Order Code RL30916

Report for Congress
Received through the CRS Web

Housing Issues in the 107th Congress

Updated February 7, 2003

E. Richard Bourdon
Analyst in Housing
Domestic Social Policy Division

Housing Issues in the 107th Congress

Summary

The 107th Congress adjourned without adopting a FY2003 budget for the Department of Housing and Urban Development (HUD), with the agency operating at FY2002 funding levels under a continuing resolution. The Administration had requested $31.35 billion, with significant cuts to the public housing and Community Development Block Grant (CDBG) programs. The House Appropriations Committee approved H.R. 5605 (H.Rept.107-740), also recommending $31.35 billion for HUD, enough to "ensure every family currently assisted by a Section 8 voucher continues to receive assistance." However, the Center on Budget and Policy Priorities contended that the Committee's proposed change for Section 8 funding could have resulted in 127,000 fewer vouchers being available. On July 25, 2002, the Senate Appropriations Committee reported S. 2797 (S.Rept. 107-222), recommending $32.1 billion for HUD. Both the House and Senate Committees rejected HUD's proposed cuts to the public housing and CDBG programs.

S. 1248 and H.R. 2349, which called for the creation of a National Affordable Housing Trust Fund to subsidize the production of affordable rental housing, had about 230 largely Democratic co-sponsors. The Administration said it favored more market-based assistance. However, critics said that the 33,400 additional vouchers that the Administration requested was insignificant when compared with HUD data showing 4.9 million very low-income renters who pay more than 50% of their income for shelter or live in substandard housing, but who receive no assistance. The congressionally-mandated Millennial Housing Commission report released on May 30, 2002, *Meeting Our Nation's Housing Challenges*, said that "there simply is not enough affordable housing" for the very poor, recommending substantially increased funding for more vouchers and for the HOME block grant program.

The "Ten Year Rule" that limits the use of tax-exempt bonds for first-time homebuyers, would have been removed by S. 677/ H.R. 951, which had 436 cosponsors. Hearings were held on S. 2438, the Predatory Lending Consumer Protection Act of 2002, but no legislation was enacted. Several welfare reauthorization bills that incorporated housing assistance were considered , including a substitute version of H.R. 4737, which was approved by the Senate Finance Committee (S.Rept. 107-221). H. R. 4775 (P. L. 107-206), the FY2002 supplemental appropriation bill, rescinded $738 million in HUD funding and made an additional $783 million of CDBG funds available for New York City recovery efforts. There was also interest in the President's Faith-Based Initiative for housing programs and reforms to the Real Estate Settlement Procedures Act. On December 14, 2002, the President signed P.L. 107-326 that indexes FHA multifamily mortgage insurance limits for inflation and makes permanent a simplified FHA downpayment formula.

This report on the 107th Congress covers activities through the end of 2002 and will not be further updated.

Contents

Proposed FY2003 HUD Budget 1
FY2002 HUD Budget 5
FY2002 Supplemental Appropriations 6
Policy Issue: The Shortage of Affordable Rental Housing 6
A Brief History of Federal Housing Assistance 8
Is There Housing Available at an Affordable Price? 9
Increasing the Supply of Affordable Housing 11
The Housing Affordability For America Act of 2002 15
The Housing Voucher Improvement Act of 2002 18
OMHAR/Mark-to-Market Reauthorization and Reform 19
Provisions in Title VI of P.L. 107-116 20
Increasing Homeownership 20
Administration Homeownership Proposals 22
Other Homeowner Proposals 24
High FHA Delinquency Rates and Other Concerns 26
Low Income Housing Tax Credits 27
Mortgage Revenue Bond Program 30
Predatory Lending 31
Oversight of Fannie Mae and Freddie Mac 34
Welfare Reform and Housing Assistance 35
Management Reforms and the Oversight of HUD 36
Millennial Housing Commission 37
Millennial Housing Commission 37

List of Tables

Table 1. Department of Housing and Urban Development Appropriations, FY1998 to FY2003 1
Table 2. Homeownership Rates, Various Categories 21
Table 3. Homeownership Rates, Various Areas 22
Table 4. States with Highest and Lowest Homeownership Rates 24
Table 5. Homeownership Rates in Selected Metropolitan Areas 25

Housing Issues in the 107th Congress

Proposed FY2003 HUD Budget

At the end of 2002, final action on the FY2003 HUD budget had not occurred, and the agency was operating at the FY2002 funding level under a continuing resolution, leaving final decisions on FY2003 spending levels to be made by the 108th Congress.

The Administration presented its FY2003 budget for the Department of Housing and Urban Development (HUD) on February 4, 2002, requesting $31.35 billion, the first budget that fully reflected the Bush Administration's vision for the agency, and for federal policy on housing and urban development. This was $1.2 billion more than the $30.5 billion originally enacted for FY2002, but $846 million less than the reported budget figure for FY2002 of $32.19 billion.[1] The House Appropriations Committee reported H.R. 5605 (H.Rept. 107-740) on October 9, 2002, recommending $31.35 billion for HUD for FY2003, the same increase as the HUD request. On July 25, 2002, the Senate Appropriations Committee filed their report (S. 2797, S.Rept. 107-222), recommending $32.1 billion, about $734 million more than the Administration's request.

Table 1. Department of Housing and Urban Development Appropriations, FY1998 to FY2003

(Net budget authority in billions)

FY1998	FY1999	FY2000	FY2001	FY2002	FY2003
$21.44	$24.08	$25.92	$28.48	$32.19	N/A

Source: Budget levels remain uncertain until all program experience has been recorded, and any supplemental appropriations or rescissions have been taken into consideration. FY1998-FY2002 figures are from budget submissions of subsequent years. The FY2002 figure of $32.19 billion includes $2.045 billion of emergency supplemental authority and related rescissions approved in late 2001for New York City to assist in recovery efforts from the terrorists attacks of September 11, 2001.

The Administration's $17.53 billion request for the **Housing Certificate Fund** (that includes the carryover of $640 million of unobligated Section 8 program reserves) essentially would have maintained the "status quo" for the **Section 8 Rental Assistance program** since it would only renew, but not significantly add to

---

[1] In addition to the $30.15 billion, there was $2.045 billion of one-time emergency supplemental appropriations for aid to New York City, along with related rescissions, bringing a final base-line total for FY2002 for HUD to $32.19 billion as shown in **Table 1**. This can make comparisons of proposals for FY2003 with FY2002 subject to differing interpretations.

the 2.9 million assisted rental units. The Administration estimated it would take about $1.7 billion more spending than in the previous year just to continue assisting this number of units, largely because of rising rent levels. The President's proposal to add 33,400 additional vouchers, at a cost of $204 million, would not have significantly reduced the 4.9 million very low-income renter households that HUD says pay more than 50% of their income for shelter or who live in substandard housing, but who receive no federal assistance. These are often referred to as "worst case" renters.

In its version of the FY2003 budget for HUD, the House Appropriations Committee proposed several controversial changes to the Section 8 program: (1) funding for the renewal of Section 8 housing assistance and (2) limits to administrative fees that HUD pays to PHAs for administering the Section 8 tenant-based voucher program.

Proposed Section 8 Funding Formula Change for FY2003. For several years, both the House and Senate Appropriations Committees have expressed concern and frustration about the amount of unspent Section 8 funds that have been accumulating in the reserve accounts of Public Housing Authorities (PHAs). The House bill contained several controversial formula changes that attempted to resolve this. H.R.5605 recommended $18.35 billion of spending authority for the Housing Certificate program (largely for Section 8 rental assistance). While this was substantially above the amount enacted in FY2002, only $16.6 billion of this amount would have come from direct appropriations. The remaining $1.8 billion would come from the unobligated (unspent) balances in two reserve accounts maintained by individual public housing authorities (PHAs). An estimated $938 million would have come from the carry-over of Section 8 program reserves and about $830 million from unobligated balances in Section 8 administrative reserve accounts. Under the House bill, PHAs would have been funded from direct appropriations based on the number of units actually rented, as shown in their most recent financial statement available. If this were not enough to renew all of their Section 8 contracts, they would have been able to draw upon their program reserves. Individual PHAs could then apply to HUD for additional funds from a new "central reserve fund" that would have been established with an initial amount of $280 million. PHAs that had at least a 97% lease up rate and who made the case that they could have put more funds to use within 90 days could also have applied for these new funds.

The House Committee said their new funding approach would have been sufficient to assure that all families currently receiving Section 8 rental assistance could continue to be helped. However, the Center on Budget and Policy Priorities [http://www.cbpp.org] said that the proposed funding formula was flawed since it was based on financial statements that could be one or more years old and not reflect the current level of a PHA's Section 8 activity. The CBPP claimed that the reduction in funds for the renewal of vouchers represented about 127,000 fewer vouchers than the Administration had indicated would expire in FY2003. They argued that PHAs who had been most successful in increasing their voucher utilization rates would have had the smallest reserves to draw upon, and that the new central reserve account with $280 million would not have been adequate. They concluded that families currently using vouchers in some PHAs could end up either paying higher rents or losing their voucher.

The House bill would also have changed the formula for determining **public housing administrative fees** paid by HUD to PHAs for administering rental contracts, limiting these fees to 10% of the rental subsidy they receive from HUD. If these administrative fees were inadequate to cover their costs, PHAs would have to draw upon their administrative reserves, which the Committee said are substantial. The House Committee would also have restricted the use of funds in administrative reserve accounts to activities related to the provision of rental assistance under the Section 8 program. Some PHAs have been using these funds for a much wider variety of housing activities.

Under the House bill, $36 million would have been allocated for about 6,000 **additional vouchers** that would have been targeted to non-elderly disabled families living in public housing projects that had been designated to be occupied only by the elderly.

The Senate bill recommended an appropriation of $17.4 billion for the Housing Certificate Fund in FY2003, about $100 million below the Administration's request. An additional 15,000 vouchers would have been funded with $90 million.

Proposed changes to **public housing programs** also had to do with large amounts of unspent funds. The Administration had proposed a controversial cut of $417 million from the Public Housing Capital Fund, from $2.843 billion in FY2002 to $2.426 billion in FY2003. Under a proposed Public Housing Reinvestment Initiative, the Administration said that PHAs could make up the proposed $417 million reduction by seeking private financing to rehabilitate or replace aging properties, pledging project-based revenue as collateral for loans, and moving towards more efficient market-based operations. Both the House and Senate bills rejected this initiative. H.R. 5605 recommended level funding for the capital program, at $2.843 billion, $417 million more than the Administration's request. The Senate Appropriation Committee recommended $2.783 billion, $357 million above the President's budgeted amount.

The **HOPE VI program**, that is used to rehabilitate or tear down the worst public housing units, would have received $574 million under the Administration's proposal, the same as provided for FY2002. Both H.R. 5605 and S. 2797 would also have provided $574 million. In its report, the Senate Committee expressed certain concerns about the future of the program and included language to sunset the program on September 30, 2003 to encourage "a meaningful reauthorization process" between HUD and the appropriate authorizing committees.

The **Public Housing Drug Elimination Grant program**, that had been funded at about $300 million in recent years, received no funding in FY2002. The Administration did not request funding for FY2003 and neither the House nor the Senate bills recommended funding, despite interest in renewing funding by some in Congress. Others pointed out that the capital and operating accounts could be used to combat drug use.

The **HOME block grant program** would have been increased by $238 million to $2.08 billion under the Administration's request. The House bill would have increased the HOME program by $137 million more than the Administration's

proposal, while the Senate bill, at $1.95 billion, was $134 million less than the Administration amount, but $104 million more than the program received in FY2002. The Administration again requested (as it did for FY2002) a $200 million set-aside within the HOME block grant program for FY2003 for its Downpayment Assistance Initiative. This initiative was initially funded at $50 million in FY2002, but the funds were later rescinded by a FY2002 supplemental appropriations bill (P.L. 107-206). Some local governments argued that the set-aside would mean they would have to make cuts to some existing HOME-funded efforts. For FY2003 however, the Administration would have increased the overall HOME program by $238 million to $2.08 billion to cover the downpayment initiative. The House bill recommended $375 million more than enacted for FY2002 and included the $200 million set-aside. The Senate bill would have increased the HOME program by $104 million, but did not recommend funding for the downpayment initiative.

The Administration requested that the **Community Development Block Grant (CDBG) program** be cut by $284.5 million for FY2003, from $5.0 billion to $4.716 billion. Most of these funds, $4.43 billion in FY2003, go to over 1,000 cities, urban counties and states through formula grants. (Congress also provided $2.7 billion in CDBG assistance to New York City in FY2002 to assist in post-September 11, 2001 recovery efforts.) The Administration proposed to change the formula to reduce grants to the wealthiest 1% of communities, defined as those with per capita incomes two times the national average. The estimated $16 million savings from this proposal would have been used to fund a regional initiative to increase the availability of affordable housing, economic opportunity, and infrastructure in the "Colonias." Colonias are communities within 150 miles of the U.S. Mexican border that are often described as having "third world" living conditions. Neither the House nor the Senate bills recommended funding for the Colonia Gateway Initiative. Most of the proposed cuts to the CDBG program would have come from economic development initiatives (also called special purpose grants). These grants received $294 million in FY2002 despite opposition from the Administration. Neither the House nor the Senate appropriators agreed to cuts in the special purpose grants. The House bill recommended $5.0 billion for CDBG, the same as in FY2002, and the Senate bill asked for slightly more, at $5.05 billion.

Neither the House nor the Senate Committees accepted the Administration's request to eliminate funding for the **Office of Rural and Economic Development**, but instead, recommended funding at $25 million, the same as in FY2002.

HUD has a number of programs to protect vulnerable populations - the elderly, persons with physical and mental disabilities, individuals with HIV/AIDS, and the homeless. Funding for supportive services for the **Elderly and Disabled** was recommended at $1.02 billion, the same as in FY2002, $774 million for the elderly and $251 million for the disabled. These funds are awarded through a competitive process to non-profit organizations to build new facilities for low-income residents. H.R. 5605 would have provided $841 million and $259 million respectively for the elderly and disabled programs, both fairly significant increases over FY2002 levels. S. 2797 provided level funding for the elderly and a $10 million increase for the disabled. The Administration, and the Housing and Senate appropriators all recommended $292 million, a $15 million increase over the FY2002 level for

Housing for Persons with AIDS. Most of the grants are allocated by formula, based on the number of cases and highest incidence of AIDS.

HUD proposed to spend $1.13 billion on **Programs for the Homeless**, about level with funding during the previous 2 years. Secretary Martinez said that ending chronic homelessness in the next 10 years is a top priority. The budget proposed to consolidate HUD's three largest homeless programs into one. Some organizations have expressed concerns in recent years that HUD might change the current competitive grants process used to award funds under these three programs into a "formula grant" process. But HUD has not yet made this proposal. Both the House and Senate bills recommended increases in funding for the homeless programs: $128 million over the FY2002 level in the House bill, and $93 million more in the Senate bill.

While the Administration requested a $16 million increase in the **Office of Lead Hazard Control**, and the House bill recommended the same $16 million increase, the Senate bill asked that the program be funded at $201 million, a significant increase of $75 million over the $110 million enacted in FY2002 and $91 million more than the Administration's request for $126 million.

HUD's **Federal Housing Administration (FHA)** mortgage insurance program continues to operate at very high delinquency rates. The Senate Appropriations Committee report contained extensive comments on the FHA's lender oversight program. The Committee noted 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 directs HUD to report to the appropriate congressional committees on further actions that can be taken to protect homebuyers and communities.

As noted above, at the end of 2002, no FY2003 budget for HUD had been adopted. Programs were operating under a series of continuing resolutions at the FY2002 levels; final action was left for the 108th Congress.

For more details on action in the 108th Congress and on individual programs in the FY2003 HUD budget, see CRS Report RL31304, *Appropriations for FY2003: VA, HUD, and Independent Agencies*.

FY2002 HUD Budget

On November 26, 2001, President Bush signed P.L. 107-73 providing HUD with $30.15 billion for FY2002 (H.R. 2620, H.Rept. 107-272). This was $1.67 billion more than the FY2001 appropriation of $28.48 billion. All Section 8 contracts were renewed, and $144 million was provided for an additional 25,900 vouchers, $104 million of which were to be distributed on a fair share basis only to public housing authorities with a voucher utilization rate of at least 97%. Nearly $3.5 billion was approved for the Public Housing Operating Fund, an increase of $253 million over the prior year to reflect the merger of Drug Elimination Grants into this fund. (In FY2001, the Drug Elimination Grants program was funded separately at $310 million.) The Public Housing Capital Fund received $2.84 billion, a decrease of $157 million from the previous year. The HOPE VI program received $574

million. Housing for people with AIDS was funded at $277 million, up by $19 million from FY2001. Housing for the elderly received $783 million, and housing for the disabled, at $241 million, was up $24 million. The FY2002 budget provided $1.12 billion for Homeless Assistance Grants. While this amount was about $98 million above the FY2001 level, it included the Shelter Plus Care Renewal program, which had its own line item in the FY2001 budget at $100 million.

Community Development Block Grants were funded at $5 billion, about $58 million less than in FY2001, and the HOME program received $1.85 billion, $46 million more than the FY2001 funding level. Empowerment Zones received $45 million, compared to $75 million in FY2001 and to the Administration's request for $150 million.

For more details, see CRS Report RL31004, *Appropriations for FY2002: VA, HUD, and Independent Agencies (P.L. 107-73).* For general background on housing programs, see CRS Report RL30486, *Housing the Poor: Federal Programs for Low-Income Families*.

FY2002 Supplemental Appropriations. The Administration's request for FY2002 emergency supplemental funding provided an additional $750 million to HUD's Community Development Fund for assistance to properties and businesses damaged by, and for economic revitalization directly related to, the terrorist attacks that occurred on September 11, 2001 in New York City. This amount was in addition to the $2 billion in emergency supplemental funds that were enacted for the Community Development Fund in late 2001 for similar assistance (P.L. 107-38). The Administration's request also contained a $20 million rescission from the Rural Housing and Economic Development program.

On July 26, 2002, a supplemental appropriations bill approved by House and Senate conferees, H.R. 4775 (Conference Report H.Rept. 107-593), was sent to the President. It rescinded $738.5 million in HUD funds, including $388.5 million of unobligated balances from the Section 8 voucher program, $300 million realized from the prepayment of Section 236 subsidized mortgages, and $50 million from the Administration's HOME downpayment assistance initiative. The Section 236 money had been intended for the rehabilitation of assisted multifamily housing, and some housing organizations criticized HUD for the delay in the spending of these funds, thus leaving them open for rescission. The bill provided an additional $783 million for the Community Development Fund to further recovery efforts in New York City. For more details, see CRS Report RL31406, *Supplemental Appropriations for FY2002: Combating Terrorism and other Issues.*

Policy Issue: The Shortage of Affordable Rental Housing

Despite the fact that HUD now spends most of its budget to help low-income families with their housing costs, the shortage of *affordable* rental housing continues to be the most important housing issue before the Congress. (Housing that costs more than 30% of one's income is considered by the government to be excessively burdensome or "unaffordable".) At least anecdotally, there are reports that the number of homeless in a number of large cities has increased, with many attributing this to a growing shortage of affordable housing. Others believe this shortage is

reducing the chances that some welfare recipients will be able to achieve economic self-sufficiency.

Since most of the HUD budget addresses the shortage of rental housing, and because many mayors and governors and other elected officials believe the problem has become serious, this report reviews this issue in some detail. The shortage of affordable housing is a complex matter with many dimensions, including the often overlooked but important role of local governments. There are many statistics available for advocates who argue that more federal assistance is needed. HUD reported in 2001 that 1999 American Housing Survey data from the U.S. Census Bureau showed 4.9 million "worst case" households, those with incomes below 50% of the local area median ("*very-low incomes*") who pay more than 50% of their income for housing or live in substandard housing, but who receive no assistance because of limited funding.[2] These same data showed that in 1999, 44% of *extremely low-income* renters, about 3.75 million households, were in the worst case situation. To put these median incomes into more meaningful perspective, on a national basis, those with very-low incomes would be households with recent incomes below about $21,000. Those with extremely low-incomes had incomes below $13,000.

Those who support more federal efforts to help low-income households with their housing costs generally want either more funds for housing vouchers or more funds to encourage the construction of affordable rental housing, or both. HUD Secretary Martinez has said he favors housing vouchers over subsidized housing production to address the affordability issue, pointing out that there are already government programs that can and are being used to produce affordable rental housing.

Some conservative critics of HUD programs believe that with the exception of a few metropolitan areas, there is generally no shortage of rental housing units. They say the affordability issue is not a housing issue at all, but an income issue, and argue that a better and more direct way to respond to worse-case renters is through government efforts to help low-income households become more productive and earn higher incomes. Presumably this would mean they would not need federal housing assistance, or not as much of it.

The Administration seems to favor this approach. The FY2003 budget says "....HUD would fail in its mission if families were not moving towards eventual self-sufficiency. An important measure of HUD's success should be the number of families that no longer need to reside in assisted housing because they have moved to safe, decent, and affordable private housing." The Administration (and the Clinton Administration before it) has placed increasing emphasis on promoting homeownership for lower-income families in the belief that this is an effective way to move families towards self-sufficiency and wealth accumulation. A number of housing analysts believe that there is now too much emphasis on homeownership for lower-income families. Some liberal critics of HUD say this is because promoting

---

[2] *Report On Worst Case Housing Needs In 1999: New Opportunity Amid Continuing Challenges. Executive Summary*. January 2001. U.S. Department of Housing and Urban Development. Office of Policy Development and Research.

homeownership is less expensive than addressing more costly and intractable rental housing issues.

A Brief History of Federal Housing Assistance. In the Housing Act of 1949, Congress established a national goal of providing: "a decent home and suitable living environment for every American family." Much progress was made in the next two decades in eliminating substandard housing as many of the nation's worst slums were torn down. But against the backdrop of the inner city riots of the 1960s and the recommendations of the 1967 Douglas Commission, the 1968 Kaiser Committee, and the 1968 Kerner Commission on Civil Disorders, Congress adopted the Housing Act of 1968 which set a specific 10-year goal of building 6 million housing units for low- and moderate-income families.

Federally-subsidized housing production increased from 91,000 in 1967 to 166,000 in 1968; 200,000 in 1969, 430,000 in each of 1970 and 1971, and 339,000 in 1972. During the 4 years from 1968-1972, there was also a total of about 200,000 units rehabilitated with federal subsidies and 2,200,000 mobile homes built, the latter considered an important source of affordable housing for lower-income households.[3]

During the 1970s, attention on housing issues changed from its previous focus on the problem of too many substandard housing units, to the problem of housing being too expensive for lower-income families to afford. In effect, the 1949 Housing Act paved the way for the more elusive goal of making it possible for all families to have a decent *affordable* home and suitable living environment.

The problem of substandard housing has not been entirely eliminated. Data from 2001 show more than 2.5 million housing units lacked some or all plumbing facilities, with more than a million without a bathtub or shower, and over 976,000 without a flush toilet. At the same time, the quality of the new housing built in the past 25 years and the level of amenities provided or required, such as off-street parking, wide sidewalks and roads, air conditioning, landscaping, health, safety, additions and modifications for the handicapped and environmental protections, had so upgraded housing and neighborhoods that many lower income families cannot afford it. Increases in the minimum standards for housing by local governments began to conflict with the goal of the availability of affordable housing. An important public policy issue is now the cost and advisability of putting low-income people in middle-class housing.

Reducing the size and level of amenities is only one of the many dimensions of the affordability issue. Some point out that many of the recent immigrants to the United States come from a culture of extended families, thus needing larger units, not smaller. But many lower income households must now cope with high housing costs by sharing a single-family home or apartment, sometimes two or three households in a unit meant for one.

[3] U.S. Department of Housing and Urban Development. *Housing in the Seventies*. A Report of the National Housing Policy Review, 1974.

During the latter half of the 1970s, HUD began phasing out its involvement in subsidizing new housing construction. By the early 1980s, this withdrawal was nearly complete and the shift towards subsidizing existing units with housing vouchers was well underway.

Since the 1980s, there has been no obvious consensus about what should be done to improve housing opportunities for those with difficulties finding adequate and affordable housing. Beginning in 1982, the number of *additional* rental units receiving assistance under HUD dropped sharply. In 1986, Congress replaced a number of existing rental housing tax provisions that were thought to be poorly targeted, with the Low Income Housing Tax Credit program, a tax incentive to encourage developers to build apartments affordable to households with incomes no greater than 60% of the local area median. After a slow start, the number of subsidized units built or rehabilitated averaged about 50,000 to 60,000 a year during most of the 1990s. More than 1.2 million units are now said to have been built with subsidies under this program.

After a number of years in which no new housing vouchers were added, Congress appropriated money for 50,000 additional vouchers in FY1999 and 60,000 in FY2000. The Clinton Administration recommended 120,000 additional vouchers for FY2001, with 79,000 approved. The Bush Administration requested 34,000 additional vouchers for FY2002; 25,900 were funded. As noted, HUD requested 33,400 additional vouchers for FY2003. The House Appropriations Committee recommended funds in FY2003 for about 6,000 new vouchers directed at the non-elderly handicapped. The Senate Committee recommended funds for about 15,000 incremental vouchers.

Is There Housing Available at an Affordable Price? With the exception of some cities in the Northeast, West Coast, and a few other places, most areas have an adequate supply of modern apartments - those with large kitchens and baths, high ceilings, fireplaces, exercise facilities, enclosed balconies, covered parking, and other amenities. But restrictive zoning, building codes, health and safety and environmental regulations, new requirements for the handicapped, and local opposition have made it difficult to construct basic no-frills rental housing affordable to lower-income households. The smaller apartment units built in the 1940s and 1950s with 500 square feet or less, with no walk-in closets or in-unit washer-dryers, with small kitchens and baths, and with no on-site parking, are much sought after in older cites because of their low rents, but they cannot be built today under current laws.

The strong rental markets in middle-income and rehabilitated areas of cities have not escaped the attention of Section 8 landlords whose buildings have been set aside for lower-income families under long-term federal contracts. As more profitable alternatives presented themselves during the prosperous 1990s, some owners decided not to renew their expiring contracts. Older apartment buildings, with their lower rents, continue to be torn down or renovated for a more upscale and profitable market. Mobile home parks that provide relatively affordable housing have largely disappeared from most large metropolitan areas. And most of the remaining inner-city "single-room-occupancy" "hotel" units (including many YMCA/YWCA facilities that provided shelter to the near-homeless), have been torn

down. Since it is so difficult to build new affordable rental housing, a first line of defense by housing advocates is to try to preserve the affordable rental stock that currently exists. Nevertheless, tens of thousands of these units are lost each year.

There is no shortage of statistics, reports, studies, and commissions documenting the difficulties that lower-income people have in finding affordable housing. The National Low Income Housing Coalition has done extensive research showing the hourly wage a household would have to earn (with one wage earner or more), to afford the rent on a "standard" apartment in major cities across the country.[4] Their research finds that in most major cities and counties, it is very difficult for households earning near the minimum wage of $5.15 an hour or even $6, $8, or $10 an hour, to find an affordable apartment. Waiting lists for rental assistance in most major cities are so long that no others are allowed to be added.

The National Housing Conference (NHC) examined recent American Housing Survey data, looking at households with low to moderate incomes, those with incomes from 80% to 120% of the local area median income (nationally, about $33,000 to $50,000). These households are much less likely to receive government rental assistance than those with incomes below 50% of the local median. The NHC concluded that affordable housing problems had moved up the income ladder. Police, teachers, fire fighters, and other public municipal employees, who have been cited in the media as having problems affording housing, generally fall into this 80% to 120% median income category. (Although two-earner families, for example, a police officer and teacher, can often reach securely into the middle-class.) The NHC concluded that simply having a full-time job does not guarantee a family a decent place to live at an affordable cost. Among its findings: "More than 220,000 teachers, police, and public safety officers across the country spend more than half their income for housing, and the problem is growing worse."[5]

Local governments are often reluctant to adopt policy approaches that may attract low-income households, the mentally and physically disabled, ex-felons, many of the estimated 7.5 to 11 million unauthorized aliens, and others – partly, some say, because of their negative fiscal impact. Many of these households would pay much less in local taxes than the cost of providing schools, police, fire and rescue, trash collection, and other social services.

Many homeowners may believe that affordable rental units built near their homes would lower their property values, and resist local government efforts to increase the supply of low-income housing in their neighborhoods. The result is that very-low-income households or even those not quite so poor, are heavily concentrated in particular neighborhoods, and local officials in these areas often find it necessary to look the other way as many apartments are shared by two or three

---

[4] *Out of Reach 2001: America's Growing Wage-Rent Disparity,* can be found at [http://www.nlihc.org].

[5] The Center for Housing Policy (a research affiliate of the National Housing Conference), *Housing America's Working Families*, New Century Housing, Washington, D.C., June 2000. p. 2.

families in violation of local laws. Some housing analysts and others believe that the social and financial cost of this isolation is much greater than is often perceived.

Increasing the Supply of Affordable Housing. Aside from the issue of how much additional money could or should be spent to address the housing affordability problem, the question remains about how funds could best be spent towards achieving the 1949 national housing goal. Housing analysts inside and outside of HUD, elected officials, and others have been debating for decades the relative advantages and disadvantages of "tenant-based" rental assistance and "project-based" assistance. In simple terms, this usually means whether to use housing vouchers to assist individual households, or to subsidize the construction (or rehabilitation) of more housing. Knowing when each type of assistance is most appropriate requires a knowledge of local housing market conditions. The discussion that follows reviews this on-going debate.

Voucher utilization rates. In the past few years, there has been growing concern that not all of the housing vouchers awarded to local public housing authorities have been put to use. Some households with vouchers have found it difficult or impossible to find an apartment within the time period for which the voucher is approved. An increasing number of vouchers have been returned unused (although these vouchers are often given to someone else who does succeed in finding appropriate housing).

In recent years, arguments have surfaced in Congress that because not all vouchers are used, there is less reason to increase the number of vouchers. Both HUD and the House Appropriations Committees expressed concern (H.Rept. 107-740) over the amount of Section 8 voucher funds that were going unspent - 13% in FY2001.

The 33,400 additional vouchers that HUD proposed for FY2003 would only have been awarded to PHAs with a voucher utilization rate of 97% or greater. Some PHAs with lower voucher utilization rates have tried, with limited success, to better inform landlords about the voucher program, and to encourage more to participate in it by offering various incentives. Some voucher holders have been provided transportation to assist them with their search, and help with security deposits. Nevertheless, where vacancy rates are very low, it may have become prohibitively expensive on a per-unit basis for PHAs to try to locate additional units for voucher holders. Local PHAs have some flexibility to raise the payment standard - the maximum rent on a unit that is acceptable for a household with a voucher. While this makes it easier for a voucher holder to find a unit, this raises the cost of the program since the government pays a part of the rent. The October 10, 2002 report by the House Appropriations Committee says that "Since fiscal year 1999, the Section 8 program has realized a net increase of $5, 764, 433,000, even after accounting for rescissions of unspent Section 8 funds included in the bill each year."

Rental Vacancy Rates. In one of the many paradoxes of housing policy, the national vacancy rate for rental housing reached a record high of 9.1% in the third quarter of 2002 (also 9.1% in the 1st quarter), while statistics show a serious shortage of affordable rental housing in many metropolitan areas. A vacancy rate above 5% is often considered adequate for a marketplace to function without difficulty.

Vacancy rates for 2001 varied widely across the country: Atlanta, 11.9%; Louisville, 10.8%; Houston, 11.1%; West Palm Beach, 18.0%, New York, 3.6%; Boston, 2.9%; Los Angeles, 3.4%, San Francisco, 3.4%; and Jacksonville, 4.6%. As noted, low vacancy rates make it more difficult to use a voucher. Many landlords who have a choice of tenants will not pick very low-income families, with (or without) vouchers.

Some landlords are unwilling to accept vouchers because they want to avoid the bureaucratic "red tape" of the program, or because they believe, rightly or not, that low-income families will cause problems. A few local governments have recently adopted laws requiring landlords to accept renters with vouchers, although landlords can often reject a voucher holder because of bad credit, lack of references, and for other reasons. Reports also continue to show that discrimination in rental housing on the basis of race and against households with children is still common, which makes the use of vouchers more difficult.

But as this review has suggested, vacancy rates tell only part of the story about the shortage of affordable housing. A higher vacancy rate may not help a very low-income household if the available units are too expensive. Furthermore, statistics on vacancies can be misleading. Many large cities have tens of thousands of boarded-up rental units. For example, Philadelphia lists more than 14,000 housing units as abandoned.

Many vacant units are or were owned by landlords who could not charge their very low-income renters enough to pay the cost of operating the units. Other landlords struggle to survive, letting their buildings deteriorate over time. Among the policy questions this raises – Would more housing vouchers, if made available to very low-income renters in marginally profitable buildings, help landlords to continue operating often shabby but affordable units? With increased rent revenue, some of these units that may have housing code violations could be brought up to code. A related policy issue is the advisability of new federally-subsidized apartment buildings being built near these struggling landlords. Some think this can make it even more difficult for marginally profitable landlords to compete and stay in business.

Increasing the Number Receiving Assistance by Adding Vouchers. The HUD Secretary has said he is not in support of a new HUD program to subsidize the construction of affordable rental housing. He says that instead, he favors housing vouchers because of the freedom of mobility they offer to low-income renters. In theory at least, a family with a voucher can move out of a poorly maintained building or a dangerous neighborhood and go to a safer one with better schools and more job opportunities. However, as the above discussion has indicated, the freedom of a voucher holder can be quite limited. Those who do not have automobiles are very limited in where they can live. Most of the $31.35 billion proposed for HUD in FY2003 would continue housing assistance for the approximately 5.5 million housing renters now receiving federal rental assistance – through the Section 8, public housing, HOME, and CDBG programs, and several others.

At a congressional hearing on the FY2003 budget, some concern was expressed at the increasing cost of the Section 8 program. It will cost about $1.7 billion more in FY2003 just to renew all 2.9 million Section 8 contracts and protect some

vulnerable groups from losing their current rental assistance. The proposed $17.5 billion for the Housing Certificate Fund (largely Section 8) will account for well over half of the total HUD budget. There are a number of reasons why Section 8 costs continue to increase rapidly, the main one being that rents have increased significantly.

In 2001, in 39 tight rental markets, HUD began permitting the allowable rent level (Fair Market Rents) for units eligible for vouchers to be based on the 50th percentile for the local rental housing market rather than the previous 40th percentile. Since voucher holders generally pay 30% of their income towards the rent, with the government paying the rest, allowing units with higher rents to be eligible means a higher cost to the government. Also, major housing legislation passed several years ago (P.L. 105-276, The Quality Housing and Responsibility Act of 1998), requires that 75% of all new households getting vouchers have to have incomes below 30% of the local area median. More voucher holders with even lower incomes than previously means that these new households will require a larger rental subsidy. The cost of an average voucher is now about $6,000 a year. For illustrative purposes, one million additional vouchers would cost $6 billion a year. For comparison purposes, the Joint Committee on Taxation shows taxpayers with incomes over $100,000 received an estimated $55 billion of federal assistance in FY2002 to help pay their mortgage interest and property taxes.

Increasing Rental Housing Production. The difficulty of using vouchers in some areas has led to legislative proposals for a new HUD program devoted solely to the development of rental housing for extremely low-income households. Referring to the limited value of vouchers in many tight rental markets, the Senate Appropriations Committee expressed its concerns in 2001 that "families with vouchers often have little choice in their rental decisions, leaving them often in low-income and very low-income neighborhoods and living in substandard housing."

A number of bills were introduced in the 107th Congress that would have subsidized the production of additional "affordable" rental housing: S. 1248, H.R. 2349, H.R. 1990/S. 940 (Title VII). H.R. 2349 and S. 1248 had 229 (largely Democratic) co-sponsors. Several of these bills are summarized immediately below. In addition, the House Financial Services Committee approved H.R. 3995, which is discussed in a following section.

- S. 1248, the National Affordable Housing Trust Fund Act of 2001, introduced by Senator Kerry, had a goal of producing 1.5 million homes for low-income families by 2010. It would be financed by "excess reserves" of the FHA program that are above what is necessary to maintain a 3% "capital ratio." The capital ratio is the value of the reserves divided by the amount of mortgage insurance in force. A 2% ratio is now required by law. (The excess reserves are what some call the surplus or profits from HUD's FHA mortgage insurance business. Since the reserves have become an integral part of rental housing production proposals, this controversial matter is discussed in detail immediately below.) At least 75% of the trust funds would be used for the construction of rental housing and rental housing subsidies in the same manner as voucher assistance under

Section 8. States would be provided with $0.25 of non-federal resources for every $1 of federal assistance. No less than 75% of trust funds used for rental activities would be used for extremely low-income families (income below 30% of the local area median). Three-quarters of money from the trust fund would be given as matching grants to states through a formula based on the need for housing; the remainder would be awarded by HUD through a national competition to non-profit intermediaries. Assisted housing would remain affordable for 40 years. States would distribute funds to grantees, giving preference based on 1) the degree to which the development is mixed-income; 2) whether the housing is located in a census tract in which the poverty rate is less than 20%; and 3) the accessibility of jobs to the project.

- H.R. 2349, the National Affordable Housing Trust Fund Act of 2001, introduced by Representatives Sanders, Lee, and McHugh, would have used FHA reserves in excess of that necessary to maintain the capital ratio of 2%. There would be the same state matching requirements as in S. 1248. Forty-five percent of the funds for affordable rental housing would be targeted to families with incomes less than 30% of the area median income; 30% would go to families with incomes equivalent to the federal or state full-time minimum wage, whichever is higher; and 25% would be for the development, preservation, or rehabilitation of existing affordable housing for rental or homeownership for families with incomes below 80% of the area median income. All of the funds would be distributed to the states under a formula that considers the percent of families in substandard housing, the percent that pay more than 50% of their income for rent, the percent below the poverty line, counties with vacancy rates below 2%, and the age of the housing stock.

Using mortgage insurance reserves to fund additional rental construction. As noted, several bills (H.R. 2349, S. 1248, S. 652) introduced in the 107th Congress sought to stimulate rental construction through a "trust fund" financed by what some believe to be "excess" reserves of a mortgage insurance premium pool. Others point out that these reserves are not idle pools of unutilized capital, but federal funds booked for insurance purposes, and treated like other federal revenue. Thus, these excess reserves cannot be used as if the reserves were unspent resources.

A simplified explanation of this funding dispute is as follows. HUD operates a successful mortgage insurance business under the Federal Housing Administration (FHA) program. During the strong economy of the 1990s, this insurance business was very profitable for HUD – the premiums were much larger than the expenses from defaults on loans. A serious economic downturn, with increased unemployment, would increase the number of mortgage defaults. Then, more of the reserves would have to be used to pay off the loans held by lenders, and also be used by HUD to fix up properties and to pay real estate agents to sell these homes. Each default could cost the FHA tens of thousands of dollars. Thus, because of the uncertainties of the economy in the years ahead, the insurance program must keep a certain amount of the profits as rainy day "reserves."

Supporters of using the steady growth in the trust fund believe the reserves are more than required by law and more than enough to cover future needs and, as noted, they want to tap some of the "excess reserves" for a housing trust fund. The Administration does not favor using the reserves in this manner. The reserves now go to the U.S. Treasury and help fund the overall federal budget. In turn, the FHA program has the explicit financial backing of the Treasury. Thus, the debate over the reserves is largely academic. Both sides agree that if Congress were to redirect part of the FHA reserves into a housing trust fund, there would have to be additional appropriations made to make up for the reserves already built into the federal budget.

There is another view that the growing FHA reserves means that the insurance premiums are too high and should be lowered to more closely approximate the estimate of future needs. S.607 in the 107th Congress would have done this. Even some who support efforts to increase the production of affordable rental housing are uneasy about using the FHA reserves since these reserves come from charging higher than necessary insurance premiums that are paid largely by low- and moderate-income households, including many minority families. To some, this would constitute a regressive method of funding a rental production program.

Are there other options for obtaining more affordable rental housing? Some point to the Congressional Budget Office report of February 2001, *Budget Options: Restrict Itemized Deductions, Credits, And Exclusions Under the Income Tax*. One of the options identified by CBO to increase federal revenues is: limit the mortgage principal on which interest can be deducted to $300,000. Taxpayers may now deduct interest on up to $1 million of mortgage debt used to buy and improve a first and second home. CBO says that reducing the eligible amount of debt for the mortgage interest deduction from $1 million to $300,000 would trim deductions for 1.2 million taxpayers with large mortgages and increase revenues by $55.8 billion over the 2002-2011 period. Some argue that this would be a less regressive option to fund a rental housing production program for extremely low-income families. Limiting deductions to the interest on not more than $300,000 of mortgage debt would affect high-cost areas such as San Francisco, Los Angeles, New York, and Boston. It is probably no coincidence that these are the areas that have some of the lowest rental vacancy rates in the country, and the most severe shortages of affordable rental housing.

Another option for addressing the shortage of affordable rental housing is to encourage more local governments to use "inclusionary zoning," which requires home builders to construct and set-aside a minimum percentage of new units in a specific residential development that are affordable to a particular income level. (See *Inclusionary Zoning: A Viable Solution to the Affordable Housing Crisis?* The Center for Housing Policy, October 2000, for the pros and cons of this approach and how it has worked in Montgomery County, Maryland.)

The Housing Affordability For America Act of 2002

H.R. 3995 in the 107th Congress was a wide-ranging omnibus bill. The House Financial Services Subcommittee on Housing and Community Opportunity held a series of hearings on H.R. 3995 in April 2002. The Subcommittee approved a significantly modified version of the original bill on June 18. The full committee

completed its mark-up on July 10, and this version of the bill is summarized below. While no further action occurred on this bill, several of its provisions were later passed as part of a supplemental appropriations bill signed by the President on December 4, 2002 (P.L. 107-326). P.L. 107-326 makes permanent the FHA downpayment simplification calculation for single-family homes and provides for the indexing of multifamily mortgage limits for FHA insurance programs.

Title I. Section. 101. Home Investment Partnership Program. The most contentious part of the full Committee mark-up occurred over competing proposals to establish either a national housing trust fund, using excess FHA reserves ("the Sanders amendment") or to fund state and local housing trust funds ("the Kelly amendment"). On June 20, the Committee adopted the Sanders amendment on a party-line vote. This amendment would have created a National Affordable Housing Trust Fund as a modified version of H.R. 2349 (the original bill is summarized on pages 14 and 15 in this report). The modified version made four changes to the original H.R. 2349: 1) funds would be the distributed to cities and states, instead of states only, 2) cooperatives would be an eligible activity, 3) all rehabilitation, not just substantial rehabilitation, would be an eligible activity, and 4) Davis-Bacon prevailing wage laws would be applicable.

However, on July 10, the Committee reversed itself, voting 35-34 against another Sanders amendment to establish a National Housing Trust Fund, with funding subject to appropriations. Then Representative Kelly offered an amendment, modified by Representative Sanders, to authorize matching grants to state and local governments, which was adopted by voice vote as the "Kelly-Sanders amendment." As ordered reported by the Committee, the bill would have created a HUD program that would provide dollar for dollar matching grants to distinct affordable housing trust funds established by states and units of general local government for the production, preservation, and rehabilitation of affordable housing. Most of the federal match, 75%, would have to be used for rental housing made available to extremely low-income families. The other 25% would have to be used for either rental or homeownership housing for low-income families. Eligible forms of assistance include capital grants, noninterest bearing or low-interest loans or advances, deferred payment loans and loan guarantees. To be eligible for grants, a trust fund must have an allocation plan approved by HUD that includes the activities to be conducted, rents to be charged, the availability of units to voucher holders, and providing that housing units will remain affordable for a period of 40 years. Criteria for allocating grants to eligible entities would include the existence of extremely low vacancy rates, the extent that employment and other economic opportunities would be created for low-income families, and the extent to which the applicant has worked to address issues of siting and exclusionary zoning and other barriers to affordable housing. Appropriations of "sums as may be necessary" would be authorized for FY2003 and each fiscal year thereafter. (Note: Although the new program of grants to state and local trust funds would have been part of the HOME program, the new program would have required a separate appropriation.)

Title I also included the following provisions: a downpayment assistance initiative for first-time homebuyers of grants to participating jurisdictions with allocations based on the jurisdiction's need for and prior commitment to assist homebuyers, and an amendment to the HOME program to allow certain municipal

employees, including policemen, firemen, maintenance workers, and teachers whose income does not exceed 115% of the area median, to qualify for downpayment assistance, help with closing costs, and discounted mortgage interest rates under the HOME program.

Title II. FHA Mortgage Insurance. FHA multifamily mortgage limits would be adjusted based on annual construction cost indexes; the FHA downpayment simplification calculation for single-family housing would be made permanent; and the cap on FHA adjustable-rate mortgages would be eliminated. The HUD Secretary would be provided with authority to reduce downpayment requirements to at least 1% of the loan amount for FHA insured mortgages for teachers and public safety officers. The HUD Secretary could discount HUD-held single-family properties by 50% to qualified teachers and public safety officers. A 3-year pilot program would be authorized for no-downpayment FHA insured loans to qualified public safety officers who purchase homes in designated high-crime activity areas.

Title III. Supportive Housing for Elderly and Disabled Families. This title would authorize grants for capital repairs for modernization to nonprofit owners of federally assisted housing for the elderly which is being converted to assisted living facilities; the provision of service coordinators for supportive housing for elderly and disabled residents in federally assisted housing; a demonstration program for elderly housing for intergenerational families; and a provision that requires that occupancy by elderly families with maximum set incomes continue in Section 202 projects that have undergone foreclosure.

Title IV. Section 8 Rental Housing Assistance Program. A project-based voucher demonstration program would be established to be used in conjunction with new construction or substantial rehabilitation for use exclusively by extremely low-income families. This voucher could be used with other capital subsidy programs such as HOME, CDBG, or Low-Income Housing Tax Credits. Appropriations would be authorized for FY2003 and 2004 in the amount necessary to provide a total of 5,000 such incremental vouchers. To assist hard-to-house families, PHAs would have been permitted, beginning with funding for FY2003, to use up to 2% of any amounts allocated to the agency for counseling, downpayment assistance, security deposits, and other activities that will help families find suitable housing.

Other Title IV provisions included ensuring the ability of families to use enhanced vouchers in the case of owners prepaying mortgages or opting-out of the program; an extension of project-based Section 8 contract renewals; the escrow of tenant rent in cases of owner failure to maintain the unit; increased payment standards up to 120% of the fair market rent for certain PHAs without HUD approval; modifications in project-based vouchers; expanded use of enhanced vouchers; a demonstration program for rental assistance for grandparent-headed or relative-headed families; and protection of innocent tenants (in both Section 8 and public housing) who are victims of domestic violence, from the "one strike and out" provision (upheld by a recent Supreme Court decision).

Title V. Public Housing. The HUD Secretary would be directed to develop a third-party assessment system for evaluating the performance of public housing agencies. Other provisions included: the exemption of certain small public housing

authorities from submitting annual agency plans for FY2003 through FY2005; authorization of appropriations for capital repair grants for non-profit owned, federally-assisted elderly housing; a demonstration program for HUD to make grants to PHAs to cover the capital costs of converting public housing primarily occupied by elderly persons to assisted living facilities; authority for HOPE VI grants for assisting affordable housing through "main street" projects; and reauthorization of the HOPE VI program through FY2004.

Title VI. Homeless Housing Programs. A number of programs would have been reauthorized through FY2004: the Supportive Housing for the Homeless program, Shelter Plus Care, the Emergency Shelter Grants program, the Interagency Council on the Homeless, and the Federal Emergency Management Food and Shelter program. Under the Supportive Housing program, renewals from FY2003 forward would have been funded through Section 8 appropriations, and a set-aside for permanent housing would have been added by requiring that at least 30% of funds for homeless assistance (except for contract renewals) be used for permanent housing. Appropriations would have been authorized for housing assistance to victims of domestic violence, stalking, or sexual assault when it had been determined that relocation would assist in avoiding future incidents. The McKinney-Vento Homeless Assistance Act would have been amended to state that Congress declares a national goal of ending homelessness within 10 years after enactment of H.R. 3995.

Title VII. Native American Housing. The Native American Housing and Self Determination Act of 1996 would have been reauthorized for FY2003-FY2007.

Title VIII. Housing Impact Analysis. This title would have required federal agencies, with some exceptions, to certify (with documentation) in the Federal Register and to the HUD Secretary that any proposed or final rule would not have a significant impact on housing affordability. (This title of H.R. 3995 also was referred to the House Judiciary Committee, which approved it on July 23, 2002.)

Title IX. Other Housing Programs. Some of the 18 sections in this title include: repeal of the scheduled increase to nine basis points in the Government National Mortgage Association guarantee fee; establishment of a single office in HUD designated to administer and coordinate all housing counseling programs; increases in allowed average assistance per unit under the SHOP program to $15,000; use of CDBG funds for construction of tornado-safe shelter for manufactured housing parks; a clarification of the subsidy layering review responsibilities for low income housing tax credit projects; correction of inequities in the second round of empowerment zone funding; expansion of income eligibility of CDBG homeownership programs for municipal employees; sense of Congress that HUD appoint a permanent director of the Office of Disability Policy; and the transfer of rural multifamily housing projects to nonprofits and local housing authorities.

The Housing Voucher Improvement Act of 2002

S. 2721, introduced by Senator Sarbanes on July 11, 2002, sought to improve the voucher rental assistance program through a number of provisions. The bill would have:

- authorized thrifty vouchers (TV) to make additional housing affordable to extremely low-income families. PHAs could issue TVs out of their existing allocation of vouchers or Congress could appropriate additional incremental assistance;
- created a voucher success fund with $50 million for untroubled PHAs that do not have unused funds;
- allowed more flexibility in the inspection process to prevent units being lost to voucher holders due to delayed inspections;
- allowed certain PHAs to raise their payment standards to 120% of Fair Market Rents without HUD approval;
- required that HUD ensure that PHAs have a list of Low-Income Housing Tax Credit and HOME developments to give to voucher holders;
- allowed people who live in project-based Section 8 housing to be eligible for Family Self-Sufficiency activities;
- authorized Welfare to Work Vouchers;
- allowed Resident Opportunities and Self-Sufficiency (ROSS) funds to be used to serve Section 8 families;
- provided incentives to low-income families to increase earnings;
- allowed PHAs to use electronic fund transfers for rental payments; and
- clarified that tenants cannot be required to go through the application process again to receive an enhanced voucher.

OMHAR/Mark-to-Market Reauthorization and Reform

The Office of Multifamily Housing Assistance Restructuring (OMHAR) was created within HUD by the Multifamily Assisted Housing Reform and Affordability Act of 1997. Authority for OMHAR, which administers the Section 8 restructuring program known as "mark-to-market," was set to expire on September 30, 2001. Several continuing resolutions extended the program until it was finally reauthorized through FY2006 under Title VI of the Labor, Health and Human Services, Education, and Related Agencies Appropriations Act for FY 2002 (P.L. 107-116), and signed into law on January 10, 2002.

More than 800,000 units in approximately 8,500 Section 8 project-based rental complexes have mortgages that are insured by FHA. Once these projects reach their 20th year of use as government-assisted low-income housing, the owners have the right to "opt out" or leave the program – either by converting the buildings to market-rate use, or by selling to another owner (who may or may not keep the building in the Section 8 program). The main purpose of the 1997 legislation was to preserve these projects as affordable housing as the long-term contracts expire, and to lower the rental assistance cost to the government by reducing above-market rents, often requiring, in return, a reduction in the owner's mortgage debt. About 66% of the projects with contracts expiring after September 2001 have above-market rents. The process of restructuring rents and mortgage levels requires complex negotiations with landlords on a project-by-project basis. OMHAR was slow in getting started and had contentious relations with some of the involved parties. As of June 6, 2002, 2,159 projects had been entered into the mark-to-market restructuring program, and 1,383 of these had reached completion. At one point, OMHAR estimated that the

government will save hundreds of millions of dollars over the next 20 years on the restructurings that have been completed thus far, but now prefers not to provide a figure on expected savings because of the many factors involved.

Provisions in Title VI of P.L. 107-116. Under this law, OMHAR is no longer limited to an annual budget of $10 million. The HUD Secretary can make available up to $10 million annually and can also carry over unspent money from previous years. The head of OMHAR will now report to the FHA commissioner rather than to the HUD Secretary, giving the commissioner oversight authority of OMHAR. Among the purposes of Title VI are to ensure that properties that undergo mortgage restructuring are rehabilitated to a standard, and with reserves set at levels, that allows the properties to meet their long-term affordability requirements. If significant additional features (such as air conditioning or an elevator) are required in a restructuring agreement, the owner, at HUD's discretion, can be required to pay up to 25% of the rehabilitation cost. This applies only to mortgage restructuring plans approved after enactment of OMHAR extension legislation. HUD is now required to carefully track the condition of restructured properties on an ongoing basis.

Title VI amends the current law to give grants to tenant-groups, tenant-endorsed community-based nonprofits, and public entities to provide tenant services in projects undergoing restructuring. The HUD Secretary is required to ensure that the amounts determined by the various rent standards for the same dwelling units (under enhanced vouchers, mark-to-market restructuring, and contract renewals) are reasonably consistent and reflect rents for comparable unassisted units in the same area. Refinancing of mortgages held by HUD is permitted under a restructuring plan, even for existing mortgages not FHA-insured. Tenants in buildings whose owner rejects a restructuring plan must be notified of this decision at the time of the rejection, not only by the owner as previously required, but also by OMHAR or the participating administrative entity. Project owners may request, and the HUD Secretary may consider, mortgage restructuring and rental assistance plans to facilitate sales or transfers of properties to other owners who agree to participate in the Section 8 program. OMHAR's authority to operate ends on October 1, 2004. The Mark-To-Market program is to be repealed on October 1, 2006.

For more information, See CRS Report RL31182, *Assisted Housing: Section 8 Mark-to-Market Restructuring.*

Increasing Homeownership

In the last half dozen years there has been bipartisan support for efforts to increase the homeownership rate among lower income and minority households, with the prevailing view that this is an effective way for these households to become economically self-sufficient and to accumulate wealth (although there is little or no data to support this now popular view). More vigorous enforcement of federal fair lending laws and an easing of mortgage underwriting standards have helped raise the homeownership rate for moderate-income and minority households, as has, until the past year or so, the strong economy and growth in jobs. Congress passed several pieces of legislation in late 2000 to help low- and moderate-income and first-time homebuyers. P.L. 106-554 allowed states to increase their sale of tax-exempt bonds

that are used to lower mortgage rates for first-time homebuyers (the Mortgage Revenue Bond program). Under the American Homeownership and Economic Opportunity Act, H.R. 5640, signed into law on December 27, 2000 (P.L. 106-569), qualifying households can use up to 1 year of Section 8 rental assistance as a downpayment on the purchase of a home. That law also provided for a 3-year pilot program to demonstrate the use of Section 8 vouchers by the disabled to become homeowners.

Table 2. Homeownership Rates, Various Categories

(2nd Quarter 2002)

White, non-Hispanic	74.2%
Black	46.3%
Hispanic	47.2%
Households with family incomes greater than or equal to the median family income	82.3%
Households with family incomes less than the median family income	51.5%
Married Couples (annual, 2001)	82.9%
Single Person Households (annual, 2001)	54.4%

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

On November 15, 2002, the House passed S. 2239, that, among other things, made permanent a simplified downpayment calculation for FHA-financed home purchases. The President signed this bill into law on December 4, 2002 (P.L. 107-326).

While the homeownership rate increased substantially over the period 1990-2002, from 63.9% to 67.6% (2nd quarter, 2002), **Table 2** shows that there is a sizable gap between the rate for whites and that for minorities. **Table 2** also shows the large differences in rates by income level and by marital status. **Table 3** highlights the large differences in rates between central cities and suburbs, along with the significant differences between regions of the country – the Northeast and West with their much lower homeownership rates compared to the Midwest and South. It is difficult to discern a pattern in the rates among states (**Table 4**) except that some of the states with the largest populations have the lowest homeownership rates - New York, California, and Texas. Similarly, there are no distinct patterns among cities (**Table 5**) except that the Northeast cities of New York and Boston, and the two largest cities in California, San Francisco and Los Angeles, have notably low rates. It is difficult to generalize, but some of the metropolitan areas with the lowest rates have relatively high incomes, large immigrant populations, and are coastal cities bounded by an ocean which limits the amount of land available for new housing construction.

Another reason why lower income and minority households may have lower ownership rates is that the main homeownership tax incentives – the mortgage and

property tax deductions – provide substantial financial benefits to upper-middle income homeowners, but are of little use to those in the bottom half of the income distribution. Similarly, while discrimination in mortgage lending was reduced during the 1990s, it is still considered a significant factor affecting minorities.

Table 3. Homeownership Rates, Various Areas

(2nd Quarter, 2002)

U.S.	67.6%
Inside metropolitan Areas	65.6%
In central cities	51.4%
Suburbs	74.4%
Outside metropolitan areas	74.9%
Northeast	63.9%
Midwest	72.8%
South	69.3%
West	62.4%

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

Administration Homeownership Proposals. The Administration's FY2003 HUD budget contained several homeownership proposals. One would have set aside $200 million within the existing HOME program for the "American Dream Downpayment Fund" and was introduced as H.R. 4446/S. 2584. The fund would provide a $3-for-$1 match, up to a maximum of $1,500 when third parties contribute up to $500 to help low-income families finance the purchase of a first home. HUD estimated that this would help 40,000 additional families to buy a home. In 2002, the Administration made the same request for a $200 million set-aside within HOME. This proposal was criticized because HOME money can already be used to help families buy a first home and no new money was being added to the HOME program to pay for this new initiative. It was thus argued that this proposal would create a federal mandate that could take away funds that some communities might prefer to use for affordable rental housing (National Association of Counties, U.S. Conference of Mayors, testimony before the House Subcommittee on Housing and Community Opportunity, May 22, 2001).

The FY2002 VA/HUD Appropriation conferees agreed to provide $50 million for this initiative within the HOME program subject to enactment of authorizing legislation by June 30, 2002. Without the authorizing legislation, which would have been provided by H.R. 4446/S. 2584 if enacted in time (it wasn't), the $50 million approved would simply become additional resources for the HOME program. For FY2003, the Administration again requested a $200 million set-aside for the downpayment assistance program, but also requested an increase in the HOME program of $238 million. The FY2002 emergency supplemental bill signed by the

President on August 2, 2002 (P.L. 107-206), rescinded the $50 million for downpayment assistance approved in FY2002. As noted earlier in this report, the House Appropriations Committee bill, H.R. 5605, recommended a $375 million increase in the HOME program for FY2003, including a $200 million set-aside for the Administration's downpayment initiative. The Senate bill, S. 2797, recommended an increase of $104 million to HOME, but did not recommend funding for downpayment assistance.

The Administration proposed for FY2003 to triple the set-aside in the Community Development Block Grant program to fund the Self-Help Homeownership Opportunity Program (SHOP) - from $22 million in FY2002 to $65 million in FY2003. Under SHOP, grants are made to national and regional non-profit organizations such as Habitat for Humanity. Homebuyers contribute significant amounts of volunteer labor to the construction or rehabilitation of the property. (H.R. 4446 would also have reauthorized the Self-Help Housing Program at $65 million for FY2003 and FY2004.) The House Appropriations Committee recommended $28.5 million for the SHOP program for FY2003 and the Senate Committee, $22 million.

Another Bush homeownership initiative, requested in both its FY2002 and FY2003 budget proposals, was not part of the HUD budget. It was a proposed incentive in the tax code that would provide an estimated $1.7 billion of tax credits over 5 years to homebuilders to encourage the rehabilitation of existing properties (such as abandoned housing in central cities) or new construction of 100,000 affordable single-family homes in urban or rural areas. The proposal was modeled after the Low Income Housing Tax Credit for rental housing (which raised some concerns among supporters of the rental program – see the section below on the Low Income Housing Tax Credit). Credits would be allocated to state housing allocating agencies on the basis of population ($1.75 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. Credit would be awarded as a fixed amount for individual units comprising a project. 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 taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualifying buyer would be eligible to claim credits over a 5-year period beginning on the date of the sale. Eligible homebuyers would be required to have incomes equal to 80% or less of the area median income.

Table 4. States with Highest and Lowest Homeownership Rates
(2001)

Highest		Lowest	
Michigan	77.1%	New York	53.9%
Iowa	76.6%	Hawaii	55.5%
W. Virginia	76.4%	California	58.2%
S. Carolina	76.1%	Rhode Island	60.1%
Minnesota	76.1%	Massachusetts	60.6%
Maine	75.5%	Texas	63.9%

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

The Administration also proposed a tax credit to financial institutions that would match private Individual Development Accounts to save for a first home, start a business, or pay for education. (See CRS Report RS20534, *Temporary Assistance for Needy Families and Individual Development Accounts*.)

Other Homeowner Proposals. There were at least another 18 homeownership bills introduced in the 107th Congress: H.R. 421, H.R. 858, H.R. 859, H.R. 1221, H.R. 1773, H.R. 2022, H.R. 2033, H.R. 2308, H.R. 3191, H.R. 3358, H.R. 3661, H.R. 3719, H.R. 3767, H.R. 3774, H.R. 4446/S. 2584, H.R. 4818, H.R. 5052/S. 3126, S. 1081, S. 1396, S. 2230, and S. 2239. A sample of bills are summarized below.

Purchase of FHA Owned Homes. Several bills (H.R. 1221, H.R. 3191, H.R. 3995) would have added firefighters and rescue personnel to existing programs or modify existing programs that sell FHA-owned homes to police and teachers at 50% of appraised value. The Officer Next Door program was created in 1997 and the Teacher Next Door program started in 2000. According to HUD, about 6,000 officers and teachers have bought homes under these programs. HUD suspended the Officer/Teacher Next Door Program in April 2001 for 120 days to review the program and take corrective measures to prevent fraud that had occurred by a small number of participants. Indictments were brought against 15 officers, with nine convictions for defrauding the program – some for failure to live in the purchased homes as required. Other officers who were not licensed to carry fire arms, as required by the program, purchased homes in violation of the regulations. Safeguards were added and the programs resumed in August, 2001.

Table 5. Homeownership Rates in Selected Metropolitan Areas
(2001)

Highest			Lowest	
Nassau, NY	82.6%		New York	33.4%
Richmond, VA	76.2%		San Francisco	48.6%
Detroit	76.1%		Los Angeles	50.1%
Buffalo	75.1%		Honolulu	55.4%
Salt Lake City	72.9%		Houston	55.9%
Tampa/St. Petersburg,	70.7%		Boston	59.0%

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

- H.R. 1221 would have expanded the Officer Next Door and Teacher Next Door Initiatives of HUD to include fire fighters and rescue personnel.
- H.R. 3191 would have provided for the sale of HUD-owned properties at reduced prices, reduced downpayments, and reduced mortgage insurance premiums to certain teachers and public safety officers. Homes could be purchased with downpayments of as little as 1% of the appraised value by certain part- or full-time teachers in public or private schools, or by public safety officers, who have not owned a home in the previous 12-month period in certain specified jurisdictions. Certain properties sold during FY2002-FY2006 would be available to teachers and public safety officers for 50% of the appraised value, but the homes would have to remain the purchaser's primary residence for at least 3 years or there would be some recapture of gains from the resale. There would also have been a 3-year pilot program to encourage public safety officers (including those serving a public agency of the federal government) to purchase homes, with no downpayments, in locally designated high-crime areas.

Other FHA-Related Bills. H.R. 858 would have simplified downpayment requirements for FHA insurance for single-family homebuyers. As noted above, S. 2239 was signed by the President on December 4, 2002, which made permanent the simplified downpayment formula for FHA-financed home purchases. H.R. 859, would have reduced the downpayment amount that a first time homebuyer is required to pay if purchasing a home insured by the FHA. (See CRS Report RS20661, *The Streamlined FHA Downpayment Program.)*

The existing Officer/Teacher Next Door programs (and the proposed expansions cited above) depend for their inventory on the number of homes FHA takes back in foreclosures. HUD sold 66,415 single-family homes in FY2001. However, HUD said that as of March 2002, the inventory of HUD-owned homes was 28,270, the

lowest level since 1996. In addition, HUD's proposed budget for FY2003 said "In 2003, FHA will begin to move out of the single-family property management business and accelerate the claims process by taking mortgage notes rather than requiring lenders to foreclose and transfer single-family properties to FHA. FHA will sell defaulted notes to the private sector for servicing and or disposition, thereby eliminating most of the real property that FHA currently acquires." This would presumably reduce the supply of FHA-owned homes for sale to targeted groups such as officers and teachers.

High FHA Delinquency Rates and Other Concerns. Easier lending requirements have made it possible for more lower income households to buy a first home in recent years with very little downpayment. However, many who have bought under the FHA program have little or no savings available for the inevitable financial setbacks, making these new owners particularly vulnerable to losing their home in a foreclosure. A slower economy with increased unemployment during the recent past is part of the explanation for increased mortgage delinquencies and foreclosures. Increases in the cost of homeowner insurance and high levels of consumer debt have also played a role, as has predatory lending. Data from the quarterly survey of mortgage delinquencies by the Mortgage Bankers Association of America show that the percentage of homeowners with FHA-insured mortgages who are 30 days or more behind in their payments reached a record level of 11.81% for the first time ever in the second quarter of 2002. This is a higher delinquency rate than during the recessions of the early 1980s and early 1990s. The percentage of FHA-insured loans in the process of foreclosure increased shapely from 2.14% at the end of the first quarter of 2002, to 2.79% for the second quarter of 2002. 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.

The National People's Action (NPA), a Chicago-based coalition of community groups, released a study on May 21, 2002 [6] criticizing the FHA for high default rates in 22 U.S. cities, particularly in minority and poor neighborhoods, and for its failure to take stronger action against lenders, real estate agents, and appraisers with the worst records. The study found a national default rate (90 days delinquent or in foreclosure) of 6.4% in FHA loans made from 1996 to 2000, more than six times the rate for loans not insured by the government. FHA has established a "Credit Watch" program that looks at lenders with default rates at least three times an area's average, but NPA wants the threshold reduced to two times that rate. NPA says the high default rates result in too many abandoned homes and ruined neighborhoods.

FHA commissioner John Weicher responded to the study by saying that foreclosure rates had fallen and that the agency is trying to keep families in their homes. The agency is now being more aggressive in reaching out to help delinquent homeowners from losing their homes with new assistance including (1) special forbearance -- accepting lower payments for a period months for homeowners behind

---

[6] *Families HUD Abandoned: An Analysis of the Federal Housing Administration's Loan Default Activity and Lender Performance in 22 U.S. Cities, 1996-2000.* Study done by National Training and Information Center for the National People's Action. Chicago, Illinois. May 21, 2002.

because of a temporary job loss or illness, (2) loan modification – including allowing the delinquent amount to be paid off in small monthly amounts over the remaining period of the loan, or (3) the FHA itself paying the delinquent amounts in a lump sum insurance claim, but requiring this be paid back when the home is sold in the future.

The current Administration, the previous Administration, and some in Congress believe that homeownership is an effective way for lower-income households to accumulate wealth. However, little research has been done to verify the claims. For example, not all neighborhoods participated in the economically successful 1990s. Along with certain inner cities, a number of older suburbs continue to be fiscally and economically distressed. (For example, see, *Why California Is Generating Large-Scale Slums*, Anthony Downs, Senior Fellow, The Brookings Institution, June 7, 2000.) Therefore, it would be important to know where FHA buyers are purchasing homes. Also, as discussed above, some believe that FHA homeowners are paying higher mortgage insurance premiums than necessary. Research also shows 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.[7] Predatory lending has hurt lower-income and minority homeowners most, often stripping away home equity accumulated over a lifetime. Furthermore, the tax benefits of mortgage interest and property tax deductions are worth much less, if anything, to low-income homeowners than to middle- or upper-income households. All of these factors work against lower-income homebuyers accumulating wealth.

Low Income Housing Tax Credits

Rental Housing Tax Credits. The Low Income Housing Tax Credit (LIHTC), a 1986 provision in the federal tax code, has become the major engine for subsidizing the production of privately owned rental housing affordable to lower income households. Although estimates vary, at least one million new and rehabilitated units have received support over the program's 15-year history. Apartment owners receiving tax credits under this program must set aside the units for at least 30 years, and sometimes longer, for households with incomes no greater than 60% of the local area median. Many of these units also receive funds from HUD programs, including Section 8 housing vouchers, and are thus able to serve households with incomes significantly below the program's 60% maximum.

With the robust economy of the 1990s reducing vacancy rates in buildings with lower rents, and pushing rents higher, housing tax credits have been increasingly used to help prevent the loss of the existing stock of federally-assisted rental units, rather than to increase the overall supply of affordable rental units. An increasing number of tax credits are being used to encourage Section 8 landlords with expiring contracts not to leave the program. And more tax credits are being used with HUD's HOPE VI program which is tearing down some of the worst big city high rise public housing projects, and replacing them with lower-density mixed income apartment complexes.

---

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

These new uses for housing tax credits, along with reports about the difficulties tenants are having using housing vouchers in tight rental markets, help explain the strong congressional support for increasing the annual supply of tax credits. The President signed H.R. 4577 on December 21, 2000 (P.L. 106-554). Under this law, the tax credit formula that determines the amount of tax credits that state agencies may allocate each year was increased to $1.50 per capita as of January 1, 2001 and to $1.75 in 2002. After 2002, the cap will be indexed to the inflation rate. The new law also established a $2 million minimum beginning in 2001 for small states who would get less than this under the per capita formula. These changes in the law are expected to subsidize the construction and rehabilitation of an additional 180,000 affordable rental units over the next 5 years.

The new law also made programmatic changes to the LIHTC. Added to the criteria that state agencies must consider in allocating housing tax credits among the competing projects of developers were tenant populations with special housing needs, public housing waiting lists, tenant populations of individuals with children, and projects intended for eventual tenant ownership. Housing finance agencies will also have to conduct a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project before the credit allocation is made. More regular site visits will be required to monitor existing projects for owner compliance with habitability standards.

Issues and Concerns. In terms of apartments produced, the LIHTC has been quite successful, as builders and investors have responded to this tax incentive, although the extent, if any, to which these units would have been produced in the absence of the tax credit, is not known. There has been some criticism that the tax credits are poorly targeted, being allocated on the basis of population rather than on some index of need such as the shortage of affordable units to very low income households. Some housing advocacy groups point out that many of the units are not affordable to extremely low income households without additional rent subsidies. A HUD study of 39 tax credit projects, *Assessment of the Economic and Social Characteristics of LIHTC Residents and Neighborhoods* (August 2000) found that 50% of tax credit renters pay more than 30% of their income for rent, 13% paying more than 50% of income. Some observers also worry that some of the more unfortunate results of past housing programs, such as inadequate reserve funds and inadequate maintenance, could surface later in this program as units age.

There is also concern that some of the early tax credit projects will be converted to market-rate units after their 15th year of service, as the law allows under certain conditions, creating an issue similar to landlords who decide to "opt out" of HUD's Section 8 assisted rental program. A report by the Joint Center for Housing Studies of Harvard University and the Neighborhood Reinvestment Corporation, *Expiring Affordability of Low-Income Housing Tax Credit Properties: The Next Era in Preservation,* estimates that 15-year affordability restrictions will end for the first 23,000 tax credit units in 2002. The report concludes: "Lack of monitoring or insufficient funds for property repair or purchase will place even properties for which there is interest in preserving affordability at risk of market conversion, reduced income-targeting, or disinvestment and decline" (p. 37).

Conflicting Reports on Tax Credit Projects. A recent study was conducted of tax credit projects in Chicago.[8] As is the case across the country, very little is known about Chicago's estimated 16,000 tax credit units. The Chicago Rehab Network examined the 1998 audits of projects containing 8,704 tax credit units, about 60% of the city's total units. The study found that only 6.5% of the projects were located in neighborhoods that are predominately white; nearly 60% were in minority neighborhoods, with the remaining in racially mixed areas. The vast majority were found in neighborhoods where median incomes are 40%-80% of the area median income. Twelve percent of the potential rents were lost to vacancy and another 5% to bad debt or unpaid rents. Seventy-three percent of projects had no operating reserves and 44% had no replacement reserves. About one fourth of projects had severe difficulties where expenses and debt service amounted to 115% of effective gross income, or higher. Projects that were straining to meet costs were also failing to make deposits to their reserve account, or were withdrawing funds from these accounts. The report says that this "seems to promise a future of deferred maintenance, rising vacancies and ever deepening budget shortfalls."

However, a July, 2002 study – *Understanding the Dynamics: A Comprehensive Look Affordable Housing Tax Credit Properties* -- by Ernst & Young of the year 2000 financial statements of projects representing more than 500,000 units found occupancy rates of 95% and a very low foreclosure rate, although "a material number of housing credit properties reported negative cash flows from operations in 2000."

GAO Report on the Cost of Tax Credit Projects. There are also questions about whether the cost of producing tax credit rental units is reasonable, relative to alternative ways of helping low-income households with their housing needs. In July 2001, the GAO released a study, *Costs and Characteristics of Federal Housing Assistance* (GA0-01-901R), that compared the total per-unit cost of five production programs, including housing tax credits and housing vouchers. The GAO found that the federal cost of housing tax credit units, as a percentage of the federal cost of a unit from a housing voucher, was 150% in the first year, and 119% when costs were averaged out over a 30-year life cycle. However, the GAO said a number of other factors must be weighed against the lower cost of vouchers. For example, there are the additional services that can more readily be provided for special populations, such as the frail elderly, with project-based assistance (tax credits, HOPE VI, Section 202, 811, and 515) than with tenant-based assistance (vouchers). In addition, tax credits and other production programs can be used as part of strategies to revitalize distressed communities.

Compliance with IRS Regulations. Some observers wonder about how well developers, investors, and state allocating agencies are following the complex requirements of the LIHTC program. The IRS is concerned about noncompliance among early tax credit projects that have now passed the 10-year credit period (by which time all awarded tax credits have been claimed by the investor) and may no longer feel compelled to abide by program rules. While the IRS considers overall compliance with program requirements to be good, there has been a significant

[8] *Present Realities, Future Prospects: Chicago's Low Income Housing Tax Credit Portfolio. Summary Report 2002.* Chicago Rehab Network.

increase in the number of violations reported by IRS field agents. In 2000, the agency began conducting a broad criminal investigation of low-income housing tax credit projects suspected of illegal activities.

107th Congress Legislation. There were a number of 107th Congress bills that would have made changes to the Low Income Housing Tax Credit program: H.R. 951/S.677, H.R. 2539, H.R. 3000, H.R. 3324, H.R. 3701, H.R. 4194, H.R. 4712, S. 1554, S. 2006, and S. 2479. Not all are described below.

- H.R. 951/S. 677 would have allowed the income eligibility for renters in LIHTC projects to be based on the higher of the statewide median income or the local area median income. Under current law, only the local area median income is used. Supporters of the change argue that the local area incomes in some rural communities are too low to interest developers (since the incomes determine the rents that developers can charge). They believe that adding the choice of the statewide median would help in some situations. Some oppose this change because it would allow renters with higher incomes to be eligible for the program. They think the current income maximum of 60% of the local area median is already higher than they would like since they believe the greatest need for affordable rental housing is for people with incomes of 30% or less of the area median income.
- H.R. 2539 would have repealed the Low Income Housing Tax Credit disqualification for moderate rehabilitation projects.
- H.R. 3324 and S. 2006 would have clarified the eligibility of certain expenses in determining the size of the Low Income Housing Tax Credit to developers.
- H.R. 3701 would have provided a temporary low income tax credit that would encourage the provision of housing, job training, and other services to ex-offenders.
- S. 1554 would have provided for an increased LIHTC for property located immediately adjacent to qualified census tracts.

The Administration's proposed homeowner tax credit, described in the homeownership section earlier in this report, worried some LIHTC advocates because they feared there would be competition in the sale of these tax credits to a limited pool of investors. Another concern was that, in an effort to keep the cost of the proposal down, a single cap might be combined for both the homeowner and rental programs (at less than the sum of the individual caps) and that state agencies might have to decide how much they wanted to use for each program.

Mortgage Revenue Bond Program

107th Congress bills H.R. 951/S. 677, the Housing Bond and Credit Modernization and Fairness Act of 2002, had 436 bipartisan co-sponsors. These bills would have modified several provisions in the existing Mortgage Revenue Bond (MRB) first-time homebuyer program. 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. States raise funds for the program by selling tax-

exempt bonds. Investors who buy these bonds do not have to include the interest income they earn when they pay their federal income tax, 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 estimated 120,000 buyers who receive these reduced-rate mortgages each year comes to a cost of about $8,300 per buyer. It is not clear how many of these buyers might have been able to purchase a home without the discounted mortgage.

In late 2000, the President singed P.L. 106-554 that increased the amount of tax-exempt bonds that states could sell as of January 1, 2001 -- to the greater of $62.50 per state resident or $187.5 million, and to $75 per resident or $225 million in 2002.

H.R. 951/S. 677 would repeal what is called 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, enacted in 1988 (P.L. 100-647) 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 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. H.R. 951/S. 677 would have repealed the rule. Supporters say that 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, the National Governors Association, and the Millennial Housing Commission. However, others observers maintain that the purpose of the Rule was to reduce the advantage that the MRB program has over other bond users such as those for student loans and water treatment plants that have no opportunity to recycle their payments. The Joint Committee on Taxation has estimated that the repeal would cost $770 million over 5 years, and $2.4 billion over 10 years.

A second provision in H.R. 951/S. 677 would have changed the way the home purchase price limits are set under the MRB program. Under current law, the price limit on homes purchased with MRB-financed bonds is 90% of the average area home price. The IRS is supposed to provide "safe-harbor" price limits. However, the IRS does not have access to reliable and comprehensive sales price data, so it has not updated price limits since 1994. Since house prices have risen about 30% since then, supporters of the MRB program say it cannot work in parts of many states because qualified buyers cannot find homes priced below the outdated limits. H.R. 951/S. 677 would have allowed states to use another way to set house price limits. The house price limits could also be set at three and a half times the program's homebuyer qualifying income limits, a more readily available measure.

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. These loans are said to have grown rapidly in minority neighborhoods, often stripping away wealth that may have taken owners decades or a lifetime to accumulate. The number of predatory loans increased sharply 3 or 4 years ago when Wall Street firms began buying "subprime" loans (risky loans with high interest rates and fees made to those with poor credit records).

A number of government agencies have become involved in addressing various aspects of the predatory lending issue, which suggests to some that additional legislation may not be necessary. Others disagree. The Federal Trade Commission won a large settlement against the defunct First Alliance Mortgage Company in March 2002, that could result in payments of as much as $60 million to about 18,000 mortgage borrowers. The FTC said the First Alliance used high-pressure telemarketing sales techniques and misled borrowers about increases in interest rates and monthly payments on adjustable rate mortgages. In January 2002, the Federal Reserve tightened lending rules under the 1994 Home Ownership and Equity Protection Act to reduce abusive lending practices. In the past year, HUD has used the city of Baltimore as a national laboratory to develop tactics against predatory practices in its FHA mortgage insurance program - with 40 indictments against lenders, resulting in 27 successful prosecutions thus far and 66 FHA disbarments of lenders from the FHA program.

On May 15, 2001, the Neighborhood Reinvestment Corporation (NRC) testified before the House VA/HUD Appropriations Subcommittee on its efforts to research and address the impact of predatory lending. The NRC said that predatory lending threatens to undo the work of many nonprofits that have worked with lenders and local governments to improve distressed neighborhoods. They are working with Freddie Mac to develop a loan product for families that now have predatory loans. Freddie Mac has expanded its pilot program against predatory lending, "Don't Borrow Trouble," which uses advertising and consumer education to make borrowers aware of certain dangers, including excessive fees and deceitful lending practices.

During Senate Banking Committee hearings on predatory lending on July 26 and 27, 2001, some financial organizations said more emphasis should be on enforcing existing laws. As one said, predatory lending is mortgage fraud, something that has been illegal for years. Others thought there should be more consumer 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 could stem the problem. 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. On the other hand, some 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 may be welcomed.

While HUD, Fannie Mae, the Federal Reserve, the FTC and the Department of Justice and the mortgage lending industry have taken some measures to address these concerns, a coalition of consumer groups continues to press for more safeguards and enforcement mechanisms. HUD convened a national task force in the spring of 2000 that held hearings in Washington, Atlanta, Los Angeles, New York, and Baltimore. A joint report by HUD and the Treasury Department, issued June 21, 2000, *Curbing Predatory Home Mortgage Lending,* urged Congress to adopt legislation that would restrict abusive terms and conditions on high-cost loans, prohibit harmful sales practices in mortgage markets, improve consumer literacy and disclosures, and prohibit government-sponsored enterprises from purchasing loans with predatory features and establishing predatory lending as a factor in CRA evaluations. Most recently, a study by the Center for Community Change, *Risk or Race? Racial Disparities and the Subprime Refinance Market* (the executive summary is in the May 1, 2002 Congressional Record at page S3629) analyzed the lending patterns of all 331 metropolitan statistical areas of the country. It found a geographic concentration of subprime lending in minority neighborhoods and to borrowers of color at all income levels. This is of concern because other research has shown that predatory lending is concentrated in the subprime market.

Predatory lending bills in the 107th Congress included the following:

- H.R. 1051 (LaFalce), the Predatory Lending Consumer Protection Act of 2001, would have amended the Home Ownership and Equity Protection Act (HOEPA) of 1994 and other sections of the Truth in Lending Act to expand consumer protections against predatory lending in connection with high-cost mortgage transactions, and to strengthen the civil remedies available to consumers under existing law. It would have amended HOEPA to lower interest rate and total fee "triggers" so that the Act would cover more high cost mortgage refinancings, home equity loans and home improvement loans. HOEPA would be expanded to restrict practices that facilitate mortgage "flipping" and equity "stripping" — restricting the financing of fees and points, prepayment penalties, single-premium credit insurance, balloon payments and call provisions. It would be revised to prevent lenders from making loans without regard to the borrower's ability to repay the debt, encourage credit and debt counseling and require new consumer warnings on the risk of high-cost secured borrowing.
- H.R. 1053 (LaFalce) would have amended sections of the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act. It would be made unlawful for a lender to fail to make loans on the most favorable credit terms for which the applicant qualifies. It would also become illegal to target applicants for high-cost mortgages based on the applicant's race, color, religion, national origin, sex, age, or marital status. H.R. 2531 would amend the Truth in Lending Act, the Revised Statutes of the United States, the Home Mortgage Disclosure Act of 1975, and the amendments made by HOEPA. Part of H.R. 865 would amend the Community Reinvestment Act (CRA) so that loans deemed to be predatory lending, that negatively impact the community or neighborhood,

would not count toward determining whether the institution is meeting the credit needs of the entire community.

- H.R. 4818 (LaFalce), the Mortgage Loan Consumer Protection Act, would have improved and updated the Real Estate Settlement Procedures Act of 1974 (RESPA) by simplifying and improving the accuracy of mortgage disclosures; expanding protections against junk fees and unearned closing costs; enhancing escrow account protections; and creating enforcement provisions for existing RESPA requirements.
- S. 2438 (Sarbanes), the Predatory Lending Consumer Protection Act of 2002, built upon and was similar to consumer safeguards found in H.R. 1051. For example, it would prevent prepayment penalty provisions for any payment made after the end of the 24th month of loan payments; prohibit all balloon payments; and prevent the requirement of an advance collection for single premium credit insurance for any credit life, credit disability, credit unemployment, credit property insurance, or any analogous products. It would limit the amount of points and fees that could be financed, and require additional consumer counseling before certain loans are made. The bill would have increased the amount of civil money penalties for certain violations of law and extends the statute of limitations to 3 years from the date of the occurrence of the violation.

Other Readings. See CRS Report RL30885, *Predatory Lending: Background on the Issue and Overview of Legislation in the 106th Congress*.

Oversight of Fannie Mae and Freddie Mac

Representative Richard Baker, chairman of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises (GSEs), introduced H.R. 1409, that would have tightened the government's financial oversight of Fannie Mae and Freddie Mac. This legislation would have moved the current oversight function from the Office of Federal Housing Enterprise Oversight at HUD to the Federal Reserve Board in the belief that this would provide more resources for the review and be more independent of political decisions. HUD's FY2003 budget proposal said that the agency would be more aggressive in its oversight of GSE activities.

Recent corporate accounting scandals have focused attention on the exemption that the GSEs have from registration and disclosure requirements of the Securities and Exchange Commission (SEC). H.R. 4071 would have required that Fannie Mae and Freddie Mac register their securities issuances with the SEC and make certain mandatory disclosures about those securities in their offering statements, as other publicly held corporations (including bank and financial services holding companies) must now do. On July 12, the GSEs announced that they would voluntarily register and file their annual and quarterly investor reports with the SEC and meet disclosure standards for the companies. They will not, however, register their debt and mortgage-backed securities. Hearings were held by the House Financial Services Subcommittee on Capital Markets on July 16, 2002, at which representatives of the

Treasury Department indicated that further study of liquidity issues was needed before requiring SEC-style disclosures of GSE securities.

The Capital Markets Subcommittee held hearings on May 23, 2001, and heard the Congressional Budget Office (CBO) present their study, *Federal Subsidies and the Housing GSEs,* on the activities of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The CBO estimated that these three entities received $13.6 billion in subsidies in 2000 (through the increased value of their securities) as a result of investors' perception of an implicit government guarantee (that the federal government would come to their rescue if they got into serious financial difficulty) and from tax and regulatory exemptions. Of the $13.6 billion in benefits, CBO estimated that $7 billion was passed on to borrowers through lower mortgage rates. Fannie Mae disputed these findings and has published its own competing analysis, claiming that they and Freddie Mac deliver a net benefit to homeowners of between $5.6 billion and $9.7 billion and do not retain any subsidy."

In one of the Millennial Housing Commission's supporting recommendations, it "affirms the importance of the government-sponsored enterprises."

Welfare Reform and Housing Assistance

Housing advocacy groups and others were dismayed that the original 1996 welfare reform legislation made no mention of the obstacles that high housing costs often play in efforts to get and keep a job, and they have lobbied to change this in the welfare reform reauthorization bills. 107th Congress bill S. 2116, the Welfare Reform and Housing Act, would have amended the program of block grants to states for Temporary Assistance for Needy Families (TANF) to help states address the importance of affordable housing in family efforts to achieve economic self-sufficiency. On May 1, 2002, the Senate Banking Subcommittee on Housing and Transportation held oversight hearings on TANF reauthorization and federal housing policy. Housing advocates said many welfare families are the proverbial one paycheck away from not being able to pay their rent and this can easily jeopardize their continued employment. High housing costs can leave little income for child care, food, transportation, and other basic necessities.

Under S. 2116, TANF-funded housing subsidies provided for more than 4 months would be considered "non-assistance" instead of "assistance", and therefore not subject to time limits. The bill would have required states to address housing-related problems of welfare recipients and former welfare recipients in their state plan, and to describe methods adopted by the state to address housing-related barriers to work. States would also have been required to address recipients' housing-related work barriers in developing their individual responsibility plans. The bill would have directed HHS to work with HUD to gather increased and improved data on the housing status of families receiving TANF and the location of places of employment in relation to families' housing. The legislation would have encouraged cooperation among welfare agencies and agencies that administer federal housing subsidies. S. 2116 would have authorize HHS and HUD to conduct joint demonstrations to explore the effectiveness of a variety of service-enriched and supportive housing models for TANF families with multiple barriers to work, including homeless families, and would have appropriated $50 million in FY2003 for these grants. A

similar demonstration was approved on June 26 by the Senate Finance Committee, in its markup of welfare reform legislation. The Committee also approved provisions, similar to S. 2116, that would have treated supplemental housing benefits provided with TANF funds as "nonassistance."

S. 2524 also included provisions similar to S. 2116 designed to improve states' ability to address housing issues through TANF.

On May 16, 2002, the House passed a welfare reauthorization bill, H.R. 4737, that would have given states new powers to integrate specified programs, including housing, through a "superwaiver" provision that would allow governors and local officials to request cabinet secretaries to waive certain program requirements, including those governing public housing and housing assistance for homeless people. This had some housing advocates concerned that certain protections for public housing residents and others could be lost. (See *"Superwaiver" Prospects in Current Welfare Reform Debate, CRS Report RS21219.)*

Management Reforms and the Oversight of HUD

HUD — the agency and its programs — continued to come under the scrutiny of the 107th Congress. HUD Secretary Martinez promised an ambitious first year largely devoted to putting HUD in order and getting a clean bill of health from the General Accounting Office. Secretary Martinez promised to examine the more than 300 HUD programs, up from about 240 since 1994, to see which work and which do not. GAO removed HUD's designation as a "high-risk" agency (first assigned in 1994), noting HUD's substantial overall improvements. However, despite the efforts and partial successes of the past three HUD Secretaries (Kemp, Cisneros, and Cuomo) to improve the management of HUD programs and to modernize financial and information systems, about 70% of the agency's programs are still classified by the GAO as at high-risk for waste, fraud, and abuse. Weaknesses continued in HUD's single-family mortgage insurance and rental housing assistance programs.

For many years, a top priority for HUD has been to improve management information systems that have often prevented the Congress, and HUD itself, from monitoring the progress of programs and the use of funds. There are indications that the lack of timely and comprehensive information continues to be a problem. The HUD Secretary promised to reduce the delays in getting funds out to communities, something that continued to cause frustration for state and local governments and nonprofit organizations.

During 2002, several congressional committees complained to the HUD Secretary about the difficulty of getting requested data and the lack of cooperation from HUD staff. At a February 13, 2002 hearing of the Senate Banking Committee, Chairman Sarbanes spoke about this lack of cooperation. Secretary Martinez said communications would improve. When HUD Secretary Martinez appeared before the House VA-HUD Appropriations Committee on March 19, 2002, Chairman Walsh listed more than $50 billion in unspent money in various HUD programs and about the difficulty of getting explanations for this from HUD. Martinez acknowledged the unspent money: "it's a very serious and startling problem," but said part of the problem lies with mayors and other local officials.

On May 16, 2002, the Mercatus Center at George Mason University released its *Third Annual Performance Report Scorecard: Which Federal Agencies Inform the Public?* The report analyzed the annual performance reports of 24 federal agencies required by Congress under the 1993 Government Performance Results Act (GPRA). HUD rated 11th of the 24 agencies, down from 10th the year before. Findings for HUD included the following:

- "Through goals and measures are good and the Secretary's letter indicates leadership, HUD fails to demonstrate clearly how it will achieve its goals or how it has done so in the past."
- "Through challenges are identified and corrective actions cited, no timetable for resolution suggest weak commitment."
- There is "No clear plan to improve performance at department or strategic levels, and in some cases, indicators that reveal problems are left completely unaddressed."

Millennial Housing Commission

A 22-member bipartisan Millennial Housing Commission (MHC), created by Congress as part of the FY2000 appropriations legislation, released its 124-page report, *Meeting Our Nation's Housing Challenges*, on May 30, 2002. In a cover letter to Congress, commission members said their report was based on several fundamental precepts:

- **"First, housing matters** ... Housing is inextricably linked to access to jobs and healthy communities and the social behavior of the families who occupy it. The failure to achieve adequate housing leads to significant societal costs.
- **Second, there is simply not enough affordable housing**. The inadequacy of supply increases dramatically as one moves down the ladder of family earnings. The challenge is most acute for rental housing in high-cost areas, and the most egregious problem is for the very poor."

The letter went on to say that "The inexorable growth in the number of families, of those working in the service sector, and of immigrants seeking to take part in the American Dream – coupled with community opposition to high-density development, the gentrification or abandonment and deterioration of an increasing percentage of our housing stock, and the growing affordability gap between the haves and the have nots – require that the Government of the United States seriously address the question of how our society can produce and preserve more housing for more American families in a more rational, thoughtful, and efficient way in the decade ahead." The MHC's principal recommendations are summarized below. The full report and a number of research papers can be found at the commission's website at [http://www.mhc.gov].

New "Tools" Recommended

- A state-administered homeownership tax credit modeled on the successful Low-Income Housing Tax Credit for new or rehabilitated

rental housing in "qualified census tracts," or for reduced-rate mortgages to qualified buyers.

- Tax breaks for owners who wish to opt out of federal rental programs and are willing to sell their buildings to organizations committed to the preservation of existing affordability.
- Capital subsidies for the production of rental units for extremely low-income households.
- Elimination of limits on states' ability to issue more tax-exempt bonds to produce rental housing with modest federal income targeting.
- Allowing state and local governments to blend federal funding to facilitate strategic community development. To encourage a more "holistic development strategy," one that coordinates affordable housing activities with transportation, economic development, employment, training, child care, and educational activities, the Commission recommends that governors be allowed to set aide up to 15% of federal block grant funds for this purpose.

Major Reforms Recommended

- A gradual transition to a project-based approach that would enable Public Housing Authorities (PHAs) to rehabilitate individual public housing properties using funds borrowed in private markets.
- The restructuring of the Federal Housing Administration as a wholly owned government corporation within HUD, to allow it to adapt its programs to evolving markets without relying on Congress to legislate each change.
- The elimination of chronic homelessness over a 10-year period by the creation of additional units of permanent supportive housing and the transfer of renewal funding for such units to HUD's Housing Certificate Fund.
- Several measures to move assisted families up and out of assisted housing units, over time, through a combination of work requirements and supportive services, enabling them to increase their incomes and freeing up the housing units for other, currently unassisted families.

Streamlining of Existing Programs

- Increased authority for local agencies to administer the voucher program. The Commission asserts that the voucher program is distinctly worthy of additional funding in substantial annual increments.
- Reforms to the HOME and Low-Income Housing Tax Credit (LIHTC) programs, and increased funding for HOME. The MHC recommends the elimination of rules and programmatic complexities that burden project developers and owners. The Commission recommends substantially increased appropriations for the HOME program.

- Improvements to the Mortgage Revenue Bond program, including the immediate repeal of the "10-year rule" (explained and discussed below in this CRS report) and the repeal of the program's purchase price limits, as well as restrictions that limit eligibility to first-time buyers.
- Recategorize funding for rental assistance as "mandatory" federal spending so that private-sector lenders will be more willing to finance repairs.

Supporting Recommendations

The Commission also endorsed a number of supporting recommendations that include: increased funding for housing assistance in rural areas; increased funding for Native American housing; exempt housing bond purchasers from the Alternative Minimum Tax; undertake a study of Davis-Bacon requirements; address regulatory barriers that add to the cost of housing production; improve consumer education about home mortgage lending; affirm the importance of the Community Reinvestment Act and the importance of government-sponsored enterprises.