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Housing Issues in the 108th Congress

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Summary

The Department of Housing and Urban Development (HUD) presented its proposed budget for FY2004 to Congress on February 3, 2003, requesting $31.73 billion, up $719 million over the $31.01 billion provided for FY2003. A number of initiatives are proposed: a controversial plan to convert Section 8 tenant-based vouchers into a block grant to be administered by the states — *Housing Assistance for Needy Families (HANF) (H.R. 1841/S. 947)*, and a Public Housing Reinvestment Initiative (PHRI). The FY2004 budget does not request funding for the HOPE VI program, Empowerment Zones, Brownfields or Rural Housing programs.

The FY2004 budget proposes a $200 million homeownership downpayment assistance initiative, which was introduced as H.R. 1276 and approved by the House Financial Services Committee on May 21, 2003. The HUD budget also requests $18.4 billion for the Housing Certificate Fund (HCF), which some advocacy groups believe will not be sufficient to renew all voucher contracts.

On July 25, 2003, the House approved the Departments of Veterans Affairs and Housing and Urban Development (VA-HUD) appropriations bill, H.R. 2861 (H.Rept. 108-235), with several housing-related amendments, recommending $31.8 billion for FY2004. The HCF received $18.6 billion, which was an increase of $150 million over the Appropriations Committee recommendation. Neither HANF nor the PHRI were adopted. The HOPE VI program would receive $50 million, down from $570 million in FY2003. H.R. 1614, which would reauthorize the HOPE VI program through FY2005, was approved by the House Financial Services Committee on May 21, 2003.

H.R. 1102, a bill to create a National Affordable Housing Trust Fund, has about 200 largely Democratic co-sponsors. It, and a similar Senate bill, S. 1411, would tap "excess profits" from HUD's Federal Housing Administration's (FHA) mortgage insurance program to build 1.5 million affordable housing units over 10 years. An industry-supported predatory lending bill, H.R. 833, would amend the Truth in Lending Act relating to "high cost mortgages" and preempt state or local anti-predatory lending law. Another predatory lending bill, H.R. 1663, would establish consumer safeguards for those receiving subprime home loans.

The "Ten Year Rule" that limits the use of tax-exempt bonds used to help first-time homebuyers would be repealed by H.R. 284/S. 595. The Administration has proposed a homeowner tax credit, introduced as H.R. 839/S. 198, modeled after the popular Low Income Housing Tax Credit. Hearings were held on Freddie Mac, prompted by recent reports of accounting irregularities. Some believe more stringent regulations and oversight are necessary for both Fannie Mae and Freddie Mac. Finally, the Administration has proposed regulations to reform the Real Estate Settlement Procedures Act (RESPA) but is expected to modify its proposal in light of industry resistance. Not all bills discussed in this report are cited in this summary. This report will be updated as issues develop and legislation proceeds.

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Housing Issues in the 108th Congress

Introduction

Housing issues in the 108th Congress center around the Administration's proposed FY2004 budget for the Department of Housing and Urban Development (HUD) and the congressional response, efforts to establish a National Affordable Housing Trust Fund, proposals to combat predatory lending, HUD-initiated reforms of the Real Estate Settlement Procedures Act (RESPA), homeownership initiatives for lower-income households, bills to remove obstacles to brownfields redevelopment, and proposals for more stringent oversight of Fannie Mae and Freddie Mac.

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

With mortgage rates at 40-year lows, housing prices have increased sharply in many areas. Existing homeowners have benefitted greatly from rising equity. However, high housing prices can present major problems for low and moderate income households who rent or want to buy a first home. The 2003 report, *The State of the Nation's Housing*, by Harvard's Joint Center For Housing Studies, found that "A staggering three in ten U.S. households have affordability problems. Fully 14.3 million households are severely cost-burdened (spend more than 50 percent of their incomes on housing) and another 17.3 million are moderately cost-burdened (spend 30-50% of their incomes on housing). Some 9.3 million households live in overcrowded units or housing classified as physically inadequate."

Surprisingly, the Joint Center report found that for the first time ever, more homeowners are cost-burdened than renters. While there has been a surge in lower-income homeowners over the past 5 years, more owners are having trouble paying their mortgage. Rising housing prices result in higher property taxes, which can become a serious financial burden for those with low or fixed incomes. More than 400,000 homeowners, a record number, were going through the foreclosure process at the end of 2002. Despite the growing affordability problems faced by homeowners, very low-income renters also face difficulties. In many cases, the rents they can afford to pay are not enough for landlords to cover the cost of utilities, property taxes, and maintenance; however, only about a third of renters in the bottom fifth of the income distribution receive rental assistance.

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

Many attribute reported increases in homelessness in some large cities to a growing shortage of affordable housing. Others believe this shortage is reducing the chances that welfare recipients will be able to achieve economic self-sufficiency. Lower-income households must often make long and expensive commutes to their jobs because they cannot afford to live near their work. The lack of affordable housing also makes it difficult for employers to find help for low paying jobs as retail salespersons, home health aides, child care workers, preschool and kindergarten teachers, and many who work at hospitals, nursing and retirement homes. Anecdotal evidence is showing that newly hired teachers, firefighters, and police officers are finding it increasingly difficult to live near their job. For example, Sean Connaugton, chairman of the county board of supervisors of Prince William County, Virginia, a rapidly growing outer suburb of Washington, D.C., said the county is finding it difficult to recruit and retain teachers and public safety workers as it becomes harder to find affordable housing (*Housing and Development Reporter*, June 23, 2003).

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

Highlights of the HUD Budget Request for FY2004

- Proposed budget of $31.73 billion, up $719 million from FY2003;
- Initiative to convert Section 8 voucher program to state-run block grant — Housing Assistance for Needy Families (HANF);
- An estimated 5,600 new housing vouchers targeted to the nonelderly disabled;
- Public Housing Capital Fund requested at $2.64 billion, down $71 million from FY2003, and Public Housing Operating Fund requested at $3.57 billion, nearly level with FY2003 funding;
- Proposed Public Housing Reinvestment Initiative (PHRI) to give Public Housing Authorities new ability to leverage private capital for rehabilitation and make other reforms;
- No funding for HOPE VI, Brownfields Redevelopment, Empowerment Zones, or Rural Housing Economic Development;
- The HOME program increased to $2.2 billion with $200 million for the Administration's homeownership downpayment initiative, and
- Community Development Block Grants requested at $4.716 billion, $189 million below FY2003 level, with no funding for Economic Development Initiatives (congressionally earmarked projects).

House Response to Proposed HUD Budget

On July 25, 2003, the House approved H.R. 2861 (H.Rept. 108-235) to fund HUD for FY2004.

- Provides $31.83 billion for HUD in FY2004, up $822 million over FY2003;
- HANF initiative not included;

- Housing Certificate Fund receives $18.6 billion (increased by floor amendment $150 million over House Appropriations Committee recommendation);
- No incremental vouchers funded;
- Public Housing Capital fund recommended at $2.7 billion, level with FY2003 funding, and Public Housing Operating Subsidies approved at $3.6 billion, up $23 million over FY2003;
- PHRI initiative not included;
- HOPE VI funded at $50 million compared to $570 million in previous year, Brownfields and Rural Housing level funded at $25 million each, and Empowerment Zones receive $15 million, down from $30 million in FY2003;
- HOME program funded at $2.064 billion, including $125 million for President's Downpayment Assistance Initiative;
- Community Development Block Grants funded at $4.959 billion, up $54 million over FY2003, with $137.5 million for Economic Development Initiatives.

Administration to Refocus Major Programs

The Administration presented its FY2004 budget for HUD on February 3, 2003, requesting $31.73 billion. According to figures from the House Appropriations Committee, the FY2004 proposal is $719 million more than the $31.01 billion enacted in FY2003. For several decades, HUD has had a reputation, fairly or not, for mismanaging too many programs, a number of which are considered ineffective. The Administration has stated that many existing programs address symptoms rather than addressing the root causes. Some proposals in the FY2004 budget are meant to change this. Rather than increasing the HUD budget, which may become increasingly difficult in the immediate years ahead due to rising deficits, the Administration has stated that a better approach for helping more lower income households is to make existing programs work better. This means removing confusing and restrictive federal regulations that may prevent state and local governments from developing creative and efficient approaches to their particular concerns. By refocusing housing assistance programs on ways to increase the self-sufficiency of lower income families, and by offering them a chance to accumulate financial assets through homeownership, the Administration asserts that lower-income households will have a better chance of moving into the social and economic mainstream.

Critics see the Administration's FY2004 housing budget as designed to further defund HUD programs. They point to the end in FY2001 of the $310 million public housing drug elimination grant program, the $250 million "shortfall" in public housing operating funds in FY2002, and the proposal not to fund the $570 million HOPE VI program for FY2004. In addition, the Administration's proposal to convert the Section 8 housing choice voucher program into a block grant to the states is viewed by some as a first step in financially downsizing and weakening the program that many consider the most successful of all federal housing programs.

Table 1. Department of Housing and Urban Development Appropriations, FY1999 to FY2003
(Net budget authority in billions)

FY1999	FY2000	FY2001	FY2002	FY2003
$24.08	$25.92	$28.48	$30.15	$31.01

Source: Budget levels remain uncertain until all program activity has been recorded, and any supplemental appropriations or rescissions have been taken into consideration. FY1999-FY2002 figures are from budget submissions of subsequent years. The FY2002 figure does not include $2.045 billion of emergency supplemental authority and related rescissions approved in late 2001for New York City to assist in recovery efforts from the terrorist attacks of September 11, 2001. The FY2003 figure is from estimates provided by the House VA/HUD Appropriations Committee, and includes a 0.65% across the board rescission included in the FY2003 funding measure.

The Major Budget Issues

Section 8 Housing Voucher Issues. In a sharp break with the present program structure, the Administration is proposing in its FY2004 budget to convert the Section 8 housing choice voucher program into a block grant to the states by FY2005. The new proposal was introduced on April 29, 2003 as H.R. 1841/S. 947. Under the proposed program, ***Housing Assistance for Needy Families (HANF)***, states would have the option to administer the voucher program. If a state chose not to participate, the Secretary of HUD would have the authority to choose an administrator. It is unclear what role the 2,600 PHAs who currently administer the voucher program would play under this proposed approach. Over the past several years, Congress has expressed frustration with the large amounts of appropriated funds that have gone unused by PHAs. As a result, billions of dollars have been rescinded from the voucher program and spent on other priorities. The Administration believes that the lengthy, complex, and very prescriptive program regulations inhibit PHAs from innovating in the voucher program. The Administration hopes that states would use the flexibility provided under HANF to better coordinate with the efforts of local welfare offices who administer the Temporary Assistance for Needy Families program (TANF) and other state-run self-sufficiency initiatives. The Administration hopes that self-sufficiency initiatives will permanently improve the well-being of lower-income households so they will no longer need housing assistance.

Beginning in FY2006, HANF would provide funds to states based on a new formula to be established by HUD based on the extent of poverty, housing costs, administrative performance, the number of families receiving aid, and other quantifiable factors. Underutilized funds would be retained by the states, and future grants would be reduced by the amount of the unutilized funds. States would have wide flexibility to establish program rules and requirements, but would have to submit a plan to HUD detailing quantifiable objectives and performance measures. There would be sanctions for poor state performance. Eligible block grant activities would include tenant-based rental and homeownership assistance, and other activities to support these uses. In order to be eligible, families would have to have incomes below 80% of the area median income, although HUD could set higher income limits

for the elderly. States would be required to target 75% of their vouchers to families below 30% of area median income. However, they could apply to HUD for waivers to lower their income targeting requirements to 55% of all vouchers.

Critics argue that the HANF proposal would only add another layer of bureaucracy if states simply pass the funds on to PHAs. They worry that targeting requirements for voucher recipients and other safeguards could be weakened and question whether states want this new responsibility. They believe that current problems in the Section 8 program, including those related to inspections, payment levels, and methods of payment, can best be fixed within the existing program structure. There has been little support expressed for the HANF proposal during the hearings held thus far by the House Financial Services Subcommittee on Housing and Community Opportunity.

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

Some housing advocates are worried that there may not be adequate funds under the Administration's FY2004 budget request to renew all currently authorized vouchers.[2] Analyzing new HUD data, the Center on Budget and Policy Priorities has concluded that the Administration's funding request for vouchers could result in as many as 90,000 housing vouchers now in use not being renewed in FY2004. Whether this is the case depends on the Administration's estimate of the voucher utilization rate by local PHAs and their per unit voucher costs. The proposed budget calls for $13.607 billion for tenant-based voucher renewals, likely to be sufficient under the Administration's initial estimate of a 90-91% voucher utilization rate. However, under a later Administration estimate of 96% utilization, and with several set-asides for other purposes ($72 million for Family Self Sufficiency Coordinators and $100 million for HANF start-up), the Administration's requested funding level may not be sufficient to maintain all 2 million authorized vouchers. In recognition of this possible shortfall, H.R. 2861, the House-approved budget for HUD, increased funding for the renewal of expiring vouchers $150 million above the Administration's request to $13.757 billion. Some housing groups say this is still about $600 million too little to pay for all renewals, with more than 60,000 vouchers at risk. For a detailed analysis of this issue, see May 19, 2003 CRS Congressional Distribution memorandum, FY2004 Tenant-based Voucher Funding.

Public Housing Issues. There are about 1.25 million units of public housing worth an estimated $90 billion. Many elected officials and advocacy groups view the public housing stock as a national asset that provides a last resort social safety net for the most disadvantaged and poorest households. They believe it needs to be well maintained and protected particularly since it is so difficult and controversial to find new sites for affordable housing. However, others believe that with public ownership, there are not the market-based incentives necessary for effective management. They point to a number of big city public housing authorities that have had to be taken over by HUD because of mismanagement and corruption.

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[2] *New HUD Data Show Families Will Likely Lose Housing Vouchers If Congress Approves President's Budget Request*, Center on Budget and Policy Priorities, July 11, 2003.

Furthermore, critics of public housing argue that unlike portable vouchers, public housing traps families in areas of high poverty and crime and little opportunity. Current issues involve these desires both to protect public housing and to ensure that it is well run.

The **HOPE VI** program to revitalize severely distressed public housing received $570 million in FY2003, but the Administration's HUD budget for FY2004 requests no new funding. Started in 1992, HOPE VI was envisioned as a 10-year effort to tear down about 100,000 of the worst units of public housing and replace them with "mixed income" communities. HUD Secretary Martinez says that replacement construction has been excruciatingly slow due to lawsuits and other delays, with only about 25,000 of the 85,000 units approved for construction completed. A June 30, 2003 GAO report (03-555), Public Housing: HUD's Oversight of HOPE VI Sites Needs To Be More Consistent, blames HUD staffing limitations for the slow expenditures in the HOPE VI program and says that HUD field offices have provided inadequate oversight. The report also found that the majority of HOPE VI grantees had not met their obligations, with only 15 of the 165 HOPE VI sites being fully completed.

With large amounts of funds remaining in the pipeline — only $2.1 billion spent out of $4.5 billion awarded — the HUD Secretary says it is unnecessary to appropriate any additional funds at this time. Even without additional appropriations for FY2004, program activity will continue for a number of years. Instead, he wants a dialogue with interested parties about how the program can be improved.

The program's authority to operate expires this year. H.R. 1614, which would reauthorize the program through FY2005, was approved by the House Financial Services Committee on May 21, 2003. The bill incorporated H.R. 1077 which would revise the selection criteria for the program to encourage more rapid completion of projects and give priority for revitalized units to tenants of the existing development.

Housing advocacy groups generally support the program, but say the main problem is that many more housing units have been torn down than replaced, forcing many former residents to leave their old neighborhoods with a housing voucher that is often difficult to use. Based on congressional hearings on the FY2004 budget in the spring of 2003, there appears to be bipartisan support for continued funding of this program. The House bill, H.R. 2861, recommended $50 million for HOPE VI in FY2003.

It is estimated that the nation's 1.25 million units of public housing need $20-$22 billion in capital repairs, with new needs accruing at the rate of $2-$3 billion annually. Under the Administration's **Public Housing Reinvestment Initiative (PHRI),** PHAs would be able to voluntarily convert some public housing units to project-based voucher assistance — tying federal assistance more closely to individual projects rather than to an overall lump sum annual capital grant to the PHA. Along with new federal loan guarantees, the stream of voucher subsidies would make it more possible for PHAs to turn to the private sector for rehabilitation loans, pledging the project-based revenues as collateral. In addition, after receiving a voucher for a year, a tenant at the project could take the voucher and move elsewhere if they chose to, allowing families to move to areas of lower concentrations

of poverty and greater economic opportunity. HUD believes this initiative would move public housing towards private ownership, with more market-based decisions about operations and maintenance. Some say that because there are often long waiting lists to get into public housing, tenants hesitate to leave even when the service and conditions are less than desirable. Under PHRI, they say, PHAs could no longer take a tenant's occupancy for granted.

The Congress rejected this initiative in the FY2003 budget, directing HUD to report to the Appropriations Committees about PHAs that have already obtained private financing for their capital needs, particularly in Baltimore, Chicago and Philadelphia. Some housing organizations and PHAs are concerned that the Administration's proposal is an untested experiment that could lead to serious financial difficulties for PHAs and the potential loss of large amounts of the nation's low-cost housing stock. H.R. 2861, the House approved FY2004 appropriations bill, did not support PHRI.

In related legislation, H.R. 1981 would reauthorize HUD's Public Housing Drug Elimination Program. The program was ended in FY2001 with a final appropriation of $310 million.

For more details on housing issues in the HUD budget for FY2004, see CRS Report, RL31804, *Appropriations for FY2004: VA, HUD, and Independent Agencies* or CRS Report RL31962, *The Department of Housing and Urban Development: FY2004 Budget*. For a look at housing issues in the FY2003 HUD budget, see CRS Report RL31304, *Appropriations for FY2003: VA, HUD, and Independent Agencies.*

National Affordable Housing Trust Fund

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

H.R. 1102 and S. 1411, similar but not identical bills, have been introduced in the 108th Congress to establish a National Affordable Housing Trust (the "Trust Fund") in the Treasury of the United States. H.R. 1102 has over 200 mostly Democratic cosponsors. The goal of both bills would be to produce, rehabilitate, and preserve at least 1,500,000 affordable housing units over the next 10 years. They would do so "by using profits generated by Federal housing programs to fund additional housing activities, without supplanting existing housing appropriations." The Trust Fund would focus on the production of rental housing for families with the greatest need, in mixed income settings, and in areas where families could gain access to the greatest economic opportunities.

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

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

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

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

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

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

- 50% of funds from Low Income Housing Tax Credits;
- 50% of funds from mortgage revenue bonds and tax-exempt bonds;
- 50% of grants under the Community Development Block Grant and the HOME program;
- 50% of project-based housing voucher assistance;
- 50% of funds from the rural housing assistance program;
- federal, state, or local amounts from the Temporary Assistance for Needy Families program; and
- general state revenue (any state or local government revenue not derived from federal sources, including any state tax revenue).

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

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

To be an eligible recipient, a state or participating jurisdiction must have established and submitted an allocation plan to the Secretary that includes priority housing needs and an agreement to comply with requirements relating to rents charged, the availability of units to voucher holders, the use as affordable housing for 50 years, mixed-income usage, and the Fair Housing Act.

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

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

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

Issues and Concerns. The Administration does not support a national trust fund for the construction of "project-based" assistance. They cite the existing $4 billion a year Low Income Housing Tax Credit program that provides financial support for an estimated 120,000 new and rehabilitated units a year. Trust Fund advocates respond that the Tax Credit program is targeted at renters with incomes of 50-60% of the local area median, while Trust Fund units would generally be directed at households with incomes at or below 30% of the local area median. The Administration also points to several other HUD programs, HOME and Community Development Block Grants, that can also be used to support new rental construction or rehabilitation. The HOPE VI public housing program is also being used to fund construction and rehabilitation of rental housing (although as noted above, the

Administration is not requesting funding for this program for FY2004). Again, however, critics argue that very few of the rental units constructed or rehabilitated under these other federal programs have been targeted at "extremely low-income households" (30% or less of the local area median income).

The main source of funds to support the proposed Trust Fund is the "surplus" reserves of HUD's profitable FHA mortgage insurance business. Under the FHA program, homebuyers pay mortgage insurance premiums into the program. The premiums are used to protect FHA-approved lenders, who have lent funds to many relatively risky homebuyers, from losses if homeowners are no longer able to make their mortgage payments and undergo foreclosure. Over the past decade, the favorable economy has meant low foreclosures rates (although they have been increasing in the past several years). As a result, FHA reserves have been building. The program is expected to add $2.9 billion of additional reserves in FY2004 alone, with the fund's economic value reaching $29.3 billion by FY2004 and $44.8 billion by FY2008. The capital ratios are projected to be 4.47% in FY2004 and 5.10% in FY2008, considerably above the government-mandated minimum 2%. But the levels of surplus could change quickly if there were to be a serious downturn in the economy, with many more homeowners losing their homes.

There has been considerable confusion over how the FHA insurance reserves are treated for budgetary purposes. They are not idle funds waiting to be tapped, but they flow into the Treasury like other federal revenues, and they are used to pay government expenses. Since 2001, the Office of Management and Budget has treated the net FHA reserves as revenue to HUD, offsetting appropriations that would otherwise be required. If the FHA reserves were to be tapped for the Trust Fund, they would have to be replaced by additional appropriations, the same as funding for any other HUD program. Some ask why supporters do not simply propose the financing of the Trust Fund through direct appropriations rather than through the FHA reserves, given that both approaches would have the same cost. According to the National Low Income Housing Coalition, "while all trust funds are subject to annual budget decisions ... trust funds are less subject to the vicissitudes of the annual appropriations process."[3]

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

Increasing Homeownership for Lower Income Households

Despite major gains in recent years, **Table 2** below shows that homeownership rates for lower income and minority households remain significantly lower than the rate for whites. There are a number of reasons for these lower rates. Minorities have

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[3] *2003 Advocates' Guide to Housing and Community Development Policy*, National Low Income Housing Coalition, p. 122.

lower incomes than whites and a larger percentage live in central cities, both of which make it more difficult to find a desirable home to purchase. (Many larger cities have thousands of decrepit boarded-up homes in distressed neighborhoods, but the purchase and rehabilitation of individual units is rarely an option for lower-income buyers without the help of a Community Development Corporation or some similar organization. See **Table 3** for differences in homeownership rates by area.) For a variety of reasons, many lower income households have poor credit records which makes obtaining a mortgage more difficult, more expensive, or impossible.

Table 2. Homeownership Rates, by Household Category

Household type	1993	1st Quarter 2003
White, non-Hispanic	70.2%	75.0%
Black	42.0%	48.4%
Hispanic	39.4%	46.7%
Households with family incomes greater than or equal to the median family income	N.A.	83.3%
Households with family incomes less than the median family income	N.A.	51.3%
Married couples with children	73.7%	79.0%
Married couples without children	82.9%	86.7%
Other families with children	35.5%	42.8%
Other families without children	63.9%	67.1%
Single Person Households	47.1%	52.5%

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

The main homeownership tax incentives — the mortgage and property tax deductions — provide substantial housing assistance to upper-middle income homeowners, but are of little use to those in the bottom half of the income distribution. Housing analysts have long suggested that a change from the current tax deduction to a tax credit would help put lower income homebuyers on a more level playing field, since under a progressive tax rate structure, a tax deduction favors those with higher incomes. While discrimination in mortgage lending and in the sale of homes has been reduced over the past decade, it is still considered to play a significant factor in the lower rate of homeownership for minorities.

The Administration has made increasing homeownership for lower income groups the centerpiece of its housing policy. It has proposed a number of homeownership initiatives, including the $200 million American Dream Downpayment Initiative (H.R. 1276), a new FHA mortgage insurance product to help families with poor credit records, and a single-family affordable housing tax credit (H.R. 839/S. 198) to stimulate the construction or rehabilitation of lower-priced homes.

In testimony before the House Committee on Financial Services Subcommittee on Housing and Community Opportunity on April 8, 2003, HUD Secretary Martinez stated that homeownership offers minorities the best opportunity to accumulate wealth that can later be used for education, to start a business, or to take advantage of other opportunities that may not be available to those without financial assets. Others believe that increased homeownership can help economically distressed neighborhoods to stabilize and revitalize themselves. The HUD Secretary has taken part in Habitat for Humanity construction projects and says he has seen profound changes in how families view their future prospects when, for the first times in their lives, they have something that is increasing in value.

Administration's FY2004 Homeownership Proposals. The Administration's FY2004 HUD budget contains a number of homeownership proposals.

- **American Dream Downpayment Initiative**. Under this initiative, $200 million would be set aside within the existing HOME program for the "American Dream Downpayment Fund." Introduced in the 108th Congress as H.R. 1276/S. 811, HUD estimates that this proposal would help 40,000 additional families to buy a home. The House bill was passed by the House Financial Services Committee with several amendments on May 21, 2003, authorizing $200 million to be spent in each of FY2004 and FY2005. While most assistance would be targeted to low-income first-time buyers, an adopted amendment would extend eligibility to uniformed local government employees and teachers with incomes up to 115% of the local area median (and up to 150% in high-cost areas).
- **New FHA Financing Option**. A new mortgage product is proposed that rewards credit-risk borrowers who make timely mortgage payments. This would help families with poor credit records who must often rely instead on high-cost "subprime loans."
- **Self-Help Homeownership Opportunity (SHOP)**. The Administration is proposing to expand the SHOP program by reaching out to faith-based or other organizations to help more low-income families become homeowners. Under SHOP, grants are made to national and regional non-profit organizations such as Habitat for Humanity. Homebuyers must contribute significant amounts of volunteer labor to the construction or rehabilitation of the property. The budget requests a $65 million set-aside within the Community Development Block Grant program, and is expected to help produce 5,200 new homes nationwide.

- **Housing Counseling**. Counseling helps families learn about the process of buying a home and how to avoid predatory lending practices. It also helps homeowners avoid foreclosure during periods of financial stress. The FY2004 budget requests $45 million for housing counseling, up from $35 million in FY2003.
- **Single-Family Affordable Housing Tax Credit**. The Administration has proposed a tax credit to stimulate the production of homes that are affordable to lower-income households — and to help revitalize distressed communities. It has been introduced as H.R. 839/S. 198, and is modeled after the popular Low Income Housing Tax Credit for rental housing. The tax incentive would provide an estimated $1.7 billion of tax credits to be taken by homebuilders (developer or investor partnership) over 5 years to encourage the rehabilitation of existing properties (including abandoned housing in central cities) or new construction of 100,000 affordable single-family homes in urban or rural areas. Credits would be allocated to state housing credit 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. 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.

Concerns About Administration's Homeownership Policy. While most housing advocates find it difficult to oppose additional homeownership opportunities for lower-income families, they have voiced concerns that the Administration's focus on homeownership is unbalanced. Critics say that HUD's policy should have more emphasis on maintaining or increasing choices in types of housing available, including rental housing. "Homeownership may not be the best wealth-building strategy," says Woody Widrow, project director of the Texas Individual Development Account Network. "Being a renter and owning a business or saving money to send your kids to college may be a better strategy."[4] Some also argue that without a cautious and thoughtful homeownership program that avoids concentrations of lower-income homebuyers in lower-income neighborhoods, potential benefits to buyers will be minimized. For example, several recent studies have found that homeownership has positive effects on children's development. However, "... the positive effects of homeownership on children are weakened in distressed neighborhoods, especially those that are residentially unstable and poor. Thus, helping low-income families purchase homes in good neighborhoods is likely to have the best effects on children."[5] Harm can be done to both lower-income buyers and the neighborhoods where the homes are frequently purchased if there are high default rates.

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

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

Some applaud HUD and others in the housing industry for giving more attention to increasing the financial literacy of lower-income households, but others would like more efforts to improve the credit records of these households before they buy a first home. Pre-purchase counseling has greatly increased in recent years and has been shown to be helpful. HUD is proposing to increase FY2004 funding for its major housing counseling program to $45 million from $35 million in FY2003. Almost all financial advisors recommend that households have at least 3 months and preferably 6 months of liquid assets available to cover the financial setbacks that all households face. Lower income households are most vulnerable to financial setbacks. Yet many lower income and minority homebuyers are encouraged to purchase a home when they have almost no savings before or after the purchase. Many are households who have never been able to accumulate any savings, who may have poor health and be without health insurance, and have little or no financial knowledge about budgets, mortgages, and home repair contracts. They may be especially vulnerable to layoffs and a variety of financial and housing-related scams.

Table 3. Homeownership Rates, by Area

(1st Quarter, 2003)

Area	1st Quarter 2003
U.S.	68.0%
In central cities	51.9%
Suburbs	74.7%
Outside metropolitan areas	75.6%
Northeast	64.2%
Midwest	72.9%
South	69.9%
West	62.8%

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

The Mortgage Bankers of America reported that 1.2% of all loans were in foreclosure at the end of the first quarter of 2003, a record high. Additional homeowners who are seriously behind in their mortgage payments have been able to avoid or defer foreclosure by filing for bankruptcy. HUD's largest homeownership program, its Federal Housing Administration (FHA) mortgage insurance program, helped about 700,000 first-time buyers in 2002. However, this program continues to operate with very high delinquency rates (a near record 11.45% of borrowers at least 30 days past due in the 4rd quarter of 2002). The Senate Appropriations Committee wrote in its FY2003 report that ...” in some cases and in certain neighborhoods, FHA has been misused to underwrite bad loans that lead to defaults and foreclosed homes, contributing to neighborhood decline and destabilization,” and directed HUD to report to the appropriate congressional committees on further

actions that can be taken to protect homebuyers and communities experiencing high rates of defaults and foreclosures on FHA-insured loans.

Increased homebuyer training may help to protect low-income and minority homebuyers from another significant problem: predatory lending. Research has shown that lower-income and minority buyers are more likely to receive "subprime" mortgages with higher interest rates and higher fees, often higher than can be justified by standard underwriting guidelines.[6] Predatory lending has hurt lower-income and minority homeowners most, often stripping away home equity accumulated over a lifetime. When foreclosures are concentrated in certain areas, as FHA-insured homes often are, they can pull property values down and do other damage to these neighborhoods. These and other factors work against lower-income homebuyers accumulating wealth.

Thus, some who are uneasy about current HUD policy simply urge more finesse in the design and implementation of homeownership programs and policies for lower-income households. For a review of current homeownership programs and policy, and the cautions that some recommend, see *Homeownership: Too Much of a Good Thing?*[7]

Other 108th Congress Homeowner Proposals. In addition to the Administration's proposals, a variety of homeownership proposals are pending in Congress.

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

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

[7] Leanne M. Lachman, and Deborah L. Brett, *Commentary — Lend Lease Real Estate Investments,* no. 10, 2003, 19 p.

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

Predatory Lending

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

While Congress has held hearings, and bills have been introduced, industry, consumer groups, HUD, and other interested parties have not been able to reach a consensus on what legislation, if any, is necessary to address predatory lending. Some financial organizations argue that more rigorous enforcement of existing federal laws would be sufficient. A number of government agencies (Justice Department, the Federal Trade Commission, the Federal Reserve, HUD, along with the government sponsored enterprises, Fannie Mae and Freddie Mac) have become involved in addressing various aspects of the predatory lending issue, which suggests to some that additional legislation may not be necessary. On the other hand, some consumer groups believe there should be more education initiatives to increase financial literacy. One consumer advocacy group said that predatory lending is "so hard to fight because so many people are making so much money," and that only comprehensive legislation can stem the problem.

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

Several bills designed to combat predatory lending have been introduced in the 108th Congress. Representative Ney, chair of the Financial Services Subcommittee on Housing and Community Opportunity, has introduced H.R. 833, a bill to "combat unfair and deceptive practices in the high-cost mortgage market" and pre-empt the growing number of state and local predatory lending laws. H.R. 1663, the Predatory

Mortgage Lending Practices Reduction Act, also proposes to curtail abuses among subprime lenders and encourage efforts to resolve complaints by consumers. Both bills are summarized below.

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

Consumer protections in the bill include:

- prohibiting single premium credit insurance;
- prohibiting loans made without regard to the borrower's ability to repay them;
- limiting prepayment penalties to 4 years, rather than their current 5-year period;
- prohibiting refinancing during the first 12 months of the loan, unless it benefits the borrower; and
- prohibiting lenders from profiting from foreclosure by only allowing them to recoup costs.

The bill also includes a number of new disclosure requirements:

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

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

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

also provide grants to Community Development Corporations to provide predatory lending education to borrowers, and potential borrowers.

Real Estate Settlement Procedures Act

The major purpose of the Real Estate Settlement Procedures Act of 1974 (RESPA)[8] is to encourage homebuyers or homeowners who are refinancing their mortgages, to shop around for the best prices for settlement services (also referred to as "closing costs"). Many contend that this Act has failed in its purpose over the decades, with many homeowners or homebuyers being overcharged or forced to buy unneeded services. On July 29, 2002, the Administration proposed a rule that would make major changes in RESPA regulations to simplify and improve the process of obtaining a home mortgage.[9] Homebuyers would have the option of getting a "package price" including all of the required settlement services before committing funds to any lender, so that they might compare this "one price" with others from other settlement service providers. A number of lenders already offer this as a "no closing costs"option, rolling the settlement costs into a higher mortgage rate.

The HUD Secretary said that these reforms could save Americans up to $8 billion a year, but national organizations representing mortgage brokers and real estate agents that may benefit financially from the lack of competition among settlement providers have objected strongly. Senator Shelby, chair of the Senate Banking, Housing and Urban Affairs Committee, said at a recent hearing that the change would be "significantly damaging to small businesses" and Representative Manzullo, chair of the Small Business Committee, spoke against this proposal, saying that it could bankrupt thousands of small businesses across the country.[10] Supporters of the proposed reforms argue that under the current system, it is very difficult for homebuyers to know how much they are being cheated or do anything about it.

Some expect that HUD will replace this proposed rule with a modified version in the face of strong industry objections.

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

The Housing Bond and Credit Modernization and Fairness Act of 2003 (H.R. 284/S.595) has about 280 bipartisan co-sponsors. This Act would modify 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

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[8] 12 U.S. C. Sec. 2601, et seq.

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

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

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

H.R. 284/S. 595 would repeal the "Ten-Year Rule," an obscure provision now said to be preventing tens of thousands of qualified lower-income first-time buyers each year from getting an affordable MRB-financed mortgage. The rule,[11] enacted before the MRB program was made permanent in 1993, requires states to use the mortgage payments received from homeowners to pay off the bond once the bond has been outstanding for 10 years, rather than using (or recycling) these mortgage payments to make other loans to other first-time buyers. When homeowners sell their home and pay off their mortgage, or refinance their loan, these funds must also be used to pay down the bond principal.

The 1988 Ten-Year Rule started having an impact in 1998. Repealing the rule would allow a recycling of funds and thus allow a larger volume of tax-exempt bonds to remain outstanding for a longer period of time. This change is supported by the National Council of State Housing Agencies and the National Governors Association. The Joint Committee on Taxation has estimated that the repeal would cost $770 million over 5 years and $2.4 billion over 10 years.

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

A second provision in H.R. 284/S. 595 would change 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 (price limits that will not be challenged by the IRS). 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 at least 30% since then, supporters of the MRB

[11] P.L. 100-647.

program argue it cannot work in parts of many states because qualified buyers cannot find homes priced below the outdated "safe haven" price limits. H.R. 284/S. 595 would allow states to set house price limits at three and a half times the program's homebuyer qualifying income, a more readily available measure.

Fannie Mae and Freddie Mac

The removal of Freddie Mac's top three executives in June 2003 over accounting irregularities has again raised questions about the need for more stringent regulation of Fannie Mae and Freddie Mac. Representative Richard Baker, chair of the House Financial Services Government-Sponsored Enterprises Subcommittee, has long been a critic of Fannie Mae and Freddie Mac, arguing that they have not been sufficiently accountable to the public. He has also argued that HUD's Office of Federal Housing Enterprise Oversight (OFHEO) has been ineffective in its watchdog role. H.R. 2575, the Secondary Mortgage Market Enterprises Regulatory Improvement Act (with 20 Republican cosponsors), would abolish OFHEO, and create a new Office of Housing Finance Supervision within the Treasury to oversee Fannie Mae and Freddie Mac. This new entity would establish the duties and authorities for the Director, provide for the public disclosure of information, risk-based capital tests for enterprises, and for required minimum and critical capital levels. The proposed legislation includes provisions for prompt corrective actions and for the enforcement of actions.

On July 17, 2003, the Senate Banking Committee held hearings on Freddie Mac's restatement of earnings for the past 3 years. (See CRS Report RS21567, *Accounting and Management Problems at Freddie Mac.)*

Brownfields

The Brownfields redevelopment program is used to reclaim abandoned and contaminated commercial and industrial sites — often as part of neighborhood redevelopment efforts. Some view these efforts as "smart growth," making use of the existing infrastructure. But much less progress has occurred than hoped, with many projects taking 3-4 years to get started and others abandoned because of complex environmental regulations and other difficulties. Brownfields bills in the 108th Congress include H.R. 239, H.R. 1334, and S. 645. These bills would provide grants for projects for the cleanup and economic redevelopment of Brownfields. While HUD's Brownfields program received $25 million in both FY2002 and FY2003, the Administration's FY2004 budget requests no funding, recommending instead that brownfields activities be turned over to the Environmental Protection Agency. Hearings may be held on brownfields during this Congress. (See CRS Issue Brief IB10114, Brownfields and Superfund Issues in the 108th Congress and CRS Report RL30972, *The Brownfields Program Authorization: Cleanup of Contaminated Sites*.)