LEGISLATIVE FISCAL ESTIMATE TO

SENATE, No. 2030

STATE OF NEW JERSEY

DATED: JUNE 26, 1997

Senate Bill No. 2030 of 1997 makes the Police and Firemen's Retirement System (PFRS) mortgage loan program permanent. The program, established by P.L. 1992, c.78, is scheduled to expire five years after the date of enactment, August 5, 1992. This bill removes the law's expiration provision so that the PFRS mortgage loan program can continue.

The PFRS mortgage loan program allows members of the PFRS to obtain a mortgage loan from the retirement system to acquire or construct a residential property or refinance an existing property. The mortgage loan program is available to any active member of the PFRS with at least one year of creditable service in the retirement system to purchase, construct or refinance a residential property within the State for the member's own occupation as a principal residence. No member may have more than one outstanding loan under the program at any time and no second mortgages are permitted.

No loan under the program may be sold, transferred, or assigned, nor may payments with respect to such a loan be assumed by anyone other than the member. An exception may be made, in the event a member dies, for the assignment of the mortgage to the decedent's surviving spouse if the spouse is the sole heir to the encumbered property.

A PFRS member who receives a mortgage loan under the program must, within 120 days of the making of the loan, "occupy the residence as his principal dwelling place." If a mortgagor under the program sells or ceases to occupy as a principal residence a property securing the mortgage, the balance of the mortgage loan becomes due and payable on the 120th day following the action.

The interest rate applicable to loans under the program is to be set semiannually (February 15 and August 15 of each year) and is to be equal to 2 percent over the weekly average yield on the one-year Treasury Bills at the time of the setting. The term of any loan under the program is not to exceed 30 years. The program is limited to 10 percent of the total investment assets in the retirement system, or approximately $934 million (as of the July 1, 1995 actuarial valuation of the retirement system).

Current law, P.L.1992, c.78, assigns responsibility for the administration of the PFRS mortgage loan program to the New Jersey Housing and Mortgage Finance Agency (NJHMFA or the "Agency"). The Agency's administrative responsibilities include: (1) calculation of the interest rate under the statutory formula; (2) origination of loans; (3) appraisal of real property eligible to secure loans; and (4) insurance of title. In addition, the Agency establishes standards and guidelines for loan approval.

The Office of Legislative Services (OLS) notes that this program provides qualified PFRS members with below-market rate mortgages from the assets of the retirement system. The mortgages are collateralized by first liens upon the mortgaged property, but are not backed by any State or federal mortgage guarantee.

The OLS notes that mortgages provided under this program do not have the backing of the federal government, in effect increasing the degree of investment risk while at the same time decreasing the rate of return on the amounts invested due to the below-market interest rate paid under this program.

As of July 1, 1995, the system (PFRS) had $9,334,492,318 in assets (market-value). Of this amount, $615,917,023 is invested in mortgages. No information has been provided by the Divisions of Pensions and Benefits or Investments to indicate how much, if any, of these mortgages are directly or indirectly supported (guaranteed) by the federal government or how many, if any, mortgages return a rate of interest corresponding to the market rate for such mortgages at the time of issuance.

The OLS notes that the cost to the retirement system of this program, payable by increased employer (State and local government employers) contributions, is the actual rate of return these funds would have earned if invested with the other assets of the retirement system. The mortgage loan rate of the program is 2 percent above the average yield on one-year Treasury Bills. The current rate, according to the NJHMFA, is 7.53 percent for a 30-year fixed rate mortgage. This rate is approximately .47 percent lower than the current (market-rate) 30-year fixed rate mortgage available from the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association on the open market.

Using the assumed rate of return on investments, 8.75 percent, the lost investment income on these loans is approximately $2,895,000 annually. When the system earns less than the targeted or assumed rate of return on investments, the employer (State and local governments) contributions to finance the retirement system increase.

The OLS also notes that this program may violate the Internal Revenue Code. The Internal Revenue Service may not consider pension mortgage loans to be loans but fully taxable distributions from the retirement system. Because the IRS has not made a definitive ruling, the NJHMFA includes a notice to all applicants to consult a tax advisor before submitting an application because the IRS could ultimately determine these mortgages are taxable.

This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67.