Tax-Exempt Mortgage Revenue Bonds: Another Case of "Opiate Economics"?

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Controversy surrounds the use of mortgage revenue bonds. Critics say “the government is trying to cure the harmful results of its overborrowing by engaging in more of the same, a classic case of opiate economics.” Proponents, on the other hand, view the bonds as a beneficial device in urban development. Mortgage bonds have been used to finance multi-family rental housing for a number of years; but bonds for financing single-family homes have only recently appeared on the market. These issues have experienced an explosive growth.

Today's double-digit inflation set the stage for the rapid growth in mortgage revenue bonds. The federal government’s tight monetary policy seriously affected the supply of mortgage capital at a


2. See, e.g., Remarks of Rep. Andrew Jacobs, Jr. of Indiana (printed in H.R. Rep. No. 96-678, 96th Cong., 1st Sess. 93 (1979)). “With the tax-free mortgage bond program the government is trying to cure the harmful results of its overborrowing by engaging in more of the same, a classic case of opiate economics.”

3. See, e.g., Remarks of Rep. Frank Annunzio of Illinois (printed in Seib, New Municipal Bonds Provide Home Buyers with Cut-Rate Loans, Wall St. J., Feb. 26, 1979, at 1, col. 1). “Although only a small step toward arresting the decline of America’s cities, the Chicago plan is an important one. It shows that, by shedding antagonism and working together, local businesses and government can bring our cities back to life—without the aid or supervision of the Washington bureaucracy.”


The issuance of tax-exempt housing bonds has grown tremendously during the past year. In 1978 State and local governments issued $3.3 billion of mortgage subsidy and industrial development bonds for owner-occupied residential units. This represented 7.1 percent of the total tax-exempt long-term financing for all purposes by State and local governments.

In the first four months of 1979 State and local governments already have issued more housing bonds than were issued during the entire previous year, 1978. This enormous volume of housing bonds represents 27 percent of the total State and local government issues during this 4-month period. In addition, as of April 25, 1979, their appears to be $3 to $5 billion of proposed housing bonds at various stages of development.
time when the demand for housing was strong. The rising interest rates on conventional mortgages priced many families out of the new home market. Investment banking firms saw mortgage bond financing as a solution to the lack of mortgage capital.

The popularity of mortgage revenue bonds stems from several factors. Mortgage revenue bonds are tax-exempt; the tax benefits attracted many investors. The methods used in financing housing issues place few risks on the issuers. State and local governments thus were willing to float bonds in epidemic proportions. Moreover, marketing the bonds allowed local governments to raise additional capital without burdening local taxpayers.

The purpose of this article is to discuss the controversy surrounding the use of mortgage revenue bonds. The discussion will begin with the mechanics of mortgage bond financing. It will then explain how federal and state law enables state and local governments to finance single-family homes. The rapid growth of mortgage revenue bonds will be surveyed along with a comparison of their relative benefits and failings. Finally, policy justifications will be advanced in favor of restricting the unlimited use of mortgage revenue bonds.

**THE MECHANICS OF MORTGAGE REVENUE BOND FINANCING**

In the typical mortgage revenue bond program, a state housing finance agency (HFA) or local governmental unit issues the bonds for the "public purpose" of providing low-interest loans to eligible buyers.\(^5\) Because the federal government does not tax the interest on such bonds,\(^6\) the state HFA or local governmental unit is able to sell the bonds at a lower interest rate. This in turn enables the lending institution to make home loans at a lower rate.\(^8\) Finally,

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5. See notes 46-63 and accompanying text, infra.
6. An HFA or municipality needs specific statutory authorization to issue mortgage revenue bonds. In setting up a housing finance agency the legislature will typically recite the public purpose for which it is being created. E.g., Va. Code § 36-55.25 (1976): "It is hereby further declared to be necessary and in the public interest that such state housing development authority provide . . . mortgage financing . . . for residential housing for persons and families of low and moderate income in this Commonwealth. . .". See also, S.C. Code § 31-3-30 (1976).
7. See I.R.C. §103; notes 16-42 and accompanying text, infra.
8. See Smith, *Tax-Free Housing Bonds Cost More Than They Are Worth*, Fortune, July 2, 1979, at 86. The author reported that beneficiaries of these programs saved around 20% in interest charges. For example, instead of paying $457 a month interest on a 30-year $50,000 mortgage, the participant might pay only $371. See also Chicago Tribune, July 27, 1978, at 3, col. 4; Chicago Tribune, August 1, 1978, §1 at 3, col. 1. For example, in its pioneering mortgage bond program, Chicago sold its bonds at 6.9%. The lender was then able
the issuer uses the borrower's monthly mortgage payments to pay back the bondholders.9

State HFA's and local governments use program structures that are quite similar, although a state's legislature may restrict the kinds of housing the state program can finance.10 Several different types of procedures are currently employed to direct the bond proceeds into the hands of individual borrowers.

Loans to Lenders. In a "loans to lenders" type program, the issuer lends the bond proceeds directly to a qualified lending institution.11 The lender then makes new mortgage loans to eligible borrowers. After the issuer has decided the eligibility requirements of the program (such as income ceilings, geographical target areas, or purchase price limits), it does not take an active role in the administration of the program. The lending institution takes over the servicing of the mortgages.

Forward Commitment Mortgage Purchase. Under the mortgage purchase program,12 the bond proceeds are used either to purchase mortgages from the lending institution's own portfolio or to create new mortgages. Typically, the issuer will make advance commit-

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9. See statutes listed in note 93, infra.
10. See notes 65-66, infra.
    Fund; loans to mortgage lenders; conditions. The fund may make, and undertake commitments to make, loans to mortgage lenders under terms and conditions requiring the proceeds thereof to be used by such mortgage lenders to make mortgage loans for residential housing for low or moderate income persons. Mortgage commitments or actual mortgages shall be originated through and serviced by any bank, trust company, savings and loan association, mortgage banker, or other financial institutions authorized to transact business in this state.
12. The Minn. Hous. Fin. Agency (MHFA) developed this procedure whereby the agency agrees in advance to purchase below-market mortgages from participating lenders. The lender applies for the total dollar amount of commitment desired and thereafter purchases a commitment from the MHFA. The lender then has 6 to 12 months to originate the loans. See, e.g., Neb. Rev. Stat. § 76-1623 (Cum. Supp. 1978):
    The fund may invest in, purchase or make commitments to invest in or purchase . . . mortgage loans made for the construction, rehabilitation or purchase of residential housing for low or moderate income persons. Prior to such . . . commitment, the mortgage lender shall certify that the proceeds therefrom or its equivalent will be reinvested in mortgages or used to make mortgage loans to provide residential housing for low or moderate income persons. . . .
ments with the lender to purchase eligible mortgages that the lender originated. The lender can then make below-market mortgages to persons meeting the issuer's criteria. After the bonds are sold and the mortgages closed, the issuer purchases the mortgages at a discount and usually allows the lender to continue servicing the loans for a fee.

**Direct Loans to Housing Developers.** A major facet of any state HFA is its program to make loans to developers of low- and moderate-income housing. The issuer uses the bond proceeds to provide money to the developer at below-market interest rates. The borrower in turn is usually subject to restrictions regarding the income eligibility of those buying the units or the rates charged for renting the units.

The successful marketing of housing issues depends on a number of factors. First, a mortgage pool that includes substantial high- and middle-income purchasers who are able to pay excessive down payments is preferable. Second, the level of collateralization, or the extent to which the bonds are secured by mortgages and reserves, contributes to a favorable bond rating. Third, the treatment of mortgage prepayments plays a decisive factor in the bond rating.

With a more favorable bond rating, the city markets its bonds at a lower interest rate. This in turn determines the ultimate rate that the borrower pays.

**Federal Law**

Section 103 of the Internal Revenue Code

Mortgage revenue bonds are in essence a federal subsidy of local housing programs. The tax-exempt interest on mortgage revenue bonds provides income to high-bracket taxpayers that normally


The agency shall be empowered to make or participate in the making of insured mortgage loans to qualified sponsors, developers or builders of residential housing for lower and moderate income persons and families and to lower and moderate income persons who are purchasers of residential housing. Provided, however, no insured mortgage loans available under the provisions of this section shall be made for nonowner-occupied residential housing.

Alaska Stat. § 18.56.090(1) (1974). This type of program can often be combined with the Section 8 federal assistance program for an additional capital subsidy.


15. In Chicago's first offering, $14 million was placed in a reserve fund to be later invested in United States securities earning arbitrage. *Chicago's mortgage plan may cost less than expected*, Chicago Tribune, July 26, 1978, § 4 at 3, col. 2.

would be taxed. It is estimated that for every $1 billion of outstanding bonds, the Treasury loses $22.5 million in lost revenue.  

Government bonds provide a tax-haven for high-income taxpayers because section 103 of the Internal Revenue Code excludes from gross income interest on governmental obligations. The general exemption found in section 103(a) provides that interest on

17. Tax-Exempt Bonds for Single-Family Housing (A study prepared by the Congressional Budget Office for the Subcommittee on the City of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 96th Cong., 1st Sess.) at 47 (April 1979). (Hereinafter referred to as Congressional Budget Office Study.)

18. See note 135, infra.


20. The exemption originated in the concept of intergovernmental immunity, see McCulloch v. Maryland, 17 U.S. 316 (4 Wheat. 316) (1819); Ratchford, Intergovernmental Tax Immunities in the United States, 7 Nat'l Tax J. 305 (1953); Comment, Tax-Exempt State and Local Bonds: Form of Intergovernmental Immunity and Form of Intergovernmental Obligation, 21 DePaul L. Rev. 757 (1972); Comment, Intergovernmental Tax Immunities: An Analysis and Suggested Approach to the Doctrine and its Application to State and Municipal Bond Interest, 15 Vill. L. Rev. 414 (1970); and the notion that Congress may not impair a state's essential role in a federal system of government. The tax-exempt status of municipal bonds originated in the early Supreme Court decision of Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895), where the court specifically declared that a tax on municipal interest was unconstitutional. The constitutional basis of this decision, however, was weakened by the ratification of the Sixteenth Amendment in 1913.

Over the decades, the Supreme Court has narrowed this concept, especially in relation to intergovernmental taxation. In Helvering v. Gerhardt, 304 U.S. 405 (1938), the court found the salaries of state employees were not exempt from federal taxation. The court reasoned that any constitutional immunity must be essential to the preservation of the state government's continued existence. This view was upheld in Graves v. New York ex rel. O'Keefe, 306 U.S. 466 (1939).

The ability of state's to borrow money could be critically impaired if the exemption did not exist. In New York v. United States, 326 U.S. 572 (1946), the court stated that the federal government may not tax state income if "it interferes unduly with the state's performance of its sovereign functions of government". Id. at 587 (concurring opinion). The most recent Supreme Court decision on intergovernmental immunity also supports this contention. National League of Cities v. Usery, 426 U.S. 833 (1976) found that the federal government may not interfere with the "integral governmental functions" of the state. The
"the obligation of a state . . . or any political subdivision" is not included in gross income. The term "obligation" is given a very narrow construction but does include obligations that are created by the exercise of the "state's borrowing power". Bonds are obligations specifically issued by a governmental unit to raise additional funds and therefore involve the exercise of the state's borrowing power. Treasury regulations interpreting section 103(a) provide that the obligation must be issued by or on behalf of the governmental issuer. This restriction indicates that only bonds issued "in the performance of an essential governmental function will be exempt." Subsection 103(b) excludes industrial development bonds from the general interest exemption. Prior to 1968, industrial develop-
Mortgage Revenue Bonds permitted a tax loophole.\textsuperscript{27} Local governments floated these bonds to encourage industry, using the proceeds to construct industrial plants. The issuer leased the completed project to a private business and the rental income then covered the interest due on the bonds.\textsuperscript{28} Due to the widespread abuse of these issues and the resulting loss of revenue to the Treasury,\textsuperscript{29} in 1968 Congress limited the extent to which tax-exempt securities could subsidize industrial development.\textsuperscript{30}

The section 103(b) general denial of tax-exempt status for industrial development bonds is compromised by numerous exceptions.\textsuperscript{31} Bond issues for certain industrial development activities retain the favored tax-exempt status.\textsuperscript{32} One exception is that for

money, used or to be used in a trade or business.

\textsuperscript{27} See Spiegel, Financing Private Ventures with Tax-Exempt Bonds: A Developing "Truckhole" in the Tax Law, 17 Stan. L. Rev. 224 (1965). Through section 103 and several revenue rulings issued during the 1950's and 60's, tax-exempt bonds issued by private "non-profit" corporations flourished thereby subsidizing private industrial development.


\textsuperscript{32} The exceptions include bonds used to finance facilities for sports (§103(b)(4)(B)); conventions or trade shows (§103(b)(4)(C)); specific transportation projects (§103(b)(4)(D)); sewage or solid waste disposal (§103(b)(4)(E)); air or water pollution (§103(b)(4)(F)); and water utility (§103(b)(4)(G)). See generally Arthur & Richardson, Financing of Pollution Control Facilities Through Tax-Exempt Bonds, 58 Chi. Bar Rec. 248 (1977); Early, Financing Pollution Control Facilities Through Industrial Development Bonds, 27 Tax Law. 85 (1973); Kutak & Wagner, Clearing the Air on Tax-Exempt Pollution Control Facility Financing, 8 Creighton L. Rev. 567 (1975); Note, Taxation: Public Purpose and Tax-Exempt Industrial Development Revenue Bonds to Finance Pollution Abatement Facilities, 29 Okla. L. Rev. 233 (1976).
residential real property, section 103(b)(4)(A).33

Under section 103(b)(4), an issuer may float tax-exempt industrial development bonds only if “substantially all” of the proceeds are used for the exempt facility. The regulations state that the “substantially all” test is met if 90% of the proceeds are used for that purpose.34 Two rules apply to this test: (1) proceeds are reduced on a pro rata basis between those for the exempt facility and those for other uses; and (2) amounts for the exempt facility include amounts that could be capitalized, such as taxes and interest.35 The regulations deny an exemption where more than 10% of the bond proceeds provide working capital for the development of the project.36

The Internal Revenue Service recently ruled that no more than 10% of an issue could finance existing debt on the rehabilitation of a multifamily housing project.37 In the ruling, a state had planned to use $750,000 from the sale of municipal bonds to rehabilitate a 50-unit building. In order for the rehabilitation loan to be the first mortgage, $250,000 of the proceeds would be needed to refinance the existing mortgage. The ruling rejected this proposal finding that the use of proceeds in this manner constituted working capital. As working capital is not connected with providing housing, the “substantially all” test had not been met, i.e. a third of the proceeds were to be used to refinance debt. The ruling has serious implications for other state-financed rehabilitation projects, since many issuers require they be first lienors on the project.38

The interest exemption for mortgage subsidy bonds can be found either under the general exemption contained in 103(a) or the industrial development bond exception under section 103(b)(4)(A). The applicable exemption generally depends on the type of procedure used to direct the bond proceeds to the borrowers. Bond proceeds used in the “loans to lenders” procedure39 fall under the industrial development bond exception since the funds

39. See note 11, supra, and accompanying text.
are used in the “trade or business” of the lending institution.40
Under direct loan or mortgage purchase programs,41 the bond proceeds are not used in the trade or business of a private party but by a governmental unit in either the distribution of loans or the purchase of mortgages. The bonds, therefore, are not of the industrial development type but fall under the general exemption found in section 103(a).42

STATE LAW

Before a mortgage subsidy bond program can be initiated, the issuer must examine the applicable state law. State financing of tax-exempt housing is typically done through the establishment of housing finance agencies (HFA).43 Municipal and county governments can issue housing bonds only if there is statutory authorization.44 The statutes range from specific enabling legislation to home rule provisions. Many state constitutional provisions, such as the public purpose doctrine and debt limitations, challenge the legality of housing finance programs. Nevertheless, the overwhelming majority of jurisdictions that have reviewed housing finance legislation have found them constitutionally valid.45

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Derived from Congressional Budget Office Study supra note 17, at 39, Table 7.

41. See notes 12-13, supra, and accompanying text.
43. See notes 91-97, infra, and accompanying text.
44. STATES WITH ACTIVE LOCAL SINGLE-FAMILY BOND FINANCING: BOND ISSUERS AND LEGAL AUTHORITIES

Public Purpose Doctrine

The public purpose doctrine requires that funds collected on behalf of a governmental unit be used for the benefit of the public.\(^4^6\) Often the legislature determines what constitutes a "public purpose" and courts almost uniformly defer to its opinion.\(^4^7\)


46. See Iowa Const. art. III, § 31: "(N)o public money or property shall be appropriated for local, or private purposes, unless such appropriation, compensation, or claim, be allowed by two-thirds of the members elected to each branch of the General Assembly."

47. See, e.g., Utah Hous. Fin. Agency v. Smart, 561 P.2d 1052, 1053 (Utah 1977); State ex rel. Warren v. Nusbaum, 59 Wis.2d 391, 208 N.W.2d 780, 785 (1973); Walker v. Alaska State Mortgage Ass’n, 416 P.2d 245, 251 (Alaska 1966) ("... the legislature’s findings are controlling in the absence of a controversy questioning their validity."); Massachusetts Hous. Fin. Agency v. New England Merchants Nat’l Bank, 249 N.E.2d 599, 606 (Mass. 1969) ("It is not for this court to consider whether these contentions are sound as a matter of economics and public policy."); New York City Hous. Auth. v. Muller, 1 N.E.2d 153, 154 (N.Y. 1936) ("It is true that the legislative findings and the determination of public use are not conclusive on the courts. . . . But they are entitled at least to great respect. . . ."); Martin v. North Carolina Hous. Corp., 175 S.E.2d 665, 671 (N.C. 1970) ("... questions as to public policy are for legislative determination."); Vermont Home Mortgage Credit Agency v. Montpelier Nat’l Bank, 262 A.2d 445, 448 (Vt. 1970) ("As for the purpose of the act and the legislative intent, we must take the lawmakers at their word, as stated in the statute.").

48. See New Jersey Mortgage Fin. Agency v. McCrane, 56 N.J. 414, 267 A.2d 24, 27 (1970); In ABA Advisory Commission on Housing and Urban Growth, Housing For All Under Law 485-486 (ed. R. Fishman 1978), the commission notes that public purpose is an expanding concept but that the courts have evolved three principles to determine this issue: (1) benefit to the community as a whole, (2) direct relation to the functions of government, and (3) primary objective not the promotion of private ends (though private interest may derive an incidental benefit from the activity).
public purpose.\textsuperscript{49} Gradually court decisions expanded this concept into the notion of providing housing to those who cannot afford it on the private market.\textsuperscript{50} Today, it is unquestionably within the police power of the legislature to deal with the shortage of decent housing.\textsuperscript{51}

Typically, the legislature, in establishing an HFA, determines that there exists a "scarcity of safe and sanitary housing".\textsuperscript{52} This housing shortage contributes to "blighted slum areas" which constitute a menace to the health, safety, morals and welfare of the citizenry.\textsuperscript{53} The legislative findings conclude that the "operation of

\textsuperscript{49} Early court decisions tied the public purpose of providing housing to the elimination of slums. The Massachusetts Supreme Court affirmed this notion in Allydon Realty Corp. v. Holyoke Hous. Auth., 304 Mass. 288, 23 N.E.2d 665 (1939):

The requirement that the rents be within the financial reach of families who are in the lowest income group . . . is doubtless intended as an additional guaranty that the provision of low-rent housing will result in the permanent elimination of the slums . . . . The real purpose of the statute is therefore the elimination of slums and unsafe and unsanitary dwellings, and the money expended for low-rent housing is only a means by which the main object is to be accomplished. The statute as a whole is designed to serve a public need, and the money expended for low-rent housing, as well as that expended for slum clearance, is for a public use.


\textsuperscript{52} E.g., UTAH CODE ANN. § 63-44(a)-2 (1978) ("... there continued to exist throughout the state a seriously inadequate supply of safe and sanitary dwelling accommodations . . . .")

\textsuperscript{53} E.g., NEV. REV. STAT. § 319.020(2) (1973) ("This condition is conducive to disease, crime, environmental decline and poverty . . . and is a menace to the health, safety, morals
private enterprise” cannot relieve such conditions.54 As a consequence, the legislature declares it a public purpose for the state to increase the amount of financing for low- and moderate-income housing.55

In examining housing finance legislation, courts have found that a “public purpose” exists even though the act confers benefits upon private individuals.56 Most jurisdictions have found that the increased availability of mortgage funds tends to prevent blight and urban decay.57 Homeowners promote stable rather than transient communities.58 As the byproducts of substandard housing (such as crime and disease) are not confined geographically, the entire state benefits from the mortgage revenue bonds even though only particular communities are the direct beneficiaries.59 Unless
the act primarily benefits private persons and only indirectly affects the public interest, the courts will not interfere with the legislative judgement.60

Even though a public purpose is served by providing housing, the means employed to achieve this end are open to constitutional attack. Opponents typically allege that the revenue bonds adopted by the housing act are not reasonably designed to achieve the "public purpose" of increasing the supply of housing.61 Courts, again, invariably defer to the legislature and find that the issuance of mortgage revenue bonds make funds available at more "economically feasible rates".62 The courts decline to determine whether the legislature employed the best possible means.63

Debt Restrictions

State constitutions often put restrictions on the amount of debt the state can incur.64 Most courts, however, define state debt to include only legally enforceable obligations against the state. As a consequence, states often establish HFAs as independent entities; thus, revenue bonds issued by the HFAs do not create any legally binding debt on the state.65 The "special fund" doctrine66 provides

154 (N.Y. 1936).

60. E.g., Martin v. North Carolina Hous. Corp., 277 N.C. 29, 175 S.E.2d 665, 673 (N.C. 1970) ("A legislative declaration which asserts in general terms that the statute under consideration is enacted for a public purpose, although entitled to great weight is not conclusive. When the facts are determined, what is a public purpose is a question of law for the court."); California Hous. Fin. Agency v. Elliott, 131 Cal. Rptr. 361, 551 P.2d 1193, 1198 (1976); Minnesota Hous. Fin. Agency v. Hatfield, 210 N.W.2d 298, 305 (Minn. 1973).


62. Id. at 280.

63. See Vermont Home Mortgage Credit Agency v. Montpelier Nat'l Bank, 262 A.2d 445, 449 (Vt. 1970) (court found that it was not called upon to pass judgment on whether means adopted by legislature represented sound policy); Cremer v. Peoria Hous. Auth., 399 Ill. 579, 78 N.E.2d 276, 283 (1948) (court could not say as a matter of law that administrative techniques devised for promoting new housing were inappropriate).

64. See, e.g., Colo. Const. art. XI, § 3:

The state shall not contract any debt by loan in any form, except to provide for casual deficiencies of revenue . . . and the amount of debt contracted in any one year to provide for deficiencies of revenue, shall not exceed one-fourth of a mill on each dollar of valuation of taxable property within the state, and the aggregate amount of such debt shall not at any time exceed three-fourths of a mill on each dollar of said valuation, until the valuation shall equal one hundred millions of dollars . . .

65. ALASKA STAT. § 18-56.020 (1974); COLO. REV. STAT. § 29-4-720 (1973); KY. REV. STAT. ANN. § 198A.070 (Baldwin 1977); 35 PA. CONS. STAT. ANN. § 1680.502(a) (Purdon 1977); NEB. REV. STAT. § 76-1630 (1978); NEV. REV. STAT. § 319.380(2) (1973); N.C. GEN. STAT. § 122A-6 (1974); UTAH CODE § 63-44(a)-15 (1978); VA. CODE § 36-55.46 (1976).
another method of bypassing state debt restrictions. When a debt is paid out of special funds (such as mortgage payments) rather than the "general" funds of a state, the debt restrictions do not apply.67

The obligation of a state to repay the bondholders on default may be subject to a moral obligation clause.68 This type of "makeup" provision is frequently added to bond issues to make them more appealing to investors by implying that the state is obligated in the event of default.69 The effect of the clause is somewhat misleading because most courts find that the clause does not create any legal liability on the part of the state.70

Courts addressing housing finance legislation are often faced with the issue whether an HFA's ability to sell bonds involves an unconstitutional pledging of the state's credit to an individual.71 Most jurisdictions have found that borrowing by an HFA does not

66. The origin of the special fund doctrine is attributed to Winston v. City of Spokane, 12 Wash. 524, 41 P. 888 (1896). In Winston, the city repaid a loan that was used to complete a waterworks project out of a "special fund" derived from the waterwork's receipts.

67. See State ex rel. Douglas v. Nebraska Mortgage Fin. Fund, 204 Neb. 445, 283 N.W.2d 12, 23 (1979). See also Commissioner v. Shamberg's Estate, 14 F.2d 998, 1006 (2d Cir. 1944), cert. denied 323 U.S. 792 (1942) (court held municipal bonds tax-exempt even though payment was to be made only out of "special funds" and the credit of the municipalities was not pledged).


In order further to assure such maintenance of the capital reserve fund, there shall be annually apportioned and paid to the agency for deposit in the capital reserve fund such sum, if any, as shall be certified by the chairman of the agency to the governor and director of the budget as necessary to restore the capital reserve fund to an amount equal to the maximum account of principal and interest maturing and becoming due in any succeeding calendar year on the bonds. . . .

70. See, e.g., Maine State Hous. Auth. v. Depositors Trust Co., 278 A.2d 699, 708 (Me. 1971) ("... the Legislature ... intended only to express to its successors an expectation and aspiration that the project might be found worthy of financial assistance, if later needed."); Massachusetts Hous. Fin. Agency v. New England Merchants Nat'l Bank, 249 N.E.2d 599, 609 (Mass. 1969) ("... no purchaser or holder of MHFA's bonds or notes has any basis whatsoever for relying to any extent on any appropriation under [the authorizing statute]. . . .")

71. Iowa Const. art. VII, § 1: "The credit of the State shall not, in any manner, be given or loaned to, or in aid of, any individual, association, or corporation; and the State shall never assume, or become responsible for, the debts or liabilities of any individual, association, or corporation. . . ."
violate the credit provision. If the provision suggests that the maintenance of reserve funds is discretionary, the courts have no difficulty in finding that the state did not make a binding commitment and, therefore, did not pledge its credit. Even when the applicable housing act requires the state to maintain the bond reserve fund, courts have upheld the legislation.

Other Constitutional Limitations

Many state constitutions prohibit the legislature from abdicating its power to any agency. The legislature may, however, delegate a select portion of its authority to an agency if it sufficiently prescribes the standards under which the agency will work. State statutes generally define the powers of an HFA, tightly controlling the types of programs employed and the eligibility requirements of the beneficiaries. Most housing finance acts, therefore, withstand the challenge that the delegation of legislative power is impermissible.

In West v. Tennessee Housing Development Agency, opponents of an HFA argued that the act's vague restrictions allowed the agency to define the criteria for eligibility. The court rejected this argument because the act required the agency to consider a number of factors when determining income eligibility. The act,
therefore, did not give the agency "unbridled authority." The Massachusetts Supreme Court, in a similar case, found that although the act contained no guidelines as to what constituted "low-income", the HFA could employ a "reasonable standard" in defining that term. Most courts rationalize that the necessities of modern government require the legislature to use broad standards when delegating power. Other constitutional attacks vary with each state. Where legislation grants an HFA's property tax-exempt status, challengers contend that the exemption improperly benefits private individuals. Nevertheless, in most jurisdictions, the exemption is upheld as constitutional because the program serves a public purpose. Because Iowa's HFA could forgive mortgage loans, opponents alleged that the statute violated a state constitutional provision prohibiting gifts to private individuals. The court sustained the procedure, finding a public purpose in permitting borrowers to avoid bankruptcy. Additionally unsuccessful challenges have been based on (1) the state privileges and immunities clause, (2) the state due process clause, and (3) a provision prohibiting an inde-

(a) The amount of the total income of such persons and families available for housing needs;
(b) The size of the family;
(c) The cost and condition of housing facilities available . . . ;
(d) The eligibility of such persons and families for federal housing assistance . . . ;
(e) The ability of such persons and families to compete successfully in the normal housing market . . . .

80. 512 S.W.2d 275, 282 (Tenn. 1974).
82. E.g., id. at 607.
86. Id. at 93.
87. See State ex rel. Douglas v. Nebraska Mortgage Fin. Fund, 204 Neb. 445, 283 N.W.2d 12, 25 (1979) (court found the Act permissible since it applies equally to all persons within the class).
88. See Walker v. Alaska State Mortgage Ass'n, 416 P.2d 245 (Alaska 1966). Opponents argued that the act was unconstitutional in that it attempted to create an independent agency which was not in fact within the Department of Commerce. The court rejected this argument finding that the agency was essentially within the Department of Commerce as the legislature stated.
The Growth of Mortgage Revenue Bond Financing

In the past, the federal government has subsidized homeownership through several avenues. These programs were financed through budgetary outlays, tax expenditures and the off-budget outlays of federally-sponsored housing credit agencies. Many persons of moderate income seeking governmental aid in purchasing a home were not eligible for these type of federal programs, however. In addition, priorities in national housing policy may shift without taking into consideration the particular needs of a community. For these reasons, federal programs alone could not solve the nation's housing problems.

With the creation of the first state housing finance agency (HFA) in 1961, state governments began to assume greater responsibility for solving the problems of housing shortages and urban decay. Today nearly every state has some form of housing finance agency. Typically, an HFA is set up as a quasi-indepen-

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89. See John R. Grubb, Inc. v. Iowa Hous. Fin. Auth., 255 N.W.2d 89, 97 (Iowa 1977) (court found that the Act did not deny due process on the theory that it had no rational relationship to the public health, safety and welfare).
90. Hearings on H.R. 3712, supra note 4, at 47.
dent agency of the state for the broad “public purpose” of alleviating the high cost of housing and stimulating construction. By issuing tax-exempt revenue bonds, the HFA is able to obtain funds at interest rates lower than those paid on comparable securities. The agency then uses the funds to aid eligible borrowers in obtaining cheaper mortgages.

Prior to 1978, most state HFA bonds financed multi-family rental housing for persons with low- and middle-incomes. In the early 1970’s, however, HFAs began to issue tax-exempt revenue bonds for middle-class, owner-occupied housing. A Congressional report showed that from 1971-1977, the volume of HFA bonds for single-family housing ranged from $36 million to $959 million annually. In 1978, the volume of bonds for owner-occupied housing climbed to $2.8 billion, or 62% of all bonds floated by HFAs.

Also beginning in mid-1978, numerous local governments issued bonds for owner-occupied housing. Prior to this time the issuance of single-family housing bonds by a city or county was a novel concept. Most localities did not have the existing legislative authority to issue bonds of this kind. After the success of the initial issues, municipal participation in this tax-free market expanded greatly. In 1978, local governments issued $550 million

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95. See, e.g., 35 PA. CONS. STAT. ANN. § 1680.102 (Purdon 1977): “[T]he ‘Pennsylvania Housing Finance Agency’ . . . shall exist and operate for the purposes of alleviating the hardship which results from insufficient production of private homes and of rental housing for persons and families of low and moderate income . . . . such purposes are public purposes for which public money may be spent.” See notes 46-63, supra, and accompanying text.

96. See notes 24-25, supra, and accompanying text.


100. Id.

101. Congressional Budget Office Study, supra note 17, at 25.

102. Id. at 37.


104. See note 44, supra.

105. Chicago Tribune, March 18, 1979, §N14 at 2A, col. 1., reported that by the end of 1978, in addition to Chicago, 22 local governments in 8 states had issued $600 million in
worth of single-family mortgage bonds; in the first quarter of 1979, 
$1 billion in bonds were issued.\textsuperscript{108}

State HFAs, counties, and cities marketed a growing percentage 
of their housing bonds to finance single-family housing. In 1978, 
owner-occupied housing bonds represented 7.4\% of all tax-exempt 
bonds issued for any purpose by state and local governments. After 
the first four months of 1979, this figure had risen to 26.4\%.\textsuperscript{107} The 
borrowing power of state and local governments was increasingly 
used to finance single-family housing for moderate-income 
families.

The great expansion in the use of mortgage revenue bonds is due 
to three factors. First, local politicians have the impression that 
the bonds cost the issuer nothing. For example, a city incurs no 
liability in issuing the bonds because it is only liable on general 
obligation bonds that pledge the full faith and credit of the munic-

pality’s taxing power.\textsuperscript{108} The interest and principal payments of 
the mortgage revenue bonds are not derived from the city’s taxes 
but from the mortgage payments generated by the program it-

self.\textsuperscript{109} The moral obligation clauses attached to some revenue 
bonds imply that the city is liable, but the actual risk of default is

\begin{table}[h]
\centering
\begin{tabular}{l|cccc}
\hline
\hline
Owner-occupied housing & 1.8 & 1.9 & 7.4 & 26.4 \\
Multi-family rental housing & 4.3 & 3.4 & 5.4 & 4.8 \\
Education & 15.3 & 11.3 & 13.5 & 11.6 \\
Water and sewer & 9.8 & 10.0 & 9.7 & 7.5 \\
Highways, bridges, and tunnels & 4.6 & 3.1 & 4.1 & 3.3 \\
Gas and Electric & 13.2 & 12.7 & 13.0 & 13.2 \\
Industrial development & 1.1 & 1.1 & 1.3 & 1.6 \\
Pollution control & 7.9 & 8.6 & 7.5 & 6.0 \\
Hospital & 8.1 & 10.4 & 6.8 & 4.9 \\
Various purposes & 34.0 & 37.4 & 31.2 & 20.7 \\
\hline
\end{tabular}
\caption{TAX-EXEMPT BONDS BY STATE AND LOCAL GOVERNMENTS, 1976-79*}
\end{table}

\textsuperscript{106} Congressional Budget Office Study, \textit{supra} note 17, at 37.

\textsuperscript{107} See \textit{Hearings on H.R. 3712, supra} note 4, Table 1 at 53-54.

\textsuperscript{108} See notes 65-70, \textit{supra}, and accompanying text.

\textsuperscript{109} Revenue bonds are repaid solely from the revenues of the project for which they are 
issued. General obligation bonds, on the other hand, pledge the taxing power of the govern-
mental unit issuing the bonds.
placed on the investors rather than the issuer.\footnote{110} The second reason for the success of the bond issues is their attractiveness to investors. The tax-exempt status of the bonds offers a substantial tax break to high-income investors.\footnote{111} Although the investor carries the risk of default, the actual risk is minimal. The pool of mortgage loans and a reserve account provide adequate security for the issue. In addition, private insurers and government programs insure payment on default.\footnote{112} The bondholder receives a secure investment as well as one that is tax-free.

The final factor contributing to the growth of these bonds is the wide percentage difference between mortgage rates and tax-exempt bond interest rates. Local governments did not issue housing bonds in substantial amounts prior to 1978 because housing finance programs were not economically profitable. Tax-exempt bond interest rates were comparable to conventional mortgage rates and the issuer was not able to give a lower rate to the borrower. Increasing inflation, however, has reduced the availability of funds from traditional mortgage lenders.\footnote{113} At the same time, the number of potential home buyers has steadily grown, thereby contributing to the demand for single-family housing.\footnote{114} When interest rates recently outstripped usery laws,\footnote{115} mortgage revenue bonds provided the only source of capital for mortgage lenders. Furthermore, as many of the potential beneficiaries of mortgage revenue programs do not qualify for federal homeownership subsidies,\footnote{116} mortgage revenue bond financing came to the rescue just when conventional mortgages slipped out of reach.

\footnote{110} See notes 68-70, supra, and accompanying text.

\footnote{111} See note 135, infra.


\footnote{113} See The Housing Slump, Newsweek, Jan. 28, 1980, at 62 reported the building rate projection for 1980 would be 1.5 million units—25% below 1979 and 35% behind 1978. Nevertheless, the major negative factor in the housing market is the lack of mortgage money.

\footnote{114} The increase in the demand for housing has been attributed to several factors: (1) the post-WW II baby boom is now putting more persons in the home buying range; (2) housing is considered a good investment in times of inflation; and (3) "changing lifestyles are causing more household formations". Congressional Budget Office Study, supra note 17, at 4.

\footnote{115} See Housing: Shut the Door, Newsweek, Nov. 12, 1979, at 85.

\footnote{116} See Table next page
PERCENTAGE DISTRIBUTION OF FEDERAL HOMEOWNERSHIP
SUBSIDY BENEFITS, BY INCOME GROUP

<table>
<thead>
<tr>
<th>Income Group (in Dollars)</th>
<th>Rural Housing</th>
<th>Deferral and Exclusion of Capital Gains</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FHA Credit</td>
<td>Mortgage Interest Deduction</td>
</tr>
<tr>
<td></td>
<td>Section 235</td>
<td>Section 312</td>
</tr>
<tr>
<td>0 to 9,999</td>
<td>17</td>
<td>0</td>
</tr>
<tr>
<td>10,000 to 19,999</td>
<td>82</td>
<td>62</td>
</tr>
<tr>
<td>20,000 to 49,999</td>
<td>0.7</td>
<td>33</td>
</tr>
<tr>
<td>50,000 to 99,999</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>100,000 to 199,999</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>200,000 and Over</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 12, Congressional Budget Office Study, supra note 17, at 76-77.
The Benefits

The basic benefit derived from tax-free housing bonds is that homebuyers are able to obtain more affordable home mortgages. The primary aim of all local programs has been to reduce the costs of homeownership. In addition, some local programs have included as their goal the redevelopment of blighted areas. When Chicago introduced the first municipal mortgage bond program in July, 1978, city officials hoped to attract suburbanites back into the city as well as to deter the migration of city residents to the suburbs. Expected collateral benefits were an increase in the tax base and the attraction of additional industry to the area.

The increased involvement of state and local governments in the problems of housing development has generally been regarded as beneficial. Proponents of mortgage bond programs applaud the initiative shown by municipalities in creating a viable housing program—without the aid of federal bureaucracies. Local governments cannot control mortgage revenue bond programs as much as the federal government can control direct spending programs. Nevertheless, the mortgage revenue bond programs were created with relative ease requiring little red tape. One commentator has contrasted the remarkable success of the Chicago plan in providing low-cost housing with less successful federal programs.

The explosive growth of this financing mechanism is not surprising when one considers that—the municipal bond investor acquires additional tax-free income; the beleaguered home buyer gets a bargain mortgage; the local public officials make their constituents happy; and a few administrators receive large fees.

118. In California, localities can initiate redevelopment programs for construction or rehabilitation within blighted neighborhoods.
119. See City Council Passes Mortgage Pool Plan, Chicago Tribune, July 8, 1978, §N1 at 1, col. 5.
120. See Chicago Tribune, July 3, 1978, §1 at 12, col. 1. The editorial commends the program for "helping to maintain the residential vitality of the city".
121. See generally ABA Advisory Commission on Housing and Urban Growth, Housing for All Under Law 481 (ed. R. Fishman 1978).
122. See note 3, supra, and accompanying remarks.
123. See generally A New Way to Go, Wall St. J., April 16, 1979, at 22, col. 1. One proponent of mortgage bond programs commented that years of federal housing programs have often left only new city slums with empty mortgage-defaulted homes. Chicago Tribune, July 4, 1978, at 3, col. 1.
124. In Chicago's first $100,000,000 offering of mortgage bonds, the underwriter received $3 million off the top to cover expenses. In addition, the lender charged 3% for any loans they serviced plus $100 closing costs. Chicago Tribune, §4 at 3, col. 2.
The controversy surrounding mortgage revenue bonds has generally focused on the issue of who is to benefit from the funds. Critics have called the housing programs "cookie jars for the rich." Although most local programs were explicitly designated for low- and middle-income buyers, wide variations in income ceilings existed among the various programs. Income limits ranged from $18,000 (Pueblo, Colorado) to $60,000 (Anchorage, Alaska). California's redevelopment programs had no income ceilings at all. Municipalities defended the relatively high income ceilings as necessary to market the bonds, despite the fact that housing bond issues with low-income limits have been successfully marketed. Because the Treasury loses tax revenues from these issues, the federal government in effect was subsidizing moderate- and even high-income home buyers. Providing cut-rate mortgages to persons with $60,000 incomes ignored the "public purpose" aspect of these programs.

125. Chicago Tribune, July 8, 1979, §N1 at 6, col. 1E. The editorial remarks that the phrase misses the point since the mortgage revenue bond plan was not envisioned as another program to aid the poor. The editorial suggests that the success of the plan should be determined by whether it helps people invest in houses who would not otherwise be able to do so, not by whether it helps a particular income group.

126. Some Tax-Exempt Single Family Housing Bonds Issued By Local Governments as of April 1, 1979, and Their Income Ceilings.

<table>
<thead>
<tr>
<th>Issuing City or County</th>
<th>Income Ceiling</th>
<th>Income Ceiling</th>
<th>Income Ceiling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anchorage, Alaska</td>
<td>60,000</td>
<td>Johnson Co., Ky.</td>
<td>40,000</td>
</tr>
<tr>
<td>Sebastian Co., Arkansas</td>
<td>27,500</td>
<td>E. Baton Rouge, La.</td>
<td>29,500</td>
</tr>
<tr>
<td>Jonesboro, Arkansas</td>
<td>39,500</td>
<td>New Orleans, La.</td>
<td>40,000</td>
</tr>
<tr>
<td>Fresno, California</td>
<td>none</td>
<td>Montgomery Co., Md.</td>
<td>19,500</td>
</tr>
<tr>
<td>Pueblo Co., Colo.</td>
<td>18,000</td>
<td>Baltimore, Md.</td>
<td>none</td>
</tr>
<tr>
<td>Denver, Colo.</td>
<td>20,000</td>
<td>Minneapolis, Minn.</td>
<td>22,000</td>
</tr>
<tr>
<td>Wilmington, Del.</td>
<td>30,000</td>
<td>Albuquerque, N.M.</td>
<td>24,000</td>
</tr>
<tr>
<td>Chicago, Illinois</td>
<td>40,000</td>
<td>Clovis, New Mexico</td>
<td>28,000</td>
</tr>
<tr>
<td>Evanston, Illinois</td>
<td>50,000</td>
<td>Wood Co., W. Va.</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Derived from Congressional Budget Office Study, supra note 17.

127. In order to keep interest rates on the bonds low and still attract bond purchasers, a high quality mortgage pool was needed to provide security thereby insuring the feasibility of the entire program.

128. In 1978, $3 billion of mortgage revenue bonds were floated. These cost the federal government more than $67.5 million in lost revenues. The projected revenue loss due to mortgage revenue bonds in 1984 is expected to range between $1.6 and $2.1 billion. See Congressional Budget Office Study, supra note 17, at 47.

129. The Chicago Reporter (a monthly information service on racial issues in metropolitan Chicago) conducted a study on the breakdown of loan recipients in the first mortgage plan issued by Chicago. The study claimed that "because the city counted only 'adjusted
Mortgage revenue bond programs have not proved as beneficial to the community as originally hoped. The goal of attracting suburbanites back into the city was not realized. Competing suburban mortgage programs cancelled out the benefits of municipal mortgage revenue bonds. In Chicago, the relative flux of families moving back into the city was negligible. In addition, local bond programs threatened to impair or replace traditional mortgage financing, thereby altering the role of lenders in the mortgage market. If local governments replace traditional mortgage lenders, social or political, rather than economic, criteria may be used to determine eligibility requirements for homeownership. The Treasury Department has expressed concern that local government is infringing upon free enterprise in this large sector of the economy.

More serious criticism focuses on the effect mortgage revenue bonds have on the municipal bond market. First, the number of persons who can profit from buying tax-exempt bonds at any interest rate is limited. Secondly, a large increase in the volume of housing bonds will drive up the rates on all tax-exempt issues.

gross income' toward the program's $40,000 income ceiling, upper income applicants could shelter real income or assets and still qualify." Brune & Tell, City's Low-Interest Home Loans Bypass Minority Communities; Blacks, Latinos Buy in White Areas, Secure One-Third of Loans, 8 The Chicago Reporter 1, 3 (January 1979). The study also showed that predominantly black and Latino communities lost out under the program. Id.

130. See City's low-interest home-loan plan spreads to suburbs, Chicago Tribune, March 4, 1979, §N14 at 1, col. 1.

131. Chicago Tribune, Dec. 31, 1978, §1 at 6, col. 4. Chicago officials were pleased that 607 suburbanites and 70 out-of-staters used the loan subsidy to move into city neighborhoods. Nevertheless, 412 homeowners, who sold their homes to families in the mortgage bond program, moved out of the city. The net gain for the city—205 families—was negligible.

132. In Arkansas, where the usery rate was stuck at 10%, mortgage revenue bond programs supplied nearly the only available source of mortgage money.

133. Hearings on H.R. 3712, supra note 4, at 13.

134. A congressional study projects that by 1984 state and local governments will issue between $20 billion and $35 billion in single-family housing bonds. This would represent 30-50% of all long-term tax-exempt bonds and 10% of new mortgages. Congressional Budget Office Study, supra note 17, at xiv.

135. Since the interest on tax-exempt bonds is generally much less than on comparable securities, tax-exempt bonds are only attractive to high-bracket taxpayers. For example, if the interest on a taxable bond is 10%, a 50% bracket taxpayer would be wiser to invest in 7% tax-exempt bonds because his return after taxes on the taxable security would only be 5%. The taxpayer in the 20% bracket, however, would find it more profitable to invest in the 10% taxable bond since his after-taxes return would be 8%.

136. As more tax-exempt bonds are put on the market, issuers will be forced to offer higher interest rates in order to attract investment by taxpayers in marginal tax brackets.
The Urban Institute estimates that tax-exempt interest rates rise 0.04-0.07 percentage points for each additional billion dollars of housing revenue bonds. These two factors, in turn, could seriously jeopardize the ability of municipalities to market bonds on more traditional projects such as schools, sewage and water plants, hospitals and roads.

A constant criticism of mortgage revenue bonds, and municipal bonds in general, is their detrimental effect on the progressive rate structure of the tax system. By providing tax-free income to high-bracket taxpayers, the burden of providing federal revenue shifts to lower-bracket taxpayers. In addition, the programs provide substantially less assistance to potential home buyers than it costs the federal government in lost revenue. The number of underwriters, insurers, lenders and lawyers needed to administer the program results in high administrative costs. In comparison to federal direct spending programs, the administrative costs make this form of housing subsidy inefficient.

Congress has expressed concern that the dramatic rise in mortgage revenue bonds may hamper the determination of the appropriate amount of expenditures for housing. State and local governments are able to sidestep the federal budget and expenditure process through this form of indirect spending. Another concern is that an increase in mortgage bonds directs a greater percentage of fixed investment into housing rather than other forms of investment. This could decrease the productivity of the economy.

The federal government has become increasingly disturbed about the effect mortgage revenue bonds had on its efforts to control inflation. The Treasury has determined that mortgage revenue bonds are inflationary in several respects. First, they con-

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139. Id.

140. One commentator reported that, of a $28.9 million issue floated by Saline County, Arkansas, 17% went to cover expenses and reserves (underwriters' fee 1.9%, financial advisor's fee 1%, issuing costs 1.1%, mortgage reserve 1%, capital reserve 12%). Smith, Tax-Free Housing Bonds Cost More Than They Are Worth, Fortune, July 2, 1979, at 68.


142. Id. at 23.

143. 126 Cong. Rec. 2210 (1980).

144. Hearings on H.R. 3712, note 4 supra, at 12.
tribute to deficit spending. Second, they drive up housing prices by adding demand to an already bullish market. Third, they frustrate the administration's tight monetary policy and prevent the housing market from contributing its share in "cooling off the economy". The rapid expansion of the mortgage revenue bond market and the tight monetary policy of the Federal Reserve Board illustrate the inconsistency between federal and local governmental attitudes toward an inflationary housing market.\(^\text{146}\)

**Conclusion**

The unrestricted growth of tax-exempt housing bonds conflicts with the federal government's anti-inflation policy and contributes to the overall instability of the economic system. The issuance of mortgage revenue bonds to provide additional mortgage money is not justified when the proceeds assist upper-income borrowers to purchase homes. This constitutes an abuse of the state's borrowing power, as the "public purpose" standard has not been met. The continued expansion of the mortgage bond market also threatens the financing of traditional government projects. Excessive issues of mortgage revenue bonds may impair a city's credit rating.

The total elimination of the tax-exempt status for mortgage revenue bonds would remove the problems associated with their use, but only by sacrificing the benefits of such programs. The housing industry, which is disproportionately affected by the Federal Reserve's tight monetary policy, obtains some assistance from these bonds. In addition, with bond programs, local control replaces federal bureaucracy. Nevertheless, by taxing the interest on mortgage bonds, the federal government could maintain the progressive tax structure and curtail the loss of federal revenue.

Current legislative activity indicates that the unrestricted growth of tax-exempt bonds will not continue.\(^\text{146}\) The 96th Con-

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145. See, e.g., Chicago Tribune, July 25, 1978, §3 at 2, col. 4L. The following comment appeared in the "Voice of the People" Column:

"...Chicago intends to use a provision of the Internal Revenue Code to reduce interest rates which are artificially high because of actions of the Federal Reserve Board.

Question: Which of the following is an example of governmental lunacy?
1. The law permitting the Federal Reserve Board to raise interest rates.
2. The Internal Revenue Code which encourages such schemes as proposed by Mayor Bilandic.
3. Both of the above."

Harry D. Leinenweber, Ill. State Rep., 42nd District.

146. See, Sen. Long Wants Curb on Tax-Exempt Issues For Housing Purposes, Wall St.
gress has introduced no fewer than eleven bills attempting to eliminate or restrict the interest exemption on mortgage subsidy bonds.\textsuperscript{147} At the time of this publication, the House has passed a bill approving the continuation of mortgage bond programs but with severe restrictions. The underlying purpose of the Mortgage Subsidy Bond Tax Act of 1979\textsuperscript{148} is to restrict the volume of mortgage bonds while directing the available bond proceeds to those segments of the population in greatest need of them. Legislation such as this would eliminate the disadvantages of mortgage revenue bonds while preserving most of the benefits. A limitation on the volume of bonds issued would protect the bond market for other governmental issues. By selecting the criteria for eligible beneficiaries, the legislation would ensure that bond proceeds sat-

\textsuperscript{147} Cong. Index (CCH); S. 1180, S. 1726, S. 1751, S. 2064, H. 3712 H. 4030, H.4125, H. 4189, H. 4332, H. 5370, H. 5741.

\textsuperscript{148} H.R. 5741, 96th Cong., 2d Sesa., 126 Cong. Rec. 2218 (1980). The proposed section 103A of the Internal Revenue Code requires that beneficiaries of mortgage revenue bond programs have not been homeowners within the last three years and must use the proceeds to purchase their principal residence. There are exceptions, however, for rehabilitation loans, home improvement loans, and mortgages in target areas. In addition, the income of the borrower must not exceed 115% of the median family income in the Standard Metropolitan Statistical Area (SMSA) or county. If the beneficiary is to purchase housing in a targeted area, as defined by the Act, one-third of the houses financed by the issue can be provided to any person regardless of his income. The other third of the mortgagors cannot exceed 140% of median family income for the state or the SMSA. Regardless of the area where the residences are located, 50% of the mortgage funds must go to families with incomes of 90% or less than the median family income in the SMSA.

The House bill aids the borrower by requiring that at least 75% of the proceeds be lent for mortgages with no greater than a 5% downpayment. The purchase price of the homes bought from the housing bond proceeds must not exceed 80% of the average purchase price in the preceding year in the same SMSA in which the house is located. Additionally, none of the proceeds can be used to refinance an existing mortgage. Under H.R. 5741, the volume of mortgage revenue bonds that can be issued within a state each year cannot exceed the greater of $50,000,000 or 5% of the average of all mortgages originated in that state in the proceeding three years. The bill also contains a sunset provision on mortgages issued for owner-occupied housing. After two years from the date of enactment, interest on such bonds will become taxable.

As to multi-family housing, the Act continues the tax-exempt status of bonds where "substantially all" of the proceeds are to be used to finance rental units in which 20% are occupied by individuals of low or moderate income. In addition, H.R. 5741 provides that bonds may be qualifiedly issued for the benefit of veterans. Miscellaneous provisions pertain to such items as arbitrage restrictions and who can originate the mortgages.
isfy the public purpose of assisting low- and moderate-income families in the purchase of homes.

JAN BRUNKEN