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National Association of Bond Lawyers

October 12, 2007

John J. Cross III
Associate Tax Legislative Counsel
Office of Tax Policy
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1500 Pennsylvania Avenue, N.W.
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Washington, D.C. 20220

Dear John:

The National Association of Bond Lawyers ("NABL") respectfully submits this letter in response to your request for identification of statutory changes necessary to allow the proceeds of qualified mortgage bonds under section 143 of the Internal Revenue Code of 1986, as amended (the "Code"), to be used for refinancing certain existing mortgage loans.

For ease of consideration, NABL has divided its comments into four categories, as follows:

1. Technical and policy changes to the current qualified mortgage bond rules required to extend that program to refinancings.

2. Policy changes that NABL believes could be necessary to reach the intended population of borrowers and to make any such expansion attractive to States and other issuers of mortgage bonds.

3. Additional policy changes that could increase the incentive for States and other issuers to take advantage of the relief being proposed.

4. Effective date issues.

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Changes Required to Permit Refinancings

The following modifications to existing section 143 of the Code, would be required to permit tax-exempt mortgage bond proceeds to be used for refinancings:

1. The universe of eligible borrowers to be benefited by the new provisions must be identified. According to published reports, the difficulties currently experienced in the credit markets, initially referred to as the "subprime loan crisis," extend far beyond persons with low or moderate income and include "high-rate" loans made to finance residences in all price ranges for borrowers of high, low and moderate income. The common thread seems to be that regardless of the borrower's income level, many loans were made on aggressive, non-traditional terms, with adjustable or "teaser" interest rates, or at higher than necessary interest rates, resulting in mortgage payments that are, or when adjusted will become, unaffordable to the borrower. Congress, the Department of the Treasury ("Treasury") and other relevant agencies must make the policy determination of which borrowers are to be benefited by any proposed legislation. For discussion purposes, NABL has assumed that the intended beneficiaries will be a subset of the borrowers currently at risk due to recent lending practices and will be persons and families of low or moderate income who entered into mortgage loans to finance their principal residence and may have difficulty meeting their mortgage payment obligations. Borrowers and loans eligible for refinancing could be identified by reference to one or more of: (1) the period when the loan was originated, (2) adjustable-rate or interest-only features, (3) impending interest rate increases exceeding an established minimum amount, and/or (4) the borrower's ability to satisfy current underwriting criteria for a 30-year fixed-rate loan of either (a) the current loan balance or (b) the remaining loan balance after any write-down made available by lenders or through other programs.

2. An exception must be added to the requirement in Code section 143(i)(1) that bond-financed loans be exclusively for "new mortgages" (*i.e.*, not refinancings).

3. For ease of administration, a special rule should provide that "average area purchase price" under Code section 143(e)(2) be determined as of the date the refinancing loan commitment is made (*i.e.*, not that date or the date the house was purchased, if earlier).

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Changes to Enhance the Attractiveness of the Program to Borrowers and Issuers

The following additional changes may be appropriate to enhance the attractiveness to borrowers and issuers of the expanded program described above:

1. Waive the three-year, or first time homebuyer, requirement of Code section 143(d) to provide clarity that current ownership interests in the homes being refinanced are disregarded, *i.e.*, that current Code section 143(d)(3) is intended to apply to these newly approved loans.

2. Provide that for purposes of the purchase price limit of Code section 143(e), the acquisition cost of refinanced homes equals the lesser of (1) the acquisition cost as defined in current law, or (2) that cost reduced by any loan forgiveness received by the homeowner.

3. Treat eligible refinancing loans as loans for targeted area residences regardless of whether the residence is actually located in such an area. This change would be consistent with rules provided by Congress for Presidentially declared disaster areas generally (Code section 143(k)(11)) and Gulf Opportunity Zone bonds (Code section 1400N(a)(5)). The change would relax the generally applicable purchase price and income limits of Code section 143(e) and (f).

4. Provide a separate volume cap to allow States and other issuers to provide this new refinancing relief without curtailing their existing mortgage bond programs. Reflecting the temporary emergency nature of the new program, this limit could be set at a single fixed amount based on population (with a potential small-State minimum). Each State's volume limit should remain available until used. This approach combines the State-by-State approach of the current private-activity bond volume limit (Code section 146) and the one-time volume limit concept adopted by Congress in several recent instances.[1] As is true under the private-activity bond volume limit, current refundings would be exempt from this volume limit.

5. Clarify that bonds issued under the new volume limit can be issued simultaneously with qualified mortgage bonds issued under current law.

[1] One-time volume limits have been provided, *e.g.*, in Code section 142(l)(7) for green buildings and sustainable design structures, in Code section 142(m) for certain highway-rail freight transfer facilities, in Code section 1394(f) for certain empowerment zone projects, in Code section 1400N(a)(3) for Gulf Opportunity Zone projects, and in Code section 1400T for Hurricane Wilma and Rita mortgage bond rebuilding projects.

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Additional Incentives to Borrowers, Issuers and Bond Investors

Other provisions that could provide additional incentive to borrowers, issuers and bond investors to participate in the new program include:

1. Interest on the new sub-category of qualified mortgage bonds could be exempted from treatment as a preference item for the alternative minimum tax.

2. If the new program is targeted to borrowers of lower credit who are at risk of foreclosure, the refinancing loans permitted by new legislation may carry greater risk and require greater oversight than other qualified mortgage bond program loans. States and other issuers could be encouraged to participate in the new program by increasing the allowable program arbitrage to some amount in excess of 1.125 percentage points normally permitted for mortgage bonds (Code section 143(g)).

3. Borrowers at risk of foreclosure are likely to be wary of complicated provisions and new loan restrictions, therefore, the new category of refinancing loans could be exempted from the recapture provisions of current law.

4. Although not a part of the mortgage bond provisions of Code section 143, current law could be amended, as applicable to the targeted group of borrowers, to eliminate the income incurred on forgiveness of debt.

Effective Date Provisions

Finally, NABL assumes that Treasury's goal is to make this refinancing available at the earliest possible date.[2] This goal could be accomplished by adopting a two-fold effective date structure. First, the minimum technical changes needed (generally the first category of provisions described above) could be made effective for loans financed after enactment. This effective date would allow States and other issuers to divert proceeds of outstanding bonds to these new loans. Second, other changes could be made effective for bonds issued after the date of enactment, reflecting the fact that the additional volume limit would only become available at that time.

[2] NABL is aware that, in some cases, provisions of State law may interfere with the goal of early relief using mortgage bond loans. For example, some States have laws prohibiting the issuance of bonds to refinance mortgage loans. Unless these laws are preempted, implementation of any proposed mortgage bond changes would be delayed until the relevant State legislatures meet and amend those laws.

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NABL appreciates the request for and consideration of this submission and would welcome the opportunity to discuss these comments with you.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. A professional association incorporated in 1979, NABL has approximately 3,000 members and is headquartered in Chicago.

If you have any questions, please contact me at 205/226-3482 or though email at fclark@balch.com or Elizabeth Wagner, Director of Governmental Affairs, at 202/682-1498 or through email at ewagner@nabl.org.

Thank you again for the opportunity to submit NABL's comments.

Sincerely,

Foster Clark