

Why Repeal the Obsolete Mortgage Revenue Bond Ten-Year Rule?

What is the Ten-Year Rule?

Until recently, state and local housing finance agencies (HFAs) could use all payments they received from mortgages they financed with MRBs to make new mortgages to other lower-income, first-time homebuyers. An obscure legislative change in 1988, however, now forces HFAs to use all mortgage payments received ten years after an MRB is issued to pay off old bonds, not make new mortgages.

Why is it a problem?

By requiring HFAs to use mortgage payments to redeem bonds instead of making new mortgages, the Ten-Year Rule is preventing tens of thousands of qualified lower-income, first-time homebuyers each year from getting an affordable MRB-financed mortgage. Between 2001 and 2005, the Ten-Year Rule will have forced HFAs to use more than \$14 billion in mortgage payments to redeem bonds instead of making additional lower-income homebuyer mortgages.

If the Ten-Year Rule is repealed, will MRBs' lives be limited at all?

Yes. In actual practice, MRBs' terms are limited to 30 years, because that's the maximum term of the mortgages financed by MRBs, which are the source of their repayment. Sometimes, MRBs are replaced with what are called refunding bonds, usually to take advantage of better interest rates. All refunding MRBs, by law, must be redeemed within 32 years of the original MRB issuance date. So, in practice, no MRB or refunding bond will be outstanding for more than 32 years. The Ten-Year Rule, however, requires all mortgage payments received after the original MRB has been outstanding for ten years to be used to pay off the bond instead of being used to make new mortgages.

Why should MRB mortgage payments be used for new mortgage loans?

Recycling early mortgage payments to make new mortgages enables states to get more lower-income families into their first home. The private activity bond cap limits the total volume of MRBs. Repealing the Ten-Year Rule will not increase that cap, but will make many more lower-income, first-time homebuyer mortgages possible from bonds issued under it.

Does the Ten-Year Rule affect any other kind of private activity bonds?

No. The Rule was enacted in 1988 to hasten the end of the MRB program, which was then due to sunset the next year. Instead, Congress made the MRB program permanent in 1993, reflecting program changes and MRBs' spectacular success in helping lower-income families buy first homes. In making the program permanent, however, Congress overlooked the Ten-Year Rule, the first impact of which was not felt until 1998.

Doesn't the private activity bond cap increase make repealing the Ten-Year Rule unnecessary?

No. In 2000, Congress increased the cap only by the amount lost to inflation since Congress imposed the cap in 1986. In addition, the cap includes multifamily housing, industrial development, redevelopment, and student loan bonds (none of which are covered by the Ten-Year Rule), and HFAs must compete every year for housing's share of that cap against these other bond uses.

The Ten-Year Rule only and unfairly affects MRBs. By radically cutting MRB bond length compared to other capped bonds, it drastically reduces the number of mortgages an HFA can make to eligible homebuyers during the life of the MRB. A 2001 report by Merrill Lynch states, "The Ten-Year Rule, to a large extent, offsets gains from the volume cap increase."

How much will repeal cost and why?

The Joint Committee on Taxation estimates that using MRB mortgage payments to make new mortgages to lower-income families rather than to prematurely redeem bonds will cost \$2.64 billion over ten years. That estimate is based on how much longer MRBs would be outstanding, if they were treated equally with other tax-exempt private activity bonds.