October 10, 2005

The Honorable Connie Mack, Chairman
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW
Suite 2100
Washington, DC 20220

Dear Senator Mack:

On behalf of the members of the Mortgage Bankers Association (MBA)[1], I am writing to you regarding the implications of certain provisions of the tax code for the real estate finance industry. The housing and real estate finance industries contribute significantly to the U.S. economy and housing is a major part of both consumption and private investment, accounting for roughly 16 percent of gross domestic product. In 2004, the real estate finance industry generated $3.9 trillion in loan originations. Through their home refinancings, Americans were able to put more than $200 billion back into the economy with expenditures on education, capital improvement and other consumer needs.

As the Tax Reform Advisory Panel considers ways to simplify the tax code, we ask that you recognize the tremendous impact that federal tax policies have on the value of real estate and the effect that they have on the attractiveness of owning, mortgaging, and selling commercial and residential property. A tax code that reflects the realities of the marketplace can support, enhance, and encourage homeownership and commercial real estate development. We also need to ensure that our tax policies are an effective ally in the fight for affordable rental housing.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,900 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field.

Mortgage Interest Deduction

In the Executive Order establishing the Advisory Panel, President Bush requested that the Panel recognize the importance of homeownership in American society. Since the enactment of the federal tax code in 1913, one of the most powerful incentives for the expansion and preservation of homeownership has been the deductibility of mortgage interest. The mortgage interest deduction is consistent with America's longstanding tradition of encouraging homeownership, a pillar of U.S. housing policy. The benefits of homeownership and the mortgage interest deduction extend far beyond positive social effects; homeownership and the mortgage interest deduction strengthen the economy and play a key role in our nation's accumulation of wealth. As the Commission considers potential changes to the tax code, we urge you to preserve the mortgage interest deduction and the social and economic benefits it generates.

Deductibility of Mortgage Insurance Premiums

MBA also supports proposals allowing low- and middle-income families to deduct mortgage insurance premiums against income in the calculation of federal income tax. Mortgage insurance is paid by most homebuyers who make a down payment of less than 20 percent. However, while interest on mortgages is tax deductible, mortgage insurance, which often costs over $1,000 annually, is not. Allowing for the deduction of mortgage insurance premiums will promote the continued expansion of homeownership.

Low Income Housing Tax Credit

In order to promote affordable rental housing, the Low Income Housing Tax Credit (LIHTC) should be preserved, as it is the only incentive specifically designed to promote the production of low-income rental housing. However, while MBA supports the program, at the same time it believes that a number of existing problems must be addressed. The program's bias toward non-profit sponsors should be eliminated. In addition, statewide rather than area median income should be used to determine income limits for tenants in rural areas. The LIHTC should also be revised to encourage the original goal of creating mixed-income developments.

Real Estate Mortgage Investment Conduits (REMICs)

To continue to promote investment in mortgages, changes should be made to Real Estate Mortgage Investment Conduits (REMICs) that allow for the substitution and addition of similar collateral. REMICs were created as part of the Tax Reform Act of 1986 and are vehicles that facilitate investment in mortgages, thus promoting homeownership and economic development. As of June 30, 2004, the volume of single-family, multifamily, and commercial mortgage-backed REMICs outstanding was more than $2.2 trillion. Allowing substitution of substantially similar collateral would encourage greater use of the REMIC vehicle for single-family, multifamily, and commercial assets, while protecting the right of the IRS to receive timely payment of taxes on the income from the assets.

Capital Gains Tax Rate

Finally, MBA believes that the capital gains tax rate on gains associated with depreciation recapture for real estate should be lowered so it is the same as the rate for all other assets, and the holding period for capital gains on real estate should remain the same as the holding period for capital gains on all other assets. The Taxpayer Relief Act of 1997 reduced the rate on long-term capital gains to 20 percent and created a different rate applicable to straight-line depreciation recapture for real estate. All previously allowed straight-line depreciation for real estate is now taxed at 25 percent – a rate higher than the capital gains rates on most other assets. MBA strongly supports lowering the depreciation recapture rate and capital gains rates on the sale of income-producing real estate to the same rate for all other assets. MBA also supports the continued parity of the holding period for capital gains on real estate with the holding period for all other assets.

MBA appreciates the opportunity to share its thoughts with the Advisory Panel, and asks that you bear these concerns in mind as you complete your work. As I stated earlier, a tax code that reflects the realities of the marketplace can support, enhance, and encourage homeownership and commercial real estate development. Should you wish to discuss any real estate tax issues, please do not hesitate to contact me at 202/557-2701 or at jkempner@mortgagebankers.org.

Most sincerely,

Jonathan L. Kempner

Jonathan L. Kempner
President and Chief Executive Officer