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Housing Issues in the 108th Congress

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Summary

The Administration presented its proposed budget for FY2005 to Congress on February 2, 2004, requesting $31.5 billion for the Department of Housing and Urban Development (HUD), about 1% above the $31.2 billion enacted for FY2004. Central to this budget is a controversial proposal, the Flexible Voucher Program (FVP), to revise and control spending under the existing Section 8 voucher program. Public Housing Agencies (PHAs) would no longer be reimbursed for the actual cost of vouchers, but would be given a lump sum of money to assist any households with incomes up to 80% of the local area median. Along with this proposal, the Administration is requesting $18.5 billion in funding for the program, a reduction from last year's $19.3 billion. Low-income housing advocates state that this request could require PHAs to either reduce the number of families assisted, increase the average rent that voucher holders pay, or shift rental assistance away from the poorest of the poor. No funding is proposed for HOPE VI.

In a related matter, an April 22, 2004 HUD notice implementing the FY2004 appropriations law for housing vouchers has led to budget concerns in some communities and has prompted the introduction of H.R. 4263 to direct HUD to fund PHAs based on their most recent submitted cost data rather than August 1, 2003 data.

The Administration also is proposing a new HUD program that would allow 150,000 first-time homebuyers a year to purchase with no downpayment and finance all closing costs (H.R. 3755). On May 5, 2004, a subcommittee of the House Financial Services Committee passed an amended H.R. 3755.

Numerous additional housing related bills are pending in the 108th Congress.

H.R. 1102 would create a National Affordable Housing Trust Fund. With about 212 largely Democratic co-sponsors, it would tap "excess profits" from HUD's Federal Housing Administration's mortgage insurance program to build 1.5 million affordable housing units over 10 years. Further hearings were held March 30, 2004 on an industry-supported predatory lending bill, H.R. 833, that would address "high cost mortgages." The Administration has proposed a homeowner tax credit (H.R. 839/S. 198) modeled after the popular Low Income Housing Tax Credit, that would fix up for sale thousands of abandoned homes in inner cities. HUD has withdrawn its "final rule" to reform the Real Estate Settlement Procedures Act (RESPA) as a result of strong objections by the real estate and mortgage-broker industries. On April 1, the Senate Banking Committee approved an amended S. 1508 to create a new regulator for Fannie Mae and Freddie Mac. A January 2004 General Accounting Office report finds that tenants in over 101,000 units are at risk of paying higher rents over the next 10 years when HUD subsidized mortgages mature.

Not all bills discussed in this report are cited in this summary. This report will be updated as issues develop and legislation proceeds in the 108th Congress.

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Introduction

Housing issues in the second session of the 108th Congress center around the Administration's proposed FY2005 budget for the Department of Housing and Urban Development (HUD) and the congressional response. The budget includes efforts by the Administration to defund the HOPE VI program, initiatives to increase homeownership for lower- income households, and a proposal to restructure and limit spending on the housing voucher program. Other congressional interests include (1) legislation to combat predatory lending, (2) proposals to establish a National Affordable Housing Trust Fund, (3) concerns that landlords could raise rents rapidly on more than 100,000 affordable housing units in the years ahead as HUD subsidized mortgages are paid off, and (4) legislation to create a new supervisor for government-sponsored enterprises.

Major Policy Issue: The Increasing Number of Renters and Owners with "Severe Affordability" Problems[1]

With mortgage rates continuing near 40-year lows, home sales have been at record levels and housing prices have increased sharply in many areas. (The median price of a single-family home increased 9.6% from December 2002 to December 2003 to $222,500.) Many existing homeowners have benefitted from rising equity. However, higher housing prices are causing problems for moderate income households who rent (about 40% of renters live in single-family homes) or want to buy a first home. The 2003 report, *The State of the Nation's Housing*, by Harvard's Joint Center For Housing Studies, found that "A staggering three in ten U.S. households have affordability problems." The report found that fully 14.3 million households are severely cost-burdened (spending more than 50% of their incomes on housing) and another 17.3 million are moderately cost-burdened (spending 30-50% of their incomes on housing). Some 9.3 million households live in overcrowded units or housing classified as physically inadequate.

Surprisingly, the Joint Center report found that for the first time ever, more homeowners are cost-burdened than renters. While there has been a surge in lower-income homeowners over the past five years, more owners are having trouble paying their housing costs as property taxes increase rapidly. Others have lost jobs or can only find part-time work. The percent of FHA insured mortgages that were

[1] Housing costs that account for no more than 30% of a low-income family's adjusted income is considered an acceptable cost burden under most HUD assisted programs. For example, most HUD low-income housing programs require participants to pay 30% of their adjusted income towards rent.

delinquent 30 days or more stood at a record high of 12.59% at the end of the 2nd quarter of 2003, falling to 12.13% in the 3rd quarter. Before the year 2000, the delinquency rate had never been as high as 9%. Along with the growing affordability problems faced by homeowners and homebuyers, very low-income renters also face difficulties. In many cases, the rents they can afford to pay are not enough for landlords to cover the cost of utilities, property taxes, and maintenance; however, only about a third of renters in the bottom fifth of the income distribution receive rental assistance.

A study released by the U.S. Conference of Mayors on December 18, 2003, *Sodexho Hunger and Homelessness Survey 2003*, found that homelessness continued to rise in major American cities over the last year, and of the 25 cities surveyed, 23 reported that the lack of affordable housing was the leading cause of homelessness. Others believe this shortage is reducing the chances that welfare recipients will be able to achieve economic self-sufficiency. Lower-income households must often make long and expensive commutes to their jobs because they cannot afford to live near their work. The lack of affordable housing also makes it difficult for employers to find help for low paying jobs as retail salespersons, home health aides, child care workers, preschool and kindergarten teachers, and many who work at hospitals, nursing and retirement homes. Anecdotal evidence is showing that newly hired teachers, firefighters, and police officers are finding it increasingly difficult to live near their job.

The 2003 Joint Center report concluded that "Progress in tackling the nation's housing challenges has stalled."

HUD Budget for FY2004 (P.L. 108-199)

On January 23, 2004, the President signed the Consolidated Appropriations Act for FY2004 (P.L. 108-199) that funds numerous federal agencies, including HUD. The Senate had passed this bill on December 22, 2003 (H.R. 2673) and the House, on December 8, 2003. The FY2004 HUD budget figure of $31.2 billion, which includes the 0.59% across the board rescission approved by Congress, is about $184 million above the FY2003 enacted level. Highlights include:

- Housing Certificate Fund provided with $19.3 billion, a significant increase from the previous year, but with no incremental vouchers;
- HANF (Housing Assistance for Needy Families), Public Housing Reinvestment, Samaritan, and Colonias initiatives not approved;
- Large reduction for HOPE VI, at $149 million compared to $570 million in FY2003;
- HOME funded at $2.0 billion, with $87 million for Administration's Downpayment Initiative;
- Near level funding for Public Housing Capital and Operating programs, together at just under $6.3 billion;
- Brownfields and Rural Housing level funded at $25 million each;
- Homeless programs received $1.26 billion, up about $40 million;
- Community Development Block Grants funded at about $4.9 billion, near level funding with FY2003.

For more details on housing issues in the HUD budget for FY2004, see CRS Report, CRS Report RL31804, *Appropriations for FY2004: VA, HUD, and Independent Agencies.* [Note: the FY2004 budget figures in CRS Report RL31804 were those from the House Appropriations Committee as of the date of the final version of that report. There have since been some revisions of these FY2004 figures.]

Administration Seeks to Refocus Major HUD Programs

During the past several years, the Administration has sought through its HUD budget proposals to change the direction of several major housing programs. For a variety of reasons, the cost of the rental housing voucher program has increased much more rapidly than the overall inflation rate, a particular concern expressed by the Congress in the FY2004 Consolidated Appropriations Conference Report (H.Rept. 108-401) and in the Administration's proposed budget for FY2005. The Administration has stated that too often HUD programs address symptoms rather than addressing the root causes of low-income households' difficulties in finding affordable housing. Rather than increasing the HUD budget, which will continue to become increasingly difficult in the immediate years ahead due to large deficits, the Administration has stated that a better approach for helping more lower income households is to make existing programs work more efficiently — insuring that correct incentives are in place both for management and tenants.

Similar to proposals in the FY2004 budget, the FY2005 budget seeks to promote market-based operations which would encourage Public Housing Agencies to control costs. This approach also means removing confusing and restrictive federal regulations that may prevent state and local governments from developing creative and efficient approaches to their particular concerns. By getting housing program administrators focused on ways to increase the self-sufficiency of the assisted tenants and by offering them a chance to accumulate financial assets through homeownership, the Administration asserts that lower-income households will have a better chance of moving into the social and economic mainstream — and ending their need for federal rental housing assistance. This would free up resources so that other needy families could be assisted. Supporters of this approach point to the 1996 welfare reform, which sharply reduced welfare rolls.

Critics have viewed the Administration's proposals as designed to further defund HUD programs and reduce the federal government's involvement in subsidized housing for low-income people. Housing advocates point to the end in FY2001 of the $310 million public housing drug elimination grant program, the $250 million "shortfall" in public housing operating funds in FY2002, and the proposal not to fund the HOPE VI program in the proposed budgets for FY2004 and FY2005. In addition, the Administration's housing voucher proposals have been viewed by some as a first step in financially downsizing and weakening the program that many consider the most successful of all federal low-income housing programs. Critics also note that while welfare reform moved people from welfare to work, thereby improving their self-sufficiency, it did not necessarily increase their incomes.

Table 1. Department of Housing and Urban Development Appropriations, FY2000 to FY2004
(Net budget authority in billions)

FY2000	FY2001	FY2002	FY2003	FY2004
$25.92	$28.48	$30.15	$31.00	$31.23

Source: Budget levels remain uncertain until all program activity has been recorded, and any supplemental appropriations or rescissions have been taken into consideration. The FY2004 figure is from the House Appropriations Committee as of April 24, 2004.

Highlights of the HUD Budget Request for FY2005

- Proposed budget of $31.5 billion;
- Housing Certificate Fund requested at nearly $18.5 billion;
- New Flexible Voucher Program to convert the current voucher program to block grants to Public Housing Agencies with fixed dollar amounts to control costs;
- Public Housing Capital and Operating programs proposed at near level funding of $6.25 billion;
- New "Freedom to House" Public Housing Reform Demonstration program to increase local flexibility;
- No funding for HOPE VI, Brownfields, or rural housing;
- HOME requested at $2.1 billion (with $200 million for Homeownership Downpayment Assistance Initiative), up by about $80 million from last year ;
- Community Development Block Grant fund requested at $4.6 billion, down about $300 million, with no funding proposed for Economic Development Initiative Special Purpose Projects;
- New FHA Zero Down Payment Program to help 150,000 first-time homebuyers annually purchase with no money down and financing of all settlement costs (resulting in $180 million of net revenues);
- New FHA Sub-Prime loan product to help 60,000 families with poor credit records avoid excessive interest rates;
- Homeless Assistance Grants of nearly $1.5 billion, including a $50 million Samaritan Initiative (H.R. 4057) to end chronic homelessness, level with last year's funding;
- A Faith-Based Prisoner Re-entry Initiative of $25 million; and
- Continuing efforts to reform the Real Estate Settlement Procedures Act (RESPA) that the Administration expects to save homebuyer families and those refinancing a mortgage $6-$11 billion annually. (The proposed rule to reform RESPA was subsequently withdrawn by HUD on March 22, 2004.)

The Major Budget Issues

More than three-quarters of the HUD budget goes to support the housing voucher (often referred to as Section 8) and public housing programs, close to $24 billion of the $31 billion total budget. These are the areas with major budget and program issues.

Section 8 Housing Voucher Issues. In a sharp break with the present program structure, the Administration proposed in its FY2004 budget to convert the Section 8 Housing Choice Voucher program into a block grant to the states to improve the efficiency of the program and to cap rapidly rising costs. The Consolidated Appropriations Act signed by the President on January 23, 2004 did not include this proposal.

In its latest budget proposal, the Administration is again seeking to limit the rising cost of HUD's largest program — Section 8. The *Flexible Voucher Program* (FVP) proposed in the President's FY2005 budget for HUD would convert the current housing voucher program into a block grant to the local public housing agencies (PHAs). Rather than receiving funding based on the actual per-unit costs of the program, the PHAs would get a fixed amount of money annually to spend, with most of the regulations on how to spend it eliminated. HUD Assistant Secretary Michael Liu has testified that there is little incentive under the current system for PHAs to minimize rent subsidy payments or other program costs since they now simply get reimbursed for these expenses. He said the FVP could save $2 billion annually and serve the same number of households or more. During hearings held on April 1, 2004 by the Senate VA-HUD Appropriations Subcommittee on the FY2005 budget, Chairman Bond criticized HUD for proposing significant policy changes through the appropriations process without submitting legislation to the authorizing committees.

Many PHAs say they would welcome less onerous regulations and reasonable reforms, but they fear that a block grant approach would not keep pace with rising rental costs that are largely beyond their control. Currently, PHAs must award 75% of all newly distributed tenant-based vouchers to households with incomes no more than 30% of the local area median ("extremely low-income"). When this was enacted by the Quality Housing and Work Opportunity Reconciliation Act (QHWRA) in 1998, the goal was to use the vouchers to integrate more extremely low-income households into "mixed-income" rental buildings and the surrounding communities, away from areas of concentrated poverty. Although it was more expensive to help extremely low income households, this approach was expected to produce substantial social benefits over the longer run.

The Administration's FVP proposal would eliminate the 75% rule. PHAs would be able to use their fixed dollar grants to assist renters with incomes up to 80% of the local area median, if they chose to do so. Since households under the current voucher program pay one-third of their income towards rent, it is more expensive to serve lower income families. Shifting vouchers away from the poorest-of-the-poor to renters who are not-so-poor would mean more families could be helped. However, some housing advocacy groups believe less assistance to the poorest households will increase homelessness, already on the rise in some cities with rapidly rising housing costs, and reconcentrate poverty level households in the poorest neighborhoods.

The National Low Income Housing Coalition says that the $18.5 billion requested for the Housing Certificate fund is at least $1 billion less than needed to fund all currently authorized vouchers. The Center on Budget and Policy Priorities (CBPP) estimates that the Administration's FY2005 funding request for vouchers could result in as many as 250,000 fewer housing vouchers than now in use.

For more details, see CRS Report RL31930, *The Housing Choice Voucher Program: Background, Funding, and Issues in the 108th Congress, and CRS Report RL32284, An Overview of the Section 8 Program.*

HUD Voucher Notice of April 22, 2004. In both FY2003 and FY2004, Congress changed the way that it funds the Section 8 voucher program. Prior to FY2003, PHAs were funded based on the total number of vouchers they were authorized to lease in a year and the average cost of those vouchers. In FY2003, PHAs were funded based on the number of vouchers they could reasonably be expected to use (rather than their authorized level) and their cost, as reported in the most recent quarterly data they had submitted to HUD. Additional changes were made in the FY2004 appropriations law, which stated:

> The Secretary shall renew expiring section 8 tenant based [vouchers] for each public housing agency ...based on the total number of unit months which were under lease as reported on the most recent end-of-year financial statement submitted by the public housing agency to the Department, or as adjusted by such additional information submitted by the public housing agency to the Secretary as of August 1, 2003 (subject to verification), and by applying an inflation factor based on local or regional factors to the actual per unit cost.[2]

The HUD notice implementing the FY2004 changes was issued on April 22, 2004. It stated that PHA budgets would be based on their costs as of August 1, 2003, adjusted by HUD's Annual Adjustment Factor (AAF). While PHAs will be able to apply for higher cost adjustments if they can prove significant housing market cost increases, it does not appear from the notice that HUD will adjust budgets for PHAs who have experienced cost increases *not* due to housing market cost increases (for example, if voucher costs are higher than the inflation factor because of income changes in the voucher population or changes in family sizes in the program).

The congressionally-enacted changes in FY2003 were designed to fund the voucher program "...in a manner that more closely reflects the actual funding requirements of the Section 8 voucher program" and to "...avoid appropriations of funds in excess of actual requirements that in previous year has resulted in recaptures of funds in excess of $1 million..."[3] In FY2004, the conferees expressed additional concern about "the spiraling increase in the cost of providing assistance under the

[2] P.L. 108-199, Title II, Section (1).

[3] H.Rept. 108-10, Title II.

voucher program" and noted that the "...the Secretary has the administrative authority to control the rapidly rising costs of renewing expiring [vouchers]..."[4]

The new funding structure outlined in the HUD notice has led to concern among low-income housing and PHA advocacy groups that some PHAs may encounter funding "shortfalls," meaning they will not have sufficient funds to maintain all of their current contracts at their current cost. Those shortfalls, they fear, could lead to subsidized families losing their assistance. The changes implemented in FY2004 have also come under criticism from several Members of Congress. While HUD has stated that its notice implements the changes enacted by Congress in FY2004, some argue that HUD could interpret the law differently or use a more generous inflation factor. Senators Sarbanes and Collins, in a letter to HUD, wrote: "We urge you to reconsider your decision to publish this guidance and to work to make sure that whatever system of voucher renewals is adopted by HUD does not result in any families losing housing assistance." Representative Frank has also introduced legislation (H.R. 4263) that would alter the FY2004 language to direct HUD to fund PHAs based on their most recently submitted cost data, rather than August 1, 2003 data.

For an expanded discussion, see Congressional Distribution memo, *FY2004 Section 8 Housing Funding Issue*, issued May 5, 2004, by Maggie McCarty.

Public Housing Issues. There are about 1.25 million units of public housing worth an estimated $90 billion in the United States. Many elected officials and advocacy groups view the public housing stock as a national asset that provides a last resort social safety net for the most disadvantaged and poorest households. They believe it needs to be well maintained and protected particularly since it is so difficult and controversial to find new sites for affordable housing. However, the Administration and others believe the current public housing program lacks the market-based incentives that are necessary for efficient operations. They point to a number of big city public housing authorities that have been taken over by HUD because of mismanagement and corruption. Furthermore, critics of public housing argue that unlike portable vouchers, public housing can trap families in areas of high poverty, crime, and little opportunity. Current issues involve the desire both to protect the stock of public housing and ensure that it is well managed. The main Public Housing Capital and Operating programs were funded at about $6.25 billion in FY2004, with a similar amount requested for FY2005. Most issues have centered around the HOPE VI program.

The Future of HOPE VI. Started in 1992, HOPE VI was envisioned as a 10-year effort to tear down about 100,000 of the worst units of public housing and replace them with "mixed income" communities. By all accounts, replacement construction has been excruciatingly slow due to lawsuits and other delays. A June 30, 2003 GAO report (03-555), *Public Housing: HUD's Oversight of HOPE VI Sites Needs To Be More Consistent*, blames HUD staffing limitations for the slow expenditures in the HOPE VI program and said that HUD field offices have provided inadequate oversight. The report also found that the majority of HOPE VI grantees

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[4] H.Rept. 108-401, Title II.

had not met their obligations, with only 15 of the 165 HOPE VI sites being fully completed.

With large amounts of HOPE VI funds remaining unspent — about $2.5 billion out of $4.5 billion awarded — HUD has maintained that it is unnecessary to appropriate any additional funds. With pressures to hold the HUD budget down, and with the rising costs of the voucher program, it could be argued that this was the logical program to eliminate. The Administration has argued that the program has actually accomplished its original goal of eliminating the worst public housing sites and needs no additional funding. The HUD budget for FY2004 requested no new funding, but $150 million was appropriated nonetheless, a sharp reduction from the $570 million the program received in FY2003. No funding is proposed for FY2005. However, even without additional appropriations for FY2005, program activity will continue for a number of years.

Housing advocacy groups generally support the program, but say the main problem is that many more housing units have been torn down than replaced, forcing many former residents to leave their old neighborhoods with a housing voucher that is often difficult to use. A General Accounting Office study released on November 21, 2003, *Public Housing: HOPE VI Resident Issues and Changes in Neighborhoods Surrounding Grant Sites* (GAO-04-109) found that as of June 30, 2003, public housing authorities had demolished or planned to demolish 76,393 units, but to rebuild or renovate only 44,781 replacement public housing units. The GAO report did find that in a majority of neighborhoods with FY1996 HOPE VI projects, the percentage of the population with a high school diploma increased, average housing values had gone up, and the poverty rate had decreased.

S. 811, which was signed into law by the President on December 16, 2003, reauthorized the HOPE VI program from FY2004 through FY2006 (P.L. 108-186). This new law requires that the selection criteria for awarding HOPE VI grants consider the extent to which the plan for using HOPE VI funds minimizes the permanent displacement of current residents of the public housing site who wish to remain in or return to the revitalized community.

For more details, see CRS Report RL32236, *HOPE VI: Background, Funding, and Issues in the 108th Congress.*

How Best to Maintain Public Housing. It is estimated that the nation's public housing units need $20-$22 billion in capital repairs, with new needs accruing at the rate of $2-$3 billion annually. In HUD's FY2004 budget request, the agency proposed a program to allow PHAs to convert some public housing units to project-based voucher assistance — wishing to tie federal assistance more closely to individual projects rather than providing PHAs with a lump sum annual capital grant for all their projects, as is now done. Along with new federal loan guarantees, the stream of voucher subsidies would make it more possible for PHAs to turn to the private sector for rehabilitation loans, pledging the project-based voucher revenues as collateral.

In addition, in the FY2004 proposal, after receiving voucher assistance for a year, a tenant at the project could take the voucher and move elsewhere if they chose to, allowing families to move to areas of lower concentrations of poverty and greater economic opportunity. HUD said this initiative would make public housing more like privately owned rental housing, with more market-based decisions about operations and maintenance. Because there are often long waiting lists to get into public housing, tenants now may hesitate to leave even when the service and conditions are less than desirable. The Administration said that by allowing more tenants to leave with vouchers if so desired, PHAs could no longer take a tenant's occupancy for granted. There would be incentives to operate competitively.

The President's proposal was not adopted for FY2004. The conferees cited the number of PHAs who currently leverage private financing without the President's proposed program, highlighting Baltimore, Chicago and Philadelphia in particular. Some housing organizations and PHAs are concerned that the Administration's encouragement to borrow in the private market for capital improvements is an untested experiment that could lead to serious financial difficulties for PHAs and the potential loss of large amounts of the nation's low-cost housing stock.

The Administration is proposing in its FY2005 budget submission a new *Freedom to House* Public Housing Reform Demonstration program that would grant up to 50 PHAs the ability to combine the use of capital and operating funds, to set locally determined rent structures, and to free themselves from many of the administratively burdensome requirements of federal reporting. The PHAs in the demonstration would be compared with 50 other PHAs serving as a control group. There would be rewards for superior performance for those participating in the demonstration.

National Affordable Housing Trust Fund

Housing trust funds are public accounts established by legislation or resolution to receive specific revenues, which can only be spent on housing. The most important feature of a housing trust fund is that it receives on-going revenue from dedicated sources of funding, such as taxes or fees. According to the Housing Trust Fund Project, more than 270 housing trust funds have been established by cities, counties, and states. It is estimated that these trust funds are now spending more than $500 million a year for affordable housing, although a large majority of this spending is likely made by a small number of the largest trust funds. While housing trust funds use about three dozen sources of revenue, real estate transfer fees and direct appropriations are the primary source of funds.

H.R. 1102 and S. 1411, similar but not identical bills, have been introduced in the 108th Congress to establish a National Affordable Housing Trust (the "Trust Fund") in the Treasury of the United States. H.R. 1102 has 212 mostly Democratic cosponsors. The goal of both bills would be to produce, rehabilitate, and preserve at least 1,500,000 affordable housing units over the next 10 years, creating tens of thousands of jobs that supporters say could not be exported or be "outsourced." The Trust would be funded "by using profits generated by Federal housing programs to fund additional housing activities, without supplanting existing housing appropriations." The Fund would focus on the production of rental housing for families with the greatest need, in mixed income settings, and in areas where families could gain access to the greatest economic opportunities. Housing advocacy groups also point out that this would generate tens of thousands of jobs that could not be exported or "outsourced."

H.R. 1102. Most of the grants made by the Trust Fund to state and local governments would be required to be used for rental housing for "extremely low-income families" (not less than 45% of grant amounts) and for "minimum wage-income families" (not less than 30% of amounts). Up to 25% of the funds could be used for rental housing and homeownership assistance for families with incomes up to 80% of the greater of the median family income of the local area or of the state.

Source of Funds. Under H.R. 1102, the Trust Fund would be established and, beginning in FY2004, an amount would be appropriated annually to the Trust Fund equal to:

- the amount in the FHA Mutual Mortgage Insurance (MMI) Fund that exceeds the legally required 2% capital ratio (the economic value of the fund divided by the amount of insurance in force) each year; and
- the amount in the Government National Mortgage Association that exceeds the funds necessary to ensure the safety and soundness of the agency, as determined by the HUD Secretary.

Distribution of Funds. Of the total amount of funding available each year, 40% would go to states and 60% to participating local jurisdictions (PJs). Each state would receive at least 1.0% of the total annual funds designated for states. A formula would be established by the Secretary for allocating assistance to states and PJs based on a comparison of the relative needs of eligible recipients and would include the following factors:

- the percentage of families living in substandard housing, paying more than 50% of their annual income for housing costs, and having an income at or below the poverty line;
- the cost of developing or carrying out rehabilitation of housing; and
- counties that have extremely low vacancy rates or extremely old housing.

In order to receive its annual Trust Fund allocation, an eligible state or PJ would have to make a matching contribution from certain designated "non-federal sources." In general, eligible states or PJs would receive an allocation equal to four times their matching contribution. Only funds from the following sources could be used for the matching requirement:

- 50% of funds from Low Income Housing Tax Credits;
- 50% of funds from mortgage revenue bonds and tax-exempt bonds;
- 50% of grants under the Community Development Block Grant and the HOME program;
- 50% of project-based housing voucher assistance;
- 50% of funds from the rural housing assistance program;
- federal, state, or local amounts from the Temporary Assistance for Needy Families program; and

- general state revenue (any state or local government revenue not derived from federal sources, including any state tax revenue).

There would be a 50% reduction in the matching requirement for recipients in fiscal distress, and a 100% reduction for those in severe fiscal distress.

Use of Trust Fund Assistance By Recipients. Once eligible "recipients" (states and participating local jurisdictions) received funds, they would, in turn, distribute grants to eligible "entities" or "subrecipients." These could include any public or private nonprofit or for-profit entity, unit of general local government, regional planning entity, or any other entity engaged in the development, rehabilitation, or preservation of affordable housing, as determined by the Secretary. The HUD Secretary would establish dollar limits per unit for grant amounts that could be used for eligible activities.

Grant assistance could be provided in the form of capital grants, noninterest bearing or low-interest loans or advances, deferred payment loans, guarantees, and other forms approved by the Secretary.

Appropriations would be authorized for Section 8 project-based vouchers for units assisted under this act for families that would otherwise pay rents that exceeded 30% of their adjusted income.

S. 1411. As noted, this bill is similar to H.R. 1102. However, under S. 1411, the Trust Fund would be financed by the amount in the FHA Mutual Mortgage Insurance (MMI) Fund that is above what is necessary to maintain a 3% capital ratio, rather than the 2% ratio in H.R. 1102. Under S. 1411, 75% of the grants would have to be used for the development of affordable housing for rent by extremely low-income families, and 25% would have to be used for rental housing or for homeownership — for low-income families. Three-quarters of money from the Trust Fund would be given as matching grants to states and local governments through a formula based on the need for housing (with similar matching requirements by state or local governments from "non-federal" resources as in H.R. 1102); the remainder would be awarded by HUD through a national competition to non-profit intermediaries. Assisted housing would have to remain affordable for 40 years.

Issues and Concerns. The Administration does not support a national trust fund for the construction of "project-based" assistance. They point to the record high national rental vacancy rate of 10.4% reported by the Census Bureau in the first quarter of 2004, the highest level since the Census Bureau began tracking it in 1960. Housing advocacy groups say however that many of these units are out of the price range of low income household, even with vouchers, or are not in areas that can be reached by public transportation. The Administration also cites the existing $4.3 billion a year Low Income Housing Tax Credit program that provides financial support for an estimated 100,000 new and rehabilitated units a year. Trust Fund advocates respond that the Tax Credit program is targeted at renters with incomes of 50-60% of the local area median, while Trust Fund units would generally be directed at households with incomes with "extremely low incomes" — those with incomes at or below 30% of the local area median. The Administration also points to several other HUD programs, including the HOME program that has supported the construction or rehabilitation of more than 334,000 affordable rental units since 1992. The HOPE VI public housing program is also being used to fund construction and rehabilitation of rental housing (although as noted above, the Administration did not request funding for this program for FY2004 nor for FY2005). Again, however, critics argue that very few of the rental units constructed or rehabilitated under these other federal programs have been targeted at "extremely low-income households."

The main source of funds to support the proposed Trust Fund is the "surplus" reserves of HUD's profitable FHA mortgage insurance business. Under the FHA program, homebuyers pay mortgage insurance premiums into the program. The premiums are used to protect FHA-approved lenders, who have lent funds to many relatively risky homebuyers, from losses if homeowners are no longer able to make their mortgage payments and undergo foreclosure. Over the past decade, the favorable economy and the strong demand for housing has meant relatively low foreclosure rates. As a result, FHA reserves have been building, with the fund's economic value reaching $22.7 billion at the end of FY2003 and expected to reach $46.7 billion by FY2008. The capital ratio stood at 5.21% at the end of FY2003 and is projected to remain above 5.0% through 2010, considerably above the government-mandated minimum of 2%. But the levels of surplus could change quickly if there were to be a serious downturn in the economy or a continuing loss of jobs to other countries, with many more homeowners losing their homes. For example, the value of the reserves of $22.74 billion for FY2003 had been forecast in the FY2002 Actuarial Review by HUD's independent auditor to be $27.27 billion for FY2003. The $4.5 billion drop in the estimate was largely due to a much higher level of prepayment activity from mortgage refinancings and from higher claims activity from defaults.

There has been some confusion over how the FHA insurance reserves are treated for budgetary purposes. They are not idle funds waiting to be tapped, but they flow into the Treasury like other federal revenues, and they are used to pay government expenses. Since 2001, the Office of Management and Budget has treated annual net FHA reserves as revenue to HUD, offsetting appropriations that would otherwise be required. If the FHA reserves were to be tapped for the Trust Fund, they would have to be replaced by additional appropriations, the same as funding for any other HUD program. Some ask why supporters do not propose the financing of the Trust Fund through direct appropriations rather than through the FHA reserves, given that both approaches would have the same cost. According to the National Low Income Housing Coalition, "while all trust funds are subject to annual budget decisions ... trust funds are less subject to the vicissitudes of the annual appropriations process."[5]

There is another view that the growing FHA reserves means the insurance premiums are too high and should be lowered to more closely approximate the estimate of future needs. Proponents of this view point out that most of the reserves have come from low- and moderate-income homebuyers. S. 607 in the 107th Congress would have reduced premium levels. HUD also has the authority to reduce premium levels and did so in 2001.

[5] *2003 Advocates' Guide to Housing and Community Development Policy*, National Low Income Housing Coalition, p. 122.

Potential Loss of HUD-Subsidized Rental Housing

In January 2004, the General Accounting Office (GAO) completed a study for the House Committee on Financial Services: *Multifamily Housing: More Accessible HUD Data Could Help Efforts to Preserve Housing for Low-Income Tenants* (GAO-04-20). It found that over 101,000 tenants in buildings with HUD subsidized mortgages are at risk of paying higher rents or being displaced over the next ten years as these loans matures and landlords have the option of leaving the program, since there are no requirements to protect the tenants. These vulnerable rent-restricted units are generally affordable to households with incomes of 80% of the local area median or less, and are specific units under the Section 202, Section 221(d)(3) BMIR [below market interest rate], and Section 236 programs that do not receive rental assistance. Owners are not required to notify tenants when a property's mortgage is about to mature. Whether property owners will continue to serve low-income renters depends on a number of factors including the goals of the owners, the condition of the property, and incomes in the neighborhood (for example, units in areas undergoing gentrification are particularly vulnerable).

The GAO report found that a number of state and local housing agencies could offer tools and incentives to keep properties affordable after mortgage maturity, but that about three-quarters of those who responded to the GAO survey do not track the maturity dates of HUD mortgages.

House Financial Services Committee Chairman Michael Oxley and Ranking Member Barney Frank announced on February 24, 2004, that in light of the findings of the GAO report, the Committee would hold hearings within the next few months.

H.R. 445, the Housing Preservation Matching Grant Act of 2003, would authorize the Secretary of HUD to make grants to states to supplement assistance for the preservation of housing for low-income families.

H.R. 3485, the Affordable Housing Preservation Tax Relief Act of 2003, authorizes states to allocate preservation tax credits to owners of affordable housing properties who are willing to sell those properties to new owners committed to preserving them for low-income use.

Increasing Homeownership for Lower Income Households

The homeownership rate reached a record high of 68.6% at the end of the 1st quarter of 2004. Despite major gains in recent years, **Table 2** below shows that homeownership rates for lower income and minority households remain significantly lower than the rate for whites. There are a number of reasons for these lower rates. Minorities have lower incomes than whites and a larger percentage live in central cities, both of which make it more difficult to find a desirable home to purchase. (Many larger cities have thousands of decrepit boarded-up homes in distressed neighborhoods, but the purchase and rehabilitation of individual units is rarely an option for lower-income buyers without the help of a Community Development Corporation or some similar organization). See **Table 3** for differences in homeownership rates by area. For a variety of reasons, many lower income households have poor credit records which makes obtaining a mortgage more difficult, more expensive, or impossible.

Table 2. Homeownership Rates, by Household Category

Household type	1st Quarter 1994	1st Quarter 2004
White, non-Hispanic	69.8%	75.5%
Black	42.4%	49.3%
Hispanic	40.3.4%	47.3%
Households with family incomes greater than or equal to the median family income	78.5%	83.8%
Households with family incomes less than the median family income	48.1%	51.5.%
Married couples with children	73.6%	79.4%
Married couples without children	83.3%	87.6%
Other families with children	35.8%	43.6 %
Other families without children	64.7%	67.9%
Single Person Households	46.8%	53.1%

Source: Table prepared by the Congressional Research Service (CRS) based on data from the U.S. Census Bureau.

While discrimination in mortgage lending and in the sale of homes has been reduced over the past decade, it is still considered to play a significant factor in the lower rate of homeownership for minorities.

The main homeownership tax incentives — the mortgage and property tax deductions — provide substantial housing assistance to upper-middle and high income homeowners, but are of little use to those in the bottom half of the income distribution. Housing analysts have long suggested that a change from the current tax deduction to a tax credit would help put lower income homebuyers on a more level playing field, since under a progressive tax rate structure, a tax deduction favors those with higher incomes.

The Administration has made increasing homeownership for lower income groups the centerpiece of its housing policy. In testimony before the House Committee on Financial Services Subcommittee on Housing and Community

Opportunity on April 8, 2003, then HUD Secretary Martinez stated that homeownership offers minorities the best opportunity to accumulate wealth that can later be used for education, to start a business, or to take advantage of other opportunities that may not be available to those without financial assets. Others believe that increased homeownership can help economically distressed neighborhoods to stabilize and revitalize themselves.

The Administration has proposed a number of homeownership initiatives over the past several years, including the American Dream Downpayment Initiative, a Single-Family Affordable Housing Tax Credit, and, for FY2005, a new Zero Downpayment Program and a FHA Subprime Loan Product. These are summarized below.

Administration's Homeownership Proposals.

- **American Dream Downpayment Program**. On December 16, 2003, the President signed P.L. 108-186 (S. 811), the American Dream Downpayment Act, that authorizes the downpayment assistance program. The HUD Secretary may award grants to state and local governments to assist low-income families who are first-time homebuyers with incomes at or below 80% of the local area median income. Funds will be allocated to jurisdictions based on the percentage of the national total of low-income households residing in rental housing in the participating jurisdiction. The law authorizes $200 million for each fiscal year from 2004 through 2007. Up to 20% of the grant funds may be used to provide assistance to the first-time homebuyers for home repairs. Downpayment assistance to families is limited to not more than the greater of either 6% of the purchase price of the home or $10,000. The Consolidated Appropriations Act provided $87 million for this program in FY2004. With the Administration now estimating that grants would average $7,500 per homebuyer, the $87 million would assist about 11,600 buyers per year. HUD is giving high priority to getting this program operational — an interim rule was published in the Federal Register on March 30, 2004 at pp.16758-16761.
- **Zero Downpayment Program (H.R. 3755).** The FY2005 HUD budget request contains a new zero downpayment program for first-time buyers who could purchase single-family homes without any funds since settlement costs could be rolled into the mortgage. For example, a buyer purchasing a $100,000 house with $3,000 of settlement costs, could obtain a $103,000 mortgage. The Administration believes 150,000 buyers a year could benefit from this program, about 40% of them minorities. The 50% higher mortgage insurance premium for buyers would produce $180 million in net "offsetting receipts" for HUD (it would make money for HUD). The House Financial Services Subcommittee on Housing and Community Opportunity held hearings on the bill on March 24, 2004. There was general support for the proposal, but also concerns and cautions expressed - discussed below in *Homeownership Policy Issues.* On May 5, 2004, the Subcommittee passed an amended H.R.

3755, adding a number of consumer protections, and safeguards for HUD's Federal Housing Administration's (FHA) mortgage insurance program. Pre-purchase counseling would be required by buyers and they would have the option of receiving foreclosure prevention counseling. Under the amended bill, properties with up to 4 units could be purchased. There would be a limit on the amount HUD could charge for the mortgage insurance premium and the number of loans could not exceed 30% of all loans insured by the FHA in the previous year. The program would be ended if more than 3.5% of the mortgages are foreclosed in the preceding 12 months. Otherwise, the program would sunset (end) on September 30, 2011.

- **New FHA Subprime Loan Product**. A new FHA mortgage insurance product is proposed to help families that, due to poor credit records, must often rely on high-cost subprime loans or who are unable to borrow at all. Existing homeowners could use the program to maintain their home, and others, to purchase a new home. It would reward credit-risk borrowers who make timely mortgage payments and is expected to help 60,000 families a year.
- **Self-Help Homeownership Opportunity (SHOP)**. The Administration has proposed to expand the SHOP program (a set-aside within the Community Development Block Grant program) by reaching out to faith-based or other organizations to help more low-income families become homeowners. Under SHOP, grants are made to national and regional non-profit organizations such as Habitat for Humanity. Homebuyers must contribute significant amounts of volunteer labor to the construction or rehabilitation of the property. The Consolidated Appropriations Act provided $27 million for FY2004. The FY2005 budget requests $65 million, and is expected to help produce 5,200 new homes nationwide.
- **Housing Counseling**. Counseling helps families learn about the process of buying a home and how to avoid predatory lending practices. It also helps homeowners avoid foreclosure during periods of financial stress. The FY2005 budget requests $45 million for a separate housing counseling program; $40 million was provided for counseling in FY2004 as a set-aside within the HOME program. On March 18, 2004, the House Financial Services Subcommittee on Housing and Community Opportunity held hearings on H.R. 3938 that would establish an Office of Housing Counseling to oversee the many counseling activities now dispersed throughout HUD.
- **Single-Family Affordable Housing Tax Credit**. The Administration has proposed a homeownership tax credit to stimulate the production of homes that are affordable to lower-income households — and to help revitalize distressed communities. Introduced as H.R. 839/S. 198, it is modeled after the popular Low Income Housing Tax Credit for rental housing. Currently, the bills have more than 250 co-sponsors. The ownership tax credits would provide tax credits to be taken by homebuilders (developer or investor partnership) over five years to encourage the rehabilitation

> of existing properties (including abandoned housing in central cities) or new construction of about 40,000 affordable single-family homes a year in urban or rural areas. Credits would be allocated to state housing credit agencies on the basis of population ($1.80 per capita in the first year and indexed to inflation thereafter). State agencies would award first-year credits to single-family housing units in a project located in a census tract with median income equal to 80% or less of the area median income. The present value of credits, determined on the date of a qualifying sale, could not be more than 50% of the cost of constructing a new home or rehabilitating an existing property. The homeownership credit is projected to cost $2.5 billion over 2005-2009.

Homeownership Policy Issues. While most housing advocates find it difficult to oppose additional homeownership opportunities for lower-income families, there is increasing concern being expressed that the Administration's focus on homeownership is unbalanced. Critics say that HUD's policy should have more emphasis on maintaining or increasing the choice of housing available, including rental housing. "Homeownership may not be the best wealth-building strategy," says Woody Widrow, project director of the Texas Individual Development Account Network. "Being a renter and owning a business or saving money to send your kids to college may be a better strategy."[6] Some also argue that without a cautious and thoughtful homeownership program that avoids concentrations of lower-income homebuyers in lower-income neighborhoods, potential benefits to buyers will be minimized. For example, several recent studies have found that homeownership has positive effects on children's development. However, "... the positive effects of homeownership on children are weakened in distressed neighborhoods, especially those that are residentially unstable and poor. Thus, helping low-income families purchase homes in good neighborhoods is likely to have the best effects on children."[7] Harm can be done to both lower-income buyers and the neighborhoods where the homes are frequently purchased if there are high default rates.

Some applaud HUD and others in the housing industry for giving more attention to increasing the financial literacy of lower-income households, but others would like more efforts to improve the credit records of these households before they buy a first home. Pre-purchase counseling has greatly increased in recent years and has been shown to be helpful. As noted above, the Consolidated Appropriations Act provides $40 million in FY2004 for HUD's major housing counseling program, and HUD is requesting $45 million in FY2005. Almost all financial advisors recommend that households have at least three months and preferably six months of liquid assets available to cover the financial setbacks that all households face. Lower income households are most vulnerable to financial setbacks. Yet many lower income and minority homebuyers are encouraged to purchase a home when they have almost no savings before or after the purchase. Many are households who have never been able to accumulate any savings, who may have poor health and be without health

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[6] Winton Pitcoff, *Should Everyone Own Their Own Home?*, Shelterforce, Jan./Feb. 2003.

[7] Joseph Harkness and Sandra J. Newman, *Homeownership for the Poor in Distressed Neighborhoods. Does This Make Sense?*, Housing Policy Debate, vol. 13, 2002.

insurance, and have little or no financial knowledge about budgets, mortgages, and home repair contracts. They may be especially vulnerable to layoffs and a variety of financial and housing-related scams.

Some observers are uneasy with the Administration's proposed Zero Downpayment Program Initiative. While most who testified on the Zero Downpayment initiative (H.R. 3755) before the House Financial Services Subcommittee on Housing and Community Development on March 24, 2004, were supportive (National Association of Realtors, National Association of Homebuilders), others raised the issue of the huge disparity between the resources the government "expends to underwrite homeownership" and that spent for renters (Low Income Housing Coalition). The National Multi Housing Council pointed out that "more than half the working families with critical housing needs are owners, not renters," raising the question about whether any national housing goal is achieved if low-income renters who become homeowners soon find it necessary to pay an excessive part of their income to maintain their ownership.

The *FDIC Outlook*, *Spring 2004* (Federal Deposit Insurance Corporation) is cautioning lenders that highly leveraged homeowners (those who have purchased in recent years with very small downpayments) with subprime and adjustable-rate mortgages may become stretched too much if interest rates start to rise and local home prices decline.

Table 3. Homeownership Rates, by Area

(1st Quarter, 2004)

Area	1st Quarter 2004
U.S.	68.6%
In central cities	52.6%
Suburbs	75.3%
Outside metropolitan areas	76.1%
Northeast	65.1%
Midwest	73.5%
South	70.3%
West	63.7%

Source: Table prepared by the Congressional Research Service (CRS) based on data from the U.S. Census Bureau.

The Mortgage Bankers of America reported that 1.12% of all loans were in foreclosure at the end of the third quarter of 2003, high, but not quite a record. Other homeowners who are seriously behind in their mortgage payments are sometimes able to avoid or defer foreclosure by filing for bankruptcy. HUD's largest homeownership program, its Federal Housing Administration (FHA) mortgage insurance program, helped about 700,000 first-time buyers in 2003. However, at noted earlier, this program continues to operate with very high delinquency rates — a record high 12.59% of borrowers at least 30 days past due was reached in the 2nd quarter of 2003, declining to 12.23% at the end of the 4th quarter. Before the year 2000, this rate was never above 9%. The Senate Appropriations Committee wrote in its FY2003 report that ...” in some cases and in certain neighborhoods, FHA has been misused to underwrite bad loans that lead to defaults and foreclosed homes, contributing to neighborhood decline and destabilization,” and directed HUD to report to the appropriate congressional committees on further actions that can be taken to protect homebuyers and communities experiencing high rates of defaults and foreclosures on FHA-insured loans.

Increased homebuyer training may help to protect low-income and minority homebuyers from another significant problem: predatory lending. Research has shown that lower-income and minority buyers are more likely to receive “subprime” mortgages with higher interest rates and higher fees, often higher than can be justified by standard underwriting guidelines.[8] Predatory lending has hurt lower-income and minority homeowners most, often stripping away home equity accumulated over a lifetime. When foreclosures are concentrated in certain areas, as FHA-insured homes often are, they can pull property values down and do other damage to these neighborhoods. These and other factors work against lower-income homebuyers accumulating wealth. The Administration’s proposed FHA Subprime Loan product is seen as an attempt to address some of these issues.

Other 108th Congress Homeowner Proposals. In addition to the Administration’s proposals, a variety of homeownership proposals are pending in Congress. No hearings have been held and none have been reported out of committee.

- S. 875 would amend the Internal Revenue Code of 1986 to allow an income tax credit to promote homeownership and community development. (Very similar to the Administration’s H.R. 839/S. 198.)
- H.R. 1913 would amend the Internal Revenue Code to allow first-time homebuyers credit for the purchase of principal residences in rural areas equal to the lesser of 10% of the home purchase price or $5,000.
- H.R. 133/S. 846 would amend the Internal Revenue Code of 1986 to allow a deduction for premiums on mortgage insurance.
- H.R. 1132, the Home At Last Tax Credit Act of 2003, would provide a tax credit to promote homeownership among low-income individuals. State housing finance agencies would receive annual tax credits based on the state’s population. Qualified lenders would use the tax credits to provide below-market rate mortgages to homebuyers who, in general, have incomes of 80% or less of the local area median and who attend pre-purchase homeownership

[8] *Risk or Race? Racial Disparities and the Subprime Refinance Market* — A Report of the Center for Community Change, *Congressional Record*, May 1, 2002, pp. S3630-31.

counseling. (This is very similar to the existing Mortgage Revenue Bond program.)

- S. 1175, the First-Time Homebuyers' Tax Credit Act of 2003, would provide a refundable credit (the Treasury writes a check to the homebuyer if the credit is more than the first-time buyer owes in taxes) equal to 10% of the purchase price up to $6,000 for a joint return ($3,000 for a single) to be used for both closing costs and the downpayment. The credit could be used in the year of the purchase by transferring the tax credit to the mortgage lender.

Predatory Lending

Predatory lending involves home mortgages, mortgage refinancing, home equity loans, and home repair loans with unjustifiably high interest rates, excessive fees, balloon payments, prepayment penalties, and the imposition of other unreasonable, and sometimes fraudulent, terms. By many accounts, these loans have grown rapidly in minority neighborhoods in the past half dozen years, frequently targeted to the elderly, often stripping away wealth that may have taken owners decades or a lifetime to accumulate.

Congress continues to hold hearings on predatory lending, the most recent on March 30, 2004, by the House Subcommittees on Financial Institutions and Consumer Credit, and Housing and Community Opportunity. The focus was on the nature of subprime lending and its overlap with predatory lending. As one Member said, "Not all subprime lending is predatory, but too much of it is." Despite the many hearings and the bills that have been introduced over the last few years, industry, consumer groups, HUD, and other interested parties have not been able to reach a consensus on what legislation is necessary to address predatory lending. Some financial organizations argue that more rigorous enforcement of existing federal laws would be sufficient. A number of government agencies (Justice Department, the Federal Trade Commission, the Federal Reserve, HUD, along with the government sponsored enterprises, Fannie Mae and Freddie Mac) have become involved in addressing various aspects of the predatory lending issue, which suggests to some that additional legislation may not be necessary. On the other hand, some consumer groups believe there should be more education initiatives to increase financial literacy. One consumer advocacy group said that predatory lending is "so hard to fight because so many people are making so much money," and that only comprehensive legislation can stem the problem.

The Neighborhood Reinvestment Corporation (NRC) argues that predatory lending threatens to undo the work of many nonprofits that have worked with lenders and local governments to improve distressed neighborhoods. They have worked with Freddie Mac to develop a loan product for families that now have predatory loans. The mortgage lending industry acknowledges that a small number of lenders on the fringe give their industry a black mark, and say they are working to address the worst abuses. However, they caution about an overreaction, with excessive regulations that could increase the costs of borrowing and make it more difficult for those with impaired credit records to get needed loans. Industry groups are concerned that states are passing their own predatory lending laws, including California, North Carolina, and Georgia, and that some are so severe that reasonable federal preemptive legislation is now desired.

A number of bills designed to combat predatory lending have been introduced in the 108th Congress. Representative Ney, chair of the Financial Services Subcommittee on Housing and Community Opportunity, has introduced H.R. 833, a bill to "combat unfair and deceptive practices in the high-cost mortgage market" and preempt the growing number of state and local predatory lending laws. H.R. 1663, the Predatory Mortgage Lending Practices Reduction Act, also proposes to curtail abuses among subprime lenders and encourage efforts to resolve complaints by consumers. Both bills are summarized below.

H.R. 833 would amend the Truth in Lending Act "to combat unfair and deceptive practices in the high-cost mortgage market, establish a consumer mortgage protection board, and establish licensing and minimum standards for mortgage brokers."

Consumer protections in the bill include:

- prohibiting single premium credit insurance;
- prohibiting loans made without regard to the borrower's ability to repay them;
- limiting prepayment penalties to four years, rather than their current five-year period;
- prohibiting refinancing during the first 12 months of the loan, unless it benefits the borrower; and
- prohibiting lenders from profiting from foreclosure by only allowing them to recoup costs.

The bill also includes a number of new disclosure requirements:

- lenders must disclose that a loan has a balloon payment and that a borrower is not required to have such a feature in their loan;
- lenders must report borrower's favorable loan activity to credit bureaus at least quarterly; and
- borrowers with high cost loans must receive a free copy of their credit report upon request.

Since this bill would preempt more stringent state and local laws, the lending industry would receive protection from laws they believe raise the costs of lending and encumber the national mortgage lending market. The legislation would also bar certain "frivolous" lawsuits that raise the cost of lending. Some consumer groups oppose the bill because it would eliminate what they view as more consumer-friendly state and local laws. They claim that this proposal would do little to curb the worst abusive-lending practices.

Another predatory lending bill, H.R. 1663, would require the HUD Secretary to establish, by regulation, standards and procedures for mortgage lenders and brokers. Persons providing mortgage lending services or mortgage brokerage services in connection with a subprime, federally-related mortgage would be required to be tested and certified in a variety of areas including the Truth in Lending Act, the Equal Credit Opportunity Act, the Home Ownership and Equity Protection Act of 1994, and the Real Estate Settlement Procedures Act. A creditor would be required to make a good faith effort to resolve any consumer complaint concerning improper or questionable lending practices within 60 days. There would be prohibitions against charges by lenders that were not previously disclosed to borrowers and on arbitration clauses imposed by lenders on consumers without their consent. H.R. 1663 would also provide grants to Community Development Corporations to provide predatory lending education to borrowers, and potential borrowers.

Real Estate Settlement Procedures Act

The major purpose of the Real Estate Settlement Procedures Act of 1974 (RESPA)[9] is to encourage homebuyers or homeowners who are refinancing their mortgages, to shop around for the best prices for settlement services (also referred to as "closing costs"). Many contend that this act has failed in its purpose over the decades, with many homeowners or homebuyers being overcharged or forced to buy unneeded services. On July 29, 2002, the Administration proposed a rule that would make major changes in RESPA regulations to simplify and improve the process of obtaining a home mortgage.[10] Homebuyers would have the option of getting a guaranteed "package price" including all of the required settlement services before committing funds to any lender, so that they might compare this "one price" with others from other settlement service providers. A number of lenders already offer this as a "no closing costs"option, rolling the settlement costs into a higher mortgage rate. The analogy for the one-price proposal is similar to WalMart (and Target and a handful of other large chain stores) opening up a superstore, and because of its large purchasing power (buying soap by the trainload), and efficient operations, it can lower prices and outcompete local department stores, hardware stores, food stores, and other businesses who cannot find niche markets or adapt in other ways.

Former HUD Secretary Martinez said that these reforms could save Americans up to $8 billion a year — an estimated $700 of savings per homebuyer or those refinancing a mortgage — but national organizations representing mortgage brokers and real estate agents that benefit financially from the lack of competition among settlement providers have objected strongly. Some fear that under HUD's proposed RESPA rule, half a dozen large national lenders and real estate firms could come to dominate the settlement service business. Senator Shelby, chair of the Senate Banking, Housing and Urban Affairs Committee, said at a RESPA hearing that the change would be "significantly damaging to small businesses" and Representative Manzullo, chair of the Small Business Committee, spoke against this proposal, saying that it could bankrupt thousands of small businesses across the country.[11] Supporters of the proposed reforms, including the Consumer Federation of America and the National Association of Consumer Advocates, argue that under the current system, it is very difficult for homebuyers to avoid being overcharged and cheated.

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[9] 12 U.S. C. Sec. 2601, et seq.

[10] *Federal Register*, July 29, 2002, pp. 49134-49174.

[11] Current RESPA Proposal Doomed, *Housing Affairs Letter*, Apr. 11, 2003.

Often the settlement process is a scam, with made-up and overlapping categories of charges that must be paid because to delay or cancel a home purchase at the last minute would have even more serious financial consequences. However, even these consumer organizations were wary of what the final rule would contain. In a December 3, 2003 letter to the Office of Management and Budget (OMB), a number of consumer groups expressed concerns (although for different reasons than industry groups) — including that they did not want the rule to facilitate predatory lending or to preempt state consumer protection laws.

HUD has been frustrated over the past two years at the lack of support with its RESPA reform proposal during congressional oversight hearings. In late December 2003, HUD sent a final RESPA rule to OMB for review. OMB had 90 days to decide whether to go forward or not. If OMB had signed off on it, it would have then been published in the Federal Register, and according to some reports, the reforms would have been phased in over a 6 to 12 month period. However, on March 22, 2004, HUD's then Acting Secretary, Alphonso Jackson, withdrew the final rule. He said he planned to revise the rule, if necessary, and re-propose the rule after briefing Members of Congress and meeting with affected consumer and industry groups. Efforts to reform RESPA have been going on for more than 20 years, and few now expect progress any time soon.

The Mortgage Revenue Bond Program for First-Time Homebuyers — and the Proposed Repeal of the "Ten-Year Rule"

The Housing Bond and Credit Modernization and Fairness Act of 2003 (H.R. 284/S.595), with about 380 bipartisan co-sponsors, would modify several provisions in the existing Mortgage Revenue Bond (MRB) program for first-time homebuyers.

The MRB program is a provision in the tax code that provides reduced rate mortgages to first-time homebuyers with incomes up to 115% of the local area median. Many states also use their programs to provide help with downpayments and closing costs. States raise funds for the program by selling tax-exempt bonds. Investors who buy these bonds do not have to pay federal income tax on the interest income they earn, so they are willing to lend to states at lower interest rates. At an annual cost of $1 billion in lost tax revenue to the U.S. Treasury, the program serves an estimated 120,000 buyers who receive reduced-rate mortgages each year at a cost that averages about $8,000 per buyer. It is not clear how many of these buyers might have been able to purchase a home without the discounted mortgage.

H.R. 284/S. 595 would repeal the "Ten-Year Rule," an obscure provision now said to be preventing tens of thousands of qualified lower-income first-time buyers each year from getting an affordable MRB-financed mortgage. The rule,[12] enacted before the MRB program was made permanent in 1993, requires states to use the mortgage payments received from homeowners to pay off the bond once the bond has been outstanding for 10 years, rather than using (or recycling) these mortgage payments to make other loans to other first-time buyers. When homeowners sell

[12] P.L. 100-647.

their home and pay off their mortgage, or refinance their loan, these funds must also be used to pay down the bond principal.

The 1988 Ten-Year Rule started having an impact in 1998. Repealing the rule would allow a recycling of funds and thus allow a larger volume of tax-exempt bonds to remain outstanding for a longer period of time. This change is supported by the National Council of State Housing Agencies and the National Governors Association. The Joint Committee on Taxation has estimated that the repeal would cost $770 million over five years and $2.4 billion over 10 years.

Those who oppose the repeal of the Ten-Year Rule maintain that the purpose of the rule was to reduce the advantage that the MRB program has over other bond users competing for the state's limited bond authority. It is noteworthy that only MRBs are subject to the Rule, not bonds for rental housing, airport construction, sewage treatment facilities, or various other private activity bond categories. The MRB program has always had a significant advantage over many other categories; the uniqueness of the home mortgage program means that as homeowners make their monthly payments, the money can be used to make more home loans. In effect, bond authority used to finance mortgages can be stretched beyond the initial amount. Other uses of bond authority — such as for a water treatment plant — do not have this ability. Revenue from the water treatment plant would go directly to pay off the bond without any recycling opportunity. Thus, even with the Ten-Year Rule, the MRB program maintains a relative advantage over other bond programs.

There has been no movement on these bills thus far in the 108th Congress.

Fannie Mae and Freddie Mac

There appears to be a consensus on the need for more stringent regulation of the "Government Sponsored Enterprises" (GSEs) Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, although as congressional hearings held by the Senate Banking Committee on April 1, 2004 demonstrate, no agreement has emerged on the kind of regulator, where in the government it should be located, and its powers.

Representative Richard Baker, chair of the House Financial Services Government-Sponsored Enterprises Subcommittee, has long been a critic of Fannie Mae and Freddie Mac, arguing that they have not been sufficiently accountable to the public. He has also argued that HUD's Office of Federal Housing Enterprise Oversight (OFHEO) has been ineffective in its watchdog role of the GSEs. H.R. 2575, the Secondary Mortgage Market Enterprises Regulatory Improvement Act (with 20 Republican cosponsors), would abolish OFHEO, and create a new Office of Housing Finance Supervision within the Treasury to oversee Fannie Mae and Freddie Mac. This new entity would establish the duties and authorities for the Director, provide for the public disclosure of information, risk-based capital tests for enterprises, and for required minimum and critical capital levels. The proposed legislation includes provisions for prompt corrective actions and for the enforcement of actions.

Three additional bills have been introduced that would abolish OFHEO and establish a new regulatory framework for the GSEs (H.R. 2803, S. 1508, and S.

1656). In addition, on April 1, 2004, the Senate Banking Committee reported legislation sponsored by Chairman Shelby, which would establish an independent regulatory agency to replace OFHEO and certain practices of the Federal Housing finance Board. One controversial part of the bill is a provision that would provide the new regulator with the power of receivership over Fannie Mae and Freddie Mac — if either were to get into serious financial trouble, the regulator could take over the GSEs and sell their assets. Supporters of this provision believe this would help convince investors that the government does not guarantee the debts of the GSEs. The current belief that the government would come to the aid of the GSEs (believing they are too big for the government to allow them to fail) allows the GSEs to borrow funds in the capital markets at lower interest rates than their competitors. Housing advocacy groups oppose the provision since they think this could mean GSEs would have less funds to support affordable housing goals (these are set each year by HUD, for example, in 2003, 50% of loans purchased by Fannie Mae and Freddie Mac were to help low- and moderate-income families).

For a side-by-side comparison of GSE regulation proposals, including Chairman Shelby's draft bill that was offered as a substitute for S. 1508 during the markup and passed largely along party lines on April 4, 2004, see CRS Report RL32069, *Improving the Effectiveness of GSE Oversight: Legislative Proposals.* Of particular interest to housing advocacy groups, the Shelby proposal contains a requirement that Fannie Mae and Freddie Mac spend 2.5% of their pre-tax profits on capital grants to support production and preservation of low income housing. Another 2.5% would go into a loan loss reserve fund to allow the GSEs to take greater risk in their lending to serve lower income people. Five percent of Fannie Mae and Freddie Mac's pre-tax earnings for last year would have been about $1 billion. The bill would also significantly increase the GSE affordable housing goals.

A December 2003 report by the Federal Reserve, *The GSE Implicit Subsidy and Value of Government Ambiguity,* concluded that Fannie Mae and Freddie Mac provide very little help to homebuyers, reducing mortgage rates by only seven "basis points" (1% equals 100 basis points), not enough to substantially increase the homeownership rate. According to the author, economist Wayne Passmore, most of the advantage the GSEs have in borrowing funds at lower rates in financial markets, which occurs because investors incorrectly believe that the GSEs have implicit government backing, benefits shareholders in these companies. The GSEs dispute the findings and the chief economist of the National Association of Homebuilders, David Seiders, says the results are very questionable and are in conflict with other studies.

Brownfields

The Brownfields redevelopment program is used to reclaim abandoned and contaminated commercial and industrial sites — often as part of inner city neighborhood redevelopment efforts. Some view these efforts as "smart growth," making use of the existing infrastructure. But much less progress has occurred than hoped, with many projects taking 3-4 years to get started and others abandoned because of complex environmental regulations and other difficulties. Brownfields bills in the 108th Congress include H.R. 239, H.R. 1334, and S. 645. These bills would provide grants for projects for the cleanup and economic redevelopment of

Brownfields. While HUD's Brownfields program received $25 million of appropriations in each of FY2002, FY2003, and FY2004, the Administration's FY2005 budget requests no funding, recommending instead that brownfields activities be turned over to the Environmental Protection Agency. For more details, see CRS Issue Brief IB10114, Brownfields and Superfund Issues in the 108th Congress and CRS Report RL30972, *The Brownfields Program Authorization: Cleanup of Contaminated Sites*.)