the nation's more affluent homeowners should ensure the prosperity of the housing industry for the next 10 years, but the prospects for the housing have-nots are less rosy. In the years ahead, the high housing cost burden will undermine the ability of young adults to form independent households and to purchase their own homes.

HOUSEHOLD FORMATION

After a decade of record growth, household formation rates are expected to decline for the balance of this century. In the 1970s, an average of 1.7 million households were added each year; in the early 1980s, the weak national economy and the high cost of housing combined to reduce the average increase to about 1.2 million. Growth in the number of new households has picked up somewhat since 1983, but remains erratic: the number of households increased by 1.6 million from March 1985 to March 1986, but increased by only 1.0 million from March 1986 to March 1987.

In the years ahead, the aging of the baby-boom generation and the arrival of the baby-bust generation into the prime household formation years (20 to 25) ensure a slowdown in the growth of households. (The baby-boom generation is that large cohort of individuals born in the years 1946 to 1964; the baby-bust generation includes those individuals born from 1965 to 1975, a period of low and declining fertility.) Annual household growth is expected to average 1.45 million from 1985 to 1990 before slowing to 1.21 million per year in the early 1990s and to 1.08 million per year in the late 1990s (see Appendix Table 8 for household forecast to the year 2000).

The long-term trend toward slower household formation primarily reflects the changing age structure of the population. Since the baby-boomers are now between the ages of 23 and 42, most have already passed the prime household formation ages. As the growth of population aged 20 to 25 slows, so too will household formation.

The high cost of owning and renting a home will exacerbate this slowdown. The proportion of any given demographic group that heads its own household (the headship rate) depends critically on the cost of housing. After rising steadily in the 1970s, the headship rate among young adults flattened and then turned down. Since 1980, the headship rate for the population under age 35 has fallen steadily and is now below levels posted in the mid-1970s.

High and rising housing costs seem largely responsible for the recent decline in headship rates. It will take a period of sustained growth in household income, as well as further declines in homeownership costs and rents, to restore the ratio of housing costs to household income to the more affordable levels enjoyed during much of the post-war period. Population growth ensures that the total number of households will increase, but high housing costs will constrain household formation in the years ahead.

Exhibit 15

Percentage of Population Who Head Their Own Households: 1970-1987

Age	1970	1975	1980	1983	1987
15 to 24	11.2%	13.6%	15.9%	14.2%	13.8%
25 to 34	46.9	49.7	50.5	48.6	48.1
35 to 44	50.5	52.5	55.0	55.7	55.6
45 to 54	52.6	54.8	55.8	55.6	57.4
55 to 64	57.6	58.0	58.3	59.5	58.9
65 or Older	61.7	67.5	68.4	68.7	67.9

SOURCE: Joint Center for Housing Studies estimates based on data reported in U.S. Department of Commerce, Current Population Report, Series P-20, Various Issues.

HOUSING DEMAND

In the late 1980s and early 1990s, the aging of the baby-boomers will generate considerable growth in the number of households with heads aged 35 to 44. Many baby-boomers delayed marriage and having children, but now are doing so in sufficient numbers to create a significant increase in the number of married couples and an "echo" baby boom. Not only will many baby-boom households move into a more family-oriented phase of the life cycle during the late 1980s, but they will also pass through their peak earning years, sparking demand for more expensive homes.

The housing market activity of the baby-boom generation has been a key ingredient in the unusually long housing recovery of the past five years. Indeed, even though new housing construction activity is expected to slow in 1988, demand for good-quality, single-family homes should remain strong well into the 1990s as current baby-boom homeowners continue to trade up to better housing. The strong tradeup demand should also support growth of the renovation and repair market as some baby-boomers improve their current housing by repairing or adding to an existing home.

An important factor in this optimistic outlook is that more than half of all baby-boom households already own homes. Many baby-boomers bought homes in the late 1970s and therefore benefited from at least some of the rapid house price appreciation that occurred throughout the country. Unlike younger families still struggling to break into the ownership market, current baby-boom homeowners have the resources—in terms of both income and wealth—to acquire bigger and better housing, or to make substantial investments in their current homes.

RECENT TRENDS IN HOMEOWNERSHIP

Although the percent of households owning their own homes did increase nationwide from 1973 to 1980, this share has since fallen—from 65.6 percent in 1980 to 64.0 percent in 1987. The decline in homeownership is a nationwide phenomenon affecting areas with strong and weak economies alike. As indicated in Exhibit 16, the homeownership rate has fallen off most sharply in the Midwest, though marked declines occurred in the South and the West as well.

Exhibit 16

Homeownership Rates By Region and Age (Percent Homeowner)

	1973	1976	1980	1983	1987
Region					
Northeast	59.2%	59.8%	60.7%	61.4%	61.4%
Midwest	69.1	69.5	70.3	70.0	67.1
South	66.5	66.4	68.3	67.1	66.9
West	60.6	61.2	60.5	58.7	57.9
Age					
Under 25	23.4%	21.0%	21.3%	19.3%	16.1%
25-29	43.6	43.2	43.3	38.2	35.9
30-34	60.2	62.4	61.1	55.7	53.2
35-39	68.5	69.0	70.8	65.8	63.8
40-44	72.9	73.9	74.2	74.2	70.6
45-54	76.1	77.4	77.7	77.1	75.8
55-64	75.7	77.2	79.3	80.5	80.8
65-74	71.3	72.7	75.2	76.9	78.1
75 +	67.1	67.2	67.8	71.6	70.7
Total	64.4	64.8	65.6	64.9	64.0

SOURCE: 1973 to 1980 from Annual Housing Survey, 1983 to 1987 from Current Population Survey

The growth in the number of elderly homeowners in the Northeast helped offset the effect of declining homeownership rates of young households. Many older households have owned their homes for years and have therefore been insulated from the housing cost inflation of the late 1970s and early 1980s; for these households, rising home prices meant increased wealth in terms of equity in their existing homes.

Renter households, especially young renter households, have had no such buffer against the ravages of inflation. As indicated in Exhibit 16, much of the decline in the homeownership rate has been concentrated among younger households. For households aged 25 to 29, the homeownership rate fell from 43.3 percent in 1980 to 35.9 percent in 1987. Households aged 30 to 39 suffered similarly sharp declines.

For older homeowners, improved health and growing real incomes increased their ability to remain in their homes or to purchase a retirement home. Only in the Midwest have the homeownership rates of the elderly declined along with those of younger households since 1980. The growth of homeownership for households aged 55 or older was a key ingredient in the growth of total homeownership in each of the other regions in the 1970s. Even in recent years, the rising number of elderly homeowners has offset part of the overall decline in homeownership in most regions of the country (see Appendix Table 9).

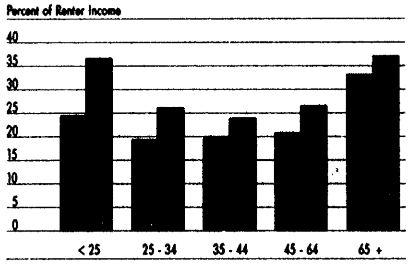
The decline in homeownership is remarkable for several reasons. First, it occurred during one of the most sustained and vigorous housing recoveries on record. Second, it has reduced the nation's homeownership rate to its lowest level in over 15 years. Third, lower homeownership rates for young adults are found in all regions of the country, not just the high-cost Northeast or West. Since 1983, homeownership among young households has declined in the oil-producing states, the farm belt and the rust belt, as well as New England, the Mid and South Atlantic and the Pacific Coast states. Apparently, the continuing high after-tax cash cost of homeownership and the growing rental payments burden are preventing renters in all regions of the country from accumulating the resources needed to make the downpayment and meet the initial year carrying costs of homes of their own.

HOUSING THE NATION'S POOR

Over the past two decades, slower real income growth and higher real housing costs have exacerbated the problems of low- and moderate-income households. Gross rent as a share of income rose sharply from 1974 to 1982 and remains at historically high levels. Even when paying a large share of their incomes for rent, many households still live in poor-quality housing. In 1983, the most recent year for which data are available, 5 million renter households—or one in six—lived in structurally inadequate dwelling units. Low- and moderate-income homeowners are also not immune to the problem: in that same year, 4.5 million owners, primarily residing in small cities and towns and outlying rural areas, lived in units classified as structurally inadequate.

Exhibit 17

Gross Rental Cost Burden by Age (Gross Rent as Percent of Renter Income)



SOURCE: See Appendix Table 11

RENTAL PAYMENTS BURDEN

The incidence of high rental burdens has increased, particularly among the young. In 1974, the gross rent burden (estimated as the ratio of median rent to income) for households with heads aged 25 to 34 was 18.7 percent; by 1983, the burden had reached 25.4 percent (Exhibit 17). Households with heads under the age of 25 experienced even sharper increases.

As noted earlier, rental housing is increasingly becoming home to low- and moderate-income families with children, especially single-parent households. From 1974 to 1987, the number of married couples aged 25 to 34 with children who rented their housing increased from 2.7 million to 3.2 million (Exhibit 18). At the same time, the number of single-parent families (primarily women with children) nearly doubled from 1.2 million to 2.2 million.

Exhibit 18 makes clear why the rental payments burden is increasingly a problem for young households: the median income of young single-parent renter households with children fell 34 percent from $10,965 in 1974 to $7,271 in 1987. With shrinking incomes and growing rents, the increase in rent burden for this type of family is inevitable. Since families with children require larger apartments than single adults or married couples with no children, they are particularly vulnerable in periods of high and rising rents. The rent burden for young single-parent families with children thus increased from 34.9 percent to 58.4 percent over this period.

Exhibit 18

Changes in Rental Burden for Selected Household Types

Age and Family Type	Households (In Thousands) 1974	Households (In Thousands) 1987	Income (1986 Dollars) 1974	Income (1986 Dollars) 1987	Gross Rent Burden 1974	Gross Rent Burden 1987
Householder Aged 25 to 34						
Single	1,510	2,963	20,623	17,817	19.2%	24.7%
Married Couple With Children	2,673	3,234	24,160	20,899	17.1%	21.9%
Married Couple No Children	1,195	1,412	32,059	29,028	14.3%	17.5%
Single Parent With Children	1,157	2,213	10,965	7,271	34.9%	58.4%
Other Households	507	1,444	20,908	19,098	22.7%	27.5%
Householder Aged 65 or Older						
Single	2,572	3,281	6,300	6,409	38.6%	42.1%
Married Couple	1,124	984	12,379	13,766	29.4%	29.0%
Other Households	464	462	11,160	10,457	27.5%	32.8%

NOTE: Income data as of prior year

SOURCE: Appendix Table 11

Elderly households continue to devote relatively large shares of their income to rent, but unlike their younger counterparts, the real income of elderly renters has not declined sharply. Indeed, elderly married-couple households enjoyed a slight increase in real income thanks to the indexation of Social Security payments against inflation.

It is important to note that the figures cited here refer to the rent burden for a dwelling unit of constant quality. To the extent that households choose to consume more or fewer housing services, the actual burden may differ. With rents in general rising relative to income, most low- and moderate-income households have been forced to cut back on their housing consumption—if they have been able to form independent households at all.

Moreover, since the homeless are not counted as households by the Census Bureau, the data in Exhibit 18 may actually understate the current payments problem. There are no reliable national figures on the homeless, but their number appears to have grown in recent years, especially among families with children. While further investigation into the causes of homelessness is clearly warranted, the data in Exhibit 18 should leave little doubt that the rising rental payments burden is a major contributing factor.

TRENDS IN HOUSING QUALITY

By some simple measures, America's housing has steadily improved for the past 40 years. For example, the proportion of units lacking some or all plumbing has fallen from 40 percent to just 2 percent. The American Housing Survey (formerly the Annual Housing Survey), however, takes a much more comprehensive look at housing conditions, providing data on some 25 housing deficiencies, including the presence or absence of plumbing fixtures, heating equipment, and other mechanical subsystems, as well as information on the repair and upkeep of properties.

The composite index of housing quality shown in Exhibit 19 indicates that the percentage of renter households living in inadequate housing declined from 15.5 percent to 12.8 percent between 1974 and 1983. While the incidence of inadequacy has been significantly reduced, improvement primarily reflects growth in the total housing supply rather than reduction in the stock of inadequate dwelling units. Accordingly, the number of inadequate dwelling units, though down somewhat in percentage terms, remains high in absolute terms. Thus in 1983, 4.5 million owners and 5.0 million renters continued to occupy structurally inadequate housing.

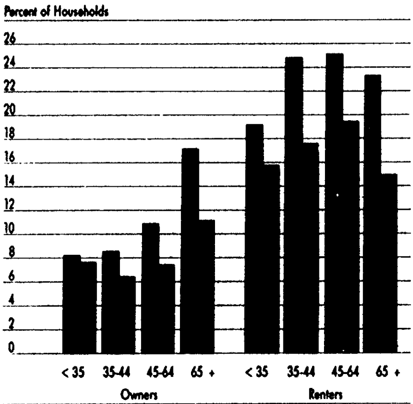
Poor-quality housing is clearly a continuing problem for the growing number of young families and other low-income households. In 1983, 26 percent of renter households with real incomes below $5,000 occupied structurally inadequate housing; in absolute terms, this means that the number of low-income households living in such conditions increased from 1 million in 1974 to 1.2 million in 1983. During the same period, the number of young single-parent households living in inadequate housing rose from 374,000 to 484,000.

Housing inadequacy is most prevalent in inner cities and in outlying rural areas, where concentrations of low-income households are high. In 1983, 1.7 million renters lived in inadequate housing located in central city locations, while another 945,000 renters occupied inadequate housing located in outlying rural areas.

While the share of renters living in inadequate housing is more than twice as high, the share of low-income owners occupying inadequate units is also a problem, particularly in outlying areas. In 1983, 1.9 million or 14 percent of all homeowners in non-metropolitan rural areas lived in inadequate dwelling units (Exhibit 20). This represents a slight improvement from the 2.1 million figure of 1974, but housing inadequacy in rural areas clearly persists.

Exhibit 19

Percent Households in Inadequate Units (By Age and Tenure)



SOURCE: See Appendix Table 12. ■ 1974 ■ 1983

Exhibit 20

Number and Percent of Households Living In Inadequate Housing By Urban/Rural Status

Location	Owners				Renters			
	Number Inadequate (in thousands)		Percent Inadequate		Number Inadequate (in thousands)		Percent Inadequate	
	1974	1983	1974	1983	1974	1983	1974	1983
Large Central Cities	687	600	8.2%	6.5%	1,947	1,746	20.8%	17.2%
Other Urban Metro	1,038	889	6.2%	4.6%	1,215	1,307	14.7%	12.3%
Fringe Metro Rural	533	514	11.3%	7.4%	342	295	26.4%	15.8%
Non-Metro Urban	781	585	13.7%	9.4%	881	730	28.1%	20.4%
Non-Metro Rural	2,119	1,888	20.5%	14.2%	1,129	945	38.3%	25.5%
All	5,158	4,476	11.3%	8.2%	5,514	5,023	22.0%	18.7%

SOURCE: Special tabulations of the Annual Housing Survey, 1974 and 1983.

LOW-INCOME HOUSING ASSISTANCE

Housing assistance efforts have done much in the past to improve the housing situations of low-income households. Eligibility varies from one program to the next, but in general federal rental assistance programs aid households with incomes at or below 80 percent of the area median. It is surprisingly difficult, however, to obtain estimates of the characteristics of households actually served by these programs. The Department of Housing and Urban Development estimates that there now are approximately 4.2 million units of public or otherwise federally subsidized rental housing, but provides no demographic data describing the characteristics of the households living in these units. Absent detailed HUD data, this paper utilizes survey based estimates that differ slightly from the HUD estimates of total households served, but have the advantage of providing needed information on the characteristics of the households living in subsidized rental units.

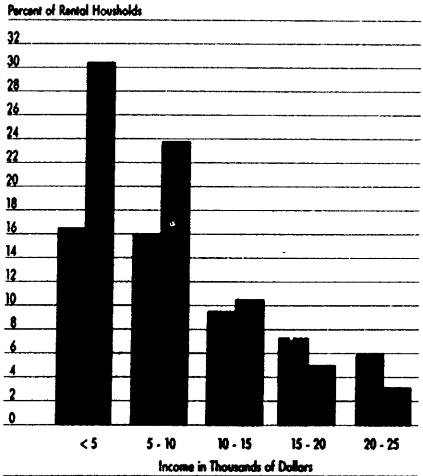
By any measure, the Housing and Community Development Act of 1974 sparked a major expansion in the number of households receiving rental assistance. According to the March 1987 Current Population Survey, 3.8 million households (consisting of 8.9 million persons) lived in public housing or rental housing otherwise subsidized by the federal government. While this growth has virtually stopped in the past several years, the 1987 figure is up nearly 73 percent from the 2.2 million recorded by the 1974 Annual Housing Survey.

Much of the increase in housing assistance resources has gone to aid households at the lowest end of the income distribution. Among renter households with real incomes below $5,000, the proportion living in subsidized housing nearly doubled between 1974 and 1987 (Exhibit 21). Households with incomes in the $5,000 to $10,000 range experienced somewhat more modest gains in the share subsidized.

Nevertheless, existing programs serve only a small fraction of eligible low-income households. According to the Current Population Survey for 1987, just 11.8 percent of all renter households received housing assistance. Even among renter households with incomes below $5,000, less than one-third received subsidies. Of those with incomes in the $5,000 to $10,000 range, less than one-quarter were assisted.

Exhibit 21

Rental Assistance By Household Income (As Percent of Rental Households)



SOURCE: Joint Center tabulation of 1974 Annual Housing Survey and 1987 Current Population Survey data.

Given the variation in housing requirements of households of different types and ages, income alone is a poor measure of the ability of a household to secure adequate housing in the private nonsubsidized market. Federal poverty definitions define the income required by various types of households to consume adequate levels of housing, food, and other necessities. By this measure, only 2.1 million (or 28 percent) of the nation's 7.5 million poverty-level renter households lived in public housing or other subsidized rental housing last year. Among the near-poverty-level renters (households with incomes above poverty level, but less than two times that level), participation was only 19.8 percent.

Whether or not these data reflect appropriate targeting of resources is, of course, a political judgment. It is clear, however, that the growth of housing assistance resources has failed to keep pace with the growth of low-income renter households. In 1974, 2.2 million renter households with incomes below $5,000 received no housing assistance. By 1987, this pool of eligible but unassisted renter households had grown to 3.2 million. Among households with incomes in the $5,000 to $10,000 range, the number of households receiving no rental assistance grew from 3.8 million to 4.5 million.

With at best only 4.2 million assisted renter housing units available, changes in the targeting of assisted renter housing alone will be insufficient to deal with the housing problems of the renter households living in poverty; there simply are more low-income households than assisted rental units. Moreover, nearly 4.4 million poverty-level households own their homes. Housing problems for this group are especially acute in low-density rural areas where the lack of a well-developed rental housing market results in high shares of households owning substandard housing.

Although more careful targeting could make better use of existing housing assistance resources, the development of new program initiatives and the expansion of national housing assistance resources are needed if the nation is to improve the housing conditions of both low-income owners and renters.

CONCLUSION

The health of the housing industry has deflected national attention from the critical problems of first-time homebuyers, disadvantaged renters, and homeless families and individuals. With rental vacancy rates at record levels, it may appear that there is no shortage of housing. With mortgage interest rates down from their peak levels of the early 1980s, it may appear that homeownership is once again an affordable option for many young households. With renovation and repair expenditures setting new records each year, it may appear that the nation's housing inventory of existing units is being well maintained and preserved.

Yet these conclusions bear little relationship to the realities of the state of the nation's housing. Despite the noticeable reductions in homeowner costs in recent years, homeownership rates among young households continue to fall. Despite high levels of new construction and equally high levels of housing rehabilitation expenditures, the supply of low-cost rental housing continues to shrink. Only one in four renter households with incomes at or below the poverty level lives in public or other subsidized housing. Some 5.4 million poverty-level renter households are left to compete for the dwindling supply of low-cost rental housing available in the private market. The result is further tightening at the low end of the rental housing market, and a growing rental payments burden for low- and moderate-income households.

For decades, moving to better housing has been an important ingredient in the upward mobility of American households. This report depicts the situation of many households who, rather than continuing to move up the ladder of housing progress, have stalled along the way. There is no single housing problem in America, but a series of problems that confront a wide range of household types. Improving the state of the nation's housing will require the concerted efforts of all levels of government and all housing providers. The problems of the nation's housing have-nots merit such special attention.

APPENDIX

Appendix Table 1

Income and Housing Cost, U.S. Totals: 1967-1987.

Year	Income[1] Total Owner	Income[1] Total Renter	Income[1] Young Renter	Owner Costs[2] House Price	Owner Costs[2] Mortgage Rate	Owner Costs[2] Mortgage Payment	Owner Costs[2] Other Costs	Owner Costs[2] After Tax Cash	Owner Costs[2] Total Cost	Renter Costs[3] Contract Rent	Renter Costs[3] Gross Rent	Cost in 1986 Dollars[4] Real After Tax	Cost in 1986 Dollars[4] Real Total Cost	Cost in 1986 Dollars[4] Contract Rent	Cost in 1986 Dollars[4] Gross Rent	Cost as Percent of Income[5] First-Time Buyers Cash Burden	Cost as Percent of Income[5] First-Time Buyers Total Burden	Cost as Percent of Income[5] All Renters Contract Rent Burden	Cost as Percent of Income[5] All Renters Gross Rent Burden
1967	$ 8,200	$ 5,300	$ 8,000	$16,530	6.40%	$1,074	$ 800	$1,700	$1,465	$ 96	$100	$5,375	$4,425	$288	$325	22.2%	18.3%	21.6%	24.4%
1968	$ 8,500	$ 5,500	$ 8,300	$17,400	6.90%	$1,103	$ 830	$1,893	$1,413	$ 99	$111	$5,496	$4,102	$286	$322	22.8%	17.0%	21.5%	24.2%
1969	$ 9,100	$ 5,700	$ 8,600	$18,653	7.40%	$1,359	$ 871	$2,068	$1,354	$102	$115	$5,783	$3,786	$287	$322	24.0%	15.7%	21.6%	24.3%
1970	$ 9,700	$ 6,300	$ 9,500	$19,344	8.20%	$1,467	$ 925	$2,195	$1,612	$108	$121	$5,814	$4,271	$285	$320	23.1%	17.0%	20.5%	23.0%
1971	$10,800	$ 6,600	$ 9,900	$20,288	7.54%	$1,462	$ 993	$2,311	$1,593	$113	$126	$5,913	$4,077	$290	$327	23.3%	16.1%	21.3%	23.9%
1972	$10,700	$ 6,900	$10,400	$21,611	7.38%	$1,535	$1,059	$2,441	$1,544	$118	$133	$6,043	$3,871	$293	$330	23.5%	15.0%	20.9%	23.5%
1973	$11,500	$ 7,200	$10,700	$23,400	7.82%	$1,733	$1,119	$2,705	$1,513	$124	$140	$6,204	$3,516	$288	$325	25.3%	14.1%	20.7%	23.3%
1974	$12,800	$ 7,700	$11,900	$25,682	8.70%	$2,055	$1,233	$3,108	$1,596	$131	$149	$6,546	$3,370	$278	$316	26.0%	13.4%	20.5%	23.3%
1975	$13,600	$ 7,900	$12,300	$28,432	8.97%	$2,318	$1,342	$3,414	$1,402	$139	$160	$6,653	$2,732	$271	$312	27.0%	11.4%	21.1%	24.3%
1976	$14,500	$ 8,200	$12,600	$30,868	8.90%	$2,494	$1,437	$3,661	$1,552	$148	$171	$6,742	$2,857	$272	$315	29.1%	12.3%	21.6%	25.0%
1977	$16,000	$ 8,800	$13,300	$34,000	8.83%	$2,795	$1,567	$4,200	$1,496	$158	$184	$7,420	$2,600	$274	$319	32.2%	11.3%	21.5%	25.1%
1978	$16,800	$ 9,300	$14,400	$39,046	9.40%	$3,351	$1,673	$4,806	$1,260	$170	$198	$7,845	$2,056	$278	$324	33.4%	8.7%	21.9%	25.6%
1979	$18,300	$10,000	$15,200	$45,518	10.63%	$4,208	$1,775	$5,629	$1,450	$184	$215	$8,333	$2,147	$272	$318	37.0%	9.5%	22.1%	25.8%
1980	$19,800	$10,500	$16,300	$50,530	12.53%	$5,344	$1,988	$6,785	$2,732	$202	$238	$8,960	$3,651	$270	$318	41.1%	16.0%	23.1%	27.2%
1981	$21,000	$11,400	$17,700	$54,775	14.59%	$6,588	$2,284	$7,872	$4,799	$221	$262	$9,586	$5,844	$269	$319	44.5%	27.1%	23.2%	27.6%
1982	$23,200	$11,800	$18,400	$56,282	14.78%	$6,864	$2,398	$8,359	$6,803	$239	$286	$9,399	$7,984	$275	$329	45.4%	37.4%	24.3%	29.1%
1983	$24,400	$12,400	$19,400	$57,594	12.29%	$5,993	$2,404	$7,767	$7,189	$255	$306	$8,560	$7,844	$281	$337	40.0%	36.7%	24.7%	29.6%
1984	$26,100	$13,300	$20,800	$59,828	12.08%	$6,182	$2,627	$8,090	$7,630	$270	$324	$8,458	$8,057	$286	$342	38.5%	36.7%	24.4%	29.2%
1985	$27,800	$14,000	$21,900	$61,387	11.18%	$5,980	$2,694	$7,940	$7,376	$289	$343	$8,181	$7,525	$295	$350	36.3%	33.7%	24.8%	29.4%
1986	$29,300	$14,500	$22,700	$64,867	9.80%	$5,540	$2,696	$7,691	$4,433	$308	$362	$7,695	$4,433	$308	$362	33.9%	28.3%	25.5%	30.0%
1987	$31,400	$15,200	$23,800	$66,886	8.93%	$5,487	$2,736	$7,720	$6,225	$324	$377	$7,449	$6,006	$312	$364	32.4%	26.2%	25.5%	29.7%

1. Annual income of families and primary individuals. Annual Housing Survey, various years. Young renters defined as married couple renters aged 25 to 29.

2. House price is Annual Housing Survey median value of house purchased by first-time home buyer aged 25-29 in 1977, indexed by Department of Census, Construction Reports C-27 Constant Quality Home Price Index. Mortgage Rates equal Federal Home Loan Bank Board contract mortgage rate. Mortgage Payments assume 25 year mortgage with 20% down. Other Costs include property tax, insurance, fuel and utilities, and maintenance. After-Tax Cash-Cost equals Mortgage Payment plus Other Costs, less tax savings of homeownership. Total Cost equals After-Tax Cash-Cost plus opportunity cost of down payment, amortization of fees and closing costs, less expected equity buildup. Cost data are 1977 Annual Housing Survey data indexed by Bureau of Labor Statistics Consumer Price Indices for various components of housing cost.

3. Contract Rent equals median 1977 Contract Rent indexed by Joint Center for Housing Studies Contract Rent Index adopted from data from the Bureau of Labor Statistics Index of Residential Rent. Gross Rent equals Contract Rent plus fuel and utilities, property taxes and insurance.

4. Housing Cost expressed in 1986 constant dollars using Bureau of Labor Statistics Consumer Price Index (CPI-UXI) for All Items.

5. First Time Buyer Cost Burden is cost as a percent of income of potential homebuyer proxied by median family income of married couple renters aged 25 to 29. Renter Cost Burden is annual rental payments as percent of median income of all renters.

Appendix Table 2

Income and Housing Cost, Northeast Region: 1967-1987

Year	Income[1] Total Owner	Income[1] Total Renter	Income[1] Young Renter	Owner Costs[2] House Price	Owner Costs[2] Mortgage Rate	Owner Costs[2] Mortgage Payment	Owner Costs[2] Other Costs	Owner Costs[2] After Tax Cash	Owner Costs[2] Total Cost	Renter Costs[3] Contract Rent	Renter Costs[3] Gross Rent	Cost in 1986 Dollars[4] Real After Tax	Cost in 1986 Dollars[4] Real Total Cost	Cost in 1986 Dollars[4] Contract Rent	Cost in 1986 Dollars[4] Gross Rent	Cost as Percent of Income[5] First-Time Buyers Cash Burden	Cost as Percent of Income[5] First-Time Buyers Total Burden	Cost as Percent of Income[5] All Renters Contract Rent Burden	Cost as Percent of Income[5] All Renters Gross Rent Burden
1967	$ 9,300	$ 5,900	$ 8,000	$17,797	6.40%	$1,156	$1,025	$ 2,041	$1,499	$ 93	$105	$ 6,164	$4,206	$281	$318	25.5%	17.7%	19.0%	21.4%
1968	$ 9,500	$ 6,100	$ 8,300	$19,573	6.90%	$1,331	$1,065	$ 2,217	$1,177	$ 96	$108	$ 6,437	$3,417	$279	$315	26.7%	14.2%	18.9%	21.3%
1969	$10,200	$ 6,300	$ 8,600	$21,275	7.68%	$1,551	$1,121	$ 2,441	$1,210	$100	$113	$ 6,825	$3,383	$280	$316	28.4%	14.1%	19.1%	21.5%
1970	$10,900	$ 6,900	$ 9,500	$22,755	8.20%	$1,735	$1,195	$ 2,648	$1,371	$106	$119	$ 7,015	$3,632	$280	$316	27.9%	14.4%	18.4%	20.7%
1971	$11,200	$ 7,200	$ 9,900	$24,272	7.54%	$1,749	$1,290	$ 2,805	$1,522	$115	$129	$ 7,179	$3,894	$294	$331	28.3%	15.4%	19.2%	21.5%
1972	$11,500	$ 7,500	$10,300	$26,048	7.38%	$1,850	$1,377	$ 2,974	$1,611	$121	$137	$ 7,361	$3,988	$300	$339	28.9%	15.6%	19.4%	21.9%
1973	$12,600	$ 7,800	$10,800	$28,157	7.82%	$2,078	$1,484	$ 3,309	$1,844	$129	$146	$ 7,686	$4,284	$301	$339	30.6%	17.1%	19.9%	22.5%
1974	$14,000	$ 8,200	$12,700	$30,673	8.78%	$2,454	$1,650	$ 3,813	$2,081	$138	$158	$ 8,053	$4,394	$291	$334	30.0%	16.4%	20.2%	23.1%
1975	$14,800	$ 8,300	$13,600	$33,263	8.97%	$2,703	$1,765	$ 4,123	$2,113	$147	$170	$ 8,033	$4,117	$287	$332	30.3%	15.5%	21.3%	24.6%
1976	$15,600	$ 8,600	$13,700	$34,632	8.90%	$2,798	$1,883	$ 4,312	$2,783	$157	$182	$ 7,941	$5,125	$289	$334	31.5%	20.3%	21.9%	25.4%
1977	$16,800	$ 9,200	$15,200	$37,000	8.83%	$2,971	$2,029	$ 4,791	$3,203	$167	$195	$ 8,316	$5,559	$290	$338	31.5%	21.1%	21.0%	25.4%
1978	$17,500	$ 9,600	$15,900	$41,107	9.40%	$3,457	$2,160	$ 5,286	$2,931	$178	$208	$ 8,629	$4,784	$291	$339	33.2%	18.4%	22.3%	25.9%
1979	$19,100	$ 9,800	$16,400	$46,657	10.63%	$4,313	$2,292	$ 6,150	$2,631	$190	$222	$ 9,105	$3,896	$281	$328	37.5%	16.0%	23.2%	27.2%
1980	$21,200	$10,700	$16,500	$51,245	12.53%	$5,420	$2,565	$ 7,278	$3,731	$206	$243	$ 9,725	$4,986	$275	$324	44.1%	22.6%	23.1%	27.2%
1981	$23,400	$11,600	$18,600	$55,389	14.51%	$6,654	$2,887	$ 8,529	$5,686	$225	$268	$10,386	$6,924	$274	$326	45.9%	30.6%	23.3%	27.7%
1982	$24,700	$12,200	$20,100	$58,201	14.78%	$7,108	$3,085	$ 9,162	$7,151	$244	$291	$10,521	$8,212	$280	$334	45.6%	35.6%	24.0%	28.6%
1983	$26,400	$12,800	$22,000	$60,680	12.29%	$6,314	$3,163	$ 8,597	$7,027	$262	$312	$ 9,476	$7,745	$289	$344	39.1%	31.9%	24.5%	29.3%
1984	$28,700	$13,400	$23,000	$67,044	12.00%	$6,838	$3,350	$ 9,247	$6,379	$278	$331	$ 9,764	$6,736	$294	$349	40.2%	27.7%	24.9%	29.6%
1985	$30,700	$14,800	$25,500	$74,444	11.10%	$7,165	$3,426	$ 9,604	$4,818	$299	$352	$ 9,799	$4,916	$305	$359	37.7%	18.9%	24.3%	28.6%
1986	$32,500	$15,700	$27,200	$88,282	9.80%	$7,661	$3,396	$10,026	$ 924	$325	$378	$10,026	$ 924	$325	$378	36.9%	3.4%	24.8%	28.9%
1987	$34,800	$17,000	$29,600	$93,844	8.93%	$7,600	$3,460	$10,223	$3,096	$346	$397	$ 9,863	$2,987	$334	$383	34.5%	10.5%	24.4%	28.8%

Appendix Table 3

Income and Housing Cost, Midwest Region: 1967-1987

Year	Income[1] Total Owner	Income[1] Total Renter	Income[1] Young Renter	Owner Costs[2] House Price	Owner Costs[2] Mortgage Rate	Owner Costs[2] Mortgage Payment	Owner Costs[2] Other Costs	Owner Costs[2] After Tax Cash	Owner Costs[2] Total Cost	Renter Costs[3] Contract Rent	Renter Costs[3] Gross Rent	Cost in 1986 Dollars[4] Real After Tax	Cost in 1986 Dollars[4] Real Total Cost	Cost in 1986 Dollars[4] Contract Rent	Cost in 1986 Dollars[4] Gross Rent	Cost as Percent of Income[5] First-Time Buyers Cash Burden	Cost as Percent of Income[5] First-Time Buyers Total Burden	Cost as Percent of Income[5] All Renters Contract Rent Burden	Cost as Percent of Income[5] All Renters Gross Rent Burden
1967	$ 8,400	$ 5,800	$ 8,500	$16,350	6.40%	$1,062	$ 772	$1,739	$1,224	$ 97	$109	$5,253	$3,696	$292	$330	20.5%	14.4%	20.0%	22.6%
1968	$ 8,800	$ 6,000	$ 8,900	$17,429	6.90%	$1,185	$ 803	$1,863	$1,185	$ 99	$112	$5,410	$3,442	$288	$325	20.9%	13.3%	19.8%	22.4%
1969	$ 9,400	$ 6,200	$ 9,200	$19,031	7.68%	$1,307	$ 842	$2,057	$1,076	$103	$116	$5,753	$3,010	$287	$324	21.9%	11.5%	19.9%	22.4%
1970	$10,000	$ 6,700	$10,100	$19,831	8.20%	$1,451	$ 895	$2,149	$1,707	$107	$121	$5,692	$4,523	$283	$320	21.3%	14.9%	19.1%	21.6%
1971	$10,300	$ 6,800	$10,200	$19,751	7.54%	$1,423	$ 949	$2,241	$1,819	$112	$126	$5,736	$4,656	$286	$324	22.0%	17.8%	19.7%	22.3%
1972	$11,000	$ 7,100	$10,700	$20,993	7.38%	$1,491	$1,011	$2,363	$1,726	$116	$131	$5,850	$4,273	$287	$325	22.1%	16.1%	19.6%	22.2%
1973	$11,700	$ 7,400	$11,200	$22,620	7.82%	$1,670	$1,060	$2,605	$1,603	$121	$137	$6,052	$3,725	$282	$318	23.3%	14.3%	19.7%	22.2%
1974	$13,200	$ 8,100	$12,000	$24,460	8.78%	$1,957	$1,152	$2,942	$1,693	$127	$144	$6,213	$3,574	$269	$305	24.5%	14.1%	18.8%	21.4%
1975	$14,000	$ 7,900	$12,700	$26,978	8.97%	$2,192	$1,270	$3,260	$1,504	$133	$154	$6,353	$2,930	$260	$300	25.7%	11.8%	20.3%	23.6%
1976	$15,000	$ 8,300	$12,900	$29,397	8.90%	$2,375	$1,369	$3,509	$1,526	$140	$164	$6,461	$2,810	$258	$302	27.2%	11.8%	20.3%	23.7%
1977	$16,700	$ 8,900	$14,800	$32,700	8.83%	$2,626	$1,506	$4,078	$1,620	$149	$177	$7,064	$2,812	$259	$307	27.5%	10.9%	20.1%	23.9%
1978	$17,300	$ 9,300	$15,100	$37,376	9.40%	$3,143	$1,624	$4,586	$1,395	$160	$189	$7,487	$2,277	$261	$308	30.4%	9.2%	20.6%	24.4%
1979	$19,000	$10,000	$15,500	$41,823	10.63%	$3,866	$1,727	$5,307	$1,888	$172	$204	$7,856	$2,796	$255	$303	34.2%	12.2%	20.7%	24.5%
1980	$19,800	$10,100	$14,700	$44,276	12.53%	$4,683	$1,912	$6,108	$3,727	$187	$223	$8,161	$4,980	$250	$298	36.6%	22.3%	22.3%	26.5%
1981	$21,500	$11,000	$17,600	$48,134	14.51%	$5,783	$2,118	$7,155	$5,130	$202	$243	$8,713	$6,247	$246	$296	40.7%	29.1%	22.0%	26.5%
1982	$22,800	$11,600	$18,000	$50,162	14.78%	$6,126	$2,306	$7,682	$6,302	$216	$262	$8,821	$7,236	$248	$301	42.7%	35.0%	22.3%	27.1%
1983	$24,300	$12,100	$18,200	$49,050	12.29%	$5,104	$2,444	$7,083	$7,208	$227	$280	$7,719	$8,033	$250	$308	38.5%	40.0%	22.5%	27.7%
1984	$26,200	$13,100	$19,900	$51,503	12.00%	$5,253	$2,550	$7,241	$7,283	$238	$293	$7,646	$7,690	$251	$309	36.4%	36.6%	21.8%	26.8%
1985	$27,800	$13,400	$20,400	$51,862	11.10%	$4,991	$2,609	$7,110	$7,308	$252	$308	$7,253	$7,454	$257	$314	34.9%	35.8%	22.5%	27.6%
1986	$29,200	$13,900	$21,100	$54,282	9.80%	$4,711	$2,613	$6,916	$6,003	$266	$322	$6,916	$6,003	$266	$322	32.8%	28.5%	22.9%	27.8%
1987	$31,100	$14,700	$22,300	$56,562	8.93%	$4,581	$2,654	$6,929	$5,826	$277	$332	$6,686	$5,622	$267	$320	31.1%	26.1%	22.6%	27.1%

Appendix Table 4

Income and Housing Cost, South Region: 1967-1987

Year	Income[1] Total Owner	Total Renter	Young Renter	Owner Costs[2] House Price	Mortgage Rate	Mortgage Payment	Other Costs	After Tax Cash	Total Cost	Renter Costs[3] Contract Rent	Gross Rent	Cost in 1986 Dollars[4] Real After Tax	Real Total Cost	Contract Rent	Gross Rent	Cost as Percent of Income[5] First-Time Buyers Cash Burden	Total Burden	All Renters Contract Rent Burden	Gross Rent Burden
1967	$ 6,800	$ 4,700	$ 7,400	$15,206	6.40%	$ 900	$ 677	$1,004	$1,392	$ 85	$101	$4,843	$4,202	$256	$304	22.0%	19.7%	21.7%	25.7%
1968	$ 7,200	$ 4,900	$ 7,700	$15,800	6.90%	$1,070	$ 700	$1,703	$1,375	$ 87	$103	$4,945	$3,992	$253	$300	22.7%	17.9%	21.0%	25.0%
1969	$ 7,700	$ 5,000	$ 8,000	$16,809	7.40%	$1,232	$ 736	$1,800	$1,334	$ 90	$106	$5,173	$3,704	$252	$298	22.0%	16.2%	21.6%	25.6%
1970	$ 8,200	$ 5,400	$ 8,700	$17,434	8.20%	$1,329	$ 773	$1,963	$1,490	$ 94	$111	$5,199	$3,946	$240	$294	22.6%	17.1%	20.0%	24.0%
1971	$ 8,500	$ 5,600	$ 9,000	$18,800	7.54%	$1,354	$ 837	$2,001	$1,340	$ 98	$117	$5,325	$3,177	$259	$299	23.1%	13.0%	21.0%	25.0%
1972	$ 9,100	$ 6,100	$ 9,806	$19,958	7.30%	$1,408	$ 887	$2,194	$1,203	$102	$121	$5,438	$3,177	$252	$300	22.4%	13.1%	20.0%	23.9%
1973	$ 9,800	$ 6,600	$10,700	$21,295	7.80%	$1,571	$ 940	$2,423	$1,470	$106	$126	$5,630	$3,416	$244	$294	22.6%	13.7%	19.3%	23.0%
1974	$11,100	$ 7,300	$11,400	$22,900	8.70%	$1,839	$1,054	$2,765	$1,673	$112	$135	$5,840	$3,534	$236	$285	24.3%	14.7%	18.9%	22.8%
1975	$11,800	$ 7,400	$11,800	$25,375	8.97%	$2,053	$1,154	$3,049	$1,479	$118	$145	$5,941	$2,883	$231	$282	25.8%	12.5%	19.2%	23.5%
1976	$12,700	$ 7,700	$12,800	$27,857	8.90%	$2,186	$1,235	$3,239	$1,646	$127	$156	$5,964	$3,030	$233	$287	27.0%	13.7%	19.7%	24.3%
1977	$13,800	$ 8,200	$12,300	$29,700	8.83%	$2,385	$1,360	$3,745	$1,836	$136	$169	$6,499	$3,187	$236	$293	30.4%	14.9%	19.9%	24.7%
1978	$14,900	$ 8,800	$14,000	$33,323	9.40%	$2,882	$1,446	$4,192	$1,783	$146	$180	$6,844	$2,910	$238	$294	29.9%	12.7%	19.9%	24.5%
1979	$16,300	$ 9,700	$14,500	$38,165	10.67%	$3,528	$1,541	$4,899	$1,664	$158	$195	$7,252	$2,464	$234	$289	33.8%	11.5%	19.6%	24.2%
1980	$17,800	$10,300	$15,700	$42,857	12.59%	$4,533	$1,708	$5,829	$2,338	$174	$216	$7,789	$3,124	$232	$289	37.7%	14.9%	20.3%	25.2%
1981	$19,400	$11,200	$16,900	$47,045	14.59%	$5,652	$1,892	$6,878	$3,844	$190	$240	$8,376	$4,680	$232	$292	40.7%	22.7%	20.4%	25.7%
1982	$20,600	$12,600	$18,000	$48,975	14.78%	$5,981	$2,062	$7,356	$5,509	$207	$263	$8,447	$6,326	$238	$302	39.1%	29.3%	19.7%	25.0%
1983	$21,700	$12,700	$18,000	$49,806	12.29%	$5,192	$2,161	$6,832	$6,097	$229	$288	$7,530	$6,720	$242	$300	36.3%	32.4%	20.8%	26.4%
1984	$23,000	$13,600	$20,100	$51,609	12.08%	$5,265	$2,268	$7,805	$6,763	$231	$293	$7,407	$7,142	$243	$309	34.9%	33.6%	20.3%	25.9%
1985	$24,100	$14,200	$21,000	$52,985	11.18%	$5,009	$2,324	$6,959	$6,578	$242	$306	$7,100	$6,711	$247	$312	33.1%	31.3%	20.5%	25.8%
1986	$25,600	$14,600	$21,600	$54,183	9.80%	$4,806	$2,343	$6,600	$6,197	$254	$317	$6,600	$6,197	$254	$317	30.9%	28.7%	20.9%	26.1%
1987	$27,600	$15,300	$22,600	$55,342	8.93%	$4,464	$2,365	$6,581	$6,343	$259	$322	$6,358	$6,128	$250	$310	29.1%	28.1%	20.4%	25.2%

Appendix Table 5

Income and Housing Cost, West Region: 1967-1987

Year	Income[1] Total Owner	Total Renter	Young Renter	Owner Costs[2] House Price	Mortgage Rate	Mortgage Payment	Other Costs	After Tax Cash	Total Cost	Renter Costs[3] Contract Rent	Gross Rent	Cost in 1986 Dollars[4] Real After Tax	Real Total Cost	Contract Rent	Gross Rent	Cost as Percent of Income[5] First-Time Buyers Cash Burden	Total Burden	All Renters Contract Rent Burden	Gross Rent Burden
1967	$ 8,700	$ 5,400	$ 8,200	$18,300	6.40%	$1,390	$ 796	$1,878	$ 1,784	$104	$113	$ 5,672	$ 5,387	$313	$341	23.0%	22.6%	23.0%	25.1%
1968	$ 9,300	$ 5,600	$ 8,500	$18,747	6.90%	$1,275	$ 820	$1,969	$ 1,830	$109	$118	$ 5,717	$ 5,315	$315	$343	23.2%	21.5%	23.3%	25.3%
1969	$10,000	$ 5,800	$ 8,900	$20,463	7.60%	$1,401	$ 867	$2,172	$ 1,447	$114	$124	$ 6,073	$ 4,046	$320	$347	23.6%	15.7%	23.7%	25.7%
1970	$10,700	$ 6,500	$ 9,800	$20,935	8.20%	$1,596	$ 916	$2,294	$ 1,715	$123	$133	$ 6,077	$ 4,543	$325	$352	23.4%	17.5%	22.6%	24.5%
1971	$11,000	$ 6,600	$ 9,900	$21,579	7.54%	$1,555	$ 979	$2,378	$ 1,836	$127	$138	$ 6,085	$ 4,700	$325	$353	24.0%	18.5%	23.1%	25.1%
1972	$11,800	$ 7,800	$10,500	$22,700	7.30%	$1,600	$1,059	$2,516	$ 1,865	$132	$143	$ 6,229	$ 4,617	$326	$354	24.0%	17.8%	22.6%	24.5%
1973	$12,700	$ 7,500	$11,300	$25,703	7.82%	$1,900	$1,085	$2,828	$ 1,217	$138	$150	$ 6,569	$ 2,828	$321	$349	25.0%	10.8%	22.1%	24.1%
1974	$14,100	$ 7,600	$11,830	$29,806	8.70%	$2,337	$1,174	$3,309	$ 914	$148	$161	$ 6,903	$ 1,930	$312	$341	27.7%	7.7%	23.3%	25.5%
1975	$15,100	$ 8,000	$11,500	$32,600	8.97%	$2,656	$1,202	$3,608	$ 601	$157	$173	$ 7,048	$ 1,327	$305	$336	31.5%	5.9%	23.5%	25.9%
1976	$16,200	$ 8,500	$12,200	$36,293	8.90%	$2,932	$1,374	$3,946	$ 852	$167	$184	$ 7,267	$ 1,568	$307	$339	32.3%	7.0%	23.5%	26.0%
1977	$17,800	$ 9,100	$12,700	$42,900	8.83%	$3,445	$1,407	$4,736	$ 192	$179	$198	$ 8,219	$ 332	$311	$344	37.3%	1.5%	23.6%	26.1%
1978	$18,900	$ 9,700	$13,300	$50,837	9.40%	$4,275	$1,577	$5,440	($406)	$196	$216	$ 8,928	($600)	$320	$352	41.1%	-3.1%	24.2%	26.7%
1979	$20,500	$10,800	$15,000	$58,559	10.63%	$5,403	$1,648	$6,482	$ 154	$217	$238	$ 9,596	$ 228	$321	$352	43.2%	1.0%	24.1%	26.5%
1980	$22,700	$11,500	$16,400	$66,152	12.53%	$6,997	$1,871	$7,923	$ 1,804	$241	$270	$10,587	$ 2,518	$322	$360	48.3%	11.5%	25.2%	28.1%
1981	$24,900	$12,900	$18,500	$70,609	14.59%	$8,404	$2,053	$9,243	$ 5,381	$268	$299	$11,256	$ 6,455	$326	$365	50.0%	28.7%	24.9%	27.9%
1982	$26,900	$13,400	$19,300	$71,386	14.78%	$8,710	$2,260	$9,739	$ 8,583	$293	$330	$11,103	$ 9,764	$337	$379	50.5%	44.1%	26.3%	29.6%
1983	$28,000	$13,800	$20,000	$73,700	12.29%	$7,678	$2,345	$8,999	$ 8,308	$314	$353	$ 9,919	$ 9,246	$346	$390	45.0%	41.9%	27.3%	30.7%
1984	$30,700	$15,500	$22,500	$73,359	12.08%	$7,403	$2,408	$9,002	$10,062	$330	$380	$ 9,505	$10,625	$357	$401	40.0%	44.7%	26.2%	29.4%
1985	$32,600	$16,000	$23,200	$75,547	11.18%	$7,271	$2,562	$8,937	$ 9,053	$366	$409	$ 9,118	$ 9,236	$374	$418	38.5%	39.0%	27.5%	30.7%
1986	$34,300	$16,600	$24,100	$78,293	9.80%	$6,794	$2,598	$8,620	$7,782	$391	$433	$ 8,620	$ 7,782	$391	$433	35.0%	32.3%	28.3%	31.3%
1987	$36,600	$17,400	$25,200	$82,385	8.93%	$6,664	$2,610	$8,600	$6,717	$400	$450	$ 8,375	$ 6,481	$394	$434	34.4%	26.7%	28.1%	31.0%

Appendix Table 6

Households and Household Income By Age And Type

Age and Household Type	Number of Households (In Thousands) 1974	1987	Percent Change	Median Income (1986 Dollars) 1974	1987	Percent Change
Household Head Under 25						
Single	1,136	1,252	10.2%	$11,848	$11,994	1.2%
Married With Children	1,709	929	-45.6%	20,908	15,233	-27.1%
Married No Children	1,825	909	-50.2%	23,347	20,401	-12.6%
Single Parent With Children	540	832	54.1%	7,332	4,688	-36.0%
Other Households	833	1,275	53.1%	13,101	11,400	-13.0%
TOTAL	6,043	5,197	-14.0%	18,248	13,011	-28.7%
Household Head 25 to 34						
Single	1,810	3,858	113.1%	20,931	18,920	-9.6%
Married With Children	8,368	8,723	4.2%	28,843	28,850	0.1%
Married No Children	2,268	3,070	35.4%	35,020	35,802	2.2%
Single Parent With Children	1,603	2,859	78.4%	12,545	9,621	-23.3%
Other Households	623	1,993	219.9%	22,388	21,524	-3.9%
TOTAL	14,672	20,503	39.7%	27,366	24,230	-11.5%
Household Head 35 to 44						
Single	963	2,642	174.4%	20,908	23,624	13.0%
Married With Children	8,217	9,873	20.2%	34,922	37,800	8.2%
Married No Children	1,055	2,169	105.6%	35,192	42,515	20.9%
Single Parent With Children	1,416	2,701	90.7%	16,027	17,444	8.9%
Other Households	414	1,318	218.4%	23,101	26,211	13.5%
TOTAL	12,065	18,703	55.0%	32,291	31,831	-1.4%
Household Head 45 to 64						
Single	2,867	3,329	16.1%	12,080	13,050	8.0%
Married With Children	7,342	5,349	-27.1%	35,543	38,018	7.0%
Married No Children	9,192	11,429	24.3%	31,826	35,902	12.8%
Single Parent With Children	1,403	1,658	18.2%	16,824	16,896	0.4%
Other Households	7,157	7,844	9.6%	20,197	19,668	-2.6%
TOTAL	18,590	20,324	9.3%	27,877	28,819	3.8%
Household Head 65 or Older						
Single	3,353	5,257	56.8%	6,889	7,881	14.4%
Married	6,164	8,386	36.0%	15,911	18,265	14.8%
Other Households	5,826	6,798	16.7%	13,788	14,406	4.5%
TOTAL	15,343	20,441	33.2%	10,874	12,959	19.1%

NOTE: Income data as of prior year

SOURCE: U.S. Department of Housing and Urban Development, Annual Housing Survey, 1974, and U.S. Department of Commerce, Current Population Survey, March 1987.

Appendix Table 7

Households and Household Income By Age, Tenure And Household Type

	Owner				Renter			
	Number (In Thousands)		Median Income (1986 Dollars)		Number (In Thousands)		Median Income (1986 Dollars)	
	1974	1987	1974	1987	1974	1987	1974	1987
Household Head Under 25								
Single	81	142	$13,099	$14,307	1,055	1,110	$11,732	$12,437
Married With Children	658	270	23,231	17,822	1,051	659	18,608	13,690
Married No Children	507	250	26,715	26,196	1,318	659	22,325	17,879
Single Parent With Children	48	52	11,523	8,920	492	780	7,248	4,581
Other Households	83	119	21,721	16,099	750	1,156	11,906	11,279
TOTAL	1,377	833	23,419	18,934	4,666	4,364	15,828	11,737
Household Head 25 to 34								
Single	300	895	24,160	22,604	1,510	2,963	20,623	17,817
Married With Children	5,695	5,489	31,362	32,839	2,673	3,234	24,160	20,899
Married No Children	1,073	1,658	38,563	41,126	1,195	1,412	32,059	29,028
Single Parent With Children	446	646	16,954	17,302	1,157	2,213	10,965	7,271
Other Households	116	549	29,461	28,769	507	1,444	20,908	19,098
TOTAL	7,630	9,237	31,220	32,006	7,042	11,266	22,340	18,199
Household Head 35 to 44								
Single	269	933	23,312	27,512	694	1,709	19,282	19,934
Married With Children	6,765	8,020	37,055	40,146	1,452	1,853	26,715	23,793
Married No Children	723	1,603	37,169	48,020	332	566	30,200	29,749
Single Parent With Children	692	1,312	22,525	22,902	724	1,389	12,665	12,988
Other Households	204	639	28,913	33,114	210	679	16,999	19,288
TOTAL	8,653	12,507	35,284	38,044	3,412	6,196	21,963	20,357
Household Head 45 to 64								
Single	1,955	2,642	12,974	15,691	2,091	2,223	11,615	10,341
Married With Children	5,750	4,047	37,402	40,186	912	687	24,406	21,662
Married No Children	8,771	10,944	32,755	37,454	1,592	1,302	26,170	25,092
Single Parent With Children	688	681	21,493	20,462	421	404	12,013	9,961
Other Households	1,426	2,090	23,231	23,369	715	1,057	15,565	14,333
TOTAL	18,590	20,404	30,965	33,168	5,731	5,673	18,216	15,814
Household Head 65 or Older								
Single	3,312	5,230	7,434	8,997	2,572	3,281	6,300	6,409
Married	5,070	7,421	15,603	18,982	1,124	984	12,379	13,766
Other Households	1,211	1,621	15,184	15,807	464	462	11,160	10,457
TOTAL	9,593	14,272	12,730	14,962	4,160	4,727	8,485	8,336

NOTE: Income data as of prior year

SOURCE: Joint Center tabulations of U.S. Department of Housing and Urban Development, Annual Housing Survey, 1974, and U.S. Department of Commerce, Current Population Survey, March 1987.

Appendix Table 8

Households By Age And Type: 1980 to 2000

Age and Household Type	1980	1985	1990	1995	2000
Household Head Under 25					
Single	1,644	1,351	1,271	1,255	1,287
Married With Children	1,446	1,219	905	748	869
Married No Children	1,370	929	623	506	554
Single Parent With Children	727	732	698	663	693
Other Households	1,235	1,067	923	789	761
TOTAL	6,422	5,298	4,420	3,961	4,164
Household Head 25 to 34					
Single	3,364	4,172	4,746	4,868	4,621
Married With Children	8,887	9,214	9,235	8,130	6,832
Married No Children	2,732	2,518	2,223	1,846	1,554
Single Parent With Children	2,193	2,582	2,788	2,748	2,481
Other Households	1,302	1,817	2,000	1,814	1,571
TOTAL	18,478	20,303	20,992	19,406	17,059
Household Head 35 to 44					
Single	1,531	2,361	3,376	4,101	4,580
Married With Children	8,590	10,135	11,343	12,326	12,523
Married No Children	1,352	1,665	2,042	2,283	2,339
Single Parent With Children	1,859	2,434	3,002	3,271	3,400
Other Households	645	1,057	1,438	1,603	1,676
TOTAL	13,977	17,652	21,201	23,584	24,518
Household Head 45 to 64					
Single	4,535	4,855	5,498	6,802	8,941
Married With Children	6,038	6,033	6,358	7,033	7,630
Married No Children	11,238	10,845	10,898	11,991	13,749
Single Parent With Children	1,216	1,353	1,557	1,861	2,164
Other Households	2,204	2,489	2,713	3,117	3,867
TOTAL	25,231	25,575	27,024	30,804	36,351
Household Head 65 or Older					
Single	7,087	8,279	9,776	11,124	12,102
Married	7,344	8,071	8,813	9,213	9,180
Other Households	1,780	2,119	2,338	2,506	2,632
TOTAL	16,211	18,469	20,927	22,843	23,914

SOURCE: John R. Pitkin and George S. Masnick, Households and Housing Consumption in the United States, 1985 to 2000, *The Joint Center for Housing Studies of Harvard University, 1986.*

Appendix Table 9

Homeownership Rate By Region And Age: 1973 to 1987

Region and Age	1973	1976	1980	1983	1987
Northeast	59.2%	59.8%	60.7%	61.4%	61.4%
<25	17.4%	15.7%	14.5%	16.5%	14.6%
25-29	36.2%	34.3%	35.9%	32.4%	34.1%
30-34	51.3%	59.3%	55.0%	53.6%	51.3%
35-39	62.2%	60.3%	65.8%	61.2%	62.0%
40-44	69.2%	65.4%	66.0%	68.2%	67.2%
45-54	72.2%	73.7%	72.7%	72.7%	72.1%
55-64	69.8%	71.8%	74.0%	74.6%	75.9%
65-74	60.1%	63.0%	67.4%	69.6%	71.2%
75+	58.2%	57.5%	56.0%	61.2%	61.3%
Midwest	69.1%	69.5%	70.3%	70.0%	67.1%
<25	25.3%	24.4%	24.6%	21.8%	16.2%
25-29	47.9%	48.6%	50.5%	43.5%	40.2%
30-34	66.5%	68.6%	68.1%	63.0%	58.6%
35-39	76.0%	77.5%	78.0%	74.0%	69.7%
40-44	79.2%	81.3%	80.7%	81.6%	73.3%
45-54	80.9%	81.1%	83.7%	82.6%	80.7%
55-64	79.6%	82.4%	83.1%	85.0%	84.2%
65-74	76.6%	77.6%	79.1%	81.6%	79.4%
75+	71.8%	70.0%	69.0%	74.7%	70.1%
South	66.5%	66.4%	68.3%	67.1%	66.9%
<25	29.9%	24.2%	25.0%	23.0%	21.0%
25-29	47.6%	46.8%	46.4%	41.7%	39.4%
30-34	62.1%	63.2%	63.4%	56.6%	55.2%
35-39	68.7%	69.2%	71.7%	66.0%	65.8%
40-44	71.5%	74.1%	76.3%	76.3%	73.3%
45-54	76.1%	78.1%	79.1%	78.2%	76.9%
55-64	77.9%	78.1%	81.7%	83.0%	82.7%
65-74	75.9%	76.1%	78.2%	80.2%	81.3%
75+	71.9%	72.2%	74.6%	77.4%	78.6%
West	60.6%	61.2%	60.5%	58.7%	57.9%
<25	15.3%	15.1%	16.2%	11.6%	9.6%
25-29	39.7%	39.0%	36.0%	31.4%	27.0%
30-34	59.5%	56.9%	54.9%	48.2%	45.4%
35-39	65.2%	67.5%	66.1%	60.5%	55.6%
40-44	71.1%	72.6%	71.2%	67.9%	66.4%
45-54	74.6%	75.4%	73.3%	73.2%	71.9%
55-64	74.4%	75.7%	76.7%	76.9%	79.0%
65-74	70.0%	71.4%	73.9%	73.7%	78.7%
75+	62.2%	65.6%	67.7%	70.2%	69.8%

SOURCE: Joint Center tabulations of U.S. Department of Housing and Urban Development, Annual Housing Survey, 1973, 1976, 1980, and U.S. Department of Commerce, Current Population Survey, 1983 and 1987.

Appendix Table 10

Homeownership Rate By Age And Family Type

Age and Family Type	1973	1974	1976	1980	1983	1987
Household Head Under 25						
Single	7.7%	7.1%	7.8%	11.5%	10.9%	11.3%
Married With Children	38.9%	38.5%	34.5%	38.8%	32.7%	29.1%
Married No Children	26.1%	27.8%	30.9%	33.6%	30.5%	27.5%
Single Parent With Children	13.7%	8.9%	8.2%	10.1%	7.9%	6.3%
Other Households	7.6%	10.0%	8.5%	9.9%	11.1%	9.3%
TOTAL	23.4%	22.8%	21.0%	21.3%	19.3%	16.1%
Household Head 25 to 34						
Single	18.0%	16.6%	16.0%	24.8%	24.1%	23.2%
Married With Children	66.8%	68.1%	69.8%	71.1%	64.7%	62.9%
Married No Children	45.5%	47.3%	49.2%	58.3%	53.5%	54.0%
Single Parent With Children	31.7%	27.8%	28.7%	31.8%	24.5%	22.6%
Other Households	18.0%	18.6%	25.3%	29.4%	29.1%	27.5%
TOTAL	51.4%	52.0%	52.2%	52.3%	47.0%	45.1%
Household Head 35 to 44						
Single	28.0%	27.9%	28.5%	36.8%	37.5%	35.3%
Married With Children	81.0%	82.3%	83.0%	85.4%	83.2%	81.2%
Married No Children	66.8%	68.5%	67.3%	75.2%	74.0%	73.9%
Single Parent With Children	48.2%	48.9%	48.0%	50.1%	49.6%	48.6%
Other Households	51.5%	49.3%	50.8%	53.9%	48.1%	48.5%
TOTAL	70.7%	71.7%	71.4%	72.3%	69.6%	66.9%
Household Head 45 to 64						
Single	50.7%	48.3%	48.5%	51.6%	54.2%	54.3%
Married With Children	85.7%	86.3%	87.0%	87.7%	86.9%	85.5%
Married No Children	83.7%	84.6%	86.1%	88.4%	89.1%	89.4%
Single Parent With Children	61.4%	62.0%	61.7%	64.5%	57.2%	55.3%
Other Households	66.8%	66.6%	66.9%	68.0%	68.1%	66.4%
TOTAL	75.9%	76.4%	77.3%	78.5%	78.8%	78.2%
Household Head 65 or Older						
Single	57.8%	56.3%	56.8%	59.2%	62.0%	61.4%
Married	81.5%	81.9%	83.1%	85.0%	87.3%	88.3%
Other Households	69.3%	72.3%	73.5%	73.6%	75.9%	77.9%
TOTAL	69.8%	69.7%	70.6%	72.3%	74.8%	75.1%

SOURCE: Joint Center tabulation of U.S. Department of Housing and Urban Development, Annual Housing Survey 1973, 1974, 1976, 1980, 1983, and 1987, and U.S. Department of Commerce Current Population Survey, 1983 and 1987.

Appendix Table 11

Rent Burden By Age And Family Type

Age and Family Type	Median Income (1986 Dollars) 1974	1987	Gross Rent (1986 Dollars) 1974	1987	Gross Rent Burden 1974	1987
Household Head Under 25						
Single	$11,732	$12,437	$287	$318	29.3%	30.7%
Married With Children	18,608	13,690	292	324	18.9%	28.4%
Married No Children	22,325	17,879	329	365	17.7%	24.5%
Single Parent With Children	7,248	4,581	279	309	46.2%	81.1%
Other Households	11,906	11,279	367	407	37.0%	43.3%
TOTAL	15,828	11,737	312	348	23.7%	35.6%
Household Head 25 to 34						
Single	20,623	17,817	331	367	19.2%	24.7%
Married With Children	24,160	20,899	344	382	17.1%	21.9%
Married No Children	32,059	29,028	382	424	14.3%	17.5%
Single Parent With Children	10,965	7,271	319	354	34.9%	58.4%
Other Households	20,908	19,098	395	438	22.7%	27.5%
TOTAL	22,340	18,199	347	385	18.7%	25.4%
Household Head 35 to 44						
Single	19,282	19,934	325	360	20.2%	21.7%
Married With Children	26,715	23,793	363	403	16.3%	20.3%
Married No Children	30,200	29,749	359	398	14.3%	16.1%
Single Parent With Children	12,665	12,988	319	354	30.2%	32.7%
Other Households	16,999	19,288	325	360	22.9%	22.4%
TOTAL	21,963	20,357	343	375	18.8%	22.1%
Household Head 45 to 64						
Single	11,615	10,341	257	285	26.6%	33.1%
Married With Children	24,406	21,662	348	386	17.1%	21.4%
Married No Children	26,170	25,092	350	388	16.0%	18.5%
Single Parent With Children	12,013	9,961	310	343	30.9%	41.4%
Other Households	15,565	14,333	294	326	22.7%	27.3%
TOTAL	18,216	15,732	306	333	20.1%	25.4%
Household Head 65 or Older						
Single	6,300	6,409	203	225	38.6%	42.1%
Married	12,379	13,766	302	335	29.4%	29.0%
Other Households	11,160	10,457	257	285	27.5%	32.8%
TOTAL	8,836	8,540	238	257	32.4%	36.0%

SOURCE: Joint Center tabulations based on U.S. Department of Housing and Urban Development, Annual Housing Survey, 1974, and U.S. Department of Commerce, Current Population Survey, March 1987.

Appendix Table 12

Households In Inadequate Housing By Age, Tenure And Household Type

	Owner				Renter			
	Number (In Thousands)		Percent (%)		Number (In Thousands)		Percent (%)	
Age and Family Type	1974	1987	1974	1987	1974	1987	1974	1987
Household Head Under 25								
Single	9	12	11.0	8.0	236	187	22.4	16.2
Married With Children	78	44	11.8	11.0	243	180	23.1	20.4
Married No Children	39	39	7.6	11.6	190	101	14.4	13.3
Single Parent With Children	8	7	17.7	13.1	134	154	27.2	24.9
Other Households	7	16	8.7	11.4	142	124	18.9	11.2
TOTAL	141	118	10.8	11.1	945	746	21.1	17.8
Household Head 25 to 34								
Single	18	60	6.1	7.0	255	350	16.9	13.6
Married With Children	444	419	7.8	7.2	521	474	19.5	15.3
Married No Children	69	75	6.4	5.0	154	148	12.9	11.3
Single Parent With Children	53	81	11.9	12.8	282	408	24.4	23.0
Other Households	10	47	8.5	9.5	91	166	18.0	13.6
TOTAL	594	682	8.0	7.8	1,303	1,546	19.1	16.4
Household Head 35 to 44								
Single	39	58	14.4	7.6	167	182	24.1	14.2
Married With Children	522	458	7.7	5.9	347	321	23.9	19.2
Married No Children	67	67	9.2	5.2	69	63	20.7	14.6
Single Parent With Children	86	116	12.4	10.3	210	253	29.0	20.9
Other Households	26	42	13.0	9.2	52	82	24.9	16.3
TOTAL	740	741	8.9	6.8	845	901	25.0	18.1
Household Head 45 to 64								
Single	319	257	16.3	11.0	608	448	29.1	21.6
Married With Children	579	307	10.1	6.8	226	143	24.8	20.1
Married No Children	782	608	8.9	5.7	318	239	19.9	15.9
Single Parent With Children	125	71	18.1	12.8	117	93	27.8	25.6
Other Households	233	225	16.3	11.6	180	191	25.1	18.9
TOTAL	2,038	1,468	11.8	8.1	1,449	1,114	25.8	20.1
Household Head 65 or Older								
Single	689	616	20.8	13.0	604	413	23.5	13.4
Married	682	595	13.8	8.6	221	154	19.9	14.2
Other Households	275	254	22.7	17.9	147	152	31.7	28.8
TOTAL	1,646	1,465	18.2	12.0	972	719	23.9	16.8

SOURCE: Joint Center tabulations of U.S. Department of Housing and Urban Development, Annual Housing Survey, 1974 and 1983.

March 28, 1988

**TESTIMONY OF ROBERT A. GEORGINE, CHAIRMAN
NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS
BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
ON THE NEED TO MAKE PERMANENT
THE EXCLUSION FROM EMPLOYEE INCOME FOR
EMPLOYER-PAID GROUP LEGAL SERVICES**

My name is Robert A. Georgine and I am testifying in my capacity as Chairman of the National Coordinating Committee for Multiemployer Plans.

The Coordinating Committee was organized shortly after the passage of ERISA in 1974, to represent the interests of the more than nine million working men and women, and their families, who are covered by multiemployer plans. The Committee's affiliates include more than 170 pension funds, health and welfare funds, and related international unions.

As I have testified on numerous occasions in the past, the NCCMP and its affiliates are deeply concerned by the recent legislative trend toward (1) proposing elimination of tax incentives for essential employee benefit programs under the misnomer of "tax reform;" and (2) attacking federal budget deficits through the imposition of additional tax burdens on these essential programs. We are afraid these crucial programs will be destroyed if this trend continues.

An important recent example of this trend is the failure of Congress to act prior to the close of 1987 to make permanent the group legal services exclusion, which consequently expired with respect to taxable years ending after December 31, 1987. This provision, which was found in section 120 of the Internal Revenue Code, excluded from the gross income of an employee the amounts contributed by an employer to a qualified group legal services plan, and the value of benefits received through the plan. The President, in proposals that evolved into the Tax Reform Act of 1986, had urged Congress to make this exclusion permanent. Despite the efforts of many others, the provision nonetheless was allowed to expire. Today, Senators Heinz, Durenberger, Moynihan and Boren have introduced S. 2119, and Congressman Rangel has introduced H.R. 1810, to reinstate and make this exclusion permanent. We strongly support these efforts.

Group legal services plans have proven their ability to deliver high-quality legal services -- especially preventive legal care -- at low cost to employers and at a minimal cost in foregone revenue.

This exclusion has been responsible for the phenomenal growth and success of these plans over the last eleven years. From fewer than 100,000 covered employees in 1976 when section 120 was enacted, legal services plans have grown to cover over 6.3 million Americans. I am pleased to say that multiemployer plans have been a significant factor in that growth.

Group legal services plans are actively supported by the labor and consumer movements, the legal profession, and the insurance industry. There is no opposition to group legal services plans.

Section 120 has proven its effectiveness in stimulating the growth of legal services plans at minimal cost in foregone revenue. Even according to Office of Management and Budget estimates, the tax expenditure associated with section 120 was $75 million for 1987. Assuming this figure is accurate, this is a small price to provide these important benefits to 6.3

million Americans. We note, however, that failure to make section 120 permanent will likely result in a far smaller revenue increase than that figure reflects, because much of the money previously used to provide group legal services may be allocated to tax-deductible pension or welfare benefits.

While more than 35 percent of the general population each year encounter problems that could be solved by a lawyer, only ten percent actually seek legal assistance. By contrast, an average of 20 percent of the covered employees in a group legal plan seek legal services each year. These facts indicate that twice as many people obtain legal assistance in resolving everyday legal problems through participation in a group legal services plan. Most of these employee users receive preventive legal services that often make it possible to avoid litigation or other protracted remedial services. Thus, group legal services plans tend to preserve employee morale and productivity and assist in unblocking our overburdened judicial system. These plans are in the best American tradition of pragmatic, voluntary group action to meet important needs.

What is it about group legal services plans that creates "win-win" situations where everybody benefits? Basically, it is that transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements drastically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises. More people receive legal advice early, before their problems get out of hand, allowing matters to be handled at lower cost and in a way that minimizes disputes and litigation.

Without a tax exemption, multiemployer plans and participating employers would face nightmarish recordkeeping and administrative requirements in implementing withholding and the payment of employment taxes on relatively insignificant amounts of money. Multiemployer legal benefit plans typically provide coverage at a cost in the area of $3 - $20 a month. Without a tax exemption, in addition to the participants being taxed on income they never receive, employers and plans would be required to track participant coverage and administer the withholding requirements and the payment of employment taxes. These burdens cannot be justified, given the amounts involved and the laudatory goal of providing cost-effective legal services to those who need them.

Congress has an unbroken record of supporting group legal services plans, from an amendment of the Taft-Hartley Act in 1973 to the 1986 Tax Reform Act's extension of section 120 through the end of 1987. I urge you to continue this wise and well-chosen course by making the group legal services exclusion permanent.

Thank you very much for the opportunity to make our views known.

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