

ALTERNATIVE TO STATE AND FEDERAL FINANCING OF HOUSING

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It is commonly held that the major cost of housing is materials and labor, and yet, it could be shown that the largest single cost is financing. Therefore, anything that can be done to reduce financing cost will lower the ultimate cost of the house.

Many people were depressed when the federal government put a freeze on assistance to housing. Local authorities and elected officials felt there was no way they could meet their local housing needs. Yet, under present laws there appears to be no reason why local housing authorities cannot proceed with housing and be able to bring the cost at least equal to state housing finance authority costs.

There were three categories of federal programs: (1) Loan Guarantees, (2) Payments on Operating Costs, Principle and Interest, and (3) Subsidies (payments to reduce the rents below actual cost). Resources for all three of these programs are available at the

local level. If the local government is to look at its housing in these three different areas, they will find they can address their needs without federal assistance. In this paper two of the three kinds of programs — the loan guarantees and the payments on operating costs, principle and interest — will be explored. Subsidy at the local level will be dealt with in a subsequent article.

Let us look at an example where the housing authority wishes to build a unit for elderly. If an individual or a company were to go to the local savings and loan to build a unit precisely the same as the one we are talking about with the housing authority, they would have to provide equity in the form of a down payment and then take a mortgage on the building. If the down payment or equity were large enough to suit the lender, nothing else would be needed. If the down payment were small or the individual had a small income pattern, the lender might require mortgage

insurance. This insurance could be either federal insurance or provided from the private market. The housing authority likewise would need equity, credit, and income but equity could come from the local government. The site, for example, would be a form of equity which could be given to the housing authority or credit could be granted on the basis of its reputation as a semi-government institution with its tax exempt feature. Income pattern in such an example would be from the rents charged, exactly the same as with the private sector. The price of the rent would need to be the price that would bear the interest, principle, and operating costs exactly the same as the private sector. The housing authority could charge slightly less because it would not have an interest on its equity and it would not need to be making a profit, but other than this the costs are comparable.

Let us now look at the credit aspect of the housing authority. Any unit owned by the local housing authority may be made exempt from local property taxes if the local government agrees. This can be a major advantage to an elderly housing unit as it is a very efficient source of a subsidy since a dollar that isn't collected is a dollar of direct subsidy. Wisconsin considers, in its Homestead Relief Act, that about 20% to 25% of the gross rent is attributable to real estate tax. A second source of credit is available to a local housing authority. This is a form of tax exemption on its debts. The interest paid by a housing authority is tax exempt income to the recipient. (NOTE: Internal Revenue Ruling — Local housing authorities are governed by the U.S. Housing act of 1937 and as such, interest on their obligations are tax exempt. *Special Ruling dated April 27, 1942*; and, interest income subsequently realized on the obligation is not taxable to the owner thereof under the provisions of Section 66.40(14)(a), Wisconsin Statutes.) Since it has credit, equity, and

income the local housing authority meets all the requirements for financing by the savings and loans.

Now let us examine these components in detail. Wisconsin Statutes limit the savings and loans in that they can loan 90% of the value of a project. Therefore, the housing authority must provide 10% in equity. (These percentages may vary from state to state.) The equity may be in any form that is consistent and a component to the specific project. It could be land, improvements, cash, etc. Wisconsin law permits local governments to provide all of these to the housing authority either as loans or as a grant. With this 10% minimum as equity, the savings and loan can then advance the remainder to produce the building. As stated previously, the rents charged must be structured so as to pay the principle, interest, and operating costs.

With this procedure the housing authority could then have a structure that is exactly comparable with that which could be built by the private sector. In addition, the savings and loans mortgage would be tax exempt income. To figure the amount of the tax exemption, one must determine how much the savings and loan is paying in federal tax. If the private sector, as an illustration, is being charged 9% for its loans from the savings and loan, this 9% includes profit, overhead, defaults and contingencies, and federal and state taxes. Therefore, if the savings and loan does not have to pay the federal and/or state taxes the 9% can be reduced.

This reduction is the same as the reduction in tax exempt bonds versus regular bonds. In order to determine the amount of the reduction the savings and loans can work with, take the regular tax rate times the reciprocal of the effective state and federal taxes paid by the association. This amount would equal the tax exempt rate on the mortgage. Since the effective tax rate paid by

savings and loans is approximately 25.55%, the reciprocal times an example of 9% would be the rate that a housing authority could borrow funds. It must be noted that the interest rate on a large loan is negotiated and the 9% used here is an illustration.

By combining this credit reduction along with the equity given by the city, it is possible to construct housing for the moderate income group. The very low income are not provided for in this plan. However, local welfare departments have an amount specified which is considered to be adequate to obtain housing. The amount that must be made up in some way for the low income is the differential between the rents charged in this interest reduction program with the savings and loan, and the amount of housing provided for by welfare.

The local savings and loan, after negotiating this kind of a mortgage, has a tax exempt instrument. They can do several things with it. If, for example, this mortgage is drawn up in components similar to serial bonds where the component is equal to a given percentage of the mortgage, the component can be sold as a tax exempt instrument to an individual or corporation. This feature opens a new market for the savings and loans in that they can now offer certificates of deposit for a given

amount of interest but with these components they could also offer a component mortgage with a given amount of interest that is tax exempt to the holder. If the savings and loan did not care to move the mortgage in this manner it could handle the mortgage in the regular manner.

The illustration given was financed with a savings and loan. It appears that a similar situation could be created with a commercial bank. Due to a different taxing policy, however, the numbers of the system would come out differently. Work is still underway in a research project with commercial bank financing.

In summary, an outline of a new procedure by which a housing authority can obtain mortgage money at a rate approximately 3 to 3½% below the current market rate has been presented. This rate is competitive with state finance authorities. Since all decisions are local in this procedure, the time involved in federal and state loan reviews is eliminated. This fact alone is worth money if one considers that costs are changing at about 1 to 1½% per month on the total costs of a project. This procedure should produce housing competitive with the former federal programs 235 and 236.