

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered within the hourglass. The text is overlaid on the hourglass.

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*Housing Issues in the 110th Congress*

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November 4, 2008

**Abstract.** A number of housing-related issues have been prominent in the 110th Congress. Possibly the most visible issue is the prevalence of subprime loans and growing mortgage default and foreclosure rates. On July 30, 2008, the President signed the Housing and Economic Recovery Act of 2008 (P.L. 110-289) into law. In order to assist troubled borrowers, P.L. 110-289 gives the Federal Housing Administration (FHA) the authority to insure an additional \$300 billion in mortgage loans; the new authority will be available to help borrowers at risk of foreclosure refinance into more manageable loans. This program is called HOPE for Homeowners. The new law also appropriates \$4 billion to the Community Development Block Grant (CDBG) program to be allocated to states and localities for the purchase, rehabilitation, resale, or rental of foreclosed properties.

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# Housing Issues in the 110<sup>th</sup> Congress

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## Summary

A number of housing-related issues have been prominent in the 110<sup>th</sup> Congress. Possibly the most visible issue is the prevalence of subprime loans and growing mortgage default and foreclosure rates. On July 30, 2008, the President signed the Housing and Economic Recovery Act of 2008 (P.L. 110-289) into law. In order to assist troubled borrowers, P.L. 110-289 gives the Federal Housing Administration (FHA) the authority to insure an additional \$300 billion in mortgage loans; the new authority will be available to help borrowers at risk of foreclosure refinance into more manageable loans. This program is called HOPE for Homeowners. The new law also appropriates \$4 billion to the Community Development Block Grant (CDBG) program to be allocated to states and localities for the purchase, rehabilitation, resale, or rental of foreclosed properties.

P.L. 110-289 also establishes a new regulator for the Government-Sponsored Enterprises (GSEs)—Fannie Mae and Freddie Mac—and gives the Treasury Department temporary authority to purchase an unlimited amount of debt or stock in Fannie Mae and Freddie Mac. In addition, P.L. 110-289 makes changes to the FHA loan insurance program. These changes include increasing the maximum loan amount that FHA will insure and prohibiting certain seller-financed downpayment assistance programs (including the Nehemiah Corporation).

Another provision of P.L. 110-289 creates an affordable housing trust fund that is to be financed by profits from the GSEs. In the initial years after enactment of P.L. 110-289, the law calls for a declining portion of GSE profits to support the HOPE for Homeowners Program, with the remainder supporting the housing trust fund. The trust fund contains two separate funds: (1) the Housing Trust Fund, the primary purpose of which is to increase housing opportunities for extremely low- and very low-income renters and (2) the Capital Magnet Fund, which promotes affordable housing and economic development.

Activity in the 110<sup>th</sup> Congress also includes enactment of P.L. 110-411, a law that reauthorizes the Native American Housing Assistance and Self-Determination Block Grant. Additional legislation includes Section 8 voucher reform legislation in both the House (H.R. 1851) and Senate (S. 2684); the House passed its version on July 12, 2007. Legislation also includes a bill to reauthorize the HOPE VI program (H.R. 3524), which has been approved by the House; and versions of bills to reauthorize the McKinney-Vento Homeless Assistance Act, which have been approved by the Senate Banking Committee (S. 1518) and the House (H.R. 7221).

The House has considered legislation that would preserve assisted housing, including the Market-to-Market Extension and Enhancement Act (H.R. 3965), which was approved by the House Financial Services Committee, and the Section 515 Rural Housing Property Transfer Improvement Act (H.R. 3873), which was approved by the House. And a version of a bill that would make changes to the Section 202 Housing for the Elderly program (H.R. 2930) has been passed by the House. A similar bill has been introduced in the Senate (S. 2736).

# Contents

The Housing and Economic Recovery Act of 2008 .....	1
The Current Housing Market: Subprime Lending and the Rise in Foreclosures .....	4
Subprime Lending.....	5
Exotic Mortgages, Resets, and Rising Foreclosures .....	5
The Role of Securitization .....	6
Price Declines, Unsold Inventories, and Falling Construction Starts .....	7
Initiatives That Would Change the Lending and Homebuying Process .....	7
Regulating Participants in the Lending Process.....	8
Lenders.....	8
Mortgage Brokers .....	9
Appraiser Objectivity.....	9
Suitability.....	10
Borrower Counseling .....	10
Disclosure Requirements .....	11
The Truth in Lending Act.....	11
The Home Ownership and Equity Protection Act.....	12
Real Estate Settlement Procedures Act .....	13
Home Mortgage Disclosure Act.....	14
Predatory Lending and Fraud.....	15
Efforts to Assist Troubled Borrowers .....	16
Borrower Counseling and Workouts .....	16
Refinancing Loans by Expanding the Authority of GSEs and FHA.....	17
The Economic Stimulus Act of 2008 .....	17
The Housing and Economic Recovery Act of 2008.....	18
Assisting Communities with Foreclosed Properties.....	18
Grants and Loans to Assist States and Communities .....	18
Expanding the Use of Mortgage Revenue Bonds .....	19
Issues in Bankruptcy .....	19
Taxing Debt Forgiveness.....	20
Treasury’s Troubled Asset Relief Program .....	20
Reforming Federally Sponsored Financing Institutions .....	21
GSE Regulation.....	21
Fannie Mae, Freddie Mac, and Federal Home Loan Bank Regulation.....	21
Affordable Housing Funds.....	23
FHA Reform.....	25
Seller-Funded Downpayment Assistance (Nehemiah Program).....	27
Housing After the 2005 Hurricanes .....	28
Rebuilding .....	29
FEMA Assistance.....	29
The Road Home .....	29
Mississippi Waiver.....	30
Rebuilding Public Housing .....	30
Ongoing Housing Assistance .....	30
Manufactured Housing.....	30
Rental Assistance .....	31

http://wikileaks.org/wiki/CRS-RL33879

Legislative Initiatives ..... 32  
    H.R. 1227 and S. 1668..... 32  
    Disaster Housing Strategy..... 32  
Housing Assistance..... 32  
    The HUD Budget ..... 33  
    The Position of HUD Secretary ..... 34  
    Federally Assisted Housing Funding and Reform..... 34  
        Section 8 Voucher Reform ..... 34  
        Public Housing Operating Funds ..... 35  
        HOPE VI Reauthorization ..... 38  
    Assisted Housing Preservation..... 38  
        Previous Legislative Efforts to Preserve Affordable Housing ..... 39  
        The Mark-to-Market Program..... 40  
        Section 202 Housing for the Elderly Program Preservation ..... 40  
        Other Preservation Legislation ..... 41  
    Native American Housing Assistance and Self-Determination Block Grant ..... 42  
    Low Income Housing Tax Credits..... 44  
    Homelessness ..... 45  
CRS Reports on Housing ..... 47

**Contacts**

Author Contact Information ..... 52  
Key Policy Staff ..... 52

<http://wikileaks.org/wiki/CRS-RL33879>

# The Housing and Economic Recovery Act of 2008

On July 30, 2008, the President signed into law P.L. 110-289, the Housing and Economic Recovery Act of 2008 (H.R. 3221), an omnibus housing package that went through a number of iterations in both the House and the Senate before its enactment. This section describes the versions of the bill that eventually became P.L. 110-289. For a detailed description of P.L. 110-289, see CRS Report RL34623, *Housing and Economic Recovery Act of 2008*, coordinated by N. Eric Weiss.

Initially, H.R. 3221 was introduced as an energy package, which was passed by the House on August 4, 2007. The bill then went to the Senate, where an amendment in the nature of a substitute transformed it into the Foreclosure Prevention Act of 2008. The Senate approved this new version of H.R. 3221 on April 10, 2008. When the bill returned to the House, it was again amended and approved, this time as the American Housing Rescue and Foreclosure Prevention Act, on May 8, 2008. In June 2008, the Senate Banking Committee again amended the bill (S.Amdt. 4983) and retitled it, this time as the Housing and Economic Recovery Act of 2008. The Senate approved this amended version of H.R. 3221 on July 11, 2008, and sent it back to the House. On July 24, 2008, the House approved a modified version of the Senate-passed Housing and Economic Recovery Act of 2008. Two days later, on July 26, 2008, the Senate voted to approve H.R. 3221, and the bill went to the President, who signed it into law on July 30, 2008. The provisions in each of the housing-related versions of H.R. 3221 are discussed below.

## *Initial Senate Version*

On April 10, 2008, the Senate passed a foreclosure prevention measure as an amendment to H.R. 3221, a House-passed energy bill. The Senate's version of the bill was entitled the Foreclosure Prevention Act of 2008. The Senate amendment proposed to distribute \$4 billion through the Community Development Block Grant program to allow state and local governments to purchase and rehabilitate foreclosed homes. The measure also included FHA reform provisions, foreclosure protection provisions for servicemembers, and additional funding for housing counseling. In addition, the bill contained tax-related provisions, one of which pertained to business net operating losses. (For more information about net operating losses, see CRS Report RL34535, *Net Operating Losses: Proposed Extension of Carryback Period*, by Mark P. Keightley.) Another tax-related provision concerned purchasers of foreclosed homes. The bill included a \$7,000 tax credit for foreclosed and newly constructed homes purchased within 12 months of enactment. The tax credit was to be equally divided among the two taxable years beginning with the year of purchase.

## *Initial House Version*

On May 8, 2008, the House passed its first housing-related version of H.R. 3221, entitled the American Housing Rescue and Foreclosure Prevention Act, as a series of three amendments to the version passed by the Senate on April 10, 2008. The amendments contained many provisions already passed by the House or approved by committees. The first amendment addressed expansion of the FHA loan insurance program (H.R. 5830), GSE reform (H.R. 1427), FHA modernization (H.R. 1852), and loan modification protection for servicers (H.R. 5579). The second amendment provided foreclosure protections for servicemembers (H.R. 4883). It also included housing tax provisions, one of which proposed to make changes to the Low Income

Housing Tax Credit program (H.R. 5720). The second amendment included a temporary first-time home-buyer tax credit equal to the lesser of \$7,500 or 10% of the purchase price of a principle residence before April 1, 2009. Under the proposed legislation, the tax credit would have been recaptured over a 15-year period, starting in the second year after the taxable year the home was purchased. The recapture provision essentially made the tax credit a loan. The third amendment to H.R. 3221 clarified that the provisions of the legislation, as well as provisions of the National Bank Act and the Home Owner's Loan Act, would not preempt state laws regulating the foreclosure of residential real property or the treatment of foreclosed property.

### ***Senate Amendment to House-Passed Version***

After House passage of H.R. 3221, Members of the Senate Committee on Banking, Housing, and Urban Affairs again amended the bill through a manager's amendment (S.Amdt. 4983). On July 11, 2008, the full Senate approved the amended version of the bill, entitled the Housing and Economic Recovery Act of 2008. Some of the provisions that were made part of H.R. 3221 had been part of an unnumbered bill approved by the Senate Banking Committee on May 20, 2008. These included provisions to reform the Government Sponsored Enterprises (GSEs), to increase the GSE conforming loan limits, and to create a Housing Trust Fund. The Senate's amendment to H.R. 3221 eliminated many differences in GSE oversight reform that previously had been proposed in the House and Senate. However, there were differences in proposed changes to the GSE conforming loan limits in the Senate's version of H.R. 3221 approved on July 11, 2008, compared to those in the House-passed version of H.R. 3221 approved on May 8, 2008. The House bill proposed to make permanent the increase in the conforming loan limit included in the Economic Stimulus Act of 2008 (P.L. 110-185); the Senate would have set a lower permanent increase. The conforming loan limits in high cost areas under the House bill would have been \$729,750, whereas the Senate bill would have set a limit of \$625,000. The House would have allowed the limit to decrease, unlike the Senate bill; instead, the Senate version would have "banked" any declines in the house price index to be applied against future increases.

There were also differences between the Senate-passed version and the House-passed version of H.R. 3221 with regard to an affordable housing fund. Both bills proposed to use fees from the GSEs to create the fund, but the House and Senate differed in how the fee would have been calculated. The House would have had first-year funds go to areas damaged by Hurricanes Katrina and Rita. The Senate would have had first-year funds go to support the HOPE for Homeowners Program. HOPE for Homeowners was a proposed program through which homeowners at risk of foreclosure would have been able to refinance their current mortgages with FHA-insured loans. Similar to the provisions in the May 8, 2008, House-passed version of H.R. 3221, under HOPE for Homeowners, FHA would have been authorized to insure refinanced mortgages up to a total principal balance of \$300 billion. In the July 11, 2008 Senate-passed version of the bill, the support from the housing trust fund for the HOPE for Homeowners program would have been phased down during the second and third years.

The July 11, 2008, Senate-passed version of H.R. 3221 also contained provisions that were in the initial version of H.R. 3221 passed by the Senate on April 10, 2008. Among these was a proposed appropriation of \$4 billion to assist communities with foreclosed properties; the May 8, 2008, House-passed version of H.R. 3221 did not include a similar provision. Additional provisions that were in the version of H.R. 3221 initially passed by the Senate were FHA reform provisions, protections for servicemembers, and funding for housing counseling. The version of H.R. 3221 passed by the Senate on July 11, 2008, also proposed a first-time home-buyer credit equal to the lesser of \$8,000 or 10% of the purchase price of a principle residence before April 1, 2009. The

credit would have been recaptured over a 15-year period, starting in the second year after the taxable year the home was purchased.

### ***Enacted Version, P.L. 110-289***

On July 23, 2008, the House passed a modified version of the Senate-passed Housing and Economic Recovery Act of 2008. On July 26, 2008, the Senate approved H.R. 3221 as passed by the House on July 23. The President had initially threatened to veto the bill, but rescinded his veto threat.<sup>1</sup> On July 30, 2008, the President signed H.R. 3221 into law as P.L. 110-289. The paragraphs below briefly summarize the major provisions in P.L. 110-289; more detailed discussion of some provisions is provided in relevant sections throughout this report. For a detailed description of P.L. 110-289, see CRS Report RL34623, *Housing and Economic Recovery Act of 2008*, coordinated by N. Eric Weiss.

The Housing and Economic Recovery Act gave temporary authority for the Treasury Department to purchase an unlimited amount of debt or stock of Fannie Mae and Freddie Mac (the Secretary of the Treasury will establish the terms of the agreement). This authority expires December 31, 2009. The Congressional Budget Office (CBO) has estimated the expected federal budgetary costs at \$25 billion on the basis of a less than 50% probability of Treasury having to use this authority before the authority expires at the end of December 2009.

P.L. 110-289 also created a new federal regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The bill created the Federal Housing Finance Agency (FHFA) to replace the existing regulators: the Office of Federal Housing Enterprise Oversight (OFHEO), which oversaw Fannie Mae and Freddie Mac, and the Federal Housing Finance Board (FHFB), which monitored the Federal Home Loan Banks. While the law gave the FHFA authority as regulator of Fannie Mae and Freddie Mac, shortly after enactment of P.L. 110-289, the FHFA also became responsible for their operations. This occurred on September 7, 2008, when regulators placed Fannie Mae and Freddie Mac under conservatorship. The Housing and Economic Recovery Act also raises Fannie Mae and Freddie Mac conforming loan limits in areas where 115% of the median home price exceeds the current limit (\$417,000) to the lesser of 115% of the median home price or 150% of the conforming loan limit.

The Housing and Economic Recovery Act also created a new program, called HOPE for Homeowners, through which FHA has authority to insure up to \$300 billion in loans to assist troubled borrowers. Homeowners who meet certain conditions can refinance into an FHA-insured mortgage if the current lender(s) agrees to write down the principal of the current loan to achieve a 90% loan-to-value ratio and to pay a 3% insurance premium. The new law also made changes to FHA; these include prohibiting seller-assisted downpayments, raising the loan limit on home equity conversion mortgages (HECMs) to the conforming and high cost loan limits, increasing the minimum downpayment on FHA mortgages from 3% to 3.5%, and prohibiting HUD from implementing risk-based insurance premiums. P.L. 110-289 also increased FHA loan limits to the lesser of (1) 115% of the median home price for the area, or (2) 150% of the GSE conforming loan limit, but the limit for an area may not be less than 65% of the conforming loan limit for Freddie Mac.

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<sup>1</sup> See White House Press Briefing, July 23, 2008.

P.L. 110-289 also created a new affordable housing trust fund with profits from the GSEs. The trust fund consists of two separate funds called the Housing Trust Fund and the Capital Magnet Fund. In the initial years after enactment of P.L. 110-289, a declining portion of GSE profits are to be used to support the HOPE for Homeowners program, with the remainder going to the Housing Trust Fund and Capital Magnet Fund. The primary purpose of the Housing Trust Fund is to provide rental assistance for extremely low-income families (those with incomes at or below 30% of area median income). At least 75% of funds allocated to the Housing Trust Fund must be used for this purpose. Funds that are allocated to the Capital Magnet Fund are to be used for competitive grants to attract private capital and to support investment in housing for low-income, very low-income, and extremely low-income households, as well as economic development activities and community service facilities.

P.L. 110-289 appropriated \$4 billion to the Community Development Block Grant (CDBG) program for allocation to states and localities to purchase, rehabilitate, resell, or rent foreclosed properties. The program created under P.L. 110-289 is referred to as the Neighborhood Stabilization Program. The law called on HUD to create a formula to distribute funds to states and communities using three factors: (1) the number and percentage of home foreclosures in each jurisdiction, (2) the number and percentage of homes financed by a subprime mortgage, and (3) the number and percentage of homes in default or delinquency. On September 26, HUD announced the states and communities that would receive funds, and how much each would receive.

Among other provisions in the Housing and Economic Recovery Act is one that created a tax credit of \$7,500 for first-time homebuyers. The credit will be recaptured over a 15-year period, however. The new law also made changes to the Low Income Housing Tax Credit; this includes a temporary increase in the per capita tax credit allocation to states by \$0.20 for calendar years 2008 and 2009. Another provision encouraged the states to create a national database of mortgage originators through the S.A.F.E. Mortgage Licensing Act.

## The Current Housing Market: Subprime Lending and the Rise in Foreclosures

The housing market experienced significant stress in 2007 and 2008. Borrowers found it difficult to meet their mortgage obligations, and late payments and foreclosures increased. In absolute terms, the biggest percentage point increases in mortgage defaults have occurred among subprime borrowers—those borrowers with significant indicators of heightened risk of default, such as blemished credit history or high debt-to-income ratio. In relative terms, the default rate among prime borrowers with adjustable rate mortgages (ARMs) has risen even faster than subprime default rates.<sup>2</sup> Borrowers may have relied upon the low interest rates and rapid house price appreciation that occurred between 2001-2005 to continue, but now face significant risk of foreclosure as housing markets decline in some areas. Changes in mortgage contracts and the method of funding mortgages, such as interest-only and adjustable rate mortgages, could have contributed to housing market stress. Troubles in the housing market are not relegated to defaulting borrowers, however. Falling prices and slowing home sales affect all home owners.

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<sup>2</sup> Subprime default rates can increase more percentage points even though the prime default rate is rising faster because subprime defaults start from a higher base.

Declining construction starts affect local employment. These troubles in the current housing market, combined with changes in mortgage contracts, have led some economists to forecast even higher default rates in coming months.

## Subprime Lending

Since the early 1990s, lenders have developed better methods for estimating the risks posed by borrowers with blemished credit profiles, with the result that lenders now offer home loans to consumers who earlier would have been denied mortgage credit. These loans are often referred to as subprime loans. Typically, loans to subprime borrowers have higher interest rates and fees than loans to prime borrowers because subprime borrowers have historically experienced higher default rates. Delinquency and foreclosure rates for subprime loans rose rapidly during the second half of 2006 and the first half of 2007. On April 11, 2007, the Joint Economic Committee issued a special report on rising foreclosures. The report predicted that subprime foreclosures would continue to rise, and recommended immediate action to minimize any costs that foreclosures can impose on surrounding communities.<sup>3</sup>

Although the primary causes of foreclosure are traditionally personal financial setbacks (job loss or medical calamity), the recent rise in subprime foreclosures may be partly due to imprudent underwriting standards during the housing boom that occurred between approximately 2001 and 2005. House prices rose rapidly in certain markets, which may have encouraged some borrowers in hot markets to assume more debt than was prudent. Rapidly rising prices encourage excess debt because, once in the home, the borrower earns the house price appreciation, which can then be used to refinance the house on more favorable terms. In order to take advantage of anticipated appreciation, some borrowers turned to mortgage products with low introductory payments, but which risked higher future payments.

## Exotic Mortgages, Resets, and Rising Foreclosures

Slowing housing markets frustrated the plans of some borrowers who used nontraditional mortgages, sometimes referred to as exotic mortgages, to finance their homes. One form of alternative mortgage has an interest-only (I/O) introductory period for two, three, five, or more years. The borrower pays no principal during the introductory period, but then payments increase when the I/O period expires because the remainder of the borrower's payments must pay off the principal over a shorter period of time. For example, a 2/28 mortgage has an I/O introductory payment for two years but then resets to a higher payment for the remaining 28 years of the loan. Another form of alternative mortgage, the adjustable rate mortgage (ARM), employs a variable interest rate, which adjusts to changes in a market interest rate. One of the simplest ARMs offers an initial low rate, called a teaser, at the beginning of the loan and then resets after an introductory period. The teaser rate may apply for one year or for as little as one month. (For more information about alternative mortgage terms, see CRS Report RL33775, *Alternative Mortgages: Causes and Policy Implications of Troubled Mortgage Resets in the Subprime and Alt-A Markets*, by Edward V. Murphy.)

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<sup>3</sup> U.S. Congress Joint Economic Committee, *Sheltering Neighborhoods from the Foreclosure Storm*, April 11, 2007, available at [http://jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore\\_id=389d9fc3-d503-4168-9b11-2d73f3757ca8](http://jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore_id=389d9fc3-d503-4168-9b11-2d73f3757ca8).

These I/O loans, ARMs, and hybrids of the two result in fluctuating monthly house payments for borrowers. Because of the increased use of 2/28 hybrid ARMs during 2005 and 2006, tens of billions of dollars of loans will reset their payments each month until fall of 2008. Since some borrowers with resetting mortgages had planned to refinance their mortgages using continued house price appreciation, the recent declines in housing markets and rise in lending standards have resulted in sharply rising foreclosure rates.

Foreclosure rates are rising, especially among borrowers in formerly rapidly appreciating regions and among borrowers with ARMs. Some of the geographic distribution of mortgage defaults can be explained by the performance of local economies. Late payments, as measured by a Mortgage Bankers Association survey, are rising among borrowers with ARMs, whether subprime or not. Subprime borrowers with fixed rate mortgages, however, are not experiencing higher rates of late payment. Although most subprime ARMs reset by summer of 2008, there remains a large number of Alt-A loans that still need to reset during 2008-2010. Many resetting loans in California were jumbo mortgages.<sup>4</sup> (For more information about foreclosures, see CRS Report RL34232, *The Process, Data, and Costs of Mortgage Foreclosure*, by Darryl E. Getter et al.)

## The Role of Securitization

Many loans, especially subprime and jumbo loans, were financed outside of traditional banking channels in a process called securitization. In securitization, a lender sells loans quickly, rather than keeping them on the lender's books. Many similar loans are then pooled together in trusts, or special purpose vehicles (SPVs). Pieces of the funds flowing through the trusts, called tranches, are sold to investors. Although securitization may have helped increase the supply of funds available for mortgages and thus held down interest rates for borrowers, it may also have facilitated the rise of non-bank lenders operating without federal supervision of their underwriting standards. The disproportionate rise in defaults among loans originated and securitized outside federal supervision has caused some to call for greater scrutiny of the process. (For more information about securitization, see CRS Report RS22722, *Securitization and Federal Regulation of Mortgages for Safety and Soundness*, by Edward V. Murphy.)

One concern is that securitization may have separated the up-front returns of mortgage originators from the long-term risk of securities holders. If the securitization process does not have adequate controls, mortgage originators could have the incentive to encourage borrowers to take on too much debt because the mortgage originator might not suffer losses if the borrower defaults in the future. The securitization community argues that investors are sophisticated market analysts who include contract clauses in securitization transactions to prevent mortgage originators from passing on this risk.

One proposal to address concerns raised by securitization would make secondary market investors liable for deceptive or predatory marketing by primary lenders. Some believe that extension of liability to the secondary market, referred to as assignee liability, would prevent secondary market investors from purposefully remaining ignorant of the marketing strategies of primary lenders. In this view, if secondary market investors were held liable, they would tighten

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<sup>4</sup> Jumbo loans are too large to be eligible for purchase by Fannie Mae or Freddie Mac. This cap, called the conforming loan limit, was \$417,000 until the enactment of P.L. 110-289. Under P.L. 110-289, in areas where 115% of the median home price exceeds the current limit (\$417,000), the conforming loan limit is the lesser of 115% of the median home price or 150% of the conforming loan limit.

underwriting standards and more closely monitor the practices of their lending partners. Others argue that extension of liability could create too much uncertainty for rating agencies to evaluate risks and lead to a shutdown of the secondary market.

## Price Declines, Unsold Inventories, and Falling Construction Starts

After increasing at a rapid rate during 2001-2005, house prices slowed significantly during 2006-2007 and began to decline significantly in 2008. In several parts of the country, such as California and Florida, the decline in housing markets preceded any loss of jobs in the local communities, an unusual condition. In other parts of the country, such as Michigan and Ohio, increases in foreclosure rates could in part be explained by stresses in the local economy.

The inventory of unsold homes has become large by historical standards, as is the homeowner vacancy rate. One indicator of the strength of a local housing market is the length of time it takes to sell a house. If houses are selling more slowly than the rate at which people are offering them for sale, then the inventory of unsold homes grows. According to the National Association of Realtors, at the beginning of 2005, the month's supply of homes on the market was 3.8;<sup>5</sup> a month's supply is calculated by taking the number of homes currently offered for sale and dividing by the current number of sales per month. It is meant to represent the amount of time that would be required to sell the houses that are on the market. A balanced market has a month's supply between 5.0 and 6.0 according to the National Association of Realtors. The month's supply reached 11.1 in June 2008 and then fell back to 9.9 by September 2008.<sup>6</sup> The existence of a glut of unsold homes is also evidenced by rising vacancy rates. Homeowner vacancy rates measure the percentage of the homeowner inventory that is vacant and for sale. According to the Census Bureau, homeowner vacancy rates in the first quarter of 2008 were at 2.9%, the highest level they had reached since the survey began in 1956.<sup>7</sup>

The slowing housing market is hurting builders and construction workers. As the supply of unsold homes has increased, builders have begun canceling options to acquire land for new construction and have offered reduced-price upgrades and other discounts on existing homes. The result has been even further downward pressure on prices and a slowdown in new construction. For example, the National Association of Home Builders confidence index fell more than 50% from 2005 to 2007. The index measures home builders' expectations of home sales for the next six months.

## Initiatives That Would Change the Lending and Homebuying Process

Some Members of Congress have responded to the troubles in the current housing market by introducing legislation that would modify the lending and home purchase process in an effort to

<sup>5</sup> Robert Freedman, *2006 Economic Outlook*, National Association of Realtors, January 1, 2006, available at <http://www.realtor.org/rmomag.nsf/pages/feature2jan06>.

<sup>6</sup> National Association of Realtors, *Existing Home Sales*, June 2008, available at <http://www.realtor.org/research/research/ehsdata>.

<sup>7</sup> See U.S. Census Bureau, *Housing Vacancies and Homeownership, Historical Tables*, available at <http://www.census.gov/hhes/www/housing/hvs/historic/histtab2.html>.

prevent similar events from occurring in the future. Some of these proposals would regulate the behavior of lenders, mortgage brokers, and other participants in the lending process. Other legislation would either expand the amount of information required to be disclosed to borrowers or increase the availability of borrower counseling. Some legislation would attempt to prevent fraudulent practices, sometimes referred to as predatory lending. Provisions that are included in some of these bills are summarized in the following sections. However, the discussion does not include an exhaustive list of legislation that has been introduced.

## Regulating Participants in the Lending Process

### Lenders

The mortgage lending market does not have a unified regulatory system. Banks that make mortgage loans are regulated by one of several federal regulatory agencies such as the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve System. Similarly, savings and loans and credit unions have their own federal regulators, the Office of Thrift Supervision and the National Credit Union Administration respectively. However, there is no federal regulatory system for mortgage lenders that are not banks, savings and loans, or credit unions. Instead, these institutions are licensed at the state level, where they are subject to state regulation. Since the recent increase in subprime loans and foreclosures, questions have been raised about the adequacy of state regulation over non-bank mortgage lenders. Treasury Secretary Henry Paulson has recommended that a Mortgage Origination Commission be created to evaluate state licensing and regulatory systems.<sup>8</sup>

The Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted on July 30, 2008, encourages the states to create a Nationwide Mortgage Licensing System and Registry.<sup>9</sup> P.L. 110-289 enumerates multiple purposes for this licensing system. Among these are (1) to adopt a uniform system of licensing and reporting for lenders, (2) to create a database to track information, (3) to provide information about lenders to consumers, and (4) to create training and examination requirements related to subprime lending. If, within one or two years of the enactment of P.L. 110-289 (depending on how often state legislatures meet), a state does not have its own registration or licensing system, or has not joined the Nationwide Mortgage Licensing System and Registry, P.L. 110-289 requires the HUD Secretary to establish a licensing system for that state. Under the law, HUD shall also have authority to establish a national licensing system if a system established by the states is not meeting the requirements of P.L. 110-289.

Additional legislation that has been introduced in the 110<sup>th</sup> Congress includes the following provisions regarding the regulation of lenders:

- requiring that loan originators be registered through the state and that if a state registration system does not exist, requiring the establishment of a national licensing system (H.R. 3915, H.R. 5857, and S. 2595);

<sup>8</sup> U.S. Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure*, March 2008, p. 78, available at <http://www.treas.gov/press/releases/reports/Blueprint.pdf>.

<sup>9</sup> See Division A, Title V of P.L. 110-289, the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act).

- establishing a certification system specifically for subprime mortgage lenders (H.R. 2061);
- establishing a federal duty of care for mortgage originators (S. 2452 and H.R. 3915);
- requiring lenders to take into account a borrower's ability to repay (H.R. 3081, H.R. 3915, and S. 2114); and
- prohibiting brokers from "steering" borrowers to loans that are more expensive than loans for which they qualify (H.R. 3081, H.R. 3813, S. 1299, and S. 2452).

## Mortgage Brokers

Mortgage brokers help match borrowers with mortgage lenders. Some have argued that brokers have a conflict of interest because, although they are agents of mortgage lenders, many borrowers rely on the advice of mortgage brokers when choosing a mortgage. In many cases, borrowers think that brokers are working for them and in their best interests. In order to reduce any conflict of interest, some critics suggest additional regulation of mortgage brokers. Mortgage brokers argue that, as members of the community in which they operate, they rely on their reputations for business and therefore do not require additional regulation. Nonetheless, under the Housing and Economic Recovery Act of 2008 (P.L. 110-289), mortgage brokers that meet the definition of "loan originator" will be subject to the S.A.F.E. Mortgage Licensing Act, which encourages the states to create a Nationwide Mortgage Licensing System and Registry. A loan originator under the new law is, generally, one who takes a residential mortgage loan application and offers or negotiates the terms of a residential mortgage loan for compensation or gain.

Additional legislation that would regulate mortgage brokers has been introduced in the 110<sup>th</sup> Congress. These include the following proposals:

- requiring mortgage brokers to be licensed by either state or federal law (H.R. 3915) or registered through a national registry (S. 2114);
- creating a fiduciary or agency relationship between brokers and borrowers (H.R. 3018, H.R. 3296, S. 1299, and S. 2452);
- verifying a borrower's ability to repay a loan (H.R. 3081, S. 1299, and S. 2452); and
- prohibiting brokers from "steering" borrowers to loans that are more expensive than loans for which they qualify (H.R. 3081, H.R. 3296, S. 1299, and S. 2452).

## Appraiser Objectivity

Another area where a potential conflict of interest could occur is in the appraisal of property in order to determine a home's value. Appraisers are supposed to be objective. However, the desire for repeat business from lenders may result in some appraisers feeling pressure to assess a house at a high enough value to ensure that a borrower will qualify for the proposed loan. Currently, the Appraisal Subcommittee of the Federal Financial Institutions Examinations Council (FFIEC) helps set minimum standards for state licensing of appraisers. Among the legislative proposals that would regulate appraisals are the following:

- establishing federal standards for appraisers and appraisal management firms (H.R. 3915);
- establishing as an unfair and deceptive trade practice the attempt to influence an appraiser (H.R. 3915 and S. 2860) and imposing penalties against parties that attempt to exercise influence over an appraisal (H.R. 1723, H.R. 1852, H.R. 2061, H.R. 3915, and S. 2860);
- imposing a duty of care on appraisers (S. 2452);
- enacting new appraisal standards that apply to subprime loans, including the requirement that a qualified appraiser conduct a physical inspection of the premises, that a second appraisal must take place under certain circumstances, and that borrowers receive a free copy of the appraisal (H.R. 5857); and
- amending the Truth in Lending Act and Financial Institutions Reform, Recovery, and Enforcement Act to ensure proper appraisal practices (H.R. 3837).

### **Suitability**

The term “suitability” in the mortgage lending context refers to whether the terms of a loan are suitable for a particular borrower on the basis of income, monthly mortgage payments, and other financial characteristics. A loan might be considered unsuitable if a borrower is unable to support the monthly mortgage payments on his or her income. Mortgage originators, including brokers and lenders, could be made liable for defaults if underwriting standards are unsuitable for the borrower’s circumstances. One advantage of this approach is that originators have direct contact with borrowers and generally have the potential to obtain a great deal of information about each borrower’s circumstances (as compared to mortgage-backed securities investors or financial regulators). Originator liability could ensure that mortgage brokers and lenders retain a stake in the long-term performance of their loans even if the loans are sold or securitized. A disadvantage of this approach is that suitability is difficult to define, is subject to significant uncertainty and litigation risk, and is determined only after events occur that trigger defaults. Legislation has been introduced in the 110<sup>th</sup> Congress that would require lenders to ensure that borrowers have adequate income and an ability to repay their mortgage loans (H.R. 3915 and S. 2452).

### **Borrower Counseling**

Through its Housing Counseling program, HUD provides competitive grants to local housing counseling agencies, national intermediaries, and state housing finance agencies to fund assistance to homebuyers, homeowners, renters, and homeless persons. Examples of housing counseling assistance include pre-purchase counseling for first-time homebuyers, foreclosure prevention counseling for homeowners, and eviction prevention assistance for renters. Legislation has been introduced in the 110<sup>th</sup> Congress that would increase the availability of borrower counseling beyond what is provided in HUD’s existing program in order to improve borrowers’ understanding of loan terms prior to entering into mortgage loans, among other things. These provisions include the following:

- creating an Office of Housing Counseling within HUD to coordinate counseling for home buyers and renters (H.R. 3915, and H.R. 5857);
- awarding grants to states to establish State Homeownership Protection Centers (S. 1386); and

- requiring lenders to notify borrowers about homeownership counseling services (S. 1386 and S. 2452), and requiring borrowers to participate in counseling in certain circumstances (H.R. 3894).

## Disclosure Requirements

The mortgage lending industry has multiple laws that regulate the information that must be disclosed to consumers. These include the Truth in Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), and the Real Estate Settlement Procedures Act (RESPA). Another law, the Home Mortgage Disclosure Act (HMDA) regulates the information that lenders are required to collect from loan applicants; the information is then made available to the public. The current increase in subprime and exotic mortgages has resulted in proposals to increase disclosure requirements as a means of ensuring that borrowers understand the terms of their loan transactions.

A Federal Trade Commission (FTC) study tested 819 mortgage consumers to document their understanding of current mortgage cost disclosures and loan terms, as well as their ability to avoid deceptive lending practices.<sup>10</sup> The authors found that borrowers (both prime and subprime) did not understand important mortgage costs after viewing mortgage cost disclosures. Some borrowers had difficulty identifying the annual percentage rate (APR) of the loan and loan amounts. Many borrowers did not understand why the interest rate and APR of a loan would differ.<sup>11</sup> In addition, borrowers had the most trouble understanding loan terms for the more complicated mortgage products such as those with optional credit insurance, interest-only payments, balloon payments, and prepayment penalties. Borrowers were unable to determine whether balloon payments, prepayment penalties or up-front loan charges were part of the loan. Survey results also indicated that some consumers may still need borrower counseling and education to understand terminology used in the mortgage lending and settlement industry.

## The Truth in Lending Act

The Truth-In-Lending Act (TILA) of 1968 requires lenders to disclose the cost of credit and repayment terms of mortgage loans before borrowers enter into any transactions.<sup>12</sup> Among the items that must be disclosed pursuant to TILA are an itemization of the amount financed, the annual percentage rate of the loan, the total finance charge, details of a variable interest rate, and a payment schedule. TILA also gives borrowers the right to rescind the loan transaction within three days from the date of signing the mortgage documents.

The Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted on July 30, 2008, adds to the disclosures that are required pursuant to TILA. In cases of variable interest rate loans, lenders are required to label the payment schedule provided to the borrower with the phrase

<sup>10</sup> See James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Bureau of Economics Staff Report, Federal Trade Commission, June 2007, available at <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>.

<sup>11</sup> The APR is the annual cost of a loan, which includes the interest cost of the principal loan amount, insurance, and other fees expressed as a percentage. The mortgage interest rate only includes the interest cost of the principal loan amount expressed as a percentage.

<sup>12</sup> TILA is contained in Title I of the Consumer Credit Protection Act, P.L. 90-301, 81 Stat. 146, as amended by 15 U.S.C. §1601 et seq. Regulations are at 12 C.F.R. §226.

“Payments Will Vary Based on Interest Rate Changes.” The TILA disclosures must also state in conspicuous type examples of how payments might change. The examples must include one that shows the maximum amount that a borrower would have to pay under the terms of the variable interest rate loan.

A number of other bills in the 110<sup>th</sup> Congress would also make changes to TILA. These include the following provisions:

- ensuring that lenders disclose additional information about loan terms to borrowers (S. 2296, S. 2636, S. 2734, and S. 2791), disclose information about adjustable rate mortgages and interest rate resets (H.R. 3705, H.R. 3915, H.R. 5857, S. 2636, S. 2734, and S. 2791) and negative amortization (H.R. 3894), disclose maximum possible payments if interest rates are variable (H.R. 5857), and that mortgage brokers disclose to borrowers the risk, benefits, and characteristics of loans (H.R. 3296);
- requiring disclosures regarding mortgage brokers and mortgage broker fees (S. 2114), or limiting points, finance charges, and fees (H.R. 3081);
- requiring creditors, assignees, or mortgage servicers to provide periodic statements to borrowers disclosing the principal balance of the loan, the interest rate, the date of interest rate reset, if any, and prepayment or late payment penalties (H.R. 5857); and
- requiring, in certain circumstances, escrow accounts to be established for borrowers in order to ensure sufficient funds for property taxes and insurance (H.R. 3535, H.R. 3837, H.R. 3915, and H.R. 5857).

## The Home Ownership and Equity Protection Act

The 1994 Home Ownership Equity Protection Act (HOEPA) was enacted as an amendment to TILA.<sup>13</sup> Borrowers of HOEPA loans must be provided with certain disclosures three days before the loan is closed, in addition to the three-day right of rescission generally required by TILA. This gives consumers a total of six days to decide whether to enter into the transaction. HOEPA applies to mortgages that are secured by a borrower’s primary residence but exempts certain loans from its coverage, most notably residential mortgage transactions. Residential mortgage loans are those provided for the purchase or initial construction of the homes securing the loans, often referred to as purchase money mortgages. Because of the exemption of “residential mortgage transactions,” HOEPA’s coverage is basically limited to certain second mortgages and refinances. HOEPA’s protections apply where (1) the non-exempt loan’s “APR exceeds by more than 10 percentage points the yield on Treasury securities with comparable periods ... of maturity ...” or (2) “the total points and fees payable by [a borrower] at or before closing exceed the greater of 8 percent of the total [non-exempt] loan amount” or \$561.<sup>14</sup> (For more information about HOEPA, see CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act (HOEPA)*, by David H. Carpenter.)

<sup>13</sup> HOEPA is implemented through Regulation Z, 12 C.F.R. Part 226, sections 31, 32, and 34.

<sup>14</sup> The \$561 figure is current for 2008. The Federal Reserve Board adjusts this number annually based upon changes to the Consumer Price Index.

In light of the recent increase in subprime mortgage lending, proposals to add to HOEPA's protections have been advanced. Among the proposed provisions are those

- including home purchase loans in the definition of "high cost mortgages" covered by HOEPA (H.R. 3915 and S. 2452);
- reducing, in some cases, the fee thresholds that trigger HOEPA protections (H.R. 3915 and S. 2452); and
- making lenders subject to state laws that provide greater protections than HOEPA (H.R. 1996).

## Real Estate Settlement Procedures Act

The Real Estate Settlement Procedures Act (RESPA) was enacted in 1974 to effect certain changes in the settlement process for residential real estate.<sup>15</sup> The law requires lenders to provide to borrowers estimates of settlement costs, referred to as a good faith estimate (GFE); a list of the *actual* closing costs must be provided to borrowers at the time of closing. Examples of settlement costs included in the GFE are loan origination fees or points, credit report fees, property appraisal fees, mortgage insurance fees, title insurance fees, home and flood insurance fees, recording fees, attorney fees, and escrow account deposits. Additionally, servicers are required to provide borrowers with certain notices each time a federally related mortgage loan is sold, transferred, or assigned to a new holder.

Consumers generally find the real estate settlement process confusing, and lenders find it cumbersome. Although RESPA requires lenders to provide consumers with estimates of settlement costs, no federal or state law requires the lenders to deliver settlement costs in the amounts stated in the estimates. As a result, consumers often receive unexpected fees at closing, and these unexpected fees can sometimes be hundreds and even thousands of dollars more than expected. Changes to both current GFE disclosure forms as well as the information disclosed within them could arguably lead to less confusion about loan and settlement costs. HUD has proposed changes to RESPA designed to enhance the ability of homebuyers to understand mortgage terms and associated costs as well as to enhance their ability to shop for the best deals. (For more information about HUD's proposed changes, see CRS Report RL34442, *HUD Proposes Administrative Modifications to the Real Estate Settlement Procedures Act*, by Darryl E. Getter.)

In addition to changes proposed by HUD, legislation has been introduced in the 110<sup>th</sup> Congress that would make changes to RESPA. Some of the provisions in proposed bills include the following:

- requiring additional disclosures about loan characteristics such as variable interest rate adjustments, the monthly payment, and the existence of a balloon payment (H.R. 3725 and H.R. 3915);

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<sup>15</sup> The HUD regulation administering RESPA was issued on June 4, 1976. The regulation is referred to as Regulation X and is found in the Code of Federal Regulations at 24 C.F.R. Part 3500. The only major revision to Regulation X occurred on November 2, 1992.

- shielding borrowers, in certain circumstances, from liability for fees that were not disclosed on a settlement statement given to the borrower within three days of application for the loan (S. 2343);
- requiring the disclosure of additional information when a mortgage is assigned, transferred or sold to a new mortgage holder (S. 2452); and
- proscribing force-placed insurance<sup>16</sup> unless there is a reasonable basis to believe the borrower has not maintained required property insurance (H.R. 3837 and H.R. 3915).

## Home Mortgage Disclosure Act

The Home Mortgage Disclosure Act (HMDA), was enacted in 1975 (P.L. 94-200) to help regulators determine where it was necessary to further investigate redlining or geographical discrimination.<sup>17</sup> HMDA requires covered institutions<sup>18</sup> to report home mortgage originations by geographic area, financial institution type, borrower race, sex, income, and whether the loan is for home purchase or refinance. In 1989, Congress expanded HMDA to include the race, sex, and borrower income of those applicants who were rejected for loans.<sup>19</sup> In 2002, Congress expanded HMDA again to include the annual percentage rate of loans and to require lenders to identify loans subject to HOEPA requirements; the law requiring loan rate or pricing information was implemented in 2004.

Currently, HMDA does not require lenders to report every variable used to evaluate applicants. Because the collected data are released to the public, there is concern about protecting the privacy of individuals. However, HMDA requirements have been criticized for not including more variables that could be used to help verify or rule out discrimination, such as borrower credit history information. Some borrowers pay more for their loans relative to others because they exhibit higher levels of credit risk. Having credit history information would be necessary to determine if observed pricing differentials reflect differences in financial risk or discrimination. Other useful variables include borrower characteristics such as total assets and debts as well as loan characteristics, such as the loan-to-value ratio. Suggested additions to the information required to be disclosed pursuant to HMDA include discount points, origination fees, financing of lump sum insurance premium payments, balloon payments, prepayment penalties, loan-to-value ratios, debt-to-income ratios, housing payment-to-income ratios, and credit score information (H.R. 1289).

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<sup>16</sup> Force-placed insurance is insurance coverage obtained by a servicer to protect the mortgagee's interest in the property.

<sup>17</sup> HMDA is implemented by the Federal Reserve Board Regulation C (12 C.F.R. Part 203).

<sup>18</sup> Covered institutions required to report HMDA data include banks, savings and loans, credit unions, and mortgage and consumer finance companies depending upon the size of their assets and percentage of business related to housing-lending activity. Although most home-secured mortgage loans are reported under HMDA, there are some exceptions. Home equity loans taken out for purposes other than those related to the home are not reported under HMDA. Also, lenders that do not have offices in metropolitan statistical areas are not required to report HMDA data.

<sup>19</sup> P.L. 101-73, Sections 1211(d) and 1212.

## Predatory Lending and Fraud

As discussed earlier in this report, the subprime mortgage market has made it possible for borrowers with poor credit, low income, or little savings to qualify for mortgage loans. “Predatory lending” is a term that is sometimes used interchangeably with “subprime lending,” although prime loans also may be predatory. However, the majority of predatory loans are confined to the subprime mortgage market. Commentators have had a difficult time arriving at an explicit definition of “predatory lending.” A Joint Report issued by HUD and the Department of Treasury offered this definition: “In a predatory lending situation, the party that initiates the loan often provides misinformation, manipulates the borrower through aggressive sales tactics, and/or takes unfair advantage of the borrower’s lack of information about the loan terms and their consequences. The results are loans with onerous terms and conditions that the borrower often cannot repay, leading to foreclosure or bankruptcy.”<sup>20</sup>

Drawing the line between valid subprime lending and predatory lending has proven to be a difficult task.<sup>21</sup> Determining at what point higher rates and fees and more onerous loan terms become predatory is a fundamental factor in adopting appropriate legislation to curb these practices. If restrictions on lending practices go too far, the availability of credit for those with damaged credit profiles could dry up, leaving them without the option of homeownership. On the other hand, if the restrictions are too loose, then borrowers may be stripped of the equity in their homes by unscrupulous lending practices. The unnecessary loss of equity caused by points, fees, or rates that make a loan more expensive than what a borrower should qualify for considering the borrower’s financial and other relevant characteristics is detrimental to borrowers. It can be especially harmful to low-income, subprime borrowers who have little savings other than the equity in their home. (For more information about predatory lending, see CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act (HOEPA)*, by David H. Carpenter.)

The 110<sup>th</sup> Congress has begun to examine the practices of predatory lending, and legislation with the following provisions has been proposed:

- ensuring that certain refinances provide a net tangible benefit to the borrower (H.R. 3915 and S. 2452);
- imposing civil and criminal penalties for committing fraud in the extension of credit (S. 1222), or imposing civil penalties for committing unfair and deceptive acts and practices (H.R. 2061 and H.R. 3915);
- amending the Community Reinvestment Act (CRA) so that loans resulting from practices such as predatory lending would not count toward determining whether an institution is meeting the credit needs of the entire community under CRA (H.R. 1289); and
- authorizing the appropriation of funds to assist the Department of Justice and Federal Bureau of Investigation to prevent, investigate, and prosecute mortgage fraud.

<sup>20</sup> National Predatory Lending Task Force, *Curbing Predatory Home Mortgage Lending: A Joint Report*, by the United States Department of Housing and Urban Development and the United States Department of the Treasury, 17 (June 2000); available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf>.

<sup>21</sup> Ibid.

## Efforts to Assist Troubled Borrowers

In addition to initiatives to modify the homebuying process for future buyers, efforts have also been made to assist borrowers who are currently at risk of losing their homes. Congress has enacted legislation—and administrative agencies have taken action—aimed at encouraging borrower workouts and improving the availability of refinancing options.

### Borrower Counseling and Workouts

One of the ways in which Congress has proposed to assist troubled borrowers is through assistance for housing counseling organizations. Much of the focus of housing counseling for troubled borrowers involves working with lenders to arrive at payment plans or other options to make up arrearages—often referred to as borrower workouts<sup>22</sup>—or helping borrowers refinance into loans with better terms. The FY2008 Consolidated Appropriations Act (P.L. 110-161) provided \$180 million to the Neighborhood Reinvestment Corporation (NRC) for mortgage foreclosure mitigation activities. The NRC (also known as NeighborWorks America) is a national nonprofit organization created by Congress primarily to revitalize urban neighborhoods. P.L. 110-161 also appropriated \$50 million for HUD’s housing counseling program. In addition, the Housing and Economic Recovery Act (P.L. 110-289), enacted on July 30, 2008, appropriated \$100 million for the NRC to be used for foreclosure mitigation activities.

One vehicle for encouraging borrower workouts is the “HOPE Now Alliance,” an arrangement among lenders, servicers, and investors brokered by the Administration. The program sets voluntary guidelines under which some borrowers whose mortgage payments are set to rise may get temporary relief. The plan provides for a five-year freeze on mortgage interest rates for certain subprime mortgage borrowers. The plan is designed to buy time for both homeowners and lenders so that borrowers can refinance into more affordable fixed-rate loans in order to limit the number of mortgages going into default and reduce the number of homes for sale in an already saturated market.<sup>23</sup>

To qualify for HOPE Now, at least six conditions must be met: (1) borrowers must reside in the residences covered by the mortgage, (2) borrowers must be current with their mortgage payments, (3) the loans must have been taken out between January 1, 2005 and July 31, 2007, (4) the loans must have an adjustable interest rate that will reset between January 1, 2008 and July 31, 2010, (5) payments would increase by more than 10% after the scheduled reset; and (6) borrowers must have credit scores below 660 and less than 10% higher than their scores at the time of origination. (For more information on HOPE NOW, see CRS Report RL34372, *The HOPE NOW Alliance/American Securitization Forum (ASF) Plan to Freeze Certain Mortgage Interest Rates*, by David H. Carpenter and Edward V. Murphy.)

Another Administration initiative is FHASecure, announced in September 2007. FHASecure is a temporary, voluntary program through which the Federal Housing Administration (FHA) will

<sup>22</sup> Securitization of loans may present an obstacle to borrower workouts in some cases. For more information on this issue, CRS Report RL34386, *Could Securitization Obstruct Voluntary Loan Modifications and Payment Freezes?*, by Edward V. Murphy.

<sup>23</sup> For more information about the Hope Now Alliance, see the program’s web page, available at <http://www.hopenow.com/>.

insure refinanced mortgages of troubled borrowers. The program applies to borrowers with non-FHA-insured, adjustable rate mortgages who had been able to make timely payments prior to their interest rate resets. These borrowers may be eligible to refinance their loans with FHA insured mortgages (if they are able to find FHA-approved lenders to extend credit), as long as they can meet certain criteria, such as having sufficient income to support payments on the new loans.<sup>24</sup> The program will only accept loan applications signed no later than December 31, 2008.

## Refinancing Loans by Expanding the Authority of GSEs and FHA

Some overextended borrowers, or those facing interest rate resets, have had difficulty refinancing their loans on better terms, in part because of a lack of liquidity in the private market. Fannie Mae and Freddie Mac (known as government sponsored enterprises, or GSEs) purchase mortgages from lenders so that the lenders have funds available to make additional loans. The law limits both the total value of loans that the GSEs may purchase as well as the dollar value of individual mortgages that are available for purchase. The latter limit is referred to as the conforming loan limit.

In addition to the need for liquidity, another issue is protection for lenders. The Federal Housing Administration (FHA) loan insurance program insures lenders against loss from loan defaults by borrowers. Through FHA insurance, lenders make loans that otherwise may not be available to borrowers. Under current law, like that for the GSEs, FHA is limited in the total value of loans that it may insure as well as the dollar value of individual mortgages that may be insured.

The 110<sup>th</sup> Congress has enacted legislation to increase the purchasing power of the GSEs, to raise conforming loan limits, and to increase the number and principal value of loans that FHA may insure in order to help borrowers refinance their mortgages.

## The Economic Stimulus Act of 2008

The Economic Stimulus Act of 2008 (P.L. 110-185), which was enacted on February 13, 2008, includes provisions that temporarily increases the size of loans that Fannie Mae and Freddie Mac can purchase and that FHA can insure. The stimulus bill increases the GSE conforming loan limit for mortgages originated between July 1, 2007, and December 31, 2008 to a maximum of \$729,750 in high-cost areas. This means that Fannie Mae and Freddie Mac can purchase mortgages in these areas above the current conforming loan limit of \$417,000 up to the new limit. In addition, FHA is able to insure mortgages in high-cost areas up to this same \$729,750 limit. The authority for FHA to insure these mortgages expires December 31, 2008. Outside of the limits set by the stimulus bill, the FHA limit ranges from \$200,160 to \$362,790 in high-cost areas. (For more information about these provisions, see CRS Report RS22799, *The Recovery Rebates and Economic Stimulus for the American People Act of 2008 and Jumbo Mortgages*, by N. Eric Weiss.)

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<sup>24</sup> For HUD guidance on FHA Secure, see the FHA website at <http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/07-11ml.doc>.

## The Housing and Economic Recovery Act of 2008

On July 30, 2008, the President signed the Housing and Economic Recovery Act of 2008 (P.L. 110-289). The new law expands the authority of FHA to insure mortgages through the creation of a program called HOPE for Homeowners. The program provides FHA with the authority to insure an additional \$300 billion in loans to help troubled borrowers refinance their mortgages. Included among the requirements of P.L. 110-289 are that borrowers must be unable to pay their existing mortgage, have a mortgage debt to income ratio greater than 31% as of March 1, 2008, not have been convicted of fraud in the previous ten years, and live in the home as their primary residence with no ownership interest in another residence. The mortgage cannot exceed 90% of the appraised value of the home, nor can it exceed 132% of the Freddie Mac conforming loan limit. Lenders must agree to waive prepayment penalties, subordinate liens must be extinguished, and the lender must pay FHA an insurance premium of 3%, which is obtained through a reduction of the borrower's indebtedness.

P.L. 110-289 also increases the GSE conforming loan limits; however, the terms are different from those in the Economic Stimulus Act. The Housing and Economic Recovery Act increases the conforming loan limits in areas where 115% of the median home price exceeds the current GSE conforming loan limit of \$417,000. In those cases, the conforming loan limit will be the lesser of 115% of the median home price or 150% of the conforming loan limits. This provision also affects the maximum loan amount that FHA will insure. As changed by P.L. 110-289, the FHA maximum loan amount will be the lesser of (1) 115% of an area's median home price, or (2) 150% of the GSE conforming loan limit, but the limit for an area may not be less than 65% of the conforming loan limit for Freddie Mac.

## Assisting Communities with Foreclosed Properties

### Grants and Loans to Assist States and Communities

In some communities, high numbers of foreclosures have resulted in numerous vacant properties, leaving some neighborhoods subject to falling property values, crime, and deterioration. Several large cities, including Baltimore and Cleveland, have sued lenders, alleging damages such as reduced property tax revenue, the increased costs for police and fire personnel, and the costs associated with maintaining lots and rehabilitating foreclosed and abandoned properties.<sup>25</sup> The U.S. Conference of Mayors, at its winter meeting in January 2008, called on Congress to appropriate additional Community Development Block Grant (CDBG) funds to help cities cope with the costs arising from increased foreclosures.<sup>26</sup>

The Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted July 30, 2008, appropriated \$4 billion to the CDBG program to be distributed to states and local communities for the purchase and rehabilitation of foreclosed properties. The program under which states and communities receive these funds has come to be known as the Neighborhood Stabilization

<sup>25</sup> See, for example, Grethen Morgenson, "Baltimore is Suing Bank Over Foreclosure Crisis," *New York Times*, January 8, 2008, p. A12.

<sup>26</sup> U.S. Conference of Mayors Press Release, "Mayors Urge Congress and Lenders to Implement Recommendations to Help Mitigate Economic Distress of Mortgage Foreclosures," January 24, 2008, available at [http://usmayors.org/76thWinterMeeting/release\\_012408d.pdf](http://usmayors.org/76thWinterMeeting/release_012408d.pdf).

Program. Under P.L. 110-289, HUD was to create a formula within 60 days of the law's enactment to determine which states and communities would receive funds, and how much each would receive. The law required HUD to use the following factors in arriving at a formula: (1) the number and percentage of home foreclosures in each jurisdiction; (2) the number and percentage of homes financed by a subprime mortgage; and (3) the number and percentage of homes in default or delinquency. On September 26, 2008, HUD announced the release of funds to communities.<sup>27</sup> HUD has published a notice in the Federal Register in which it explains the formula and lists the communities that received funds and the amount of each allocation.<sup>28</sup> (For more information about the proposal to assist communities with foreclosed properties, see CRS Report RS22919, *Community Development Block Grants: Legislative Proposals to Assist Communities Affected by Home Foreclosures*, by Eugene Boyd and Oscar R. Gonzales.)

## Expanding the Use of Mortgage Revenue Bonds

Mortgage revenue bonds are issued by states and local governments, and the proceeds are used to assist first-time homebuyers.<sup>29</sup> The proceeds of the bond issuance are exempt from federal taxes as long as they meet certain requirements: (1) at least 95% of the proceeds must be used to finance the residences of homebuyers who have not owned a principal residence during the past three years; (2) the homebuyer's family income cannot exceed 115% of the applicable median family income, though this limitation is adjusted in certain cases (e.g., it is increased up to 140% if the residence is in an area with high housing costs); and (3) the residence's purchase price generally cannot exceed 90% of the average purchase price of single-family residences sold in the area during the past year.

The Housing and Economic Recovery Act of 2008 (P.L. 110-289) allows mortgage revenue bonds to be used to refinance mortgages that were originally financed by qualified subprime loans. A qualified subprime loan is considered any adjustable rate single-family residential mortgage originated between December 31, 2001 and January 1, 2008 that the bond issuer determines would be reasonably likely to cause financial hardship to the borrower if not refinanced. This change means that borrowers need not meet the first-time homebuyer requirement. Another change increases the volume cap on the amount of mortgage revenue bonds that may be issued by each state. Funds under the increased cap may be used for both mortgage revenue bonds and for exempt facility bonds—used to finance rental projects in which a portion of units must be occupied by low-income renters. (For more information about these provisions, see CRS Report RS22841, *Mortgage Revenue Bonds: Analysis of Sections 3021 and 3022 of the Housing and Economic Recovery Act of 2008*, by Mark P. Keightley and Erika Lunder.)

## Issues in Bankruptcy

Several legislative proposals have been made to amend bankruptcy law to help borrowers keep their homes after filing for bankruptcy. Under current law, a bankruptcy court does not have the

<sup>27</sup> HUD Press Release, "Preston Allocates Nearly \$4 Billion to Stabilize Neighborhoods in the States and Local Communities Hard-Hit by Foreclosure," September 26, 2008, available at <http://www.hud.gov/news/release.cfm?content=pr08-148.cfm>.

<sup>28</sup> *Federal Register*, vol. 73, no. 194, October 6, 2008, pp. 58329-58349.

<sup>29</sup> Mortgage revenue bonds are also used to finance multifamily housing. They are governed by the Internal Revenue Code, 26 U.S.C. §143.

authority to modify the debt that is secured by a debtor's primary residence.<sup>30</sup> Section 1322(b)(2) of the Bankruptcy Code states in relevant part, "the plan may ... modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's primary residence." By virtue of this provision, a court may modify the debt of a mortgage secured by a debtor's vacation home, for instance, but may not modify the debt on a mortgage secured by the same debtor's primary residence.

At least five bills seeking to amend § 1322 of the Bankruptcy Code have been introduced in the 110<sup>th</sup> Congress. These bills are H.R. 3609 (the Emergency Home Ownership and Mortgage Equity Protection Act); S. 2133 and H.R. 3778 (the Home Owners' Mortgage and Equity Savings Act, or HOMES Act); S. 2136 (the Helping Families Save Their Homes in Bankruptcy Act of 2007); and S. 2636 (the Foreclosure Prevention Act of 2008). Each of these bills would allow for the modification in bankruptcy of debts secured by the debtor's primary residence under certain circumstances. These proposals could make it easier for some debtors to protect their homes from creditors in bankruptcy. (For more information about these bills see CRS Report RL34301, *The Primary Residence Exception: Legislative Proposals in the 110<sup>th</sup> Congress to Amend Section 1322(b)(2) of the Bankruptcy Code*, by David H. Carpenter.)

## Taxing Debt Forgiveness

As lenders and borrowers work to resolve indebtedness issues, some transactions are resulting in cancellation of debt. Mortgage debt cancellation can occur when lenders restructure loans, reducing principal balances, or sell properties—either in advance, or as a result, of foreclosure proceedings. If a lender forgives or cancels debt, current tax law may treat it as cancellation of debt (COD) income, which is subject to tax.

On October 4, 2007, the House passed the Mortgage Debt Forgiveness Relief Act of 2007 (H.R. 3648) by a vote of 386 to 27. As passed by the House, the act would have permanently excluded discharged, or canceled, qualified residential debt from income. The Senate modified H.R. 3648 by proposing a temporary three-year exclusion of COD income. The Senate passed H.R. 3648 on December 14, 2007; the House passed the modified version of H.R. 3648 on December 18, 2007. The bill was signed into law (P.L. 110-142) on December 20, 2007, with the temporary exclusion of COD income rather than a permanent exclusion. (For more information on this issue, see CRS Report RL34212, *Analysis of the Tax Exclusion for Canceled Mortgage Debt Income*, by Mark P. Keightley and Erika Lunder.)

## Treasury's Troubled Asset Relief Program

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (H.R. 1424/ P.L. 110-343) which contained the Troubled Asset Relief Program (TARP). TARP authorizes the Department of the Treasury to purchase up to \$700 billion of mortgage-related assets. Although at least \$250 billion will be used to inject capital into banks, TARP could help borrowers in several ways. First, if the Treasury owns a mortgage or mortgage-backed security, TARP commits Treasury to agreeing to any reasonable request for loan modification. This commitment is countered, however, by a requirement that Treasury maximize returns to taxpayers. Second, Treasury could work with the FDIC or other organizations to offer to insure

<sup>30</sup> 11 U.S.C. §1322(b)(2).

mortgages that lenders agree to modify. Third, it is possible that Treasury's intervention will improve bank balance sheets, which might help homeowners by making mortgage credit more available generally. (For more information about TARP, see CRS Report RS22963, *Financial Market Intervention*, by Edward V. Murphy and Baird Webel.)

## Reforming Federally Sponsored Financing Institutions

### GSE Regulation

#### Fannie Mae, Freddie Mac, and Federal Home Loan Bank Regulation

Fannie Mae and Freddie Mac are federally chartered, privately owned corporations charged with supporting the secondary mortgage market. They are not allowed to lend directly to homeowners, but by purchasing mortgages from the original lenders, they free up funds to be lent for more mortgages. After Fannie Mae and Freddie Mac purchase mortgages, they either guarantee the mortgages, package and sell them to investors, or Fannie Mae and Freddie Mac keep them in their own portfolios. To finance their portfolios, they sell bonds and other debt to investors.

Due to financial problems at Fannie Mae and Freddie Mac, on September 7, 2008, shortly after enactment of the Housing and Economic Recovery Act of 2008 (P.L. 110-289), the Federal Housing Finance Agency (FHFA) placed the two entities under conservatorship. FHFA has said that continuing audits of the Fannie Mae and Freddie Mac determined that their financial positions were weaker than previously thought and that they were unlikely to survive without conservatorship. The conservatorship will end when FHFA determines that Fannie Mae and Freddie Mac have adequate capital and have improved their controls and risk management sufficiently. (For more information about the conservatorship of Fannie Mae and Freddie Mac, see CRS Report RL34661, *Fannie Mae's and Freddie Mac's Financial Problems*, by N. Eric Weiss; CRS Report RL34657, *Financial Institution Insolvency: Federal Authority over Fannie Mae, Freddie Mac, and Depository Institutions*, by David H. Carpenter and M. Maureen Murphy; and CRS Report RS22950, *Fannie Mae and Freddie Mac in Conservatorship*, by Mark Jickling.)

Fannie Mae and Freddie Mac were created to make the secondary mortgage market more liquid and efficient and thereby lower the interest rate that homeowners pay. Before the conservatorship, many economists and other analysts believed that because of their ties to the federal government, Fannie Mae and Freddie Mac (also known as government-sponsored enterprises, or GSEs) can borrow at lower interest rates than they could otherwise and that some of this advantage accrues to stockholders and employees.

A third housing GSE, the Federal Home Loan Bank (FHLBanks) System, consists of 12 regional banks (the Banks). Started in 1932 as lenders to the savings and loan associations that were the primary sources of home mortgages, the FHLBanks have undergone major changes, particularly since the cleanup of the savings and loan association failures of the 1980s. As a result, membership in the Banks has changed, today encompassing more commercial banks than savings associations and including credit unions, insurance companies, and some associated housing providers. Purposes of lending—although still primarily housing-related—now include agricultural and small business lending. The changes also have resulted in special mission set-

asides for low- and moderate-income housing, special programs for community development, and a continuing responsibility for paying debt raised to fund deposit insurance payouts in the 1980s. (For information on the FHLBs, see CRS Report RL32815, *Federal Home Loan Bank System: Policy Issues*, by Edward V. Murphy.)

A series of financial and accounting problems at Fannie Mae, Freddie Mac, and some of the Federal Home Loan Banks (FHLBs), led many in Congress to conclude that a stronger regulator was needed for these congressionally chartered companies. Fannie Mae and Freddie Mac are stockholder owned; the Federal Home Loan Banks are owned by their Members. The Housing and Economic Recovery Act creates the FHFA to replace the existing regulators: the Office of Federal Housing Enterprise Oversight (OFHEO), which oversaw Fannie Mae and Freddie Mac, and the Federal Housing Finance Board (FHFB), which monitored the Federal Home Loan Banks. The task of setting mission goals for Fannie Mae and Freddie Mac moves to the FHFA from the Department of Housing and Urban Development (HUD); Federal Home Loan Bank mission oversight moves from the Federal Housing Finance Board to the FHFA.<sup>31</sup> (For more information about the provisions in P.L. 110-289 regarding the GSEs, see CRS Report RL33940, *Reforming the Regulation of Government-Sponsored Enterprises in the 110<sup>th</sup> Congress*, by Mark Jickling, N. Eric Weiss, and Edward V. Murphy.)

The Housing and Economic Recovery Act gives the new FHFA broad regulatory authority over the GSEs. It has the responsibility to review and to approve new types of mortgages, it can take over and reorganize an insolvent Fannie Mae or Freddie Mac, and it has greater authority to set capital requirements for the housing GSEs. The FHFA can also require the GSEs to dispose of assets and limit their portfolio sizes. In addition, the FHFA has the authority to reduce the number of Federal Home Loan Banks. Under previous law, there had to be at least eight FHLBs (the Banks can merge and reduce the number from twelve if one or more is in financial difficulty). Under P.L. 110-289, however, the FHFA can reduce this number below eight.

Another change is that the conforming loan limits will increase to reflect the annual change in a housing price index maintained by FHFA. The limit cannot decline, and decreases will be “banked” and used against later increases. In high-cost housing areas, defined as areas where the median home price exceeds the conforming loan limit, the limit is increased to the lesser of 115% of area median or 150% of the national conforming loan limit. For example, using 2008’s conforming loan limit of \$417,000, the maximum high-cost limit would be \$625,500. According to the legislation, the sense of Congress is that loans above the national conforming loan should not be held in a GSE’s portfolio but should be securitized.

The Housing and Economic Recovery Act also responded to concerns about insolvency surrounding Fannie Mae and Freddie Mac. The law provides that if there is a mortgage or financial market crisis, the Secretary of the Treasury can lend or invest as much money as necessary to the regulated entities and can set the terms of the loan. In response to Fannie Mae’s and Freddie Mac’s financial problems, the Treasury signed agreements that permit it to buy mortgage-backed securities from the GSEs and raise funds for them. On September 7, 2008, each GSE issued Treasury \$1 billion of senior preferred stock and warrants (options) to purchase common stock. If the warrants are exercised, Treasury would own 79.9% of each company. (For more information about the Treasury Department’s role, see CRS Report RL34661, *Fannie Mae’s and Freddie Mac’s Financial Problems*, by N. Eric Weiss.)

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<sup>31</sup> The GSE provisions are in Division A, Titles I-III of P.L. 110-289.

Another provision under the act involves the creation of an affordable housing trust fund. Fannie Mae and Freddie Mac are each to contribute to a new housing trust fund 4.2 basis points (0.042%) of the unpaid principal balances of their total new business purchases. (The housing trust fund is described in greater detail, below.) If this had been in effect in calendar year 2007 when Fannie Mae and Freddie Mac purchased \$1.2 trillion in mortgages, the enterprises would have contributed \$500.8 million to the housing trust fund. The contributions can be suspended if they would cause severe financial problems for an enterprise. With Fannie Mae and Freddie Mac being under conservatorship, the future of the housing trust fund is not clear. The Federal Home Loan Banks will continue their separate affordable housing funding programs.

## Affordable Housing Funds

For several years, a coalition of low-income housing organizations led by the National Low Income Housing Coalition (NLIHC) has advocated for the establishment of an affordable housing trust fund.<sup>32</sup> Such a program would provide a permanent source of funds for the production, preservation, and rehabilitation of low-income housing (especially rental housing), and would have a dedicated source of funding that does not depend on annual appropriations. Legislation to create a National Affordable Housing Trust Fund had been introduced, but not enacted, in every congressional session since the 106<sup>th</sup> Congress. The first proposals would have used a portion of Federal Housing Administration (FHA) receipts as the dedicated source of revenue for the trust fund, but because FHA receipts are currently deposited in the U.S. Treasury, diverting them to a housing trust fund would have counted as new spending. Therefore, in the 109<sup>th</sup> and 110<sup>th</sup> Congresses, the NLIHC advocated creating an affordable housing fund using non-federal resources by including a provision in GSE reform legislation. H.R. 3221, which was enacted as The Housing and Economic Recovery Act (P.L. 110-289) on July 30, 2008, includes a provision for such an affordable housing trust fund.

### *Enactment of P.L. 110-289*

P.L. 110-289 includes two affordable housing programs funded by contributions from Freddie Mac and Fannie Mae. The first, the Housing Trust Fund, will distribute formula-based grants to states to increase housing opportunities for extremely low- and very low-income renters and homeowners. A household is considered to be extremely low-income if its income is at or below 30% of area median income and is considered very low-income if its income is at or below 50% of area median income. The second program, the Capital Magnet Fund, will offer competitive grants to certified community development financial institutions and qualified nonprofit organizations to encourage investment in affordable housing for extremely low-, very low-, and low-income families, as well as economic development activities and community service facilities. A household is considered low-income if its income is at or below 80% of area median income.

Fannie Mae and Freddie Mac will each be required to contribute 4.2 basis points, or .042 cents, for each dollar of the unpaid principal balance of their total new business purchases toward funding for these programs. The Director has the authority to temporarily suspend these

<sup>32</sup> For a history of affordable housing trust fund legislative proposals and the NLIHC's campaign, see the NLIHC's website, "Details about the National Housing Trust Fund Campaign," January 31, 2007, available at [http://www.nlihc.org/detail/article.cfm?article\\_id=3834](http://www.nlihc.org/detail/article.cfm?article_id=3834).

contributions by either GSE upon (1) finding that they are contributing to the GSE's financial instability, (2) causing it to be undercapitalized, or (3) preventing its successful completion of a capital restoration plan. The first 25% of all GSE contributions each year will go to a HOPE for Homeowners Reserve Fund for as long as the HOPE for Homeowners program is financially obligated. HOPE for Homeowners, as discussed earlier in this report, is a program through which homeowners at risk of foreclosure can refinance their current mortgages with FHA-insured loans. Between 2009 and 2011, a decreasing percentage of the remaining 75% of GSE contributions will go to provide additional funding for the HOPE for Homeowners Program. After 2011, the entirety of the remaining 75% of the funding will be divided between the Housing Trust Fund, which will receive 65%, and the Capital Magnet Fund, which will receive 35%.

### ***Housing Trust Fund***

Funds in the Housing Trust Fund will be distributed to states by HUD according to a formula developed by the Secretary within 12 months of the enactment of P.L. 110-289. The law requires the formula to be based in part on the following factors: (1) the shortage of affordable standard rental units available to extremely low-income renter households in the state relative to all states (this factor will be given priority), (2) the shortage of affordable standard rental units available to very low-income renter households in the state relative to all states, (3) the number of extremely low-income renter households living with incomplete kitchen or plumbing facilities, more than one person per room, or paying more than 50% of income for housing in the state relative to all states, and (4) the number of very low-income renter households paying more than 50% of income on rent in the state relative to all states. The sum of these four factors will be multiplied by the relative cost of construction in the state to arrive at a grant amount. Each state and the District of Columbia will receive a minimum annual grant of \$3 million.

States can designate a for-profit or non-profit organization such as a housing finance agency, a housing and community development entity, a tribally designated housing entity, or another qualified "instrumentality of the State" to receive the grants. Funds can be used for the production, preservation, rehabilitation, and operation of rental housing, provided that at least 75% of the grant amounts for rental housing are used for the sole benefit of extremely low-income families or families with incomes at or below the poverty line for a family of its size. No more than 25% of the funds for rental housing may be used to solely benefit very low-income families. Funds can also be used for the production, preservation, and rehabilitation of homeownership housing and related homeownership costs, including down payment assistance, closing cost assistance, and interest-rate buy-downs, provided that the home will serve as a principal residence for extremely low- or very low-income first-time homebuyers and meets certain initial purchase price and resale restrictions and that the homeowner meets a financial education and counseling requirement. No more than 10% of the funds allocated to a state or state designated entity may be used for homeownership activities.

P.L. 110-289 includes a provision that would transfer the funds in the Housing Trust Fund to any other affordable housing trust fund created in the future that provides grants only for affordable rental housing and affordable homeownership opportunities.

### ***Capital Magnet Fund***

The remaining 35% of GSE contributions after the allocation to the HOPE for Homeowners program will be directed to the Capital Magnet Fund, which will be situated within the existing

<http://wikileaks.org/wiki/CRS-RL33879>

Community Development Financial Institutions (CDFIs) Fund in the Department of the Treasury. The Capital Magnet Fund will promote economic and community development through assistance to community development financial institutions, which typically provide loans and financial services in under-served neighborhoods, and non-profit organizations whose principal purpose includes the development or management of affordable housing. The Capital Magnet Fund will award competitive grants to attract private capital and support investment in housing for low-income, very low-income, and extremely low-income households, as well as economic development activities and community service facilities. Eligible uses of funds include capitalizing a revolving loan fund, an affordable housing fund, or a fund to support economic development activities, providing loan loss reserves, and risk-sharing loans. No single organization can receive more than 15% of the available funding from the Capital Magnet Fund in a given year. The Secretary of the Treasury is directed to take into account geographic diversity and measures of economic distress when awarding grants and to seek to fund projects that will have total costs that are at least ten times the amount of the grant.

## FHA Reform

The Federal Housing Administration (FHA), an agency within HUD, oversees a variety of mortgage insurance programs that insure lenders against loss from loan defaults by borrowers. Through FHA insurance, lenders make loans that otherwise may not be available to borrowers and enable borrowers to obtain loans for home purchase and home improvement, as well as for the purchase, repair, or construction of apartments, hospitals, and nursing homes. The programs are administered through two program accounts: the Mutual Mortgage Insurance/Cooperative Management Housing Insurance fund account (MMI/CMHI) and the General Insurance/Special Risk Insurance fund account (GI/SRI). The MMI/CMHI fund provides insurance for home mortgages. The GI/SRI fund provides insurance for more risky home mortgages, for multifamily rental housing, and for an assortment of special-purpose loans such as hospitals and nursing homes. (For more information on FHA, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview*, by Bruce E. Foote and Katie Jones.)

In 1934, FHA was established to provide consumers with an alternative during a lending crisis. Since then, FHA has insured more than 34 million properties. In recent years, however, its market share has been dropping. In 1991, FHA loans accounted for about 11% of the market; by 2004, that share had dropped to about 3%.<sup>33</sup> The mortgages insured through the FHA program are also judged to have become increasingly risky.<sup>34</sup> Default rates and the amounts of insurance claims have grown even as participation in the program has declined, raising the need to both increase participation in the program and improve its financial stability by ensuring that participants are credit-worthy in order to maintain the viability of FHA.<sup>35</sup>

The Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted on July 30, 2008, made a number of changes to the FHA program. Among the changes implemented by the new law is an increase in FHA loan limits. Under prior law, loans on one-family homes were limited to the

<sup>33</sup> Alan Greenspan and James Kennedy, *Estimates of Home Mortgage Originations, Repayments, and Debt on One-to-Four-Family Residences*, Federal Reserve Board, September 2005, available at <http://www.federalreserve.gov/Pubs/feds/2005/200541/200541pap.pdf>.

<sup>34</sup> Senate Appropriations Committee, report to accompany H.R. 5576, the Transportation, Treasury, Housing and Urban Development Appropriations Act 2007, 109<sup>th</sup> Cong., 2<sup>nd</sup> sess., S.Rept. 109-293, July 26, 2006.

<sup>35</sup> *Ibid.*

lesser of 95% of the median home price for an area, or 87% of the conforming loan limit for Freddie Mac and Fannie Mae. P.L. 110-289 amended the National Housing Act to set the FHA loan limit for an area to the lesser of (1) 115% of the median price of a 1-family residence, as determined by HUD, or (2) 150% of the Freddie Mac conforming loan limit, except that the limit for an area may not be less than 65% of the Freddie Mac conforming loan limit. The FHA loan obligation is not to exceed 100% of the appraised value of the property. These limits will be in effect upon expiration of the Economic Stimulus Act of 2008 (January 1, 2009).

The Housing and Economic Recovery Act also changed FHA insurance premiums. Prior law required borrowers to pay to FHA an upfront mortgage insurance premium of 2.5% of the mortgage amount or 2% of the mortgage amount if the borrower had received homeownership counseling. P.L. 110-289 increases the insurance premiums to 3% and 2.75%, respectively. In addition, the new law places a 12-month moratorium on FHA's planned implementation of risk-based premiums as set forth in a notice published in the Federal Register on September 20, 2007. The law also provides that FHA insurance premiums for the multifamily housing programs may not be increased above the amounts in effect on October 1, 2006, unless HUD determines that, absent the increase, new appropriations of budget authority would be required to cover the costs of the program. At least 30 days prior to the increase, HUD is required to notify the Senate Banking Committee and the House Financial Services Committee and publish a notice in the Federal Register.

The section of law governing the Mutual Mortgage Insurance (MMI) fund was changed by P.L. 110-289 to (1) limit loan commitments to the amount specified in appropriations acts for each fiscal year; (2) establish that HUD has the fiduciary responsibility to ensure that the MMI fund remains financially sound; (3) require an annual independent actuarial study of the fund; (4) require quarterly reports to Congress; (5) require the adjustment of insurance premiums when needed; (6) establish operational goals for the Fund; and (7) provide that the homeownership voucher program and the home equity conversion program become obligations of the MMI Fund instead of the General Insurance Fund.

The new law also made a number of changes to the Home Equity Conversion Mortgage (HECM) program; HECMs are reverse mortgages insured by FHA through which an older home owner receives payments backed by the equity in their home. The reverse mortgage is repaid when the home is sold. (For more information on HECMs and other reverse mortgage products, see CRS Report RL33843, *Reverse Mortgages: Background and Issues*, by Bruce E. Foote.)

Present law limits the aggregate number of FHA-insured reverse mortgages to 275,000 loans, and that limit has been exceeded. Notwithstanding the limit in present law, the 2009 Continuing Appropriations Resolution, P.L. 110-329, provides that FHA may continue to insure reverse mortgages through March 6, 2009. Unless Congress amends the law, FHA may not insure reverse mortgages after March 6, 2009.

As revised by P.L. 110-289, HECMs have a national mortgage limit of \$625,500 through December 31, 2008. If the general Freddie Mac limit does not change, beginning on January 1, 2009, the HECM limit will range between \$417,000 and \$625,500, depending on the median home price in the area of the mortgaged property.

Under another provision, borrowers who wish to enter into home equity conversion mortgages must receive counseling by an independent third party that is not associated with, or compensated by, either the party that is involved in funding, originating, or servicing the mortgage, or by

entities that sell annuities, investments, or other financial or insurance products. The law also allows borrowers to use proceeds from HECMs for home purchase and for the purchase of cooperatives. Origination fees on HECMs are limited under P.L. 110-289, and lenders are prohibited from requiring borrowers to purchase insurance, an annuity, or other product as a condition of eligibility for a HECM. The Government Accountability Office (GAO) is directed to study mortgage insurance premiums for HECMs to determine the effect of limiting costs and fees under the program, and HUD is to conduct a study to determine the consumer protection and underwriting standards to ensure that the purchase of such products would be appropriate for the borrowers.

Among other provisions in P.L. 110-289 that make changes to the FHA insurance program are those that

- limit energy efficiency improvements paid for by FHA-insured loans to the greater of 5% of the property value or 2% of the maximum FHA-insured mortgage;
- establish through a pilot project a process for providing alternative credit rating information for borrowers with insufficient credit histories to determine their creditworthiness;
- create a three-year pre-purchase homeownership counseling demonstration program to test the effectiveness of alternative pre-purchase counseling;
- direct HUD and FHA, in consultation with the industry, the Neighborhood Reinvestment Corporation, and other entities involved in foreclosure prevention activities, to develop and implement a plan to improve FHA's loss mitigation process, and to report the plan to the Senate Banking Committee and the House Financial Services Committee;
- authorize \$25 million to be appropriated in each of FY2009 through FY2013 from the negative credit subsidy of the FHA insurance funds to be used for improving technology, processes, program performance, staffing, and fraud elimination in the FHA program; and
- add FHA to 18 U.S.C. §1014 as an agency against which parties may not knowingly make any false statement or report, or willfully overvalue any land, property or security, for the purpose of influencing in any way the action of the agency.

### **Seller-Funded Downpayment Assistance (Nehemiah Program)**

Under the National Housing Act, borrowers had been required to contribute at least 3% (in cash or its equivalent) of the cost of purchasing a home when the home is financed with an FHA-insured loan.<sup>36</sup> Loans from family members are considered cash or its equivalent for this purpose. For borrowers aged 60 and over, or for homes provided through the Homeownership and Opportunity Through HOPE Act,<sup>37</sup> the 3% contribution could be paid by a corporation or other person under terms and conditions prescribed by HUD.

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<sup>36</sup> 12 U.S.C. §1709(b)(9).

<sup>37</sup> Title IV of the Cranston-Gonzalez National Affordable Housing Act, P.L. 101-625. The title authorizes HUD to (continued...)

Although the law did not provide any other exceptions regarding eligible donors of the borrower's required cash contribution, a practice was established through which an FHA borrower was able to receive the funds from a nonprofit corporation that had received equivalent donations from the seller of the property. One of the primary nonprofit organizations that participated in this practice was the Nehemiah Corporation. HUD viewed this practice as an indirect form of seller-funded downpayment assistance and had attempted to limit the practice through regulation.

The Housing and Economic Recovery Act of 2008 (P.L. 110-289) changed this practice, however. Under the new law, borrowers will be required to contribute at least 3.5% in cash or its equivalent to the cost of acquiring a property with an FHA-insured mortgage. Amounts borrowed from a family member will be considered cash for this purpose. If the borrowed amount is secured by a lien, the lien must be subordinate to the mortgage, and the sum of the lien and the mortgage may not exceed 100% of the appraised value of the property. Prohibited sources of funding for the required funds will be the seller or any entity that financially benefits from the transaction, or any third party that is directly or indirectly reimbursed by the seller or by anyone that would financially benefit from the transaction. The law is in effect for transactions entered into on or after October 1, 2008. (For more information on seller-assisted downpayments, see CRS Report RS22934, *Treatment of Seller-Funded Downpayment Assistance in FHA-Insured Home Loans*, by Bruce E. Foote.)

As introduced on July 31, 2008, H.R. 6694 would amend the new law (P.L. 110-289) to provide exceptions to the prohibition on seller contributions. Sellers would be permitted to contribute to the borrower's required downpayment on certain mortgages: (1) mortgages under which the borrower has a credit score in excess of 680; (2) mortgages under which the borrower has a credit score between 620 and 680, and upon which the borrower is charged a mortgage insurance premium that is high enough to permit the loan to be insured without the need for an appropriation of credit subsidy; and (3) mortgages insured in FY2010 or thereafter under which the borrower has a credit score of 619 or less, but only if HUD certifies that such loans can be insured without the need for an appropriation of credit subsidy. HUD would be authorized to use risk-based pricing of mortgage insurance for borrowers with lower credit scores. Downpayment assistance entities would be required to offer to make counseling available to the borrower regarding the responsibilities and financial management involved in homeownership and to provide such counseling if the borrower accepts the offer. On September 16, 2008, the House Financial Services Committee approved H.R. 6694.

## Housing After the 2005 Hurricanes

Hurricane Katrina, and to a lesser extent, Hurricanes Rita and Wilma, which struck Gulf Coast states in the fall of 2005, had enormous effects on the housing stock in that region. Studies estimate that the hurricanes and the related flooding damaged 1.2 million housing units in Louisiana, Mississippi, Florida, Texas, and Alabama. The level of damage wrought by the storms was unprecedented and has resulted in a large federal commitment of resources and a revisiting of the way that the government responds to large-scale disasters.

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(...continued)

make grants under the Homeownership and Opportunity for People Everywhere (HOPE) programs to enable grantees to carry out homeownership programs in public and Indian housing and in other multifamily housing projects.

## Rebuilding

The re-building of housing in the Gulf Coast has been a slow process. Questions about insurance payouts, future flood maps, the integrity of levees after repairs, and the character of new communities have all contributed to the pace of recovery. The federal government—through the Federal Emergency Management Agency (FEMA) as well as many other federal agencies, including HUD—has invested tens of billions of dollars in resources to aid in the recovery and rebuilding process, but those funds have also not always been used as quickly as desired, in some cases because of local planning issues, in other cases because of the complexity of federal program rules.

## FEMA Assistance

On October 4, 2006, the Post-Katrina Emergency Management Reform Act was enacted as part of the FY2007 Department of Homeland Security Appropriations Act (P.L. 109-295).<sup>38</sup> The act made significant revisions to FEMA's structure and mission in response to perceived weaknesses following the 2005 hurricanes. Although components of the act could contribute to post-disaster rebuilding after *future* disasters (these components include lifting the cap on home repairs,<sup>39</sup> providing FEMA the authority to construct semi-permanent or permanent housing,<sup>40</sup> and establishing a pilot program for the use and repair of rental units for temporary housing<sup>41</sup>), the legislation was not retroactive and did not address the *immediate* needs along the Gulf Coast.

To address some of the recovery needs, in the 110<sup>th</sup> Congress the House passed H.R. 3247, the Hurricanes Katrina and Rita Recovery Facilitation Act of 2007. However, its provisions for retroactivity would apply only to public infrastructure repairs. The Senate Homeland Security and Governmental Affairs Committee subsequently amended H.R. 3247 to make the pilot program for the repair of rental units, as well as a case management<sup>42</sup> provision from the Post-Katrina Act, retroactive to the hurricane disasters of 2005. The Senate Committee ordered the bill to be reported on April 10, 2008.

## The Road Home

Louisiana's state-run program to repair and restore the housing stock is called the "Road Home" program; it has been funded primarily through \$13.4 billion in emergency Community Development Block Grant (CDBG) funds provided by Congress between December 2005 and November 2007.<sup>43</sup> The Road Home program, and particularly its Homeowners Assistance Program, is intended to help homeowners repair or replace their homes. The program sets a threshold for eligibility and provides varying degrees of assistance to homeowners depending on the program option they select. Those options include staying in their home, relocating to another

<sup>38</sup> For more information, see CRS Report RL33729, *Federal Emergency Management Policy Changes After Hurricane Katrina: A Summary of Statutory Provisions*, by Keith Bea et al.

<sup>39</sup> P.L. 109-295, Sec. 686, 120 Stat. 1448.

<sup>40</sup> P.L. 109-295, Sec. 685, 120 Stat. 1447.

<sup>41</sup> P.L. 109-295, Sec. 689i, 120 Stat. 1454.

<sup>42</sup> P.L. 109-295, New Sec. 426 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 120 Stat. 1453.

<sup>43</sup> See CRS Report RL34410, *The Louisiana Road Home Program: Federal Aid for State Disaster Housing Assistance Programs*, by Natalie Paris Love.

home in Louisiana, or selling their home. The amount of compensation provided to homeowners depends on the option they select.

## Mississippi Waiver

Mississippi has also received a substantial amount of CDBG funding, approximately \$5.5 billion, for their disaster recovery efforts. From that total, \$3.4 billion was allocated to repair or replace some of the large number of homes that were damaged or destroyed by Hurricane Katrina. Not all homeowners could meet the criteria developed by the state, so Mississippi officials requested a waiver from HUD to use \$600 million on the port of Gulfport, MS. HUD granted the waiver in late January;<sup>44</sup> it has been a controversial decision because of concerns about outstanding housing problems in the area.<sup>45</sup>

## Rebuilding Public Housing

Some Members of Congress, as well as low-income housing and tenants' rights advocates, have questioned HUD's plans to demolish public housing units in New Orleans that were damaged by the 2005 hurricanes. In June 2006, a group of tenants filed a class action suit claiming that tenants' rights are not being protected and seeking an injunction to block the demolition of housing units by the Housing Authority of New Orleans (HANO); however, a judge ruled that HANO could continue with demolition while the lawsuit is pending. In mid-September 2007, HANO announced that HUD had approved the agency's plan to demolish 4,500 of the agency's over 7,000 public housing units, with plans to rebuild 7,000 units: 3,300 public housing units, 1,800 units for voucher holders, and the rest market-rate housing.<sup>46</sup> The demolitions were initially delayed awaiting action by the New Orleans City Council, but all four have now been approved and the demolition has begun.<sup>47</sup>

## Ongoing Housing Assistance

Families who remain displaced following the 2005 hurricanes are generally receiving one of two types of assistance: (1) manufactured housing or trailers (referred to by FEMA as *direct assistance*) or (2) rental assistance (referred to by FEMA as *financial assistance*).

## Manufactured Housing

Although FEMA has traditionally used manufactured housing as a last resort in providing temporary housing (when home repairs and available rental units are not sufficient), in the case of

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<sup>44</sup> HUD approved the waiver in a letter sent by then-Secretary Alphonso Jackson to Governor Haley Barbour. The letter was not made public; however, the approval was reported in the news media. See, for example, Mike Stuckey, "Feds OK Mississippi's Katrina Grant Diversion," MSNBC, January 28, 2008, available at <http://www.nbc6.net/msnbcnews/15138281/detail.html>.

<sup>45</sup> See House Financial Services Committee Press Release, "Frank and Waters Call on HUD to Deny Waiver to Re-Program CDBG for Mississippi Port," October 17, 2007.

<sup>46</sup> Gwen Filosa, "HANO Gets OK to Raze 4,500; Those with Vouchers Will Keep Benefits," *Times-Picayune* (New Orleans), September 22, 2007.

<sup>47</sup> Katy Reckdahl, "Nagin OKs Demolition of Lafitte Housing Complex," *The Times-Picayune* (New Orleans), March 25, 2008.

Hurricane Katrina that last resort became the prime option. FEMA purchased over 144,000 manufactured housing units at a cost of more than \$2.7 billion.<sup>48</sup> In a House hearing in July of 2007, the House Government Reform and Oversight Committee heard testimony regarding high levels of formaldehyde in the trailers and mobile homes that FEMA had purchased and used as temporary housing.<sup>49</sup> Although FEMA has been working to move disaster victims out of the trailers by providing alternative housing options, as of April 23, 2008, more than 27,000 households were still in trailers. The great majority of those households—over 22,000—are living in trailers parked on private sites (generally in the yards and driveways of homeowners) awaiting the repair or replacement of their original homes.<sup>50</sup>

## **Rental Assistance**

FEMA began providing short-term rental assistance to disaster victims shortly after the 2005 hurricanes. After six months, in February 2006, FEMA began to convert the short-term assistance to longer-term rental assistance (up to 18 months).<sup>51</sup> On April 26, 2007, the President announced that HUD would assume administration of the program beginning September 1, 2007, and that assistance would be extended through March 1, 2009.<sup>52</sup> Prior to that announcement, HUD had only been tasked with providing assistance to families that were displaced from HUD-assisted housing or were homeless before the storm.

After an initial delay, HUD assumed administration of FEMA's rental assistance program on December 1, 2007, renaming it the Disaster Housing Assistance Program (DHAP). The program initially served the 28,000 households that were being aided by FEMA rental assistance, with HUD and FEMA transitioning those families out of trailers and into rental assistance.<sup>53</sup>

Under a FEMA and HUD joint agreement, beginning in March 2008, families receiving rental assistance as well as those living in trailers are required to pay a portion of the cost of their housing.<sup>54</sup> The amount they are required to contribute will increase each month, with an

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<sup>48</sup> Testimony of DHS Deputy Inspector General Matt Jadacki, in U.S. Congress, House Committee on Appropriations, Subcommittee on Homeland Security, 110<sup>th</sup> Congress, 1<sup>st</sup> sess., March 14, 2007, available at [http://www.dhs.gov/xoig/assets/testimony/OIGtm\\_MJ\\_031407.pdf](http://www.dhs.gov/xoig/assets/testimony/OIGtm_MJ_031407.pdf).

<sup>49</sup> U.S. Congress, House Committee on Oversight and Government Reform, 110<sup>th</sup> Cong., 1<sup>st</sup> sess. March 14, 2007, available at <http://oversight.house.gov/story.asp?id=1413>.

<sup>50</sup> U.S. Department of Homeland Security, Federal Emergency Management Agency, Gulf Coast Recovery Office, Individual Assistance, Global Report, Executive Summary, available at [http://www.fema.gov/pdf/hazard/hurricane/2005katrina/gulf\\_wide\\_iag.pdf](http://www.fema.gov/pdf/hazard/hurricane/2005katrina/gulf_wide_iag.pdf).

<sup>51</sup> See HUD News Release, "Housing Assistance Extended for Gulf Coast Hurricane Victims for Another 18 Months," April 26, 2007, available at <http://www.hud.gov/news/release.cfm?content=pr07-051.cfm>, and HUD News Release, "Fact Sheet: Providing Continued Assistance for Gulf Coast Hurricane Victims," available at <http://www.hud.gov/news/releases/pr07-051.cfm>.

<sup>52</sup> FEMA Press Release HQ-07-042, "Fact Sheet: Providing Continued Assistance For Gulf Coast Hurricane Victims," April 26, 2007.

<sup>53</sup> See HUD New Release, "Rental Payments Continue for Remaining Katrina/Rita Households in Rental Housing: FEMA-HUD Disaster Housing Assistance Program (DHAP) Launched December 1, 2007," December 4, 2007, available at <http://www.hud.gov/news/release.cfm?content=pr07-176.cfm>.

<sup>54</sup> According to HUD Notice PIH-2008-21 (HA), issued April 16, 2008, families transitioning from trailers and other temporary housing will not be required to make rental payments, although families that transitioned from FEMA's rental assistance program will be required to make rental payments.

exemption made for elderly and disabled families. The assistance is scheduled to end on March 1, 2009.<sup>55</sup>

In his FY2009 budget request, the President requested funding for permanent rental vouchers for elderly, disabled, and formerly homeless families who are facing the expiration of their DHAP voucher. (For more information, see CRS Report RL33173, *Hurricane Katrina: Questions Regarding the Section 8 Housing Voucher Program*, by Maggie McCarty.)

## Legislative Initiatives

### H.R. 1227 and S. 1668.

On March 21, 2007, the House approved the Gulf Coast Hurricane Housing Recovery Act of 2007 (H.R. 1227). The bill contains a wide range of provisions, including those that would make modifications to, and increase reporting on, assistance provided in earlier supplemental appropriations acts. The bill would also clarify the treatment of certain federally assisted properties. On June 20, 2007, the Gulf Coast Housing Recovery Act of 2007 (S. 1668) was introduced in the Senate. The bill contains many of the same provisions as H.R. 1227; it was referred to the Senate Banking Committee, which held a hearing on September 25, 2007.

### Disaster Housing Strategy

The Post-Katrina Emergency Management Reform Act (enacted as part of P.L. 109-295) directed FEMA to develop a Disaster Housing Strategy in conjunction with HUD, the U.S. Department of Agriculture, and other federal entities, as well as the Red Cross and state, local, and tribal governments. The law directs FEMA to develop a broad strategy assessing current resources and policies “concerning the cooperative effort to provide housing assistance during a major disaster.”<sup>56</sup> Congress requested that the strategy be delivered within 270 days after enactment—July 6, 2007. On July 21, 2008, FEMA provided to Congress a draft Housing Strategy. The 60-day public comment period commenced on July 23, 2008. For the actual development of plans for implementation, the Strategy calls for a “National Disaster Housing Task Force, to be jointly led by FEMA, the U.S. Department of Housing and Urban Development, and the American Red Cross.”<sup>57</sup> (For more information about FEMA housing policy, see CRS Report RL34087, *FEMA Disaster Housing and Hurricane Katrina: Overview, Analysis, and Congressional Issues*, by Francis X. McCarthy.)

## Housing Assistance

The U.S. Housing Act of 1949 (P.L. 81-171) established a national goal of “a decent home and a suitable living environment for every American family.” Since the enactment of P.L. 81-171, a number of HUD programs have been established to provide rental housing assistance for low-

<sup>55</sup> Ibid.

<sup>56</sup> P.L. 109-295, § 683, 120 Stat. 1446.

<sup>57</sup> U.S. Department of Homeland Security, Federal Emergency Management Agency, Fact Sheet, *National Disaster Housing Strategy*, July 21, 2008, see <http://www.fema.gov/news/newsrelease.fema?id=45191>.

income individuals and families who struggle to afford housing.<sup>58</sup> Affordable housing remains beyond the reach of many, however. According to the Harvard Joint Center for Housing Studies, in 2006, approximately 8.1 million low-income renter households were severely cost burdened (paying more than 50% of their income toward housing), an increase of over one million from 2001 (and an increase from 18.9% of all renter households to 22.1%).<sup>59</sup> Although moderate-income renters were not immune from severe rent burdens, low-income renters faced the greatest burdens; over 91% of severely cost burdened renters were in the bottom quartile of the income distribution.<sup>60</sup> Further, HUD, in its most recent report on worst case housing needs, found that 5.99 million unassisted, very low-income renters either paid more than half their income in rent or lived in severely substandard housing in 2005, representing 5.50% of all households.<sup>61</sup> This was an increase from 5.01 million renters in 2001 (4.76% of all households).<sup>62</sup> The federal government's role in addressing worst-case housing needs is increasingly in question as deficits grow and pressure to restrain domestic spending mounts.

## The HUD Budget

Funding for HUD's assisted housing programs has been affected in recent years both by the efforts of the Administration and Congress to contain discretionary spending and by concerns internal to the HUD budget. In his FY2009 budget, the President has proposed to hold the growth in non-defense discretionary spending to less than 1% in the coming year, and to keep discretionary spending below the rate of inflation.<sup>63</sup> The majority of the HUD budget is discretionary funding, and the President requested large cuts for several programs in FY2009, including Housing for the Elderly and Persons with Disabilities and the Community Development Block Grant. However, the President's FY2008 budget recommended similar cuts to housing programs, and Congress appropriated over \$2 billion more than was recommended by the President for FY2008. (For more information about FY2009 HUD funding, see CRS Report RL34504, *The Department of Housing and Urban Development: FY2009 Appropriations*, by Maggie McCarty et al.)

Within the HUD budget, the cost of the Section 8 voucher program—which accounts for over a third of the total HUD budget—generally requires increased funding to serve the same number of people each fiscal year. (The program is partially pegged to housing costs, which have risen faster than inflation in recent years.) Since HUD's overall budget has been constrained, any increases in funding for the voucher program have come at the expense of other programs. Another internal HUD budget pressure involves the contribution of the FHA insurance program. FHA collects fees from participants, and excess fees are used by Congress to offset the cost of the HUD budget. FHA's market share has been dropping in recent years, and as a result, the amount of excess fees

<sup>58</sup> Housing is generally considered affordable if it costs no more than 30% of a family's income.

<sup>59</sup> Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2008*, June 2008, Table A-7, p. 40, available at <http://www.jchs.harvard.edu/publications/markets/son2008/son2008.pdf>. The Joint Center uses the bottom quartile of the income distribution to determine which households are "low income."

<sup>60</sup> Ibid.

<sup>61</sup> U.S. Department of Housing and Urban Development, *Affordable Housing Needs 2005: Report to Congress*, May 2007, p. 11, available at <http://www.huduser.org/Publications/pdf/AffHsgNeeds.pdf>.

<sup>62</sup> Ibid., p. 13.

<sup>63</sup> *Overview of the President's 2009 Budget*, p. 5, available at <http://www.whitehouse.gov/omb/budget/fy2009/pdf/budget/overview.pdf>.

has been declining. With fewer fees to offset the cost of the HUD budget, the President and Congress have had to find additional dollars in order to keep the overall budget at the same level.

## The Position of HUD Secretary

On March 21, 2008, Senators Patty Murray and Christopher Dodd—the respective chairpersons of the Departments of Transportation and HUD Appropriations Subcommittee and the Banking, Housing, and Urban Affairs Committee—sent a letter to President George W. Bush requesting the resignation of the Secretary of HUD, Alphonso Jackson. The letter noted several allegations made against the Secretary and the Department for inappropriate contracting practices. The letter stated that “despite four separate allegations of impropriety, as well as damning testimony by senior staff to the HUD Inspector General regarding Secretary Jackson inappropriately advising senior staff to take political affiliation into account in awarding contracts, the Secretary refused to answer legitimate Congressional inquiries about his conduct and the use of taxpayer funds at the Department.” The Senators argued that “the allegations surrounding Secretary Jackson, as well as his rejection of appropriate Congressional oversight of his Department, undermine his ability to effectively address the current housing crisis.”<sup>64</sup> Although HUD did not issue a response to this letter, a White House spokesperson stated that the President “continues to have confidence in Secretary Jackson.”<sup>65</sup>

On March 31, 2008, Secretary Jackson stated that he was resigning from his post at HUD, effective April 18, 2008, citing a desire to “attend more diligently to personal and family matters.”<sup>66</sup> The same day that Secretary Jackson’s resignation became effective, President Bush nominated the Administrator of the U.S. Small Business Administration, Steve Preston, to be the new HUD Secretary.<sup>67</sup> On June 5, 2008, the Senate unanimously confirmed Mr. Preston as the new HUD Secretary, and he was sworn in the next day.

## Federally Assisted Housing Funding and Reform

### Section 8 Voucher Reform

The Section 8 voucher program provides portable housing subsidies to low-income families that they can use to subsidize the cost of rental housing in the private market. Since 2003, HUD has advocated that the existing Section 8 housing choice voucher program be abolished and replaced with a new program. Part of the Administration’s rationale for advocating major program changes was a desire to curb cost growth in the program. However, the effects of earlier program reforms, market changes, and recent funding allocation changes<sup>68</sup> have all worked together to limit growth in the cost of a voucher within the structure of the current program. The other rationale for

<sup>64</sup> See press release, Senator Christopher Dodd, “Senate Housing Leaders Call for HUD Secretary Jackson’s Resignation,” March 21, 2008. The letter is available at [http://dodd.senate.gov/multimedia/2008/032108\\_DoddMurraytoPOTUS.pdf](http://dodd.senate.gov/multimedia/2008/032108_DoddMurraytoPOTUS.pdf).

<sup>65</sup> “2 Senators Want HUD Official Out,” *New York Times*, March 22, 2008, p. A11.

<sup>66</sup> HUD Press Release, “Jackson to Step Down as HUD Secretary,” March 31, 2008.

<sup>67</sup> White House Press Release, “President Bush Announces Nomination of Steve Preston as Secretary of Housing and Urban Development,” April 18, 2008.

<sup>68</sup> For more information, see CRS Report RL33929, *Recent Changes to the Section 8 Voucher Renewal Funding Formula*, by Maggie McCarty.

program reform has to do with reducing administrative complexity in the program and providing the public housing authorities (PHAs) that administer the program with more flexibility. It is generally agreed, by the Administration, low income housing advocates, and PHA industry groups, that the voucher program is too complex and administratively burdensome. However, the Administration, low-income housing advocates, and PHA industry groups do not necessarily agree about the best way to reduce that complexity without compromising the level of assistance provided to low-income tenants.

In the 109<sup>th</sup> Congress, a bipartisan Section 8 voucher reform bill was approved by the House but not enacted before the end of the Congress (H.R. 5443). A similar bill, the Section 8 Voucher Reform Act of 2007 (H.R. 1851), was introduced in the 110<sup>th</sup> Congress. The bipartisan bill is sponsored by Chairwoman Maxine Waters of the House Financial Services Committee Subcommittee on Housing and Community Opportunity. The bill would change the way income is calculated for the purposes of eligibility and rent-setting (for the voucher program, as well as public housing and project-based Section 8) and adopt a new method for allocating voucher funds, among other changes. On May 25, 2007, the House Financial Services Committee passed H.R. 1851 with a number of amendments. Among them were provisions to expand the Moving to Work program (renamed the Housing Innovation Program) and authorization of up to 20,000 new incremental vouchers in each of the next five years. On July 12, 2007, the bill was approved by the full House.

On March 3, 2008, S. 2684, the Section 8 Voucher Reform Act of 2008, was introduced in the Senate by Senator Christopher Dodd, Chairman of the Senate Banking Committee. It is similar to H.R. 1851, but it does not contain provisions to expand the Moving to Work demonstration and does include provisions designed to improve coordination with the Low Income Housing Tax Credit program, among other differences. The Housing, Transportation, and Community Development Subcommittee of the Senate Banking Committee held a hearing on S. 2684 on April 16, 2008. (For more information, see CRS Report RL34002, *Section 8 Housing Choice Voucher Program: Issues and Reform Proposals in the 110<sup>th</sup> Congress*, by Maggie McCarty.)

## Public Housing Operating Funds

In January 2007, HUD began using a new formula to distribute public housing operating funds to public housing authorities. Under the new formula, some PHAs' eligibility for funding increased, and others decreased. Those increases and decreases are phased in over two and five years, respectively. However, any funding increases will be reduced and any funding decreases will be further deepened if the appropriations provided by Congress are not sufficient to fund all PHAs at their full eligibility levels.

Operating funds make up the difference between what tenants pay in rent and the cost of running public housing. The amount a PHA receives is based on a set of allowable expenses set by HUD. PHAs calculate their budgets by totaling up the allowable expenses for all of their units and subtracting the amount they receive in tenant rents. HUD then adds together all of the agencies' budgets and compares the total to the amount Congress appropriated for the operating fund that year. Typically, Congress appropriates less than the full amount that PHAs qualify for under the formula, so HUD applies an across-the-board cut to agencies' budgets, called a proration. The 2008 proration is estimated to be 84%, meaning that agencies will receive 84% of their budgets.

The new funding formula for FY2007, established by HUD through regulation with input from PHA industry groups, adopted new allowable expense levels. It also required PHAs to adopt a

new form of property management—called asset-based management—by FY2011. Some agencies qualify for a higher budget under the new allowable expense levels and others face reductions, although both increases and decreases will be phased in. Those that face a decrease can transition to asset-based management sooner to help limit their losses. However, the magnitude of gains and losses under the new formula will depend on how much is appropriated for the operating fund and, subsequently, how low a proration HUD will set. (For more information, see CRS Report RS22557, *Public Housing: Fact Sheet on the New Operating Fund Formula*, by Maggie McCarty.)

### *Asset-Based Management*

The new operating fund rule contained a requirement that PHAs convert to a new type of management, called asset-based management, by 2011. Historically, PHAs had been permitted to centrally manage their public housing stock, meaning a PHA could receive funding, budget, and provide services for all of their units in the same way, on a portfolio-wide basis. Under asset-based management, PHAs will receive funding and will be required to budget for their units on a project-by-project basis. PHAs will still maintain central offices; however, under the new funding formula, the central office will not receive funding directly from HUD. Instead, central office funding will come from fees charged by the central office to individual properties for the services the central office provides. As noted earlier, PHAs that are slated to lose funding under the new operating fund rule can convert to asset-based management before the 2011 deadline in order to limit their losses. In order for PHAs to limit their losses in 2009, they must prove that they have converted to asset-based management by the deadline set by HUD. Small PHAs, defined by HUD as those managing 250 or fewer units, are not required to convert to asset-based management, unless they wish to stop their losses.

There has been some controversy surrounding how PHAs demonstrate that they have successfully converted to asset-based management in order to stop their losses. HUD published preliminary guidance in September 2006.<sup>69</sup> PHA industry groups have argued that HUD's guidance is "overly prescriptive"—particularly the guidance related to funding for the central office—and have lobbied for HUD to make modifications.<sup>70</sup> Specifically, industry groups have opposed guidance related to regulating fees charged by the central office and limits to their ability to transfer funds from the public housing capital fund.

On January 16, 2007, the Chairmen of the Senate Banking and House Financial Services Committees sent a letter to HUD asking the Department to suspend implementation of the conversion to asset-based management until after the authorizing committees have "had the

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<sup>69</sup> HUD, PIH Notice 2006-35, Operating Fund Program Final Rule: Transition Funding and Guidance on Demonstration of Successful Conversion to Asset Management to Discontinue the Reduction of Operating Subsidy—Extension of Stop Loss Deadline to April 15, 2007, issued September 25, 2006.

<sup>70</sup> For example, see Public Housing Authority Directors Association, "PHADA makes recommendations to HUD on dealing with budget gap," PHADA News, July 3, 2006, available at <http://www.phada.org/news.php?id=248>.

opportunity to look into the issue further.”<sup>71</sup> HUD published revised guidance on April 10, 2007,<sup>72</sup> although it did not make all of the changes requested by the industry groups.<sup>73</sup>

*Legislation* . In the FY2008 HUD appropriations act, Congress included several provisions relating to asset-based management. The act raised the threshold for exemption from asset-management requirements for small PHAs from 250 to 400 units, and it limited HUD’s ability to restrict capital fund transfers.<sup>74</sup> HUD interpreted the provision related to small agencies as only in effect for FY2008 and interpreted the other provision, related to capital fund transfers, as a permanent change.<sup>75</sup> The Senate Appropriations Committee-passed version of the FY2009 HUD appropriations bill (S. 3261) includes the small PHA provision from the FY2008 Act.

On July 9, 2008, the House approved H.R. 6216, the Asset Management Improvement Act of 2008. The bill was the third in a series of asset-management related bills introduced by Representative Sires. The first, H.R. 3521, the Public Housing Asset Management Improvement Act of 2007, included provisions, among others, that would have prohibited HUD from publishing a management fee schedule before FY2011 and without first undertaking negotiated rulemaking; extended the exemption from asset-based management requirements from agencies with 250 or fewer units to those with 500 or fewer units; and prohibited HUD from placing restrictions on PHAs’ ability to transfer funds from their capital fund to their operating fund for central office needs. The House Financial Services Committee approved H.R. 3521 on September 25, 2007. During floor consideration on February 26, 2008, a motion to recommit related to restricting a PHA’s ability to regulate gun possession in public housing was offered. In response to the motion to recommit, the chair indefinitely postponed further consideration of the bill.

On April 17, 2008, a second version—the Public Housing Asset Management Improvement Act of 2008 (H.R. 5829)—was introduced. It contained all of the provisions of H.R. 3521, as well as the language from the motion to recommit that was offered during floor consideration of H.R. 3521. H.R. 5829 also included provisions to reauthorize the Public Housing Drug Elimination grant program and make enforcement of a community service requirement in public housing optional.

H.R. 6216, as approved by the House, includes all of the provisions from H.R. 3521, as well as the gun possession-related provisions from the motion to recommit and new language clarifying the illegal use of a firearm as grounds for termination of tenancy. It does not contain the additional provisions from H.R. 5829 related to the Public Housing Drug Elimination grant program or the community service requirement.

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<sup>71</sup> “Committee Chairs Weigh In on Asset Management Implementation,” National Low Income Housing Coalition, Memo to Members, vol. 12, no. 3, January 19, 2007.

<sup>72</sup> See PIH Notice 2007-9 Subject: Updated Changes in Financial Management and Reporting Requirements Public Housing Agencies Under the New Operating Fund Rule (24 C.F.R. part 990).

<sup>73</sup> For a summary of comments and requests submitted by industry groups and HUD’s responses, see the HUD website at <http://www.hud.gov/offices/pih/publications/notices/07/pih2007-9comments.pdf>.

<sup>74</sup> See Sections 225 and 226 of Division K of P.L. 110-161. Section 225 relates to the small agency threshold for exemption from asset-based management; HUD has interpreted the language to only be in effect for calendar year 2008. Section 226 relates to capital fund fungibility. HUD has interpreted this language to be permanent (and extend beyond 2008).

<sup>75</sup> See HUD Notice PIH 2008-16, Guidance on Asset Management Provisions in the Consolidated Appropriations Act, 2008.

## HOPE VI Reauthorization

The HOPE VI program provides competitive grants to PHAs for the demolition or revitalization of distressed public housing. HOPE VI has been popular with many Members of Congress, but it has been criticized by the Administration, which argues that grantees spend money too slowly, and by tenant advocates, who argue the program displaces more families than are housed in new developments. Reflecting these criticisms, HUD has requested no new funding for HOPE VI each year since FY2004. Congress has continued funding the program, although at lower levels than in previous years (the FY2008 appropriation was \$100 million, compared with \$570 million in FY2003).

The statute authorizing the HOPE VI program includes a sunset clause. The sunset date was September 30, 2006. However, the FY2007 funding bill (P.L. 110-5) provided an extension of the HOPE VI program through the end of FY2007, and the FY2008 funding bill (P.L. 110-161) extended the program through the end of FY2008.

On March 8, 2007, the HOPE VI Improvement and Reauthorization Act of 2007 (S. 829) was introduced by Senator Barbara Mikulski and Senator Mel Martinez. It would reauthorize the program through FY2013 and, according to the sponsors' press release, make "several improvements to ensure grants are cost-efficient, and effective at improving resident and community life."<sup>76</sup>

A House HOPE VI reauthorization bill, The HOPE VI Improvement and Reauthorization Act of 2007 (H.R. 3524),<sup>77</sup> was approved by the full House on January 17, 2007. The bill is sponsored by Representative Maxine Waters, who chairs the Housing and Community Opportunity Subcommittee of the House Financial Services Committee. It would reauthorize the HOPE VI program through FY2015 at \$800 million per year and make a number of changes to the program. According to the committee's press release, the bill would "provide for the retention of public housing units, prevent re-screening of returning residents, protect residents from disruptions resulting from the grant, increase resident involvement, improve the efficiency and expediency of HOPE VI construction, and achieve green developments."<sup>78</sup> (For more information, see CRS Report RL32236, *HOPE VI Public Housing Revitalization Program: Background, Funding, and Issues*, by Maggie McCarty.)

## Assisted Housing Preservation

Assisted housing preservation involves efforts to maintain the affordable nature of federally assisted housing. Many affordable housing projects were developed by private owners with assistance from the government, including programs administered by HUD, the Low Income Housing Tax Credit (LIHTC) program, and the programs of the Department of Agriculture's Rural Housing Service. In exchange for government assistance in developing their properties, building owners entered into contracts with the government in which they agreed to serve low-

<sup>76</sup> Press release from the office of Barbara Mikulski, *Mikulski Introduces Legislation To Continue, Strengthen Hope VI Program*, March 8, 2007, <http://mikulski.senate.gov/record.cfm?id=270346>.

<sup>77</sup> This bill is similar to a bill with the same title and sponsor, but a different bill number (H.R. 3126) that was introduced on July 23, 2007.

<sup>78</sup> Press release from the House Financial Services Committee, *Financial Services Committee Passes Housing Measures*, September 26, 2007, [http://www.house.gov/apps/list/press/financialsvcs\\_dem/press0926073.shtml](http://www.house.gov/apps/list/press/financialsvcs_dem/press0926073.shtml).

income families through reduced rents and/or federal rent subsidies for a certain number of years. Depending on the assisted housing program, the duration of these contracts, or “use restrictions,” range from 15 to 50 years.<sup>79</sup> In recent years, these contracts have begun to expire or, in some cases, property owners have chosen to pay off their mortgages early and end the use restrictions. Contracts for rental assistance, including project-based Section 8 rental assistance, have also begun to expire. By 2005, nearly 200,000 formerly assisted housing units were no longer subject to use restrictions due to mortgage prepayment or expiration of project-based rental assistance.<sup>80</sup> The mortgages on a further 2,328 HUD properties, representing 237,000 housing units, are expected to mature by 2013.<sup>81</sup> These properties make up 21% of the total number of properties with HUD-assisted mortgages.

## Previous Legislative Efforts to Preserve Affordable Housing

Beginning in 1987, Congress started to enact legislation to help preserve affordable rental housing. Congress first attempted to address the problem through the Emergency Low-Income Housing Preservation Act (ELIHPA).<sup>82</sup> The act temporarily prevented owners of Section 221(d)(3) and Section 236 developments from prepaying their mortgages without approval from HUD. In 1990 Congress enacted the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) as part of the Cranston-Gonzalez National Affordable Housing Act (P.L. 101-625). The program created incentives for building owners to continue offering affordable housing through the Section 221(d)(3) and Section 236 programs. LIHPRHA has not been funded since FY1997 (P.L. 104-204), but during the 1990s it is estimated to have preserved 100,000 units of Section 221(d)(3) and Section 236 housing.<sup>83</sup>

In 1997, the Multifamily Assisted Housing Reform and Accountability Act (MAHRA, P.L. 105-65) created the Mark-to-Market program.<sup>84</sup> The program applies to owners of multifamily housing projects that have HUD-insured or HUD-held loans as well as project-based Section 8 rental assistance contracts in which the rent collected is considered above-market. (Market rent is based on either the rent levels of comparable unassisted properties in a building’s area or on area fair market rent levels as determined by HUD.) Mark-to-Market allows those owners with above-market rents to renew their rental assistance contracts with HUD, although at a lower rate, while also restructuring their outstanding debt on the property. The program is designed both to ensure that HUD pays reasonable market rents for subsidized properties and to provide incentives for owners of assisted properties to renew their contracts with HUD. Mark-to-Market allows rents on up to 5% of units eligible for the program to be set at levels that exceed market rents, as long as they do not exceed 120% of market rent. The FY2007 year-long continuing resolution (P.L. 110-5) extended the Mark-to-Market program through the end of FY2011.

<sup>79</sup> Programs in which assisted housing preservation is an issue include the Section 221(d)(3) program, the Section 236 program, the Section 202 and 811 programs, the Section 515 rural housing program, and the Low Income Housing Tax Credit program.

<sup>80</sup> National Housing Trust, *HUD-Assisted, Project-Based Losses by State*, March 2, 2005, available at [http://www.nhtinc.org/prepayment/State\\_Loss\\_Report.pdf](http://www.nhtinc.org/prepayment/State_Loss_Report.pdf).

<sup>81</sup> U.S. Government Accountability Office, *More Accessible HUD Data Could Help to Preserve Housing for Low-Income Tenants*, GAO-04-20, January 2004, p. 4, available at <http://www.gao.gov/new.items/d0420.pdf>.

<sup>82</sup> ELIHPA was part of the Housing and Community Development Act of 1987 (P.L. 100-242).

<sup>83</sup> Emily Achtenberg, *Stemming the Tide: A Handbook on Preserving Subsidized Multifamily Housing*, Local Initiatives Support Corporation, September 1, 2002, p. 2, available at <http://www.lisc.org/content/publications/detail/893>.

<sup>84</sup> Mark-to-Market is codified at 42 U.S.C. §1437f, note.

## **The Mark-to-Market Program**

On January 23, 2007, Representative Maxine Waters introduced the Mark-to Market Extension Act (H.R. 647), a bill that would make changes to the Mark-to-Market program. On October 23, 2007, the House Financial Services Committee held a hearing regarding the bill. Two days later, Representative Waters introduced a nearly identical bill but with additional provisions. The new bill, the Mark-to-Market Extension and Enhancement Act (H.R. 3965), was approved by the House Financial Services Committee on October 31, 2007.

H.R. 3965 would extend the Mark-to-Market program until the end of FY2012 and would make eligible for the program certain properties where rent is not considered above-market, as long as the HUD Secretary determines that debt restructuring is necessary to preserve the property. The bill would also allow the Secretary to waive the requirement that rent levels be above market for properties in federally declared disaster areas (as long as uninsured damage is likely to exceed \$5,000 per unit). In addition, the bill would increase the cap on the percentage of units eligible to restructure rents to levels above market rents from 5% to 9% and would waive the cap in disaster areas. It would also permit certain non-profit owners to participate in mortgage restructuring. Another provision of H.R. 3965 would apply to late Section 8 payments from HUD to property owners. The bill would require HUD to alert owners at least 10 days before the Section 8 payment due date if it anticipates that a payment will be late. If a Section 8 payment is more than 30 days late, HUD would be required to pay interest to the building owner. An amendment adopted at the markup of H.R. 3965 would make changes to the Mark-to-Market provisions that encourage resident involvement in the preservation and improvement of their low-income housing developments. As amended, H.R. 3965 would authorize not less than \$10 million for technical assistance that may be used to train tenants and provide for capacity building.

## **Section 202 Housing for the Elderly Program Preservation**

Properties developed as part of HUD's Section 202 Housing for the Elderly program are aging, and their mortgages are beginning to mature. Between 1959, when the Section 202 program was established, and the early 1990s, the program loaned money to developers of projects for low-income elderly persons (defined by HUD as those age 62 and older). Beginning in 1974, the program also provided Section 8 rental assistance. Legislation has been introduced that would address aspects of refinancing Section 202 projects in order to maintain their affordability and prevent physical deterioration.

Two similar bills, both entitled the Section 202 Supportive Housing for the Elderly Act (H.R. 2930 and S. 2736), have been introduced in the 110<sup>th</sup> Congress. On December 5, 2007, H.R. 2930 was approved by the House. Both bills would expand the circumstances under which a building owner may refinance a Section 202 loan. Under current law, a Section 202 loan may only be refinanced if the new loan has a lower interest rate. H.R. 2930 and S. 2736 would expand circumstances in which a loan may be refinanced to include cases in which the proceeds from the new loan are used to address the project's physical needs, the rent charged to tenants does not change, and the cost of any Section 8 contract is not increased. This expansion would make it possible for older Section 202 developments, many of which have loans with interest rates of 3%, to refinance their loans and use the proceeds to make improvements to the property. The two bills would also expand the ways in which project owners may use proceeds from refinanced loans. Funds could be used to provide supportive services without limitation (current law limits 15% of funds for this use), for payment of developers fees, and for equity returns to nonprofit sellers.

In addition, H.R. 2930 and S. 2736 would create Preservation Project Rental Assistance to assist residents who live in Section 202 units that do not currently receive rental assistance (these include a portion of units financed prior to 1974). Another provision in H.R. 2930 and S. 2736 would limit HUD's ability to put conditions on the amount of proceeds that Section 202 owners may realize from a sale or refinancing, or the way in which owners use the proceeds. HUD would only be able to impose conditions on the amount or use of proceeds if there were an existing contract between HUD and the project owner that authorized such conditions to be imposed. (For more information on the Section 202 program, see CRS Report RL33508, *Section 202 and Other HUD Rental Housing Programs for Low-Income Elderly Residents*, by Libby Perl.)

Another provision in H.R. 2930 and S. 2736, regarding the "delegated processing" of Section 202 capital grants to state Housing Finance Agencies (HFAs), was included in P.L. 110-289, the Housing and Economic Recovery Act of 2008, which was enacted on July 30, 2008. Under this provision, those grantee organizations that are awarded Section 202 capital grants, and that also intend to use Low Income Housing Tax Credits to develop their properties, may have their state HFA review and process the capital grant instead of HUD. Because HFAs are the agencies that administer tax credits, delegating the processing of the Section 202 capital grant to the HFA, together with the tax credit, is thought to be more efficient. As part of the delegated processing established in P.L. 110-289, HFAs may recommend project rental assistance in excess of the amount awarded by HUD, though an increase is subject to HUD approval.

On July 10, 2008, the Senate Appropriations Committee approved its version of the Departments of Transportation and HUD funding bill (S. 3261). The bill includes a refinancing provision similar to one included in both H.R. 2930 and S. 2736. This provision would allow Section 202 owners to refinance into a new loan with a higher interest rate as long as the project owner would use the new funding to address the project's physical needs. The Senate Appropriations Committee bill also includes a provision that would require HUD to provide enhanced vouchers to Section 202 tenants in cases where insufficient project-based rental assistance is made available to the development.

### Other Preservation Legislation

The Section 515 Rural Housing Property Transfer Improvement Act (H.R. 3873) would facilitate the preservation of affordable housing developments that are located in rural areas. The Section 515 program is part of the Department of Agriculture's (USDA's) Rural Housing Service. The program provides low-interest loans to housing developers to make it possible to build multifamily housing that is affordable to low-income families and individuals. H.R. 3873 would make it easier for an owner of a Section 515 building owner to transfer the property to another owner while maintaining the property's affordability. The House approved H.R. 3873 on January 24, 2008. (For more information about USDA rural housing programs, see CRS Report RL33421, *USDA Rural Housing Programs: An Overview*, by Bruce E. Foote.)

Recent HUD appropriations have also contained preservation-related provisions. Section 318 of the FY2006 HUD appropriations law (P.L. 109-115) authorized HUD to transfer project-based rental assistance contracts, debt, and low-income use restrictions from one multifamily property to another, subject to some criteria. The provision was designed to ensure that, if a property is no longer available or viable, the rental assistance contract can be maintained at another property. Although this provision has been generally supported by preservation advocates, they have argued that some of the criteria—such as the requirement that the transferring property and the receiving property have the same number of units—should be lifted in order to make the transfers

more workable. This authority was extended in the FY2007 continuing resolution (P.L. 110-5) and the FY2008 HUD appropriations law (Sec. 215 of P.L. 110-161).

Section 311 of the FY2006 HUD appropriations law also contained a similar provision, requiring HUD to maintain rental assistance contracts on any properties held by the Secretary (generally, as a result of mortgage foreclosure), or to transfer the contracts to another viable property. In the past, when HUD took possession of a property, it would generally terminate the rental assistance contract and provide the tenants with vouchers. This authority was also extended in the FY2007 continuing resolution, and similar language was included in the FY2008 HUD appropriations law (Sec. 220 of P.L. 110-161).

## Native American Housing Assistance and Self-Determination Block Grant

The Native American Housing Assistance and Self-Determination Act of 1996 (NAHASDA, P.L. 104-330) reorganized the system of federal housing assistance to Native Americans by separating Native American programs from the Public Housing program and by eliminating several separate programs of assistance and replacing them with a single block grant program. In addition to simplifying the process of providing housing assistance, the purpose of NAHASDA was to provide federal assistance for Indian tribes in a manner that recognizes the right of Indian self-determination and tribal self-governance.

NAHASDA provides block grants to Indian tribes or their tribally designated housing entities (TDHE) for affordable housing activities. The tribe must submit an Indian housing plan (IHP), with long- and short-term goals and proposed activities, which is reviewed by HUD for compliance with statutory and regulatory requirements. Funding is provided under a needs-based formula, which was developed pursuant to negotiated rule-making. Tribes and TDHEs can leverage funds, within certain limits, by using future grants as collateral to issue obligations under a guaranteed loan program.

The House and Senate passed different versions of the Native American Housing Assistance and Self-Determination Reauthorization Act of 2007 on September 6, 2007, and May 22, 2008, respectively. Both chambers passed an amended version of the House bill, H.R. 2786, in late September 2008. On October 14, 2008, the President signed the Native American Housing Assistance and Self-Determination Reauthorization Act of 2008 (P.L. 110-411). The law reauthorizes NAHASDA through 2013 and makes some changes to its programs.

P.L. 110-411 strengthens language in the Congressional findings of NAHASDA, requiring that the federal government “shall” provide housing assistance and “shall” provide assistance in a manner that recognizes Indian self-determination and tribal self-government; the previous language stated that the government “should” pursue these objectives. The law also redefines the term *housing-related community development* to include any facility or infrastructure that is owned by an Indian tribe or tribally designated housing entity (TDHE), that is necessary for the provision of housing in an Indian area, and that would make housing more affordable, accessible, or practical in an Indian area. The expanded definition will allow tribes to construct buildings directly related to the provision of housing that contribute to sustainable communities, such as community centers, laundromats, and day-care centers.

The law also establishes the Self-Determined Housing Activities for Tribal Communities program, which allows tribal communities to use up to 20% of their annual grant amounts (up to a maximum of \$2 million) for housing activities that are wholly self-determined by the Indian tribe and that are related to the construction, acquisition, or rehabilitation of housing or related infrastructure. This program is meant to increase tribal self-determination of housing activities by allowing tribes to engage in certain housing activities without direct HUD oversight. The Secretary is directed to conduct a review of the program and report on the program's effectiveness in CY2011.

P.L. 110-411 also establishes a new demonstration program that extends the existing loan guarantee program, which provides guarantees for loans used to support affordable housing activities. Under the demonstration program, the Secretary is authorized to also guarantee loans for community or economic development activities for a limited number of Indian tribes or TDHEs, as long as 70% of the amount received by a tribe as a result of a guarantee is used to support activities that benefit low-income families. The law authorizes appropriations for the demonstration program through 2013. The law also places limits on the aggregate amount that the Secretary can guarantee, and requires the Secretary to submit a report on the program after four years.

The law prohibits the use of NAHASDA funds to benefit unauthorized aliens as defined by the Immigration and Nationality Act, and it prohibits the distribution of NAHASDA funds to the Cherokee Nation as long as its dispute with Cherokee Freedmen over Freedmen's rights is ongoing.<sup>85</sup> Cherokee Freedmen claim to be direct descendants of former Cherokee slaves or free blacks who were made citizens of the Cherokee Nation in the 19<sup>th</sup> century. This prohibition will not be in effect as long as a temporary injunction issued by the District Court of the Cherokee Nation on May 14, 2007, remains in effect, or if the Cherokees and the Cherokee Freedman reach an agreement that ends the ongoing litigation.

P.L. 110-411 also clarifies NAHASDA's relationship to other housing programs. It specifies that income from developers' fees for projects using Low-Income Housing Tax Credits (LIHTCs) will not be counted as program income for projects funded by Indian Housing Block Grants (IHBGs), and it explicitly states that Indian tribes or TDHEs are eligible to receive HOME funds from the participating jurisdictions in which they reside.<sup>86</sup>

The law also includes provisions that streamline tribes' reporting requirements, most notably by eliminating the five-year housing plan and revising the requirements for the one-year housing plan, as well as provisions that reduce the tribes' administrative burden. P.L. 110-411 also clarifies the definition of low-income housing units for the purposes of the formula used for distributing block grants, and specifies that the requirement that a housing unit remain affordable for its useful life does not apply to families or households who subsequently take ownership of a homeownership unit.

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<sup>85</sup> For more information about this issue, see CRS Report RL34321, *The Cherokee Freedmen Dispute: Legal Background, Analysis, and Proposed Legislation*, by Yule Kim.

<sup>86</sup> Through the HOME Investment Partnerships Program, HUD provides formula-based block grants to states and localities to use for affordable housing activities. States and localities that receive HOME grants are referred to as "participating jurisdictions." For a brief description of the HOME program, see CRS Report RL34591, *Overview of Federal Housing Assistance Programs and Policy*, by Maggie McCarty et al.

Finally, the law requires two further studies related to NAHASDA. The Secretary of HUD is directed to contract with an organization to perform a study of potential data sources on the housing needs used to calculate formula grant amounts. Currently, information on housing needs is taken from the U.S. Census. P.L. 110-411 also directs the Government Accountability Office (GAO) to conduct a study within one year of the law's enactment on the effectiveness of NAHASDA; the study is to focus on comparing NAHASDA's effectiveness for different types and sizes of tribes, especially small tribes.

## Low Income Housing Tax Credits

The Low-Income Housing Tax Credit (LIHTC) was created by the Tax Reform Act of 1986 (P.L. 99-514) to provide an incentive for the acquisition (excluding land) and development or the rehabilitation of affordable rental housing. These federal housing tax credits are awarded to developers of qualified projects. Sponsors, or developers, of real estate projects apply to the corresponding state housing finance authority for LIHTC allocations for their projects. Developers either use the credits or sell them to investors to raise capital (or equity) for real estate projects. The tax benefit reduces the debt or equity that the developer would otherwise have to incur. With lower financing costs, tax credit properties can potentially offer lower, more affordable rents. (For more information on the LIHTC program, see CRS Report RS22389, *An Introduction to the Design of the Low-Income Housing Tax Credit*, by Mark P. Keightley.)

In order to be eligible for the LIHTC, properties are required to meet certain tests that restrict both the amount of rent that is assessed to tenants and the income of eligible tenants. The "income test" for a qualified low-income housing project requires that the project owner irrevocably elect one of two income level tests, either a 20-50 test or a 40-60 test. In order to satisfy the first test, at least 20% of the units must be occupied by individuals with income of 50% or less of the area's median gross income, adjusted for family size. To satisfy the second test, at least 40% of the units must be occupied by individuals with income of 60% or less of the area's median gross income, adjusted for family size.<sup>87</sup> A qualified low-income housing project must also meet the "gross rents test" by ensuring rents do not exceed 30% of the elected 50% or 60% of area median gross income, depending on which income test the project elected.<sup>88</sup>

The nature of the low-income project determines the credit rate that it may be awarded. Rehabilitation and federally subsidized projects are eligible to receive what is generally referred to as the "4%" credit. New construction is eligible for the "9%" credit. References to the "4%" credit and "9%" credit are, perhaps, misleading because they imply that these rates are fixed and certain. In actuality, the credit rates awarded vary each month so that the present value of the effective subsidy, as a fraction of a project's cost, is equal to either 30% or 70%, depending on whether the building is rehabilitated or new construction. (For more information about tax credit rates, see CRS Report RS22917, *The Low-Income Housing Tax Credit Program: The Fixed Subsidy and Variable Rate*, by Mark P. Keightley.) The credit rate is then multiplied by the project's qualified basis to determine the annual tax credit award. The qualified basis generally equals the fraction of a project's development costs (minus the cost of land and federal grants)

<sup>87</sup> U.S. Department of Treasury, Internal Revenue Service, Internal Revenue Code, Section 42(g)(1).

<sup>88</sup> U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *Updating the Low-Income Housing Tax Credit (LIHTC) Database Projects Placed in Service Through 2003* (Washington: January 2006), p. 1.

that is occupied by low-income tenants. Buildings located in qualified census tracts or difficult to develop areas are eligible for an enhanced eligible basis.

The Housing and Economic Recovery Act of 2008 (P.L. 110-289), the enacted version of H.R. 3221, contains several provisions relating to the LIHTC program. Specifically, the act increases the per capita tax credit allocation to states by \$0.20 for calendar years 2008 and 2009. The proposed tax credit allocation is in addition to the annual inflation adjustment. The act also changes the method used to determine the applicable credit rate for new construction projects. Newly constructed buildings will temporarily receive a minimum credit rate not less than 9% if placed in service before December 31, 2013. The current method for determining the credit rate for rehabilitated and federally subsidized projects was left unchanged by the act. However, P.L. 110-289 changed the definition of facilities that are “federally subsidized” to exclude those that receive below-market federal loans; a federal subsidy with respect to low-income housing projects now only includes obligations the interest of which is tax exempt. In addition, states are permitted to designate certain buildings as being in difficult to develop areas and thus eligible for an enhanced eligible basis, which increases the effective subsidy the building can receive. P.L. 110-289 also eliminates the prior restriction placed on buildings developed using funds from HUD’s Section 8 Moderate Rehabilitation program that had prohibited them from receiving LIHTCs.

## Homelessness

The HUD homeless assistance grants, established as part of the McKinney-Vento Homeless Assistance Act (P.L. 100-77), consist of four separate grant programs. The Emergency Shelter Grants (ESG) program distributes funds to communities through a formula allocation, and they, in turn, may use the funds for the renovation, major rehabilitation or conversion of buildings into emergency shelters. Grantees may also use funds to provide services to homeless individuals, and for homelessness prevention activities, although not more than 30% of funds may be used for either of these purposes. The grants for the other three Homeless Assistance Grant programs are awarded competitively through HUD’s Continuum of Care (CoC) system. These programs are the Supportive Housing Program (SHP), Shelter Plus Care (S+C) program, and the Section 8 Moderate Rehabilitation Assistance for Single-Room Occupancy Dwellings (SRO) program. Unlike the ESG program, the three competitive grant programs focus on transitional and permanent supportive housing for homeless people. (For more information on the Homeless Assistance Grants, see CRS Report RL33764, *The HUD Homeless Assistance Grants: Distribution of Funds*, by Libby Perl.)

In the 110<sup>th</sup> Congress, several bills have been introduced that would reauthorize the housing programs of McKinney-Vento. The Homeless Emergency Assistance and Rapid Transition to Housing (HEARTH) Act of 2007 (H.R. 840) was introduced on February 6, 2007, and the Community Partnership to End Homelessness Act of 2007 (S. 1518) was introduced on May 24, 2007. On September 19, 2007, the Senate Banking, Housing, and Urban Affairs Committee unanimously approved S. 1518, and on July 31, 2008, the House Financial Services Committee approved H.R. 840. Many of the differences between the two bills as introduced were resolved when the House Financial Services Committee marked up H.R. 840. Then, on September 29, 2008, another bill, H.R. 7221, also called the HEARTH Act, was introduced in the House; on October 2, 2008, the House passed H.R. 7221. The new HEARTH Act further resolved differences with S. 1518, though some differences remain.

The two bills, H.R. 7221 and S. 1518, would both consolidate the three competitive homeless assistance grants (S+C, SHP, and SRO) into one consolidated grant, called the Continuum of Care Program in H.R. 7221 and the Community Homeless Assistance Program in S. 1518 (the President has also urged the consolidation of these three programs in his last seven budgets). The two bills would also codify the system through which the funds are distributed, retaining many aspects of the current Continuum of Care system. The two bills would reauthorize the Homeless Assistance Grants for different periods of time and at different funding levels, however. S. 1518 would authorize the grants at \$2.2 billion for FY2008 and for such sums as necessary from FY2009 through FY2012, while H.R. 7221 would authorize them at \$3 billion in FY2009 and such sums as necessary for FY2010. Both H.R. 7221 and S. 1518 would provide funds to renew permanent housing contracts through the Section 8 program rather than through the funds made available for the Homeless Assistance Grants.

Both bills propose to expand the definition of “homeless individual.” Under the current definition, a homeless individual is one who lacks a fixed, regular, and adequate nighttime residence, and who resides in a temporary shelter (including transitional housing for the mentally ill), an institution (with qualifications), or a place not designed for human habitation. S. 1518 would expand the definition of “homeless individual” to include individuals and families who are sharing housing, but those doubled-up households must also (1) lack the resources to pay for decent and safe housing, (2) only be permitted to remain in the shared housing for a short period of time, (3) have moved three or more times in the past year or at least two times within the last 21 days, and (4) not be able to make a significant financial contribution toward the shared housing. S. 1518 would also include among homeless individuals those persons residing in a hotel or motel, with the same reservations as those sharing housing, however. In addition, S. 1518 would change the definition of chronically homeless to include families with an adult member who has a disability (currently only unaccompanied individuals are included). The definition would also include persons released from institutions as long as, prior to entering the institution, they otherwise met the definition of chronically homeless, and had been institutionalized for fewer than 90 days. H.R. 7221 would similarly change the definition of chronically homeless.

Initially, the first version of the HEARTH Act introduced in the House (H.R. 840) would have expanded the definition of “homeless individual” to include persons who are sharing housing due to economic hardship; those living in hotels, motels, or campgrounds due to a lack of alternative accommodations; and those living in substandard housing. However, the definition in the most recent version of the HEARTH Act (H.R. 7221) was revised and is now similar to that in S. 1518, though differences remain. A person or family would be considered homeless under the definition in H.R. 7221 if they will “imminently lose” their housing, if they have no other place to go, and if they lack resources to obtain other housing. Imminent loss of housing would be evidenced by an eviction requiring an individual or family to leave their housing within 14 days, a lack of resources allowing an individual or family to remain in a hotel for more than 14 days, or credible evidence that an individual or family will not be able to stay with another homeowner or renter for more than 14 days. The bill would also consider homeless anyone who is fleeing a situation of domestic violence or other life-threatening condition. In addition, H.R. 7221 would allow communities to serve families with children or unaccompanied youth who are defined as homeless under other federal programs under certain circumstances (for example the Education for Homeless Children and Youth program, Head Start, and the Runaway and Homeless Youth program). These circumstances would include situations where unaccompanied youth or families with children had experienced a long-term period without permanent housing; had experienced instability due to frequent moves; and can be expected to remain unstably housed due to chronic disabilities, chronic physical health or mental health conditions, substance addiction, histories of

<http://wikileaks.org/wiki/CRS-RL33879>

domestic violence or childhood abuse, the presence of a child or youth with a disability, or multiple barriers to employment.

Both S. 1518 and H.R. 7221 would allow more funds to be used for homelessness prevention activities. Under current law, only ESG funds can be used to prevent homelessness; the other three homeless assistance grants cannot be used for prevention. Both H.R. 7221 and S. 1518 would allocate 20% of funds made available by Congress for the Homeless Assistance Grants to the newly named Emergency Solutions Grants program; of those funds available to the new ESG program, both bills would ensure that at least 40% would be available for activities such as rental assistance and housing relocation for persons at risk of homelessness.

S. 1518 and H.R. 7221 would also create a separate process for rural communities to apply for the competitive Homeless Assistance Grants. The two bills would allow grantees in rural communities to apply separately for funds that would otherwise be awarded as part of the consolidated Community Homeless Assistance Program (S. 1518) or the Continuum of Care Program (H.R. 7221). In addition, unlike current law, rural communities would be able to serve persons who do not meet HUD's definition of "homeless individual." S. 1518 provides that HUD may award grants for the costs of assisting those in the worst housing situations in their geographic area, those in imminent danger of losing housing, and the lowest-income residents in the community. Similarly, H.R. 7221 would allow rural communities to assist those at risk of homelessness, those in imminent danger of losing housing, and the lowest-income residents in the community. The House bill defines "at risk of homelessness" to include those households with incomes below 30% of area median income, without resources to attain housing stability, and that have moved frequently for economic reasons (these economic reasons are enumerated in the bill).

## CRS Reports on Housing

### In General

CRS Report RL34591, *Overview of Federal Housing Assistance Programs and Policy*, by Maggie McCarty et al.

CRS Report RL34504, *The Department of Housing and Urban Development: FY2009 Appropriations*, by Maggie McCarty et al.

CRS Report RL33879, *Housing Issues in the 110<sup>th</sup> Congress*, by Libby Perl et al.

CRS Report RL33421, *USDA Rural Housing Programs: An Overview*, by Bruce E. Foote.

CRS Report RL34623, *Housing and Economic Recovery Act of 2008*, coordinated by N. Eric Weiss.

### Section 8 Rental Assistance

CRS Report RL32284, *An Overview of the Section 8 Housing Programs*, by Maggie McCarty.

CRS Report RL34002, *Section 8 Housing Choice Voucher Program: Issues and Reform Proposals in the 110<sup>th</sup> Congress*, by Maggie McCarty.

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### **Public Housing**

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### **Housing for Special Populations**

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### **Federal Housing Finance**

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