THE USE OF MORTGAGE REVENUE BONDS IN CALIFORNIA

JANUARY 1985

85-7

TABLE OF CONTENTS

TABLE OF CONTENTS--contd

LIST OF TABLES

LIST OF TABLES--contd

INTRODUCTION

Current state law authorizes both state and local governmental entities to issue tax-exempt mortgage revenue bonds (MRBs). The proceeds from the sale of these bonds are used to provide financing for the development of housing at interest rates that are below prevailing market rates. State law generally restricts availability of this subsidized financing to low- and moderate-income households.

Chapter 323, Statutes of 1983, directed the Legislative Analyst to:

- Provide specific information on the housing units produced under the California Housing Agency (CHFA) and local government MRB programs, such as information on the geographical distribution of units, sales prices, and tenant incomes; and
- Prepare an analysis of the costs and benefits resulting from the issuance of these tax-exempt housing revenue bonds.

The MRB programs covered under this reporting requirement are listed and briefly described in Table 1.[1]

This report was prepared in response to the directive contained in Chapter 323. Chapter I provides background information on the use of MRBs in California and on the federal government's role in regulating their issuance. In Chapter II, we discuss state and local data relating to units produced and households assisted under these housing programs. Chapter III

---

1. This report does not include a discussion of the California Veterans Farm and Home Loan program, which uses tax-exempt revenue bonds to subsidize veterans' mortgages, and some other small housing-related bond programs conducted by state educational entities.

examines the fiscal and policy issues associated with the use of tax-exempt mortgage revenue bonds.

Table 1

CHFA and Local Government
Mortgage Revenue Bond Programs

Enabling Act	Sections of the Health & Safety Code	Entities Authorized to Issue Bonds	Purpose
Ch 1201/73	37910 et seq.	Local governments	Single-family and multifamily rental housing rehabilitation ("Marks-Foran Residential Rehabilitation Program")
Ch 48/75	33750 et seq.	Redevelopment agencies	Single-family housing and housing rehabilitation ("SB 99 Program")
Ch 610/77	50900 et seq.	CHFA	Single-family and multifamily rental housing
Ch 1069/79	52000 et seq.	Local governments	Single-family housing
Ch 114/82	52075 et seq.	Local governments	Multifamily rental housing ("AB 665 Program")

We would like to thank Karney Hodge, Marilyn Brazell, and Steve Williamson of the CHFA for their assistance in providing data on the agency's programs. We also wish to thank the following officials who provided information on the local MRB programs: Lydia DuBorg (Concord-Walnut Creek Home Financing Authority), Jim Kennedy (Contra Costa County Home Mortgage Finance Program), Steve Mitchell (City of Modesto), Bina Lefkovitz (Sacramento Housing and Redevelopment Agency), Bill Dempsey (San Mateo County), Toby Kramer (Santa Clara County), and John Gibson and

Tom Beckett (Orange County). Denise Arend of the state Department of Housing and Community Development, Martha Riley of the California Debt Advisory Commission, and Ben Bartolotto of the Construction Industry Research Board also deserve mention for their assistance in providing historical statewide MRB data.

This report was prepared by Henry Sepulveda, under the supervision of Mac Taylor. It was typed principally by Senita Robinson-Taylor.

EXECUTIVE SUMMARY

Existing law authorizes state and local governmental entities to issue tax-exempt mortgage revenue bonds (MRBs) to provide financing at below-market interest rates for the development of both single-family and multifamily rental housing units. In this report, we provide: (1) general background on the use of MRBs, (2) statistical information on the housing assistance provided under MRB programs administered by the state and seven local governments, and (3) a discussion of the major fiscal and policy issues related to the use of MRBs.

Chapter I: General Background

1. The use of MRBs to provide housing assistance has been growing rapidly. In 1977-78, a total of $168.2 million in MRBs was issued by local agencies and the California Housing Finance Agency (the state's principal MRB issuer). By 1982-83, however, total statewide MRB sales had increased to $2.8 billion.

2. The federal government recently has taken action to limit and regulate the issuance of MRBs. Changes in federal law have imposed (1) annual limitations on the total volume of MRBs that may be issued in each state for homeownership programs; (2) a "sunset," effective December 31, 1987, on the federal tax exemption for state and local single-family MRB programs, and (3) additional annual program performance reporting requirements.

Chapter II: Statistical Information on Mortgage Revenue Bond Programs

We obtained data on MRB activity at the state level from the California Housing Finance Agency, which provided information on both its Home Mortgage Purchase Program (CHFA's primary single-family MRB program) and its multifamily programs. Data on local programs, however, are sketchy. In conducting this review, we received information from just seven local agencies, and this information only covered the agencies' single-family programs. Consequently, the information presented in this report should be viewed only as illustrative of MRB activity within the state.

Because of recent state and federal legislation requiring improved reporting of statistical data on MRBs, the Legislature in the future should have better information on which to evaluate these programs.

A. Single-family Programs

1. In the eight-year period ending June 1984, the California Housing Finance Agency (CHFA) provided financing for 15,125 owner-occupied units statewide. Approximately one-half of these units are located in four counties: Alameda, Los Angeles, Sacramento, and San Diego.

2. It is difficult to draw conclusions regarding the incomes of those benefitting from local MRB programs. Based on summary data provided by seven local agencies, it appears as if these agencies' MRB programs are assisting primarily moderate-income households (that is, those with incomes of between 80 and 120 percent of median). Even this tentative conclusion, however, must be qualified, as the local data does not compare the borrowers' incomes with the median-income of comparably sized households.

The conclusion is also based on the assumption that the median income figures used by local agencies--they have wide discretion in this regard--accurately reflect local conditions.

3. State MRB assistance appears to be going primarily to households with incomes in excess of the moderate-income level. We were able to compare the incomes of CHFA borrowers in selected counties with the median incomes of comparably sized households. This data indicates that between one-half and four-fifths of state MRB assistance is going to households with incomes in excess of the moderate level.

4. The sales prices of the units financed under both the CHFA and local MRB programs comply with the applicable federal limitations. The average sale prices of locally financed units were substantially below the ceiling amount dictated under federal "safe harbor" limitations. For instance, the Concord-Walnut Creek Home Financing Authority reported an average sales price of $84,800, although it was authorized to provide assistance to units with sales prices up to $149,380. The average sales price statewide for the CHFA units was approximately $78,600, which was considerably less than the statewide median sales price for new units of $114,000.

5. State and local MRB programs have low downpayment requirements. The MRB programs examined for this report require borrowers to make downpayments of between five and ten percent, one-half the level usually required in conventional financing.

6. Monthly mortgage payments (principal and interest) of MRB program participants are not excessive. Generally, borrowers under the state and seven local programs are paying between 25 to 30 percent of their

incomes on monthly mortgage payments. These ratios are not in excess of generally accepted standards.

7. MRB financing can substantially reduce a borrower's monthly mortgage payment. Based on the average loan made to CHFA borrowers, the state MRB program reduces monthly payments by about 20 percent.

8. Borrowers assisted under the CHFA and local programs tend to be relatively small households. The average household size of CHFA-assisted units in six selected counties was 2.15 persons. About 70 percent of these units were occupied by one- or two-person households. It appears that local programs are also assisting primarily smaller households.

B. Multifamily Programs

1. Despite a statutory reporting requirement, local agencies are not submitting program information on local MRB programs that provide financing for multifamily rental housing developments. Chapter 114, Statutes of 1982 (AB 665), authorizes the issuance of up to $900 million in MRBs annually by local agencies in California for the purpose of financing multifamily units. In 1982, approximately $158.2 million in bonds were sold. As of November 1984, $521.6 million in AB 665 bonds had been issued since the start of the year. The Department of Housing and Community Development reports, however, that no detailed data on these programs have been submitted to it, as required by the statute.

2. Between 1979-80 and 1983-84, CHFA financing produced over 11,000 multifamily rental housing units in 28 counties. Over half of the total units developed are located in four counties--Alameda, Los Angeles, Riverside and San Diego.

3. <u>During 1983-84, approximately 93 percent of the tenants residing in CHFA-financed rental housing developments reported annual incomes under $12,500</u>. Generally, these households would be considered "very low income" (under 50 percent of area median income) under HUD-published median income estimates for this period.

4. <u>Almost 80 percent of the households assisted under CHFA multifamily programs were in units with rent levels between $400 and $700</u>. Tenants, however, contribute only a <u>portion</u> of this rent. Over 80 percent of these CHFA-assisted households pay less than $200 as their rent contribution (typically, the remainder is paid by the federal government through the "Section 8" program).

5. <u>Over 57 percent of the rental housing units produced under the CHFA program are one-bedroom units</u>. Tenants of these one-bedroom units comprise approximately one-third of all the tenants residing in these CHFA-financed units.

6. <u>Almost 83 percent of CHFA multifamily units are under private ownership</u>. The remainder of the units are owned by nonprofit groups (13 percent) and public housing authorities (4 percent).

<u>Chapter III: Fiscal and Policy Issues</u>

1. <u>State and local governments issue tax-exempt mortgage bonds primarily to achieve two objectives</u>. These are: (a) to assist low- and moderate-income persons in obtaining affordable housing, and (b) to increase the supply of housing by increasing the amount of capital available to support the construction and purchase of housing.

(a) <u>Housing Assistance</u>. While <u>multifamily</u> MRB programs have provided assistance to the target groups, a significant portion of assistance provided under single-family programs has gone to households with incomes in excess of the moderate level.

(b) Housing Supply. Several studies suggest that the net addition to the housing stock from the use of MRBs is equal to approximately 20 percent of the amount raised by the issuance of these bonds. Consequently, the vast majority of funds raised through the issuance of MRBs simply replaces financing that otherwise would have been available to mortgage purchasers. Furthermore, some studies contend that the long-run impact of MRBs on housing production is even less than 20 percent.

2. The issuance of MRBs affects state finances in three different ways.

(a) Income-Tax Reductions. Because interest earned on MRBs is exempt from income taxation at the state level as well as the federal level, the use of these bonds results in an annual state revenue loss. Based on estimates of federal revenue losses, we estimate the state's annual loss to be in the \$35-\$45 million range. (Since some portion of these bonds is purchased by persons living outside of California, however, this estimate has an upward bias.)

(b) Increased Interest Costs. The use of MRBs increases the public sector's demand for financial capital, thereby increasing the interest rates that the state and local governments must pay on their non-MRB debt. There is considerable uncertainty as to the extent of these costs. If, however, every \$1 billion in

MRB sales raised overall interest rates by 5 basis points (each basis point is equal to one one-hundredth of a percent), the additional annual interest cost for each $1 billion in new, non-MRB tax-exempt bonds issued would be $500,000.

(c) Impact on Net Economic Activity. It is often claimed that MRBs "pay for themselves" by increasing economic activity in the state. For the most part, however, MRBs simply reallocate existing capital, by shifting resources from the business sector and the nonhousing public sector to housing. Consequently, there is not necessarily any significant change in the level of economic activity because of this capital reallocation.

3. The use of tax-exempt MRBs is not the most efficient way to subsidize housing. A significant portion of the revenues foregone by the state go to bond investors, rather than to the intended recipients of the subsidy--housing beneficiaries.

4. It is difficult for the Legislature to exert control over the MRB program, for three reasons.

(a) Because this subsidy program operates through the tax system (as opposed to through a direct spending program), it is not subject to annual program review by the Legislature.

(b) Legislative control is also constrained because the subsidy does not go directly to intended beneficiaries (renters and homeowners). As the state must depend on local entities to establish local MRB programs, the subsidy is not a broad-based one, equally available to all eligible persons.

(c) The Legislature cannot control the extent--or even the availability--of the subsidy, due to circumstances beyond its reach. For instance, during times of high interest rates, the subsidy may not lower housing costs sufficiently to reach even moderate-income households.

5. Given that the MRB subsidy mechanism is deficient in a number of ways, the Legislature may want to consider alternative methods of achieving its housing goals. The Legislature could achieve its goals in a more efficient way by (1) using taxable bonds or mortgage credit certificates in lieu of MRBs, (2) relying more on direct appropriation programs, or (3) modifying the existing state tax treatment of housing. If the Legislature wishes to maintain the use of MRBs, it can still take steps to ensure that the preponderance of benefits go to the desired beneficiaries.

CHAPTER I

GENERAL BACKGROUND

This chapter presents a general overview of mortgage revenue bond (MRB) programs in California. Specifically, the chapter: (1) provides background information on these programs, including a brief description of the tax-exempt financing mechanism and the state's experience to date with the use of these bonds, and (2) discusses recent federal changes affecting the use of MRB financing.

THE TAX-EXEMPT FINANCING MECHANISM

Tax-exempt mortgage revenue bonds are used to lower the costs of housing to homeowners and renters. In issuing bonds, governments raise money for housing-related loans (mortgages and construction loans) at interest rates which are below prevailing market rates. These rates are below prevailing rates because interest earned by the bond purchasers is exempt from federal and (if the purchaser resides in California) state income taxation. Thus, purchasers of these government-issued bonds do not require as high an interest rate as do those lenders who must pay income taxes on their interest earnings (say, purchasers of corporate bonds).

The difference between the market interest rate and the tax-exempt rate, less any administrative costs associated with the bond sale and lending activities, is--in turn--passed through to eligible borrowers. Thus, the tax-exempt borrowing authority provides a means of subsidizing homeowners and--indirectly--renters.

USE OF MORTGAGE REVENUE BONDS

State and local governments have been authorized to issue tax-exempt MRBs since 1968. It was not until much later, however, that this method of subsidizing housing achieved widespread use. As Table I-1 shows, MRB sales by the state and local governments have gone from virtually nothing in 1976-77 to the $2 billion level in just six years.

State MRB sales are undertaken by the California Housing Finance Agency (CHFA), which was created in 1975 to help low- and moderate-income persons meet their housing needs. Through the end of 1983-84, CHFA had issued $1.7 billion in bonds, of which three-fourths have been used to subsidize single-family housing. The agency held its first multifamily bond sale in August 1979.

Local MRB activity has been much more extensive than that of the state. Between 1976-77 and 1983-84, local governments issued $7.4 billion of these bonds, accounting for over 80 percent of all MRB issues during that time. The peak year for sales was 1982-83, when $2.3 billion of MRBs were sold at the local level. While redevelopment agencies were the predominant issuers at first, all four types of local agencies are now selling significant amounts of MRBs.

Table I-1

CHFA and Local Government
Mortgage Revenue Bond Sales
1976-77 Through 1983-84
(in millions)

	CHFA		Local Governments[a]				
	Single-family	Multi-family	Counties	Cities	Redevelopment Agencies	Special Districts	Total Local Sales
1976-77	$100.0	--	NA[b]	NA	NA	NA	--
1977-78	75.0	--	$28.2	--	$0.9	$64.1	$93.2
1978-79	175.0	--	12.4	$111.2	241.3	--	364.9
1979-80	155.0	$160.0	8.6	211.9	948.3	--	1,168.8
1980-81	--	36.3	194.8	124.1	446.7	27.0	792.6
1981-82	--	102.4	370.6	73.3	349.7	193.4	987.0
1982-83	345.3	141.9	886.4	713.9	321.4	372.6	2,294.3
1983-84	328.9	77.5	248.3	588.6	743.6	155.5	1,736.0

a. These estimates may include minor amounts of general obligation bond sales. Data for local programs prior to 1976-77 is not available.
b. Information not available.

Source: Data for 1976-77 through 1980-81 was obtained from the Office of Planning and Research. Data for 1981-82 was compiled by the Legislative Analyst's Office from Weekly Bond Buyer. Data for 1982-83 and 1983-84 came from the California Debt Advisory Commission Calendar. Details may not add to totals due to rounding.

Table I-1 reflects the impact on MRB sales of the high market interest rates that prevailed between 1980 and 1982. Increased interest rates on taxable securities drove tax-exempt rates to such high levels that the MRB subsidy was not sufficient in many cases to make housing available even to moderate-income persons. As a result, total sales of CHFA and local MRB sales in 1980-81 and 1981-82 declined by approximately 44 percent and 27 percent, respectively, from the 1979-80 levels. The interest rate effect was even more severe on CHFA sales, as the agency did not issue <u>any</u> bonds to finance single-family homes in either 1980-81 or 1981-82.

Table I-1 also shows that total MRB sales in 1983-84 declined by one-fourth from the prior-year level. This was due primarily to the federal Mortgage Subsidy Bond Act of 1980, which terminated--effective December 31, 1983--the federal income tax exemption for interest earned on MRBs. Although tax exemption for MRBs was later reinstated (see below), state and local governments generally were unable to issue these bonds for one-half of the fiscal year.

RECENT FEDERAL REGULATION

In December 1980, the U.S. Congress adopted legislation to stem the growth of MRBs issued to finance single-family housing. That legislation, the Mortgage Bond Subsidy Bond Act of 1980, restricted the use of MRBs, imposed annual ceilings on the amount of MRBs issued in each state, and eliminated, effective December 31, 1983, the tax-exempt status of single-family housing bonds. Although it considered extending this "sunset" date, Congress failed to do so before the tax-exempt status of these bonds lapsed on January 1, 1984. It was not until July 1984, when the federal Deficit Reduction Act (DEFRA) of 1984 was passed, that the tax exemption for single-family MRBs was reinstated and a new sunset of <u>December 31, 1987</u> was established.

At the same time it extended the tax-exempt status of MRBs, the Congress also imposed a series of new requirements on the use of funds raised by state and local governments through the sale of these bonds. For example, the DEFRA:

- Requires each MRB issuer to publish and submit to the U.S. Treasury Department an annual "Policy Statement" that addresses certain prescribed elements of the issuer's bond program. Among other things, this statement must include the issuer's assessment of its compliance with Congressional intent that the bonds be used to the greatest extent feasible (considering interest rate and market conditions) to assist lower-income families.
- Requires agencies issuing bonds after December 31, 1984, to file an annual report with the U.S. Treasury Department that includes information relating to the issuer, the volume of bonds sold, and other prescribed data.

This 1984 federal law imposes some minor restrictions on bonds issued to finance the acquisition or rehabilitation of multifamily rental housing units, as well. For example, certain limitations are imposed on the use of these multifamily bonds to acquire land and rehabilitate existing facilities.

CHAPTER II

STATISTICAL INFORMATION ON MORTGAGE REVENUE BOND PROGRAMS

Chapter 323, Statutes of 1983, requires the Legislative Analyst to provide--in an annual report--specified information on state and local MRB programs. In order to provide this information, we obtained data on MRB activity at the state level from the California Housing Finance Agency (CHFA) and the California Debt Advisory Commission (CDAC). We also contacted 40 local agencies to obtain data on their use of these bonds. Unfortunately, only seven of the 40 agencies responded to our request for data on their single-family programs. Three of these local agencies (the Sacramento Housing and Redevelopment Agency, Orange County, and the City of Concord) provided fairly detailed responses, while the remaining four agencies (San Mateo County, Santa Clara County, Contra Costa County, and the City of Modesto) submitted summary data. Given the very limited response from local governments, it is impossible for us to make any inferences about local MRB programs in general. In the context of this report, this is a critical limitation, as local issues constitute the vast majority of all MRBs in the state.

In the future, our office should have much better statistical information on MRBs as a result of recent legislation. Not only has the federal government required state and local MRB issuers to provide better information on their bond sales and program results (see Chapter I), but the state has also acted to ensure improved reporting. Chapter 1399, Statutes of 1984 (AB 4025, Maxine Waters), which took effect January 1985, requires each local agency that issues MRBs to submit an annual report to CDAC containing statistical information of the type we need in order to comply with the requirements of Chapter 323. Upon receipt and compilation of this data, CDAC must submit a summary report to the Legislature and the Legislative Analyst. Information prepared and published under both federal law and Chapter 1399 will be included in the analyses of these California state and local MRB programs that we prepare in the future. It could be two years, however, before enough data has been provided to our office to permit meaningful analysis.

As required by Chapter 323, our analysis of MRB programs concentrates on the following statistical measures of program activity:

- The geographical distribution of the units produced under the programs;
- The incomes of those who purchased or rented the units;
- The monthly mortgage or rental payment on assisted units;
- The sale prices of these units;
- The sizes of households purchasing or renting the units; and
- The types of entities sponsoring the units.

Because of basic differences in the nature and goals of the single-family and multifamily programs, the remainder of the chapter is divided into two parts. Part A provides detailed information on and analysis of single-family (owner-occupied) programs, while Part B focuses on multifamily rental housing programs.

A. SINGLE-FAMILY HOMEOWNERSHIP PROGRAMS

GEOGRAPHICAL DISTRIBUTION OF CHFA-FINANCED UNITS

Due to the lack of comprehensive data on local governments' MRB activity, we are unable to show the geographical distribution of single-family units produced under local programs within California. Table II-1, however, shows the location--by county--of all units financed by CHFA under its single-family programs. The table indicates that 15,125 units have been financed by CHFA loans between 1976 and June 1984. The table also shows that approximately one-half of the units produced during this period are located in four counties: Alameda, Los Angeles, Sacramento, and San Diego. These counties comprise a comparable proportion (approximately 48 percent) of the state's estimated total population as of January 1984.

Table II-1 also shows each county's share of the state's total population, for comparison with the distribution of CHFA-assisted units among counties. Our review indicates that, with a few exceptions, CHFA's production has reflected the general distribution of the state's population. The notable exceptions are (1) Sacramento County, which contains 3.4 percent of the state's population, but has 13 percent of the total CHFA single-family units; and (2) Los Angeles County, which is home to 31.0 percent of California's residents but has only 17.7 percent of CHFA's single-family units.

Table II-1

CHFA
Total Units Developed Under Single-Family Programs
1976 Through 1984

Counties	Single-Family Units Number	Single-Family Units Percent	County's Share of Statewide Population
Alameda	984	6.5%	4.6%
Amador	1	--	.1
Butte	61	.4	.6
Colusa	--	--	.1
Contra Costa	634	4.2	2.7
El Dorado	1	--	.4
Fresno	441	2.9	2.2
Glenn	1	--	.1
Humboldt	21	.1	.4
Imperial	149	1.0	.4
Kern	279	1.8	1.8
Kings	35	.2	.3
Lassen	8	.1	.1
Los Angeles	2,683	17.7	31.0
Madera	24	.2	.3
Mendocino	21	.1	.3
Merced	148	1.0	.6
Monterey	114	.8	1.2
Napa	14	.1	.4
Nevada	4	--	.3
Orange	1,031	6.8	8.1
Placer	66	.4	.5
Plumas	4	--	.1
Riverside	604	4.0	3.0
Sacramento	1,989	13.2	3.4
San Bernardino	852	5.6	4.0
San Diego	1,626	10.8	8.0
San Francisco	373	2.5	2.8
San Joaquin	217	1.4	1.5
San Luis Obispo	17	.1	.7
San Mateo	265	1.8	2.4
Santa Barbara	74	.5	1.3
Santa Clara	836	5.5	5.4
Santa Cruz	9	.1	.8
Shasta	48	.3	.5
Siskiyou	90	.6	.2
Solano	272	1.8	1.0
Sonoma	239	1.6	1.3
Stanislaus	83	.5	1.2
Sutter	19	.1	.2
Tehama	1	--	.2
Tulare	157	1.0	1.1
Tuolumne	1	--	.1
Ventura	287	1.9	2.3
Yolo	319	2.1	.5
Yuba	23	.2	.2
Totals	15,125	100.0%	98.7%[a]

a. There were no units produced in the counties of Alpine, Calaveras, Del Norte, Inyo, Lake, Marin, Mariposa, Modoc, Mono, San Benito, Sierra, and Trinity. These areas constitute approximately 1.3 percent of the state's total populations.

INCOME OF BORROWERS

General Restrictions

Currently, the state imposes income requirements that borrowers in CHFA and local MRB programs must satisfy in order to qualify for financing under these programs. As a result of action by CHFA's board, borrowers under agency programs may not have incomes that exceed 120 percent of the area median income for a one-member household, 135 percent for a two- or three-member household, and 150 percent for a household consisting of four or more people. CHFA uses area median income figures which are determined annually by the federal Department of Housing and Urban Development (HUD).

Local single-family MRB programs, on the other hand, are governed by income restrictions set forth in state law (Sections 50189 and 52020 of the Health and Safety Code). These provisions generally limit the income of a participating household (regardless of size) to 150 percent of the area median income. This 150 percent limit, however, applies only until July 1, 1985, when it will be reduced to 120 percent of the area median income.

Local governments are authorized to use four different methods of determining area median income: (1) an annual estimate of area median income published by HUD (typically, these are multicounty metropolitan areas); (2) a countywide estimate of median income; (3) a statewide estimate of median income; or (4) an estimate based on a specific feasibility study prepared and/or approved by a financial consultant or bond counsel. Of the seven local MRB programs from which we were able to obtain information, four exercised the feasibility study option, two used estimates of statewide median income, and one observed the HUD-determined estimate. Localities may be selecting the option that most accurately reflects local median income, or they may be selecting the option which provides the highest estimate of income, so that more people could qualify.

Local Programs

Table II-2 provides information on the incomes of purchasers who qualified for mortgage assistance during 1983 and 1984 under seven local MRB programs. The table shows the average annual income of participants and the applicable area median income, both as determined by HUD and as used by the agency. The table indicates that the average annual income of the borrowers ranges from $30,500 for the City of Modesto to $46,600 under the Santa Clara County program.

It is difficult to draw conclusions from the information provided in Table II-2, as we do not have more detailed data on the distribution of participants by income groups. Assuming, however, that participants are normally distributed across income groups, we can infer the following from the data presented in Table II-2:

- If the area median income figures used by the agency are the reference point, the vast majority of local MRB borrowers fall within the moderate-income classification (80 to 120 percent of median).
- If, on the other hand, HUD area median income figures are used, a significant percentage of participants in each county (close to or in excess of a majority in four of the seven counties) have incomes that exceed the area median income.

Table II-2

Incomes of Borrowers
Single-Family MRB Programs of
Selected Local Governments
1983 and 1984

Issuer	Area Median income: As Used By The Agency	Area Median income: As Estimated By HUD[a]	Average Annual Income of Borrowers: Amount	Average Annual Income of Borrowers: As Percent of Agency Median	Average Annual Income of Borrowers: As Percent of HUD Median
Concord/Walnut Creek	$36,900	$31,600	$35,200	95.4%	111.4%
Contra Costa County	36,800	31,600	34,800	94.6	110.1
Modesto	28,900	24,300	30,500	105.5	126.6
Orange County	38,000	33,700	34,000	89.5	100.9
Sacramento	28,300	27,200	31,900	112.72	117.3
San Mateo County	NA	31,600	37,300	NA	118.0
Santa Clara County	37,800	34,800	46,600	123.3	133.9

a. Area median income for a household consisting of four members for the period March 1983 through March 1984.

CHFA Program

The CHFA provided borrower income information only for its Home Mortgage Purchase (HMP) program. This program, which became operational in 1982-83, has used almost three-fifths of the funds raised by the agency through the sale of single-family MRBs. CHFA's two other single-family programs, the Home Ownership-Home Improvement (HOHI) program and the Mortgage Purchase program, have used about one-third and 7 percent, respectively, of the funds raised by CHFA's MRB sales. According to CHFA staff, reliable statistical data are not available for these programs.

Borrowers under the HMP generally were selected in 1983 and 1984. Table II-3 presents detailed household income data relating to borrowers in six counties--Alameda, Santa Clara, Sacramento, Fresno, Los Angeles, and San Diego. The CHFA borrowers in these counties represent approximately 57 percent of the total for the HMP. As indicated in the table, over half of these participants reported annual incomes ranging between $25,000 and $35,000. Approximately 20 percent of these households reported annual incomes in excess of $35,000.

Table II-3

Income of Borrowers
CHFA Home Mortgage Purchase Program
1983 and 1984

Household Income	County						Total Units In These Counties		
	Alameda	Santa Clara	Sacramento	Fresno	Los Angeles	San Diego	Number	Percent	Cumulative Percent
Under $10,000	--	--	--	1	--	1	2	0.1	0.1
$10,000--$12,500	--	1	--	--	--	--	1	--[a]	0.1
$12,501--$15,000	--	--	9	2	--	1	12	0.5	0.6
$15,001--$17,500	1	--	23	12	4	4	44	1.7	2.3
$17,501--$20,000	5	--	38	17	5	11	76	3.0	5.3
$20,001--$22,500	5	2	72	35	19	15	148	5.9	11.2
$22,501--$25,000	23	9	96	32	46	34	240	9.5	20.7
$25,001--$27,500	19	21	143	45	70	33	331	13.1	33.8
$27,501--$30,000	22	29	124	38	98	60	371	14.7	48.5
$30,001--$32,500	38	42	130	41	115	80	446	17.7	66.2
$32,501--$35,000	30	44	95	8	104	68	349	13.9	80.1
$35,001--$37,500	25	29	64	4	80	62	264	10.5	90.6
$37,501--$40,000	24	44	5	--	19	16	108	4.3	94.9
$40,001--$42,500	22	35	3	--	2	--	62	2.5	97.4
$42,501--$45,000	3	28	--	--	--	--	31	1.2	98.6
Over $45,000	2	32	--	--	--	--	34	1.3	99.9
Total	219	316	802	235	562	385	2,519	100.0	100.0[b]

a. Less than 0.05 percent.
b. Details do not add to total due to rounding.

Table II-4 compares the reported income status of these CHFA borrowers with the income of other residents in these same counties. The table shows how borrowers are distributed throughout different income groups, relative to the area median income of the appropriate county. In determining these median income figures, however, CHFA has used estimates for a four-member household. That is, regardless of the actual size of CHFA households, their income is compared with the median income of all four-member households in the county. This is an important point to consider in reviewing the data because a one- or two-person household may be considerably better off financially than a four-person household, even if they have identical incomes.

Table II-4

Distribution of CHFA Borrowers By Income Groups
Applying the "Four-Member Household" Standard
for Area Median Income
1983 and 1984

County Residence of Borrowers	Median Income for Four-Member Household[a]	Estimated Percent of Borrowers Per Income Group[b]				
		Very Low	Low	Moderate	Over Moderate	Total[c]
Alameda	$31,600	--	15.5%	61.2%	23.3%	100.0%
Fresno	23,600	0.4%	12.8	64.3	22.6	100.0
Los Angeles	27,400	--	5.0	56.9	38.3	100.0
Sacramento	27,200	1.1	16.2	61.1	21.7	100.0
San Diego	26,400	0.3	7.3	53.8	38.7	100.0
Santa Clara	34,800	0.3	9.5	69.6	20.6	100.0

a. Area median income data published by HUD for the period March 1983 through March 1984.
b. "Very low": Under 50 percent of median; "Low": Between 50 percent and 80 percent of median; "Moderate:" Between 80 percent and 120 percent of median; "Over Moderate": In excess of 120 percent of median.
c. Totals may not add due to rounding.

The unit distributions by income groups in these counties are surprisingly uniform. In each of the counties, a majority (57 to 70 percent) of the participants have moderate-incomes, while a significant percentage (21 to 39 percent) have incomes in excess of the moderate level (that is, greater than 120 percent of median income).

It is not clear to us, however, why CHFA uses median income figures for four-member households in determining eligibility for its programs. In order to compare the income of CHFA borrowers relative to the income of comparably sized households, we prepared Table II-5. In this table, a borrower's income status is compared with the median income of similarly sized households. For instance, the 1983 area median income of a two-member household in San Diego was $21,100, as compared with a median income of $26,400 for four-member household (See Table II-4). Consequently, in Table II-5 two-member households in San Diego are going to show up in higher income groups. In all cases in Table II-5, the income boundaries for each of the four groups ("very low," "low," "moderate," and "over moderate") are below the boundaries used for Table II-4.

Controlling for household size causes a dramatic change in the distribution of borrowers among income groups. For example, while Table II-4 shows that 54 percent of all the CHFA-assisted homebuyers in San Diego County qualified as moderate-income (80 to 120 percent of median), Table II-5 shows that only 18 percent of these homebuyers qualified as "moderate income." Thus, if household size is held constant in evaluating the relative income status of MRB participants, CHFA is providing assistance overwhelmingly to the upper end of the spectrum of eligible borrowers.

Table II-5

Distribution of CHFA Borrowers by Income Groups
Applying Area Median Income of Comparably Sized Households
1983 and 1984

County Residence of Borrowers	Estimated Percent of Borrowers for Income Group: Very Low	Low	Moderate	Over Moderate	Total[a]
Alameda	--	1.4%	44.3%	54.3%	100.0%
Fresno	0.4%	5.5	29.4	64.7	100.0
Los Angeles	--	1.2	22.8	76.2	100.0
Sacramento	--	4.5	41.9	53.6	100.0
San Diego	0.3	0.5	18.2	81.0	100.0
Santa Clara	0.3	0.3	25.9	73.4	100.0

a. Details may not sum to totals due to rounding.

SALES PRICE OF THE UNITS

General Restrictions

Under existing federal law, tax-exempt MRB financing may not be used to finance the acquisition of housing costing more than certain region-specific amounts. Generally, MRB programs may exercise one of two options in determining these sales price limits: (1) "safe harbor" limitations, as published annually by the Internal Revenue Service (IRS), or (2) sales price estimates, as determined by a feasibility study prepared by the local MRB issuer for a specific bond sale.

If the bond issuer uses the "safe harbor" option, the program must comply with the unit sales price limitations published by IRS for that local area. The "safe harbor" estimates are generally designed to reflect the average area purchase prices for new and existing owner-occupied units in the local area for the preceding 12-month period. The single-family residential units financed under the local MRB program may not exceed

110 percent of these estimates (or 120 percent of the IRS-determined estimate in special "targeted areas").

If the "feasibility study" option is exercised, the local issuer must establish and justify an alternate estimate of the prevailing local sales price for owner-occupied units. This alternate estimate must be endorsed by both the financial consultant and the bond counsel retained by the issuer for the proposed MRB sale. Presumably, this alternative is employed when the local issuing agency concludes that the IRS "safe harbor" estimates do not satisfactorily reflect sales prices within its borders. The local programs in Sacramento, Santa Clara County, and Concord/Walnut Creek used this option to determine sales price limits.

Local Programs

A summary of sales prices, loans, and safe harbor limitations information relating to units financed under seven local MRB programs is presented in Table II-6. It shows that the average sales price for units financed under these programs range from $70,400 (Modesto) to $115,000 (Santa Clara County). In all cases, the average sales price is substantially below the safe harbor limitations. We have, however, no information on the distribution of assisted units by sales prices. Consequently, we do not know how many, if any, units had sales prices which approached or exceeded the safe harbor limitations.

Table II-6 also indicates that the ratio of average loan amount to average sales price ranges from 89 to 95 percent. This data suggests that the downpayments required by these programs are fairly low--between 5 and 11 percent. Thus, local MRB programs are requiring much lower downpayments than conventional, private sector institutions, which typically require a 10 to 20 percent downpayment.

Table II-6
Average Sales Price and Loan Information[a]
Local Single-Family Programs
1983 and 1984

	"Safe Harbor" Limitation (New Units)	Average Sales Price	Average Loan	Ratio, Average Loan to Average Sale Price
Concord-Walnut Creek	$149,380	$84,800	$76,700	90.4%
Contra Costa County	149,380	92,300	82,300	89.2
City of Modesto	99,110	70,400	N/A	--
Orange County	150,040	85,600	80,000	93.5
Sacramento	94,710	75,500	71,200	94.3
San Mateo County	149,380	96,000	91,000	94.8
Santa Clara County	157,740	115,500	104,000	90.0

a. This information is based on mortgages accepted during 1983 and 1984. Funding for the mortgages was obtained from local bond sales made in calendar years 1982 and 1983.

CHFA Program

The average sales price of all units financed under the HMP program during 1983 and 1984 was $78,600. This is considerably less than the 1983 statewide median sales price for new units--$114,000. Table 11-7 shows more detailed sales price information on single-family units financed under the CHFA program in six counties. These six counties contain approximately 57 percent of the CHFA single-family units financed in 1983 and 1984. The table shows that, in each county, the sales prices of the CHFA units are well below the "safe harbor" limitations.

Table II-7

Sale Prices of Units Financed
CHFA Single-Family Programs
1983 and 1984

Sales Prices	Alameda	Santa Clara	Sacramento	Fresno	Los Angeles	San Diego	Total
Under $40,000	--	--	14	7	--	7	28
$40,000-49,999	3	--	40	6	4	2	55
$50,000-59,999	12	17	101	96	24	23	273
$60,000-69,999	34	9	259	66	70	57	495
$70,000-79,999	88	66	255	41	187	106	743
$80,000-89,999	51	91	130	19	174	74	539
$90,000-99,999	15	60	3	--	89	102	269
$100,000-109,999	6	23	--	--	13	14	56
Over $110,000	10	50	--	--	1	--	61
CHFA Average	$78,200	$87,200	$68,800	$62,900	$79,800	$79,700	
Safe Harbor Limitations[a]	149,380	157,740	94,710	106,260	124,410	115,060	

a. Based on 110 percent of the average area purchase price, as specified by the IRS. These limitations were in effect during 1983.

MONTHLY PAYMENTS

Local Programs

Table II-8 shows the average principal and interest portion of the monthly mortgage payment made by borrowers, along with the applicable interest rate, under the seven local single-family housing programs examined. The monthly payments range from a low of $609 in Sacramento to a high of $959 in Santa Clara County. The payments vary because of: (1) differences in loan amounts, which in turn are due to average sale price variations and to different downpayment requirements; (2) differences in loan structures, such as the term of the loan and whether a "buydown" is offered (as in the case of the Contra Costa County and San Mateo County programs); and (3) differences in interest rates.

Table II-8

Average Monthly Mortgage Payments
Local Single-Family Programs
1983 and 1984

	Average Loan	Average Monthly Mortgage Payment	Interest Rate on Mortgage
Concord-Walnut Creek	$84,800	$886	13.3%
Contra Costa County	92,300	662[a]	9.5
City of Modesto	70,400	736	12.1
Orange County	85,600	666	9.4/9.6[b]
Sacramento	75,500	609	9.7
San Mateo County	96,000	942[a]	13.0
Santa Clara County	115,500	959	9.8

a. Due to interest rate buydowns offered by the developers, payments under these programs are less than what normally would be paid at the indicated rate.
b. Orange County had two bond sales.

The differences in interest rates charged borrowers in the seven local programs are significant. The rates offered are either just under 10 percent or over 12 percent. Generally, programs with the higher rates used the proceeds of bond sales made in 1982, when market mortgage rates were still at extremely high levels, while the programs with the lower interest rates issued their MRBs in 1983, after market rates had fallen. The differences in rates, however, can also be explained by other factors, such as the size of the bond issue, the fiscal condition of the issuing entity and general market conditions at the time of the bond sales.

Most housing finance experts believe a mortgagor's monthly payment should represent no more than one-third of his or her gross monthly income. Table II-9 compares the average monthly mortgage payment (principal and interest only) with the average reported monthly income of the borrowers under the seven MRB programs reviewed. As the table shows, the average borrower in these programs is spending less than one-third of reported income for mortgage payments. Of course, if monthly property tax liabilities and home-related insurance premiums were included in these payment estimates, total monthly housing costs as a percentage of income would be somewhat higher than the percentages shown in Table II-9.

Table II-9

Comarison of Average Monthly
Mortgage Payments and Income
Local MRB Programs
1983 and 1984

	Average Monthly Income	Average Monthly Mortgage	Average Monthly Mortgage As Percent of Income
Concord-Walnut Creek	$2,937	$771	26.3%
Contra Costa County	2,900	662	22.8
Modesto	2,545	736	28.9
Orange County	2,663	845	31.7
Sacramento	2,660	745	28.0
San Mateo County	3,107	942	30.3
Santa Clara County	3,881	959	24.7

CHFA Program

The CHFA provided us with some information on the monthly mortgage payments (principal and interest) made by its borrowers. For mortgages financed with bonds sold by the CHFA in 1983, the average monthly payment was about $630. This is based on a 10.125 interest rate and an average loan amount of $71,000. If compared with the cost of conventional financing--assuming, say, a 13.5 percent rate--CHFA MRB financing results in a monthly mortgage payment reduction of about $183.

HOUSEHOLD SIZE

Local Programs

In reviewing local MRB programs, we found that localities typically collect information only on the number of dependents in a participating household, not on the size of the household. Thus a "no-dependent" household may be either a one-member household or a household consisting of two or more employed adults. Consequently, information on household size provided by the localities must be interpreted cautiously.

Table II-10 presents the occupancy information reported to us by local agencies. The table indicates that the vast majority of the single-family units are occupied by households reporting no dependents. (Again, this does not mean that these units are occupied by only one person. The units may be occupied either by a one-member household or a household in which all occupants are employed.) Table 11-10 also shows the average household size for those two programs that were able to provide this information--the Contra Costa program and the Modesto program.

Table II-10

Occupancy of Units in
Local MRB Programs
1983 and 1984

	Distribution by Number of Dependents				Average Number of Dependents	Average Household Size
	0	1	2	3 or More		
Concord-Walnut Creek	80.8%	17.3%	1.9%	0	0.2	NA
Contra Costa County	NA[a]	NA	NA	NA	NA	1.4
Modesto	NA	NA	NA	NA	NA	2.6
Orange County	92.3	5.8	1.0	1.0	0.1	NA
Sacramento	85.8	10.1	3.3	0.8	0.2	NA
San Mateo County	NA	NA	NA	NA	NA	--[b]

a. Not available.
b. Program staff reported that virtually all of the units were occupied by either one- or two-member households.

CHFA Program

Table II-11 shows the size of households occupying agency-financed units in six counties. The table indicates that, as with the local MRB single-family programs, a substantial majority of the units (70 percent) are occupied by either one or two persons.[1] The table also shows that the average household size for the units in these six counties is 2.15 persons.

1. CHFA staff reports that due to concerns raised by its Board of Directors regarding the preponderance of small households in agency-financed units, the agency is discontinuing authorization to finance single-bedroom units, effective August 1984.

Table II-11

Household Size
CHFA Home Mortgage Purchase Program
July 1983 Through November 1984

	Number of Units For Each Household Size						
Persons in Household	Alameda	Santa Clara	Sacramento	Fresno	Los Angeles	San Diego	Total
1	91	95	261	61	208	112	828
2	84	141	295	79	98	138	935
3	24	47	137	35	2	69	394
4	17	24	79	42	61	51	274
5 or more	3	9	30	18	13	15	88
Totals	219	316	802	235	562	385	2,519
Average	2.02	2.09	2.15	2.48	2.06	2.27	2.15

B. MULTIFAMILY RENTAL HOUSING PROGRAMS

Under existing law, CHFA and local agencies (cities, counties, redevelopment agencies and housing authorities) are authorized to issue MRBs for the development, construction and rehabilitation of multiple-unit rental housing.

At the local level, the development of rental housing generally is conducted under the AB 665 program. This program requires that at least 20 percent of the units in an assisted project be reserved for lower-income households. In this context, a "lower-income" household refers to one whose income does not exceed 80 percent of the median income for the area.

Section 52097.5 of the Health and Safety Code imposes an annual ceiling of $900 million on the amount of tax-exempt revenues bonds that may be sold by local agencies for the purpose of financing multifamily rental projects. The total amount of annual bond sales under this program is summarized in Table II-12.

Table II-12

AB 665 Program Annual Bond Sales
1982 Through 1984
(dollars in millions)

	1982	1983	1984[a]
Total bond sales	$158.2	$635.3	$521.6
Total number of issues	14	40	50

a. Indicates activity as of November 1984.

Under Section 52098 of the Health and Safety Code, each city and county that issues bonds under the AB 665 program is directed to submit an annual performance report to the Governor, the Legislature, and the Department of Housing and Community Development. This report must include the (1) the total face value of bonds issued, (2) the total number of units financed under the program, and (3) the total number of units set aside for lower-income households.

The information required by this statute is not being submitted by local agencies. Consequently, our report does not include either a description or analysis of activity under this program.

The remainder of this chapter is devoted to a review of statistical information on the multifamily rental housing programs administered by the California Housing Finance Agency.

GEOGRAPHICAL DISTRIBUTION OF UNITS

Table II-13 shows the location--by county--of the multifamily rental housing units developed between 1976 and 1984 using CHFA financing. As indicated in the table, 11,335 units have been produced in 28 counties.

These 28 counties included approximately 90 percent of the state's total population as of January 1984. As is true of CHFA-assisted single-family units, over half of all multifamily rental units assisted by the agency are located in just four counties: Alameda, Los Angeles, Riverside, and San Diego.

Table II-13

CHFA Multifamily Rental Housing Programs
Total Units Developed
1979 Through 1984

County	Multifamily Units	Percent
Alameda	1,092	9.2%
Butte	196	1.7
Contra Costa	294	2.6
El Dorado	67	.6
Fresno	440	3.9
Humboldt	127	1.1
Kern	140	1.2
Los Angeles	2,800	24.7
Madera	122	1.1
Merced	147	1.3
Monterey	64	.6
Napa	125	1.1
Orange	349	3.1
Riverside	928	8.2
Sacramento	767	6.8
San Bernardino	562	5.0
San Diego	1,386	12.2
San Francisco	560	4.9
San Joaquin	75	.7
San Mateo	99	.9
Santa Clara	308	2.7
Santa Cruz	77	.7
Siskiyou	48	.4
Solano	141	1.2
Sonoma	94	.8
Stanislaus	150	1.3
Yolo	139	1.2
Yuba	88	.8
Totals	11,335	100.0%

INCOMES OF TENANTS

In its 1983-84 annual report, CHFA provided information on the reported 1983-84 income of tenants residing in multifamily rental housing developments financed by the agency. This data is reproduced in Table II-14.

Table II-14

CHFA Multifamily Rental Housing Program
Incomes of Tenants
1983-84

Annual Income Level	Number of Households	Percent of Total
Under $7,500	5,708	68.8%
$7,501 to $10,000	1,124	13.6
$10,001 to $12,500	843	10.2
$12,501 to $15,000	321	3.9
$15,001 to $20,000	239	2.9
Over $20,000	52	0.6
Totals	8,287	100.0%

By comparing these reported incomes with related median income figures, we can estimate the relative income status of these CHFA tenants. Since the median income for those counties having the most participants was at least $25,000, any tenant having an annual income of up to 50 percent of that amount (that is under $12,500) would be considered very low-income. As Table II-14 shows, 93 percent of CHFA's assisted tenants fall into this category.

RENTAL PAYMENTS

Table II-15, which also is taken from CHFA's annual report for 1983-84, shows the total monthly rent charged on CHFA-financed multifamily units. The table indicates that during 1983-84, the monthly rent for 61 percent of the CHFA units ranged between $500 and $700. These rent levels are regulated by CHFA using HUD-determined estimates of "Fair Market Rents" for the various regions in the state. HUD adjusts its estimates annually to reflect area market trends.

Table II-15

CHFA Multifamily Rental Housing Program
Monthly Rent Amounts
1983-84

	Amount	Percent of Total
Less than $400	419	5.1%
$401 to $500	1,430	17.2
$501 to $600	3,129	37.8
$601 to $700	1,937	23.4
$701 to $800	783	9.4
$801 to $900	268	3.2
Over $900	321	3.9
Totals	8,287	100.0%

The 1983-84 CHFA annual report also includes information on monthly contributions toward rent made by tenants in CHFA-financed rental housing units. This data is reproduced in Table II-16. This table indicates that seven out of every ten households in CHFA-financed rental units report making a monthly rental contribution of $150 or less; the balance of the rent is paid by HUD under the federal "Section 8" rent subsidy program.

Table II-16

CHFA Multifamily Rental Housing Program
Tenant Monthly Rent Contribution
1983-84

	Number	Percent
Less than $50	249	3.5%
$51 to $100	1,985	24.0
$101 to $150	3,595	43.4
$151 to $200	991	12.0
$201 to $250	758	9.1
$251 to $300	334	4.0
Over $300	330	4.0
Totals	8,287	100.0%

HOUSEHOLD SIZE

Information on the size of households occupying CHFA-financed multifamily rental housing is presented in Table II-17. The table shows that of the 8,287 occupied units, almost three out of five are one-bedroom units (studios or one-bedroom). Tenants of these one-bedroom units constitute approximately one-third of all the tenants residing in CHFA-financed units. The CHFA staff reports that 47 percent of their units are occupied by elderly persons who reside alone.

Table II-17

CHFA Multifamily Rental Housing Program
Unit Types and Household Size
1976 Through 1984

Unit Type	Units: Number	Units: Percentage of Total	Tenant Population: Number Occupying Units	Tenant Population: Percentage Of Total Population	Average Occupancy Ratio Per Unit
Studio	84	1.0%	84	0.5%	1.0
One bedroom	4,885	57.6	5,518	33.9	1.1
Two bedroom	2,185	25.7	5,282	32.4	2.4
Three bedroom	1,172	13.8	4,513	27.7	3.8
Four bedroom	160	1.9	877	5.4	5.5
Five bedroom	1	--	8	--	8.0
Totals	8,487[a]	100.0%	16,282	100.0%	1.9

a. Includes 200 additional units completed by CHFA between July and November 1984.

OWNERSHIP OF UNITS

Under current CHFA regulations, agency-financed multifamily projects may be owned and operated by a (1) local nonprofit group, (2) local public housing authority, or (3) private developer. In its 1983-84 annual report, CHFA presented summary data on the ownership of its multifamily projects. We have reproduced this information in Table II-18. The table shows that four out of every five units financed through the CHFA's multifamily rental housing programs are under private ownership.

Table II-18

CHFA Mutifamily Rental Housing Program
Projects by Type of Ownership[a]
1976 Through 1984

Ownership Type	Total Units	Percent of Total Units
Private	10,086	82.7%
Nonprofit group	1,557	12.8
Public housing authority	555	4.5
Totals	12,198	100.0%

a. Includes units occupied, under construction and committed.

CHAPTER III

FISCAL AND POLICY ISSUES

In this chapter, we examine the major fiscal and policy issues related to the issuance of tax-exempt bonds to finance the purchase and construction of housing. Specifically, we discuss:

- The <u>objectives</u> of mortgage revenue bond (MRB) programs and the extent to which these objectives have been achieved;
- The <u>fiscal impact</u> of MRB programs on the state;
- The <u>efficiency</u> of MRB's as a means of subsidizing housing and
- The degree of <u>control</u> the Legislature has over the state's MRB programs.

OBJECTIVES OF THE MRB PROGRAMS

The state and federal tax exemption for interest earned on MRBs allows state and local governments to raise funds for housing at below-market costs and use these funds to lower the housing costs of program participants. The state and local governments issue MRBs in order to raise funds for housing and thereby achieve two discrete objectives:

- To assist low- and moderate-income persons in obtaining affordable housing, and
- To increase the supply of housing by increasing the amount of capital available to support the construction and purchase of housing.

The success of the MRB programs in achieving these objectives is examined below.

Housing Assistance

In Chapter II, we described the requirements that households must satisfy in order to participate in programs financed through MRBs. We also provided information on the incomes of borrowers and renters assisted under MRB programs.

At the local level, MRB participants in single-family programs must have incomes that are less than 150 percent of the area median income. Because we received data on borrower income from only a handful of local agencies, it is impossible for us to evaluate the distribution, by income group, of the housing subsidies provided by MRB's, statewide. If, however, the seven local agencies that did provide information to us are representative of those agencies with MRB-financed programs, we can venture observations about the type of household that is being assisted. Based on the median income figures used by these seven agencies, it would seem that the vast majority of assistance is going to moderate-income households--those with incomes that are between 80 and 120 percent of the area median. If instead, however, HUD median income figures for these counties are used, nearly one-half of the assistance provided under these programs is going to individuals with incomes above the moderate-income level. (In neither cases has the data been adjusted to compare participants' incomes with households of comparable sizes.)

At the state level, CHFA has imposed income limits for its single-family programs ranging from 120 to 150 percent of median income, depending on family size. In Table II-5, we summarized the distribution--by income groups--of CHFA participants in six counties, comparing the income of these borrowers with comparably sized households. The data indicates that only 20 to 45 percent of the participants are found to be moderate-income households, and 55 to 80 percent are found to be households with incomes in excess of that amount.

In general, we conclude from the data available to us that the single-family MRB programs in California are providing assistance to households with incomes of between 80 and 150 percent of the local median income. An important reason why assistance has not been better targeted to lower-income persons is that tax-exempt interest rates have been so high in recent years that the MRB financing mechanism has not been able to reach these persons. Even with the subsidy resulting from the use of the tax-exempt borrowing privilege, monthly mortgage payments on assisted units have been too high for many households in this income category.

In the case of CHFA multifamily units, the vast majority of participants (approximately 80 percent) are in the very-low income category (incomes below 50 percent of area median). These units were within the reach of very-low income households because they also benefitted from the very large subsidies provided under the federal "Section 8" program, which provides assistance solely to low-income persons (incomes below 80 percent of area median).

Housing Supply

The issuance of tax-exempt MRBs can increase the supply of funds available in the mortgage market by redirecting capital from nonhousing purposes (that is, government and business capital spending) to housing. Any such increase in the amount of mortgage funds that is not offset by reductions in the supply of funds from other sources lowers mortgage interest rates, leading to greater housing production.

The actual increase in the housing stock resulting from the issuance of MRB's, however, is less than the dollar value of the MRBs issued. This is because part of the proceeds from these bonds simply replaces a portion of the financing that otherwise would have been available to mortgage purchasers. This "substitution" effect has been well-documented by empirical research conducted to date.

There have been various attempts by economists to estimate the impact of MRBs on the supply of mortgage funds. While no one can say with certainty exactly what this impact is, some studies indicate that the net addition to the housing stock is equal to approximately 20 percent of the amount raised by the issuance of MRBs.[1] If this is true, for every $1 billion in MRBs issued, there would be an increase in the housing stock of approximately $200 million.

Even this effect, however, may overstate the ultimate effect of MRB's on housing. For example, several studies contend that the long-run impact of MRB financing on housing production is even less than 20 percent.[2] If these studies are correct, then the primary effect of MRB financing mechanism is simply to change the timing of some housing production by shifting future production to the present, resulting in a minor impact on the total level of the housing stock.

1. George Peterson, Tax Exempt Financing of Housing Investment, Urban Institute, 1979, p.83; and George Kaufman, ed., Efficiency in the Municipal Bond Market, 1981, pp. 56 and 110.
2. Peterson, pp. 83 and 190 (footnote #12).

FISCAL CONSEQUENCES

The issuance of MRBs can affect state finances in three different ways:

- It can reduce income tax revenue,
- It can increase the state's cost of borrowing under other programs, and
- It can change the level of economic activity within the state.

State Revenue Loss

The "cost" of the MRB program to the state is the total amount of income tax revenue foregone due to the issuance of these tax-exempt bonds. The magnitude of the loss depends on such factors as: (1) the marginal tax rates of investors, (2) the interest which would have been earned on taxable alternatives, (3) the extent to which MRB investors would have invested their funds in other nontaxable activities, and (4) the proportion of bonds purchased by individuals living outside California.

It is difficult to estimate the magnitude of the revenue loss to the state. However, several estimates of the federal revenue loss from MRBs have been made. For instance, the Congressional Budget Office (CBO) has estimated that the net annual federal income tax loss is about $22.5 million for every $1 billion in MRBs issued.[3] This estimate is consistent with the results of several other studies.[4]

---

3. CBO, Tax-Exempt Bonds for Single-Family Housing, April 1979, p. 49. Note: The CBO estimate is a net annual revenue loss. The revenue loss due to the interest exemption is partially offset by revenue increases due to reductions in mortgage interest deductions.
4. Kaufman, pp. 30 and 110.

It is possible to identify the general magnitude of the state revenue loss, using the CBO estimate referenced above. Since state marginal tax rates are approximately one-fifth of federal rates, the state income tax loss is about $4-5 million for each $1 billion in MRBs sold. Given that over $9 billion in MRBs currently are outstanding, the annual state revenue loss from the issuance of these bonds probably is in the $35-$45 million range. Since some portion of these bonds is purchased by persons living outside of California, however, the revenue loss estimate has an upward bias.

Increased Interest Costs to State and Local Governments

The use of MRBs increases the public sector's demand for financial capital, and this in turn increases the interest rates that must be paid by state and local governments on their non-MRB debt issues. Thus, the issuance of MRBs by CHFA and local agencies imposes indirect costs on all other governmental entities issuing general purpose tax-exempt bonds.

There is considerable uncertainty as to the extent of these costs. Some studies suggest that for each $1 billion in MRBs issued, the interest rate on all other tax-exempt debt rises between 4 and 9 basis point.[5] (A basis point is one-hundredth of a percent. Thus, a 4 basis point increase would raise an interest rate from, say, 10 percent to 10.04 percent.)

Thus, if the increase in the interest rate on non-MRB debt amounted to 5 basis points, the additional annual interest cost for each $1 billion in new, non-MRB tax-exempt bonds issued would be $500,000 for each $1

5. Peterson, p. 115, and Kaufman, p. 64.

billion in new MRBs sold. Consequently, if California state and local governments were to issue $2 billion in non-MRB bonds and $1 billion in MRBs, the added interest costs would be $1.0 million annually over the life of the non-MRB bonds.

Impact on Net Economic Activity

It is often claimed that tax-exempt bonds "pay for themselves" by increasing economic activity within the state, which--in turn--generates additional tax revenues for the state that more than offset the revenue loss noted above.

This argument, however, is based on the premise that the use of MRBs actually increases the total amount of financial capital available in the state. For the most part, however, the issuance of MRBs simply reallocates already-available investment funds, by shifting capital from the business sector and the nonhousing public sector to MRBs. The issuance of these bonds would increase the level of available resources in California only if the purchases of California MRBs by out-of-state investors exceeded the purchase of out-of-state MRBs by Californians. We know of no conclusive evidence indicating that the use of MRBs results in greater investment in the state and, consequently, greater tax revenue than the state would experience otherwise.

OTHER ISSUES

There are two other policy issues related to the issuance of MRBs that warrant mention. Specifically, they are:

- The efficiency of the MRB subsidy mechanism, and
- The Legislature's control over MRB programs.

Efficiency of the MRB Subsidy Mechanism

One of the main arguments that economists have raised against MRBs is that the issuance of tax-exempt bonds is an inefficient (that is, not the least costly) method of subsidizing renters and homeowners. The basis for this criticism is that a significant portion of the revenues foregone by government go to bond investors rather than to the intended recipients of the subsidy--housing beneficiaries. This problem was discussed in detail in our 1982 report, The Use of Tax-Exempt Bonds in California, #82-20 (see especially pages 276-80).

Given the inefficiency associated with the tax-exempt borrowing mechanism, the Legislature may wish to consider alternative methods for subsidizing housing. Two such alternatives are: (1) the taxable bond option (see page 282 of our 1982 bond report), and (2) mortgage credit certificates (MCCs), which provide federal tax credits directly to participating individuals. The recently enacted federal Deficit Reduction Act of 1984 authorizes state and local governments to replace their MRB issuing authority with MCCs.

Legislative Control Over the MRB Subsidy

The use of MRBs also raises concerns as to the Legislature's ability to control and target housing subsidies. The state "costs" associated with MRB programs are often referred to "tax expenditures," because the tax system is used as the mechanism to confer the subsidy (in contrast to direct subsidies provided through the annual budget). There are two main problems with the use tax expenditures: (1) they are open-ended subsidies, in that the state automatically pays all persons who choose to participate (in the case of programs funded through the budget, expenditures generally are limited to the amount appropriated by the Legislature), and (2) they are not subject to annual program review by the Legislature (as are direct spending programs). (The MRB subsidy has not encountered the first of these problems in recent years as federal and state sales price and income limits have in a sense "capped" the revenue loss).

Legislative control over MRB programs is also constrained because the subsidy does not go directly to intended beneficiaries (renters and homeowners). Because the state subsidy is provided first to local governments, which then pass on the subsidy to individuals, the state must depend on local entities to establish MRB programs. Because participation by localities varies widely and most local agencies have not issued these bonds, MRB programs do not provide a broad-based subsidy that is equally available to eligible persons, regardless of where they live.

Finally, the Legislature cannot control the extent--or even the availability--of the subsidy, due to circumstances beyond its reach. For example, the amount for the subsidy is dependent on the spread between taxable and tax-exempt rates, which are determined by such factors as federal marginal tax rates and nationwide sales of municipal bonds. Furthermore, during times of high interest rates, the subsidy may not lower the cost of housing sufficiently to reach low- and moderate-income households. This was the case in 1980-82, when CHFA did not issue any single-family bonds because of high interest rates.

CONCLUSION

Our review of the fiscal and policy issues relating to the use of MRBs indicates that this housing subsidy mechanism is deficient in a number of ways.

Accordingly, we encourage the Legislature to examine alternative methods of achieving its housing goals. In addition to the options presented above (taxable bonds and mortgage credit certificates), the Legislature could, for instance, rely more on direct spending programs (such as those in the Department of Housing and Community Development) or modify the existing state income tax treatment of housing. As the state's allowance of mortgage interest deductions provides proportionately greater subsidies to higher-income taxpayers, this housing "program" works contrary to a stated objective of the MRB program.

If, however, the Legislature does <u>not</u> want to eliminate or de-emphasize the use of the state tax exemption, there are other steps it can take to ensure that MRB program subsidies are directed to the desired beneficiaries. For instance, if the Legislature were concerned about the preponderance of MRB benefits accruing to moderate-income (or greater) households or to small (one- and two-member) households, it could impose statutory constraints on MRB borrowers.