

CRS Report for Congress

Housing Issues in the 110th Congress

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**Prepared for Members and
Committees of Congress**

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Summary

A number of housing-related issues have become prominent in the 110th Congress. Possibly the most visible issue is the prevalence of subprime loans and growing mortgage default and foreclosure rates. Congress has responded with numerous hearings and legislative proposals to change the way in which the lending and home-buying industry is regulated and to assist borrowers who are facing default and foreclosure. On December 20, 2007, the President signed P.L. 110-142, the Mortgage Debt Forgiveness Relief Act (H.R. 3648). Among other bills Congress is considering are the Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), which has been approved by the House, and the Homeownership Preservation and Protection Act of 2007 (S. 2452), which was introduced on December 12, 2007.

Concern over subprime loans and mortgage foreclosures has also entered the debate over reform of the government-sponsored enterprises (GSEs) — Fannie Mae and Freddie Mac — and Federal Home Loan Banks (FHLBs), although efforts to reform the GSEs and FHLBs began prior to the prominence of the debate over subprime loans. On May 22, 2007, the House passed and sent to the Senate H.R. 1427, which would create a new regulator for the GSEs. The bill would also use profits from the GSEs to create an affordable housing fund, the funds from which would be transferred to a National Affordable Housing Trust Fund, if enacted. (The House passed a bill that would create a National Affordable Housing Trust Fund, H.R. 2895, on October 10, 2007.) Two bills that would reform the GSEs have also been introduced in the Senate — S. 1100 and S. 2391.

Another issue being considered in the 110th Congress involves potential revisions to the Federal Housing Administration (FHA) loan insurance program. Both the House and Senate have passed FHA reform bills, H.R. 1852, the Expanding Homeownership Act, and S. 2338, the FHA Modernization Act. Both bills would make changes to the FHA program, including raising single-family mortgage limits and modifying the insurance premium pricing structure. However, H.R. 1852 would authorize the transfer of some FHA funds into an affordable housing fund, while S. 2338 would not.

Another congressional agenda item is providing assistance to victims of the 2005 hurricanes. On March 23, 2007, the House passed the Gulf Coast Hurricane Housing Recovery Act of 2007 (H.R. 1227). A similar Hurricane Katrina recovery bill (S. 1668) has been introduced in the Senate.

Additional legislation in the 110th Congress includes Section 8 voucher reform legislation (H.R. 1851) and a bill to reauthorize the HOPE VI program (H.R. 3524), both of which have been approved by the House, and a bill to reauthorize the McKinney-Vento Homeless Assistance Act (S. 1518), which has been approved by the Senate Banking Committee. The House has considered legislation that would preserve assisted housing, including the Mark-to-Market Extension and Enhancement Act (H.R. 3965), which has been 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 on January 24, 2008.

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Division Abbreviations:

ALD — American Law Division

DSP — Domestic Social Policy

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Housing Issues in the 110th Congress

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

The housing market experienced significant stress in 2007. Borrowers found it difficult to meet their mortgage obligations, and late payments and foreclosures increased. The biggest 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. Subprime 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 slow. 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 subprime borrowers, however. Falling prices and slowing home sales affect all home owners. 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.¹

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.² (For more information about subprime loans, see CRS Report

¹ Some are concerned that the problems in the housing market also will lead to increased filings for bankruptcy. As a result, a number of legislative proposals have been introduced in the 110th Congress that are directed at the subprime mortgage market, including at least four bills seeking to amend § 1322 of Chapter 13 of the Bankruptcy Code. For more information about these bills and how mortgages are dealt with in bankruptcy, see CRS Report RL34301, *The Primary Residence Exception: Legislative Proposals in the 110th Congress to Amend Section 1322(b)(2) of the Bankruptcy Code*, by David H. Carpenter.

² U.S. Congress Joint Economic Committee, *Sheltering Neighborhoods from the* (continued...)

RL33930, *Subprime Mortgages: Primer on Current Lending and Foreclosure Issues*, by Edward Vincent Murphy.)

Although the primary causes of foreclosure are 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 2002 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 subprime borrowers turned to mortgage products with low introductory payments, but which risked higher future payments.

The 110th Congress has held a series of hearings on subprime markets. For example, on March 27, 2007, the House Financial Services Committee held “Subprime and Predatory Mortgage Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions.” The Senate Banking, Housing, and Urban Affairs Committee held “Mortgage Market Turmoil: Causes and Consequences” on March 22, 2007. After the Senate Banking Committee hearing, Chairman Dodd on April 18, 2007, convened a summit of mortgage market stakeholders to discuss ideas and propose solutions to subprime market volatility.

Exotic Mortgages, Resets, and Rising Foreclosures. Slowing housing markets may frustrate the plans of 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 Vincent Murphy.)

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 subprime loans will reset their payments each month until fall of 2008. If borrowers with resetting mortgages had

² (...continued)

Foreclosure Storm, April 11, 2007, available at [<http://jec.senate.gov/Documents/Reports/subprime11apr2007.pdf>].

planned to depend on continued house price appreciation to sustain their homes, then the recent housing slowdown could result in sharply rising foreclosure rates.

Foreclosure rates are rising, especially among subprime borrowers. Some of the geographic distribution of mortgage defaults can be explained by the performance of local economies. The rise in the national foreclosure rate, however, is difficult to explain because the national unemployment rate remains relatively low. 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. This heightened risk among ARMs is cause for concern because most of the subprime 2/28s that must reset between now and the fall of 2008 are hybrid ARMs. In addition to the subprime ARMs that reset in 2008, there will be increasing jumbo mortgage³ resets in 2009. The increase in unsustainable loans during relatively strong national economic conditions raises the question of how the loans were qualified by the lenders in the first place.

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 Vincent 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 underwriting

³ Jumbo loans are too large to be eligible for purchase by Fannie Mae or Freddie Mac. This cap, called the conforming loan limit is currently \$417,000.

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. Representative Frank introduced a bill (H.R. 3915, discussed below) that would establish some liability for mortgage-backed-securities (MBS) issuers under some circumstances, but not the purchasers of MBS.

The 110th Congress is examining the role of securitization in recent subprime volatility. The House Financial Services Committee held a hearing, “The Role of the Secondary Market in Subprime Mortgage Lending,” on May 8, 2007. The Senate Banking Committee held a hearing on April 17, 2007, “Subprime Mortgage Market Turmoil: Examining the Role of Securitization.”

Price Declines, Unsold Inventories, and Falling Construction Starts.

After increasing at a rapid rate during 2001-2005, house prices slowed significantly during 2006-2007, even though the national unemployment rate has not significantly increased. One important sign of inconsistencies in a housing market is a price decline in an area with a relatively strong local economy. Although not true in every case, local job growth and income growth generally lead to increases in demand for housing and result in higher prices because housing supply responds relatively slowly. The current market is unusual because the Washington DC area, for example, had an unemployment rate of 3% in July 2007, well below the national average of 4.7%, yet house prices declined 7.2% compared to July 2006, according to Standard and Poor’s Case/Schiller Index.⁴ Similar price declines were reported in Phoenix, Miami, and several California cities, despite relatively strong local employment conditions. Areas with relatively poor local job markets, such as Michigan and Ohio, are also experiencing house price declines.

The inventory of unsold homes is rising, as is the home owner 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. The National Association of Realtors (NAR) reports that the month supply of homes on the market has risen from 4.5 in 2005 to 10.0 in August 2007; a month supply is calculated by taking the number of homes currently offered for sale and dividing by the current number of sales per month. A balanced market has a month supply between 5.0 and 6.0 according to the NAR. The existence of a glut of unsold homes is also evidenced by rising vacancy rates. According to the Census Bureau, the home owner vacancy rate is at the highest level it has been since the survey began in 1956.

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

⁴ The Case/Schiller index is a survey based on same-unit transactions and covers selected metropolitan regions. The National Association of Realtors calculate changes in median sales price, which rose 0.3% for the Washington area.

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 a number of bills that would modify the lending and home purchase process in an effort to 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. Several of these pieces of legislation are discussed below; their analysis may be covered over multiple sections of the report.

Regulating Lenders and Servicers

Currently, no national system for licensing mortgage originators exists. Instead, mortgage lenders are licensed at the state level. The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would require that a person engaging in the business of loan origination (which, under the bill's definition, would include mortgage brokers) obtain and maintain a registration as a registered loan originator or a license as a state-licensed loan originator. The bill would mandate the establishment of a national system for licensing mortgage originators if a state has not established an adequate system within a specified period of time. The bill would also provide for educational requirements for mortgage originators.

H.R. 3915 would reform mortgage origination by making changes to mortgage servicing and the appraisal process. The bill would require certain borrowers to open escrow accounts for taxes and insurance. Further, it would require that these costs be included in quotes provided to consumers and be considered when assessing a borrower's ability to repay the loan. The bill would also limit forced-place insurance, which is insurance coverage obtained by a servicer to protect the mortgagee's interest in the property. If a borrower attempts to refinance his or her mortgage within six months of obtaining a loan, H.R. 3915 would require a second appraisal at no charge to the borrower. The bill would additionally require borrowers to receive a copy of their appraisal at least three days before the loan closes.

The Mortgage Reform and Anti-Predatory Lending Act, as passed by the House, would also establish a federal duty of care for mortgage originators, requiring them to "diligently work to present the consumer with a range of residential mortgage loan products for which the consumer qualifies." Mortgage originators would also be required to present consumers with comparative cost and benefit information

regarding available loans. In addition, H.R. 3915 would prohibit mortgage originators from steering borrowers toward loans that are not in their interests.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would also attempt to improve the mortgage lending process by establishing enhanced requirements and restrictions on lenders, servicers, originators, brokers, and appraisers. With regard to servicing, S. 2452 would create an agency relationship between servicers and lenders, thus bringing servicers under state and federal agency laws. Additionally, lenders and servicers would be required to “act in good faith and with fair dealing,” as well as “act with reasonable skill, care, diligence, and in accordance with the highest standards” with regard to all home mortgages. The bill would limit the amount of and types of late fees and fees applied due to insufficient funds that could be charged against a borrower. The bill also would regulate how servicers and lenders assess collateral protection insurance, handle escrow accounts, handle disputes arising with borrowers, initiate foreclosures, and provide payoff statements.

The Homeownership Preservation and Protection Act of 2007 would also require originators (which, under the bill’s definition, would include lenders and brokers) to take into account the borrower’s ability to pay and to verify that borrowers receive a net tangible benefit before originating certain loans.⁵ S. 2452, as introduced in the Senate, would also require originators to, among other things, “make reasonable efforts to secure a home mortgage loan that is appropriately advantageous to the borrower, considering all the circumstances” and “follow reasonable and lawful instructions from the borrower.”

Another bill in the House of Representatives would promote national licensing of certain mortgage originators. The Predatory Mortgage Lending Practices Reduction Act, H.R. 2061, introduced by Representative Stephanie Tubbs Jones, would require certification of mortgage lenders specifically for subprime, federally related mortgage loans.⁶ Under H.R. 2061, the Secretary of the Department of Housing and Urban Development (HUD) would establish standards and procedures for suspension and revocation of the certification.

Additionally, some legislation that would regulate mortgage brokers also contains provisions for the regulation of mortgage lenders. For a discussion of these bills, see the “Mortgage Brokers” section, below.

Regulation of Other Participants in the Process

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

⁵ These requirements are described in greater detail in the “Suitability” section of this report.

⁶ The term “federally related mortgage loan” is defined by the Real Estate Settlement Procedures Act. 12 U.S.C. §2602. The term includes loans that are made by federally regulated lenders, are insured or originated by the government, are intended to be sold to Fannie Mae, Ginnie Mae, Freddie Mac, or the Federal Home Loan Mortgage Corporation.

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.

The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would require mortgage brokers to be licensed either by state or federal law. H.R. 3915 would give states time to enact licensing systems that comport with the bill's requirements. If any state did not enact licensing laws within 24 months, HUD would have the authority to establish and maintain a licensing system. The bill also would require a system of licensing and testing for loan originators and would proscribe a loan processor or underwriter from working as an independent contractor unless licensed or registered as a mortgage broker.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would create a fiduciary relationship between brokers and borrowers. As a fiduciary, a broker would have to "act in the best interest of the borrower ... and refrain from compromising the rights or interests of the borrower in favor of the rights or interest of another, ... and clearly disclose to the borrower ... all material information that might reasonably affect" the borrower's rights, benefits, and interests under a mortgage. S. 2452 also would prohibit brokers from "steering" borrowers into loans that are more expensive than loans for which they qualify. The bill would require brokers to use income documentation to verify a borrower's ability to pay. Reliance solely on statements of income made by borrowers would not be sufficient verification of ability to pay. S. 2452 would place additional restrictions on brokers, such as limiting the circumstances in which they may be compensated through yield spread premiums. The bill would extend civil liability for many Truth-in-Lending Act (TILA)⁷ violations to mortgage brokers.⁸

The Borrower's Protection Act of 2007 (S. 1299) would require mortgage originators (including mortgage brokers) to verify the ability of an applicant to repay a loan. The bill would also prohibit the practice of steering borrowers to mortgage products that are not advantageous to them. Lenders and brokers would be prohibited from mischaracterizing borrowers' credit histories or the appraised value of the property securing the loan.

The American Home Ownership Preservation Act of 2007 (S. 2114) would create a national registry of mortgage brokers. The Federal Financial Institutions Examinations Council (FFIEC) would be responsible for maintaining the registry and would be empowered to create rules for the database. At a minimum, the database

⁷ TILA is contained in Title I of the Consumer Credit Protection Act, P.L. 90-301 (1968), 81 Stat. 146, as amended by 15 U.S.C. § 1601 et seq. TILA is described in more detail in the "Disclosure Requirements" section of this report.

⁸ Currently, 15 U.S.C. § 1640, which pertains to civil liability for certain violations of TILA, only applies to creditors and their assignees. The bill would amend § 1640 to cover mortgage brokers, as well.

would include the name and address of each broker, along with credit and criminal background checks and fingerprints.

The Mortgage Broker Transparency and Accountability Act of 2007 (H.R. 3296) would establish an “agency relationship” between mortgage brokers and consumers. Mortgage brokers would have a duty to disclose the risks and benefits of the mortgages offered. Mortgage brokers would have to obtain and permanently maintain a bond. The bill would also prohibit steering to higher-cost mortgages as long as lower-cost products were available with the loan features requested by the borrower.

The Fairness for Homeowners Act of 2007 (H.R. 3081) would require mortgage brokers (and lenders) to verify the borrower’s ability to pay back the mortgage loan. It caps at 5% the amount of compensation in the finance charge for the loan that mortgage brokers (and lenders) can receive and prohibits any undisclosed compensation.

Under the Predatory Mortgage Lending Practices Reduction Act (H.R. 2061), the Secretary of HUD would make rules for mortgage brokers in subprime, federally related mortgage transactions. The rules would certify and test mortgage brokers for knowledge of applicable federal law, subprime lending, predatory lending, and the law regarding competency to contract.

Current regulation permits independent mortgage brokers to become FHA-approved lenders, but they must have a minimum net worth of \$250,000, and they must be sponsored by lenders. H.R. 1752, the Expanding American Homeownership Act, would place the requirements for mortgage brokers in statute by amending the National Housing Act. The bill would also change the eligibility requirements to permit mortgage brokers to become FHA-approved lenders if they are licensed in the state where the property is located, they post a \$75,000 surety bond, and they meet other FHA requirements.

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 the 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 bills that would regulate appraisals is the Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), which would require a written appraisal by a licensed appraiser in Home Ownership and Equity Protection Act (HOEPA)⁹ loan

⁹ Subtitle B of Title I of the Riegle Community Development and Regulatory Improvement Act, P.L. 103-325 (1994). HOEPA is codified as part of the Truth in Lending Act (TILA) at 15 U.S.C. § 1601 et seq. HOEPA is described in more detail in the “Disclosure (continued...)”

transactions. The bill, as passed by the House, would establish federal standards for appraisers and appraisal management firms. The bill would require that appraisers be independent and that they have no financial stake in the property they are appraising. It declares that seeking to influence an appraiser, related to any loan secured by the borrower's principal residence, would be an unfair and deceptive trade practice and establishes financial penalties that would be imposed for violations. The federal banking agencies and the Federal Trade Commission would be directed to jointly make rules for unfair trade practices relating to appraisals.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would provide that appraisers, in addition to other state and federal duties, "act with reasonable skill, care, diligence, and in accordance with the highest standards; and act in good faith and with fair dealing" with regard to any mortgage with which they are involved. S. 2452 also requires that all appraisals be "accurate and reasonable" and meet certain bond requirements. Additionally, the bill would prohibit servicers and lenders from providing appraisers with expected appraisal values or attempting to otherwise inappropriately influence appraisers and would require servicers and lenders to provide appraisal reports to all home loan applicants anytime an appraisal is conducted. The bill would require certain modifications of loans that were based upon appraisals that "exceeded the true market value by 10 percent or more."¹⁰

The Homebuyers Protection Act (H.R. 3535), which also seeks to regulate appraisals, would require a licensed appraiser to appraise a home in any mortgage transaction (currently only loans extended by federally regulated lenders require licensed appraisers). The Expanding Homeownership Act (H.R. 1852) and the Predatory Lending Reduction Act (H.R. 2061) would impose civil penalties against parties who attempt to influence an appraisal.

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.

⁹ (...continued)

Requirements" section of this report.

¹⁰ The bill would provide local authorities with the power to adjust this 10% threshold in certain situations.

The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would prohibit creditors from making residential mortgage loans unless they first determined that, on the basis of documentation at the time of the loan, borrowers had a “reasonable ability to repay the loan.” Regulations establishing what constitutes a reasonable ability to repay would be established by the Federal Reserve Board, the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Trade Commission. Determination of a consumer’s ability to repay would be based on factors that include current income, expected income, credit history, current obligations, and debt-to-income ratio. H.R. 3915 would also require that creditors determine that loans would constitute a “net tangible benefit” to the consumer. A loan would *not* represent a net tangible benefit if it refinanced an existing mortgage and the points and fees exceeded the amount of newly advanced principal. Violations of the “ability to repay” or “net tangible benefit” provisions of H.R. 3915 could result in liability not only for the lender but also for any assignee, including securitizers.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would set certain suitability standards on all home mortgage loans and more stringent standards on “subprime mortgage loans” and “nontraditional mortgage loans.” First, regarding all home mortgage loans, the bill would require originators to determine a borrower’s ability to pay the loan on the basis of individual financial characteristics similar to those provided in H.R. 3915, described above. The bill would also place limitations on yield spread premiums and provide protections to certain lease holders of properties that are foreclosed upon.

“Nontraditional mortgage loans” under the bill would be loans with terms that allow negative amortization or provide payment of only the loan’s interest. “Subprime mortgages loans” are loans with APRs that exceed certain thresholds in relation to prevailing Treasury securities or prime rates as established by the Federal Reserve Board’s H.15 publications. The bill would require originators of these two types of loans to verify that borrowers have a reasonable ability to pay the principal, interest, homeowner’s insurance, and property taxes based on individual financial characteristics. The bill would establish a rebuttable presumption that a borrower does not have a reasonable ability to pay a nontraditional mortgage loan or subprime mortgage loan if total monthly debts account for greater than 45% of the borrower’s monthly gross income. Additionally, originators would not be allowed to refinance an existing mortgage with a nontraditional mortgage loan or a subprime mortgage loan unless the refinanced loan provides the borrower with a “net tangible benefit,” as that term would be prescribed through rulemaking by the Federal Reserve Board. In addition to suitability standards, S. 2452 would wholly proscribe prepayment penalties and yield spread premiums in nontraditional and subprime mortgage loans, as well as require escrow accounts for the payment of property taxes and insurance for these loans.

Borrower Counseling. Several bills in the 110th Congress would increase the availability of borrower counseling in order to improve borrowers’ understanding of loan terms. The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would create an Office of Housing Counseling within HUD to coordinate counseling for home buyers and renters. The Homeownership

Protection and Enhancement Act of 2007 (S. 1386), emphasizes homeownership counseling and assistance. The bill would direct the Secretary of HUD to award competitive grants to enable state housing finance agencies to establish State Homeownership Protection Centers. S. 1386 would require lenders to notify borrowers of the availability of homeownership counseling and homeownership protection center services. Under special circumstances, it would allow a one-time emergency grant to help troubled borrowers remain in their homes.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would require that, for certain loans, either servicers or lenders provide borrowers certain disclosures regarding the availability of HUD-approved housing counseling agencies. Disclosures would have to be made at the time of settlement, when borrowers are 30 and 60 days delinquent on their mortgage payments, and before a lender or servicer “accelerates maturity of a mortgage obligation, commences legal action, including mortgage foreclosure ... or takes possession of [the property securing the mortgage]” The bill would also bar, for 45 days, lenders and servicers from initiating or continuing foreclosure proceedings against borrowers who have confirmed their participation in HUD-approved foreclosure prevention counseling. The bill, among other things, would mandate that lenders and servicers work with HUD-approved housing counseling agencies.

The Predatory Lending Reduction Act (H.R. 2061) would amend the Community Development Banking and Financial Institutions Act of 1994¹¹ to authorize the Community Development Financial Institutions Fund to make grants to nonprofit community development corporations for the education and training of borrowers and community groups regarding predatory lending practices.

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.¹² The authors found that borrowers (both prime and subprime) did not understand important mortgage costs

¹¹ 12 U.S.C. §4701 et seq.

¹² 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, [<http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>].

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.¹³ 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.¹⁴ TILA also gives borrowers the right to rescind the loan transaction within three days from the date of signing. The Federal Reserve Board implements TILA through Regulation Z.¹⁵ Several bills in the 110th Congress would make changes to TILA.

The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would amend TILA to require escrow accounts to be established for some borrowers in order to ensure sufficient funds for property taxes and insurance. This bill would also require, for certain loans, additional disclosures regarding terms such as variable rate adjustments, payments made to originators, and payment schedules.

The Fair Disclosure for Homeowners Act (H.R. 3705) would require a separate written notice under TILA when a borrower has an adjustable rate mortgage that is scheduled to reset. The Homebuyers Protection Act (H.R. 3535) and the American Home Ownership Preservation Act (S. 2114) would require TILA disclosures regarding mortgage brokers and mortgage broker fees. The Predatory Mortgage Lending Practices Reduction Act (H.R. 2061) would amend TILA to establish a set of best practices and require creditors to provide a good faith resolution of complaints.

The Home Ownership and Equity Protection Act. The 1994 Home Ownership Equity Protection Act (HOEPA) was enacted as an amendment to TILA.¹⁶ (For more information about HOEPA, see CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act*, by David H. Carpenter.) Borrowers of HOEPA loans must be provided with certain disclosures

¹³ 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.

¹⁴ 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.

¹⁵ 12 C.F.R. § 226.

¹⁶ HOEPA is implemented through Regulation Z, 12 C.F.R. Part 226, sections 31, 32, and 34.

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, which are basically loans provided for the purchase or initial construction of the homes securing the loans.¹⁷ 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 \$561.¹⁸

In light of the recent increase in subprime mortgage lending, proposals to add to HOEPA's protections have been advanced. The Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as approved by the House, would include home purchase loans in the definition of "high cost mortgages" covered by HOEPA. The bill would also reduce, in some instances, the fee thresholds that trigger HOEPA protections. The threshold for primary mortgages would be set at a level where the APR exceeds by more than 8% (10% for transactions less than \$50,000 and where "the dwelling is personal property") the prevailing rate on Treasury securities with comparable periods of maturity.¹⁹ For subordinate mortgages, the threshold would be set where the APR exceeds by more than 10% the prevailing rate on Treasury securities with comparable periods of maturity.²⁰ The bill would establish a third set of thresholds for any covered mortgage that (1) has total points and fees exceeding 5% of the total loan amount where the loan is for more than \$20,000; (2) has total points and fees exceeding \$1,000 or 8% of the entire amount of the loan, whichever is less, where the loan is for less than \$20,000; or (3) allows for prepayment penalties more than 36 months after closing or for prepayment penalties that are greater than 2% of the prepaid amount. The bill also would expand the charges that are to be considered points and fees for high-cost mortgages. H.R. 3915 would prohibit balloon payments on high-cost loans under certain circumstances, prohibit lending without regard to a borrower's ability to repay, disallow late fees that exceed certain levels, and require lenders to verify that borrowers have received counseling from a HUD-approved agency prior to entering into a high-cost mortgage transaction.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, also would make significant changes to HOEPA. These

¹⁷ These types of loans are often referred to as purchase money mortgages. Because of the exemption of "residential mortgage transactions," HOEPA's coverage is basically limited to certain secondary mortgages and refinances.

¹⁸ The \$561 figure is for 2008. The Federal Reserve Board adjusts this number annually based upon changes to the Consumer Price Index.

¹⁹ Treasury securities are measured "on the 15th day of the month preceding the month in which the application for the extension of credit is received by the creditor"

²⁰ The Board has the authority to adjust the APR thresholds, but 15 U.S.C. § 1602(aa)(2)(B) provides a floor and ceiling for such adjustments. The bill would establish different floors and ceilings for first mortgages and secondary mortgages.

changes would be very similar to those proposed by H.R. 3915. S. 2452 would amend the definition of “high-cost mortgages” to include home purchase loans. The bill also would change the triggers for HOEPA protections much like H.R. 3915. The most significant difference between the two bills on this matter is that S. 2452 would not provide for the points and fees trigger (three) that is based exclusively on prepayment penalties. The Homeownership Preservation and Protection Act of 2007 would place additional restrictions on HOEPA loans including prohibitions on certain balloon payments, certain acceleration clauses, compensation through certain yield spread premiums, and the refinancing of certain points and fees. Additionally, the bill would bar originators from refinancing an existing mortgage into a high-cost mortgage unless the new mortgage provides the borrower a net tangible benefit.

The Preservation of Federalism in Banking Act (H.R. 1996) would make national banks and federal savings associations subject to state laws that provide greater protections than those provided by HOEPA. Currently, approximately thirty states and the District of Columbia have enacted statutes similar to HOEPA, some of which offer much broader protections than those afforded under HOEPA.²¹ The Predatory Mortgage Lending Practices Reduction Act (H.R. 2061) would implement several new requirements for high-cost mortgages governed by HOEPA. The bill would require lenders that enter into high-cost mortgages to establish and maintain a best-practices plan in accordance with regulations that the Federal Reserve Board would be directed to prescribe; prohibit lenders from imposing or collecting fees on high-cost mortgages if they had not been previously disclosed; and require that all disclosures of charges and fees on high-cost mortgages be separately enumerated and clearly labeled and described.

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.²² The law requires lenders to provide estimates of settlement costs to borrowers. Among RESPA’s requirements are (1) advance disclosure of estimated settlement costs, referred to as a good faith estimate (GFE) to home buyers and sellers (a list of the actual closing costs must be provided to borrowers at the time of closing), (2) the elimination of kickbacks or referral fees among settlement service providers (e.g., brokers, lenders, title companies, and appraisers) that tended to cause unnecessary increases in the costs of certain settlement services, (3) a limitation in the amounts that buyers are required to place in escrow accounts for the payment of property taxes and hazard insurance, and (4) reform and modernization of local record keeping of land title information. 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.

²¹ See CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act*, by David H. Carpenter.

²² 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.

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.

In the 110th Congress, the Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915), as passed by the House, would amend RESPA to prohibit servicers of federally related mortgage loans from failing to adhere to other specified requirements including charging fees for answering “valid qualified written requests,” failing to timely respond to requests to correct certain errors, and taking out force-placed insurance²³ without a “reasonable basis” for believing that the borrower has not maintained required property insurance. H.R. 3915 would also amend RESPA’s GFE form to provide additional disclosures regarding variable rate adjustments, the percentage of the borrower’s monthly income that will go towards loan payments, and other terms. The Mortgage Disclosure Simplification Act (H.R. 3725) would amend RESPA to require lenders to submit to borrowers a one-page description of the “essential terms of the loan.” This would include the “best possible estimate” of the total loan amount, loan to value ratio, final maturity date, amount and due date of a balloon payment, prepayment penalties, the interest rate and corresponding monthly payment amount, the income on which the loan amount is based, the total amount of settlement charges, and the amount of fees paid to a broker.

The Homeownership Preservation and Protection Act of 2007 (S. 2452), as introduced in the Senate, would amend RESPA to require additional information to be included in the notice that must be submitted to borrowers by servicers each time a federally related mortgage is sold, transferred, or assigned to a new holder. This information would pertain to whether the debt is current, or when and why the debt became delinquent, the loan balance, the escrow balance, and the payment history.

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.²⁴ HMDA requires covered institutions²⁵ to report home mortgage originations by

²³ Force-placed insurance is insurance coverage obtained by a servicer to protect the mortgagee’s interest in the property.

²⁴ HMDA is implemented by the Federal Reserve Board Regulation C (12 CFR Part 203).

²⁵ Covered institutions or those 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, such as home improvements, are not reported under HMDA. Also, lenders that do not have offices in

(continued...)

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 that were rejected for loans.²⁶ In 2002, Congress expanded HMDA again to include the annual percentage rate and to require lenders to identify loans subject to HOEPA requirements; the law requiring loan rate or pricing information was implemented in 2004.²⁷

Currently, HMDA does not require lenders to report every variable used to evaluate applicants. Because the collected data is released to the public, there is concern about protecting the privacy of individuals. However, HMDA has 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. The Community Reinvestment Modernization Act (H.R. 1289) would expand the information required to be disclosed pursuant to HMDA to 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. The bill would also make manufactured home loans subject to HMDA requirements.

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. The subprime market may be considered a dual market. There is “good” subprime lending that opens up credit opportunities for higher-risk borrowers, and there is “predatory” subprime lending. (Although prime loans may also be predatory loans, they are most often subprime loans.) Under “good” subprime lending, the loans are made with terms that appropriately compensate the lender for the enhanced risk posed by the borrowers, and the terms include a reasonable return to the lender. The loans are marketed in a manner that is fair to borrowers and understandable by borrowers.

Predatory subprime lending is the opposite of good subprime lending. Predatory lenders make loans on terms that overcompensate the lenders for the risk posed by the borrowers. The loans are marketed on terms that are not fair to the borrowers or

²⁵ (...continued)

metropolitan statistical areas are not required to report HMDA data. See [<http://www.fdic.gov/news/news/press/2005/pr3005a.html>].

²⁶ P.L. 101-73, 103 Stat 183. Sections 1211(d) and 1212.

²⁷ P.L. 107-155, 116 Stat 81.

understandable to the borrowers. The loans are often actively and purposely marketed to low-income minorities and the elderly.²⁸

The 110th Congress has begun to examine the practices of predatory lending. The Senate Banking Committee held a hearing on February 7, 2007, entitled “Preserving the American Dream: Predatory Lending Practices and Home Foreclosures.” In addition, legislation has been introduced that contains provisions intended to address lending practices that could be considered predatory. These bills include H.R. 1289, H.R. 2061, and S. 1222, discussed below. H.R. 3915 and S. 2452, as discussed in-depth above, also seek to regulate some common predatory lending practices. Some of these proposed changes include ensuring that certain refinances provide a net tangible benefit to the borrower and augmenting disclosure requirements for certain loans. S. 2452 would also give banking regulators the authority to promulgate rules that establish unfair and deceptive acts or practices for each of the institutions they regulate.²⁹

The Community Reinvestment Modernization Act of 2007 (H.R. 1289) would amend the Community Reinvestment Act of 1977 (CRA) to provide that if a regulated financial institution is found to have engaged in a credit practice, such as predatory lending, that negatively affects a community or neighborhood, the loans would not count toward determining whether the institution is meeting the credit needs of the entire community. The institution’s CRA rating would then be reduced accordingly. The bill would also allow limits to be placed on the ability of the institutions to sell their loans to Fannie Mae, Freddie Mac, and Ginnie Mae.

The Predatory Mortgage Lending Reduction Act (H.R. 2061) would make it illegal to engage in any unfair or deceptive act or practice when providing mortgage lending or mortgage brokerage services on a subprime, federally related mortgage loan. HUD, the Federal Reserve, and the Federal Trade Commission would be able to jointly issue interpretive rules, statements of policy, and regulations defining such acts and practices. Violators would be subject to a civil penalty of up to \$10,000 for the first violation and up to \$20,000 for subsequent violations. H.R. 2061 would also amend the Consumer Credit Protection Act³⁰ to add a new title — the “Consumer Fairness Act.” The title would declare as unenforceable a provision in any consumer contract or transaction that requires binding arbitration to resolve any controversy arising out of the contract. An exception would be made for a written agreement entered into after a controversy occurs that calls for binding arbitration of that controversy.

Another bill, the Stopping Mortgage Transactions Which Operate to Promote Fraud, Risk, Abuse, and Underdevelopment Act (STOP FRAUD Act, S. 1222),

²⁸ National Predatory Lending Task Force, *Curbing Predatory Home Mortgage Lending: A Joint Report*, U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, June 2000, p. 69, available at [<http://www.huduser.org/Publications/pdf/treasrpt.pdf>].

²⁹ This authority would be provided by amending the Federal Trade Commission Act, 15 U.S.C. § 57a(f).

³⁰ 15 U.S.C. §1601 et seq.

would impose civil and criminal penalties against mortgage brokers and lenders that defraud consumers in the process of extending credit. The bill would also require lenders of home loans without certain disclosure features to go through the state judicial or administrative process in foreclosure. In addition, S. 1222 contains provisions that would allow borrowers going through foreclosure proceedings to assert defenses against assignees of the original mortgage lender.

For more information about predatory lending, see CRS Report RL34259, *A Predatory Lending Primer: The Home Ownership and Equity Protection Act*, by David H. Carpenter.

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 is considering legislation — and administrative agencies have taken action — aimed at encouraging borrower workouts and improving the availability of refinancing options. Legislation has also been introduced to remove the requirement that debt forgiveness be treated as taxable income.

Working with Borrowers

Thus far, there are no proposals to provide direct federal funding to pay off the debt of overextended borrowers. However, Congress has provided additional funding for housing counseling programs to assist troubled borrowers. Specifically, the FY2008 Consolidated Appropriations Act (H.R. 2764) provides \$180 million to the Neighborhood Reinvestment Corporation for mortgage foreclosure mitigation activities and \$50 million for HUD's housing counseling program. 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 — or helping borrowers refinance into loans with better terms. Both legislative and administrative actions have been taken to promote borrower workouts and refinances.

The Administration Proposal to Freeze Interest Rates. Treasury Secretary Henry Paulson has brokered an alliance, known as “The Hope Now Alliance,” between lenders, servicers, and investors, which sets voluntary guidelines under which some borrowers whose mortgage payments are set to rise may get temporary relief. The plan would provide 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.³¹

³¹ For more information about the Hope Now Alliance, see the program's web page, available at [<http://www.hopenow.com/>].

To qualify, 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.

Borrower Workouts. Federal and state financial regulating agencies have issued new guidance to regulated lenders encouraging loan restructuring for troubled borrowers to avoid foreclosure where feasible.³² The agencies include the Federal Deposit Insurance Corporation, the Federal Reserve, the Office of the Comptroller of the Currency, the National Credit Union Administration, the Office of Thrift Supervision, and the Conference of State Bank Supervisors. Loan servicers were instructed to review their full authority to modify loans for borrowers who are already delinquent and for borrowers for whom it is reasonably foreseeable that they will default. Despite recognition of subprime problems since January 2006, loan workouts do not appear to be occurring in large numbers. The head of the FDIC, Sheila Bair, has expressed frustration at the relatively low level of loan modification that is occurring.³³ In a recent speech, she said that less than 1% of troubled subprime loans have been restructured in any meaningful way.

Securitization might present an obstacle to borrower workouts in some cases. Many troubled loans were sold to special purpose trusts, which pass the payments on to investors. A private servicer is typically contracted to administer the loans on behalf of the trust according to a prearranged set of rules. In order to comply with the Real Estate Mortgage Investment Conduit (REMIC) tax rules, these trusts must remain passive. The passivity requirement could be interpreted as barring the trusts from granting servicers additional discretion to modify loans when market conditions are unanticipated. These issues are further complicated by accounting rules that lenders comply with when transferring the loans to the trusts, particularly FAS 140, which governs the definition of a true sale. Under the rule, it was unclear whether these loans held in trust could be modified if a default was reasonably foreseeable (instead of after a default had already occurred). Fear of lawsuits by frustrated investors could discourage some servicers from aggressively restructuring loans.

Recognizing potential limitations on borrower workouts due to securitization, the House Financial Services Committee sent a letter (June 15, 2007) to the Securities and Exchange Commission (SEC) requesting clarification of FAS 140. The SEC, which oversees the Financial Accounting Standards Board, responded (July 24, 2007) that a servicer who modified the loan of a borrower who was likely to become delinquent would not constitute active management and therefore should not be an obstacle to loan workouts. To date, the industry does not appear to have responded to these letters with a significant increase in borrower workouts.

³² “Federal Financial Regulatory Agencies and CSBS Issue Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages,” FDIC Press Release, September 4, 2007.

³³ Remarks by FDIC Chairman Sheila Bair at Clayton Holding, Inc. Investor Conference — New York, NY, October 4, 2007.

Refinancing. 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.

Two bills in the Senate — the Protecting Access to Safe Mortgages Act (S. 2036) and the Promoting Refinancing Opportunities for Mortgages Impacted by the Subprime Emergency (PROMISE) Act (S. 2169) — would temporarily raise the Fannie Mae and Freddie Mac portfolio caps by not less than 10% in order to help increase liquidity in the market and make loans more available for at-risk or troubled borrowers. S. 2036 would dedicate 50% of the additional funds under the higher portfolio caps to purchasing mortgages with resets between June 2005 and December 2009. The PROMISE Act (S. 2169) would devote 85% of the additional funds available under the portfolio cap increase “for the purpose of refinancing subprime mortgages at risk of foreclosure.” S. 2036, unlike the PROMISE Act, would also raise loan limits in high-cost areas so that Fannie Mae and Freddie Mac could purchase loans that they would not otherwise be able to (currently the GSEs may not purchase loans above \$417,000 for single-family properties). The provisions in S. 2036 would sunset one year after enactment of the bill; those in S. 2169 would sunset after six months.

Two similar bills in the House would raise the GSE portfolio caps (also by not less than 10%) but would not increase the \$417,000 loan limit. The Protecting Access to Safe Mortgages Act (H.R. 3777) does not specify how the increase in available funds under the portfolio cap would be used; its provisions would sunset one year after its enactment. The second bill, H.R. 3838, a bill to temporarily raise the mortgage caps applicable to Freddie Mac and Fannie Mae, like S. 2169, would devote 85% of funds available under the increased caps to refinancing mortgages at risk of foreclosure. The provisions in H.R. 3838 would sunset after six months.

In September 2007, the Administration announced a new, temporary program through which the Federal Housing Administration (FHA) will insure refinanced mortgages of troubled borrowers; the program is called FHASecure. 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 lenders to extend credit), as long as they can meet certain criteria, such as having sufficient income to support payments on the new loans.³⁴ The program will only accept loan applications signed no later than December 31, 2008.

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

³⁴ For HUD guidance on FHASecure, see [<http://www.fha.gov/reference/ml2007/07-11ml.doc>].

— 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.

Proposals have been made to exclude COD income from taxation. 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 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 Proposed Tax Exclusion for Canceled Mortgage Debt Income*, by Pamela J. Jackson and Erika Lunder.)

A rationale for excluding COD income has focused on minimizing hardship for households in distress. Policymakers have expressed concern that households experiencing hardship and possibly losing their homes, presumably as a result of financial distress, should not incur an additional hardship by being taxed on canceled debt income. Additionally, legislators have been pursuing Federal Housing Administration (FHA) and government-sponsored enterprise (GSE) reform efforts, in part to alleviate the current mortgage crisis. As efforts to minimize the rate of foreclosure are being made, lenders are, in some cases, renegotiating loans with borrowers to keep them in their homes. For some policymakers, the exclusion of canceled debt income may be a necessary step to ensure that homeowner retention efforts are not thwarted by tax policy.

Opponents of an exclusion of COD income might argue that the provision makes debt forgiveness more attractive for homeowners relative to current tax law and could encourage homeowners to be less responsible about fulfilling debt obligations.

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 package and sell them to investors, or keep them in their own portfolios. To finance their portfolios, they sell bonds and other debt to investors.

This buying and selling of existing mortgages has created a secondary mortgage market that has improved the efficiency of mortgage lending and lowered the interest rate that homeowners pay. Many economists and other analysts believe 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.

Regulation of Fannie Mae and Freddie Mac is split between two parts of HUD. The independent Office of Federal Housing Enterprise Oversight (OFHEO) is the safety and soundness regulator, while HUD's Financial Institutions Regulation Division establishes and monitors affordable housing lending goals. OFHEO has been the primary regulator during recent accounting problems, although the Securities and Exchange Commission (SEC) has also been involved. (For more information about accounting problems at Fannie Mae and Freddie Mac, see CRS Report RS21949, *Accounting Problems at Fannie Mae*, and CRS Report RS21567, *Accounting and Management Problems at Freddie Mac*, both by Mark Jickling.)

Both Fannie Mae and Freddie Mac have statutory exemptions from filing financial documents with the SEC, but both have voluntarily agreed to make these filings. Freddie Mac announced on July 12, 2002, that it would begin filing with the SEC, but its accounting problems have prevented it from doing so. Fannie Mae filed its 2004 annual report (form 10-K) with the SEC on December 6, 2006, which was approximately 21 months late. Neither GSE is yet filing current annual financial statements.

On May 23, 2006, Fannie Mae signed a consent order with OFHEO agreeing to limit its portfolio of mortgages and mortgage-backed securities to \$727 billion, the December 13, 2005, level. Freddie Mac agreed on July 1, 2006 to limit retained portfolio growth to 0.5% quarterly until the company can file financial reports on a timely basis. OFHEO has said that these limitations are likely to remain in place for several years.

The Federal Home Loan Bank System is comprised of 12 regional banks (the Banks) that collectively comprise the third housing GSE. Started in 1932 as lenders to the savings and loan associations that were the primary lenders for home mortgages, the Banks 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 — while 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 both mission and safety and soundness, the five-member Federal Housing Finance Board (FHFB) regulates the System. (For information on the FHLBs, see CRS Report RL32815, *Federal Home Loan Bank System: Policy Issues*, by Edward Vincent Murphy.)

On March 9, 2007, House Financial Services Committee Chairman Frank introduced H.R. 1427, the Federal Housing Finance Reform Act of 2007. The bill would change the regulation of the GSEs, consolidate oversight, and create the Federal Housing Finance Agency (FHFA) as an independent regulator with authority similar to that of bank regulators. H.R. 1427 would give the Federal Housing Finance Agency explicit authority to adjust the enterprises' risk-based capital and, in specific circumstances, to limit the size of their portfolios for limited periods of time. The bill would also create an affordable housing fund (see discussion below). Hearings on the legislation were held on March 12 and March 15, 2007. On March 29, 2007, the House Financial Services Committee approved H.R. 1427 and reported it to the House floor. The House passed H.R. 1427 on May 24, 2007, and sent it to the Senate where it was referred to the Banking, Housing, and Urban Affairs Committee.

On April 12, 2007, Senator Hagel introduced S. 1100, The Housing Enterprise Regulatory Reform Act of 2007. S. 1100, like H.R. 1427, would abolish OFHEO and establish an independent agency to oversee the GSEs, with enhanced safety and soundness, disclosure, and enforcement tools. S. 1100 differs from H.R. 1427 on provisions to enable the new agency to monitor and control the GSEs' investment portfolios, and S. 1100 does not include an affordable housing fund. On November 16, 2007, Senator Jack Reed introduced S. 2391, the Government-Sponsored Enterprise Mission Improvement Act. The bill does not include the same regulation and oversight provisions as S. 1100, but it would define new affordable housing goals for the GSEs, establish a duty to serve underserved markets, and establish an affordable housing fund. Neither H.R. 1427, S. 1100, nor S. 2391 have been considered in the Senate. (For more information about GSE reforms in H.R. 1427 and S. 1100, see CRS Report RL33940, *H.R. 1427 and S. 1100: Reforming the Regulation of Government-Sponsored Enterprises*, by Mark Jickling, Edward Vincent Murphy, and N. Eric Weiss.)

Affordable Housing Fund. As noted earlier, H.R. 1427 would create an affordable housing fund, which would be funded by contributions from Fannie Mae and Freddie Mac on the basis of a percentage of their total mortgage portfolios (essentially, mortgages retained in portfolio plus those guaranteed and sold regardless of the form, such as mortgage backed securities). The primary purpose of the fund in H.R. 1427 would be to increase housing opportunities for extremely low- and very low-income homeowners and renters. Specifically, the funds could be used for the production, preservation, and rehabilitation of rental and homeownership housing, as well as for related infrastructure costs.

In the first year of the Affordable Housing Fund, money would be allocated to areas affected by the 2005 hurricanes. In years two through five, H.R. 1427 would distribute the funds to the states and recognized Indian tribes using a formula to be developed by HUD. The states would develop plans to further distribute the funds to for-profit, not-for-profit, and faith-based organizations. The bill would end the requirement for Fannie Mae and Freddie Mac to contribute money to the fund after five years.

The House bill contains a provision that would transfer the affordable housing funds to a National Affordable Housing Trust Fund, if such a trust fund is enacted (see discussion below).

S. 2391 would create two GSE affordable housing programs with contributions from Freddie Mac and Fannie Mae. The first, which would be called the Affordable Housing Block Grant Program, would distribute 65% of GSE contributions by formula to the states. The states, in turn, could use the funds to increase and preserve rental housing for very low- and extremely low-income households, as well as to promote homeownership among these households. In 2008, all of the resources in the Affordable Housing Block Grant Program would be used to assist borrowers facing foreclosure. Money would be distributed by the Secretary of HUD to states and tribally designated housing entities based on a formula. The bill would require the Secretary to develop a formula to distribute funds that would be based on (1) population, (2) the 90-day delinquency rate, and (3) the ratio of foreclosures to owner-occupied households in the state.

The remaining 35% of GSE contributions would be directed to a second affordable housing program, the Capital Magnet Fund, that would be within the existing Community Development Financial Institutions (CDFIs) Fund in the Department of the Treasury. The CDFI Fund promotes economic and community development through assistance to community development financial institutions, which typically provide loans and financial services in under-served neighborhoods. The new Capital Magnet Fund would award competitive grants with the purpose of attracting private capital and supporting investment in housing for low-income, very low-income, and extremely low-income households, as well as economic development activities and community service facilities. Grantees, including community development financial institutions and private nonprofit organizations, could use funds to capitalize a revolving loan fund, an affordable housing fund, or a fund to support economic development activities; to provide loan loss reserves; and for risk sharing loans.

Like the House bill, S. 2391 provides that, if a National Affordable Housing Trust Fund were to be enacted, funds from both the National Affordable Housing Block Grant Program and the Capital Magnet Fund would be transferred to the Trust Fund.

National Affordable Housing Trust Fund. The affordable housing fund portions of both H.R. 1427 and S. 2391 include a provision requiring that the affordable housing funds be transferred to a National Affordable Housing Trust Fund upon enactment of such a trust fund. A National Affordable Housing Trust Fund would provide a dedicated source of revenue to support affordable housing. A coalition of low-income housing organizations, led by the National Low Income Housing Coalition (NLIHC), has advocated establishment of such a trust fund for several years. Legislation to create a National Affordable Housing Trust Fund using a portion of Federal Housing Administration (FHA) receipts as the dedicated source of revenue was introduced, but not enacted, in the 106th, 107th, and 108th Congresses. Since FHA receipts are currently deposited in the U.S. Treasury, diverting them to a housing trust fund would count as new spending. In the 109th and 110th Congresses,

the NLIHC advocated including an affordable housing fund provision funded by non-federal resources in GSE reform legislation.

The most recent National Affordable Housing Trust Fund bill was introduced on June 27, 2007, by House Financial Services Committee Chairman Frank and several bipartisan cosponsors. The National Affordable Housing Trust Fund Act of 2007 (H.R. 2895) proposes to use affordable housing funds created by the GSE and FHA reform bills (discussed below) to provide formula grants to states and localities and competitive grants to Indian Tribes. The funds could be subgranted to for-profit and non-profit organizations for the creation, rehabilitation, or financial support of rental housing as well as downpayment and closing cost assistance for first-time homebuyers. The bill would require that all funds be used to benefit families at or below 80% of local area median income, and that 75% of all funds be used to benefit families at the higher of 30% of local area median income or the poverty line. The bill was approved by the House Financial Services Committee on July 31, 2007 and was passed by the House on October 10, 2007.

On December 19, 2007, Senator Kerry introduced legislation to create a National Affordable Housing Trust Fund (S. 2523). The Senate bill is largely the same as the House bill.

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 Loan Insurance Program: An Overview*, by Bruce E. Foote and Meredith Peterson.)

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%.³⁵ The mortgages insured through the FHA program are also judged to have

³⁵ 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>].

become increasingly risky.³⁶ 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.³⁷

The Expanding American Homeownership Act (H.R. 1852). On September 18, 2007, the House passed H.R. 1852, the Expanding Homeownership Equity Act. The bill aims to make FHA loans more marketable by increasing the loan amount insured under the program, making it easier for low-income borrowers to get FHA loans without down payments, and pricing mortgage insurance premiums according to borrower risk.

FHA mortgage limits are set on an area-by-area basis, and under current law, loans on one-family homes are limited to the lesser of 95% of the median home price for an area, or 87% of the conforming loan limit for Freddie Mac and Fannie Mae. As passed by the House, H.R. 1852 would limit FHA loans to the lesser of 125% of the area median or 175% of the Freddie Mac conforming loan limit. In addition, H.R. 1852 would give HUD authority to raise these resulting loan limit amounts by up to \$100,000 by area and/or by unit size if market conditions warrant. The bill would also increase the maximum loan term from 35 to 40 years, and allow first-time home buyers to be exempt from the 3% down payment requirement.

Under current law, HUD may collect from borrowers an up-front FHA mortgage insurance premium of up to 2.25% of the loan amount.³⁸ HUD may also collect an annual premium of up to 0.55% of the loan balance for the full term of the loan from borrowers making downpayments of less than 5%. HUD may collect an annual insurance premium of 0.50% of the loan balance from borrowers making downpayments of 5% or more, but borrowers making downpayments in excess of 10% only have to pay this annual insurance for the first 11 years of the mortgage.

For zero or low downpayment borrowers, H.R. 1852 would allow FHA to increase its up-front premium to 3%, and would increase the annual premium to 0.75%. HUD would be directed to establish underwriting standards to provide mortgage insurance for borrowers with FICO credit scores of less than 560, and such borrowers would pay an up-front mortgage insurance premium of up to 3% of the mortgage amount. For loans insured after October 1, 2007, HUD would have the flexibility to charge up front and annual insurance premiums based upon the risk that the low downpayment and high risk borrowers posed to the FHA insurance fund. (For more information about this issue, see CRS Report RS22662, *H.R. 1852 and Revisiting the FHA Premium Pricing Structure: Proposed Legislation in the 110th Congress*, by Darryl E. Getter.)

³⁶ Senate Appropriations Committee, report to accompany H.R. 5576, the Transportation, Treasury, Housing and Urban Development Appropriations Act 2007, 109th Cong., 2nd sess., S.Rept. 109-293, July 26, 2006.

³⁷ *Ibid.*

³⁸ Administratively, HUD has set the insurance premium at 1.5% of the loan amount.

H.R. 1852 would allow FHA to set mortgage insurance premiums on the basis of the risk that the borrower poses to the FHA insurance fund. The bill would then permit FHA to reduce the insurance premiums for borrowers who establish a record of timely mortgage payments. HUD would have the *discretion* to reduce the insurance premiums to high risk borrowers who make timely payments for three years. HUD would be *required* to reduce the insurance premiums to high risk borrowers who make timely payments for five years.

Under present law, HUD may insure no more than 275,000 home equity conversion mortgages (HECMs), a limit that HUD has already reached. The maximum mortgage limit for HECMs is set on an area-by-area basis. H.R. 1852 would amend the National Housing Act to remove the limit on the number of HECMs that may be insured, and provide that the national mortgage limit for HECMs would be 100% of the Freddie Mac limit. The bill would also permit HECMs to be used for the purchase of a one- to four-family home by an elderly borrower who would occupy one of the units as a principal residence. HECMs could also be used to purchase shares in cooperatives. Limits would be placed on the amount of origination fees that may be charged to HECM borrowers. (For more information on HECMs, see CRS Report RL33843, *Reverse Mortgages: Background and Issues*, by Bruce E. Foote.)

In addition to the provisions noted above, H.R. 1852 would require HUD to include the rate of default and foreclosure on zero and no downpayment mortgages in its annual reports to Congress. The report would also include actions taken by HUD with respect to loss mitigation on its single-family housing programs. Borrowers would be able to use FHA insured home loans to purchase single-family homes to be used as child care facilities and the maximum loan could be increased by up to 25%. The National Housing Act would be amended to permit FHA-insured loans to borrowers who wanted to refinance out of high cost privately-insured mortgages. Borrowers in default or at risk of default would be able to refinance into FHA-insured loans. For each fiscal year, the net increase in the negative credit subsidy for the mortgage insurance programs under Title II of the National Housing Act would be appropriated for several purposes. For FY2008 through FY2012, up to \$100 million would be appropriated for increased funding for housing counseling; up to \$25 million would be appropriated for improving technology, procedures and salaries; and the remainder would be appropriated for an Affordable Housing Fund (discussed previously).

The FHA Modernization Act (S. 2338). On December 14, 2007, the Senate passed S. 2338, the FHA Modernization Act. The bill would increase the FHA loan limit to 100% of the conforming loan limit for Freddie Mac. Currently the loan limit on one-family homes is the lesser of 95% of the median home price for an area or 87% of the conforming loan limit for Freddie Mac and Fannie Mae. The bill would require borrowers to contribute 1.5% in cash or its equivalent towards the purchase of the home. The required funds could come from relatives of the borrower, but borrowers could not use funds from either sellers or third parties reimbursed by sellers. According to the Senate Banking Committee's report, both HUD and the Government Accountability Office have found that loans with seller-funded down

payments “have led to significant losses for the FHA fund.”³⁹ Another provision of S. 2338 would place a 12-month moratorium on the implementation of risk-based premiums for FHA-insured mortgages.

The Senate bill would make changes to the Home Equity Conversion Mortgage (HECM) program that are similar to those proposed in the House bill. Like H.R. 1852, the Senate bill would remove the limit on the number of HECMs that may be insured through the FHA program. In addition, the mortgage limit for HECMs would be set at 100% of the Freddie Mac limit. The Senate bill would also permit HECMs to be used for housing cooperatives. Under S. 2338, HECMs could be used for the purchase of one- to four-unit properties as long as the borrower occupied one of the units as a principal residence. Origination fees on HECMs would be limited to 1.5% of the value of the home.

The Senate bill would also establish a five-year pilot program that would allow lenders to use an automated process to underwrite FHA-insured loans to borrowers without sufficient credit histories. This process would allow lenders to take account of payment histories that are not always included in credit reports. According to the Senate Banking Committee’s report, borrowers with low credit scores may have a history of on-time payments for items such as rent or utilities, for example, but these payments are not necessarily included in credit reports (S.Rept. 110-227).

Another provision in the Senate bill would increase the loan limits on the Title I Manufactured Housing Loan Insurance program. Under current law, the FHA loan limit on manufactured homes is \$48,000; S. 2338 would increase the loan limit to more than \$69,000. Future increases in the manufactured loan limit would be made annually and would be based on an index that HUD would be directed to develop. The bill would also prohibit the charging of kickbacks and unearned fees in transactions involving manufactured housing.

Additional provisions in S. 2338 would direct HUD and FHA, in consultation with the lending industry, to develop and implement a plan to improve FHA’s loss mitigation process. The bill would also establish a three-year pre-purchase counseling demonstration program. The demonstration program would test alternative forms of pre-purchase counseling, including telephone counseling, in-person counseling, web-based counseling, and counseling classes.

GSE and FHA Provisions in the Economic Stimulus Act

The Economic Stimulus Act of 2008 (H.R. 5140), which was approved by both the House and Senate on February 7, 2008, includes provisions that temporarily increase the size of loans that Fannie Mae and Freddie Mac can purchase, and that FHA can insure. (For more information about these provisions, see CRS Report RS22799, *The Recovery Rebates and Economic Stimulus for the American People of 2008 Act and Jumbo Mortgages*, by N. Eric Weiss.)

³⁹ See S.Rept. 110-227.

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. The limit for any area is the greater of (1) the 2008 conforming loan limit (\$417,000); or (2) 125% of the area median house price, but no more than 175% of the 2008 conforming loan limit (\$729,750, which is 175% of \$417,000). In addition, FHA would be able to insure mortgages in high-cost areas up to this same \$729,750 limit. The authority for FHA to insure these mortgages would expire December 31, 2008. Currently the FHA limit ranges from \$200,160 to \$362,790 in high-cost areas.

Housing After the 2005 Hurricanes

Hurricanes Katrina, Rita, and Wilma, which struck Gulf Coast states in the fall of 2005, had an enormous effect on the housing stock in that region. Studies estimate that the hurricanes and their related flooding damaged 1.2 million housing units in Louisiana, Mississippi, Florida, Texas, and Alabama.

Of the 1.2 million damaged housing units, more than 305,000 were severely damaged.⁴⁰ Severe damage includes real or personal property loss above certain dollar thresholds.⁴¹

- Louisiana, specifically New Orleans, had the highest percentage of severely damaged units; approximately 67%, or 204,737 renter- and owner-occupied homes with severe damage were located in Louisiana.⁴²
- Of the 305,000 severely damaged units in all five affected states, most were owner occupied — about 63% or 193,000 homes.⁴³
- More than half of the 193,000 severely damaged, owner-occupied units lacked flood insurance (55%) and about a quarter of them lacked any insurance (23%).⁴⁴

⁴⁰ CRS analysis of data found in U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *Current Housing Unit Damage Estimates: Hurricanes Katrina, Rita, and Wilma*, February 12, 2006, available at [http://www.huduser.org/Publications/pdf/GulfCoast_HsngDmgEst.pdf].

⁴¹ For a detailed breakdown of damage that qualifies as severe, see *ibid.*, pp. 4-5.

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ *Ibid.*

- Approximately 112,000 rental units in the five affected states were severely damaged.⁴⁵
- Of the 112,000 severely damaged rental units, 13%, or approximately 14,500 units, were HUD subsidized.

On February 6, 2007, the House Financial Services Committee held a hearing to discuss federal housing efforts in response to the 2005 hurricanes. Much of the discussion at that hearing focused on the slow pace of rebuilding, as well as the future of the damaged federally assisted housing stock. On March 7, 2007, the Committee approved the Gulf Coast Hurricane Housing Recovery Act of 2007 (H.R. 1227), which was subsequently approved by the full House on March 21, 2007. On September 25, 2007, the Senate Banking Committee held a hearing entitled “Two Years After the Storm: Housing Needs in the Gulf Coast.” The hearing discussed, but did not consider, S. 1668, a version of the Gulf Coast Housing Recovery Act of 2007 sponsored by the Committee Chairman (Senator Dodd) and Senator Landrieu. (For more information, see the “Legislation” section below.)

Rebuilding

Although private insurance will pay some of the cost of rebuilding housing in the affected states, federal funds are part of the effort as well. In the first year, the federal response included \$15.3 billion paid out under the National Flood Insurance Program; \$10.4 billion in Small Business Administration (SBA) disaster loans; \$6 billion from the Federal Emergency Management Agency (FEMA) in the Individuals and Households Assistance Program; \$4.8 billion in reimbursements to Alabama, Louisiana, and Mississippi for activities such as debris removal; and nearly \$975 million approved in Community Disaster Loans. FEMA also approved housing and rental assistance including travel trailers, mobile homes, and personal housing repairs for 1.6 million households.⁴⁶ Additional funds included more than \$19 billion in Community Development Block Grant (CDBG) funds to the five affected states (Louisiana, Mississippi, Florida, Texas, and Alabama) to help with rebuilding efforts.⁴⁷ (For more information, see CRS Report RL33761, *Rebuilding Housing After Hurricane Katrina: Lessons Learned and Unresolved Issues*, by N. Eric Weiss.)

⁴⁵ Testimony of HUD Deputy Secretary Roy A. Bernardi before the House Committee on Financial Services Hearing “Federal Housing Response to Hurricane Katrina” February 6, 2007, (hereafter “Katrina Hearing”), available at [http://www.house.gov/apps/list/hearing/financialsvcs_dem/htbernardi020607.pdf].

⁴⁶ Federal Emergency Management Agency, By the Numbers — One Year Later: FEMA Recovery Update for Hurricane Katrina, August 22, 2006, available at [<http://www.fema.gov/news/newsrelease.fema?id=29109>]. All numbers are as of August 18, 2006.

⁴⁷ Emergency CDBG funds were provided in P.L. 109-148, P.L. 109-234, P.L. 110-116. For more information, see CRS Report RL33330, *Community Development Block Grant Funds in Disaster Relief and Recovery*, by Eugene Boyd.

Many Members of Congress have expressed displeasure at the perceived slow pace of rebuilding after Katrina.⁴⁸ While there are indications that the pace of rebuilding is quickening,⁴⁹ many areas have not been rebuilt and many families are still displaced. According to FEMA, in February 2007, 90,000 families still lived in temporary housing and 35,000 families were still receiving rental assistance 17 months after the storm.⁵⁰ Factors behind the delay include the length of time it took to develop and approve rebuilding plans, the pace of infrastructure repairs in the neighborhoods and surrounding communities, the decisions on the future of damaged public housing units, and the size and timing of private insurance settlements to homeowners seeking to return to those neighborhoods.

Another rebuilding issue involves the rehabilitation and/or rebuilding of federally assisted housing in areas damaged by the 2005 hurricanes. At the February 6, 2007 hearing before the House Financial Services Committee, HUD Deputy Secretary Roy Bernardi testified that of the 5,100 occupied public housing units damaged in New Orleans during Hurricane Katrina, nearly 2,000 were habitable and approximately 1,200 are occupied or would be shortly.⁵¹ However, members of the Financial Services Committee questioned HUD's plans to demolish the approximately 4,100 units in the four largest public housing developments and replace them with mixed income housing. HUD's demolition plans have been met with opposition from tenant organizations and low-income housing advocates, and several lawsuits have been filed.⁵² Provisions included in H.R. 1227 and S. 1668 (discussed below) are designed to limit HUD's ability to demolish public housing.

Oversight

As noted earlier, Congress has appropriated tens of billions of dollars toward hurricane recovery and relief. Given its large investment, Congress has conducted several oversight hearings and requested many oversight reports on how effectively and efficiently the recovery and rebuilding money is being spent.

⁴⁸ See Opening Remarks of Honorable Maxine Waters, Katrina Hearing, available at [http://www.house.gov/apps/list/hearing/financialsvcs_dem/oswaters020607.pdf]; and David Hammer, "Senate Democrats Vow to Fix Disaster Recovery," *New Orleans Times Picayune*, January 29, 2007, available at [http://www.nola.com/newslogs/tpupdates/index.ssf?/mtlogs/nola_tupdates/archives/2007_01_29.html#231017].

⁴⁹ Brookings Institution, Katrina Index: Tracking Recovery of New Orleans and the Metro Area, in collaboration with the Greater New Orleans Community Data Center, January 2007, [<http://www.gnocdc.org/KI/KatrinaIndex.pdf>].

⁵⁰ Statement of David Garratt, Acting Director of Recovery, Federal Emergency Management Agency, Department of Homeland Security, Katrina Hearing, available at [http://www.house.gov/apps/list/hearing/financialsvcs_dem/htgarratt020607.pdf].

⁵¹ Deputy Secretary Bernardi's testimony is available at [http://www.house.gov/apps/list/hearing/financialsvcs_dem/htbernardi020607.pdf].

⁵² See Julia Cass and Peter Whoriskey, "New Orleans to Raze Public Housing: Many Units Closed Since Katrina to Be Demolished, Despite Protests," *Washington Post*, December 8, 2006.

Much of the assistance provided to displaced families immediately after Hurricane Katrina was in the form of individual and household direct assistance from FEMA. The Government Accountability Office (GAO) has found that system to be fraught with waste, fraud, and abuse.⁵³ In response to these and other concerns, Congress has enacted several pieces of legislation aimed at improving the flexibility and accountability of FEMA, and may consider others in the 110th Congress.⁵⁴

In addition to concerns about waste, fraud, and abuse, Congress has expressed concern about the slow pace of spending in the funding it has provided for helping families rebuild their homes. Congress thrice appropriated Community Development Block Grant (CDBG) funds to Gulf Coast states affected by the 2005 hurricanes to help rebuild homes and infrastructure. The first amount disbursed was \$11.5 billion, the second amount was nearly \$5.2 billion, and the third amount was \$3 billion (to be used exclusively for Louisiana). Each state that received funds — Louisiana, Mississippi, Florida, Texas, and Alabama — was required to develop and have approved by HUD a plan for how it would use the funds. HUD approved the state plans in the late spring and early summer of 2006, so funds have begun to be released to households and to local communities.⁵⁵ At the House Financial Services Committee Hearing on February 6, 2007, HUD Deputy Secretary Roy Bernardi testified that approximately \$1.2 billion in CDBG funds had been expended. Committee members expressed concern at the slow disbursement rate, particularly regarding the Louisiana “Road Home” program, in which only 400 claimants had received funds.

Ongoing Housing Assistance

Both HUD and FEMA have provided ongoing rental assistance through two programs for tenants displaced by the 2005 hurricanes. HUD has been providing rental assistance through the Disaster Voucher Program (DVP) to households that lived in HUD-assisted housing or were homeless prior to Hurricanes Katrina and Rita. FEMA provided rental assistance to any other tenant or homeowner in need of housing assistance. Beginning on December 1, 2007, HUD assumed administration of the FEMA rental assistance program for the program’s duration. This new arrangement was announced on April 26, 2007.⁵⁶

⁵³ U.S. Government Accountability Office, *Unprecedented Challenges Exposed the Individuals and Households Program to Fraud and Abuse; Actions Needed to Reduce Such Problems in Future*, GAO Report GAO-06-1013, September 2006.

⁵⁴ For more information, see CRS Report RL33729, *Federal Emergency Management Policy Changes After Hurricane Katrina: A Summary of Statutory Provisions*, coordinated by Keith Bea.

⁵⁵ Office of the Federal Coordinator for Gulf Coast Rebuilding, *Continuing Progress: A 1-Year Update on Hurricane Recovery and Rebuilding*, August 2006, available at [https://www.dhs.gov/xlibrary/assets/GulfCoast_Katrina1yearFactSheet.pdf].

⁵⁶ 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, Fact Sheet: Providing Continued Assistance for Gulf Coast Hurricane Victims, available at [<http://www.hud.gov/news/releases/>]
(continued...)

Although both the HUD DVP program and the FEMA program (which is now administered by HUD) provide rental assistance to disaster victims, the two programs operate differently. HUD provides DVP rental assistance through vouchers. The voucher is similar to a Section 8 voucher, and may be used to help pay for rent anywhere in the country as long as a landlord is willing to accept it. One year after Hurricane Katrina, HUD estimated that 25,000 households had been assisted through DVP;⁵⁷ at the February 6 hearing before the House Financial Services Committee, Assistant Secretary Bernardi testified that about 12,000 families were still participating in the program. DVP was originally scheduled to end September 30, 2007, at which time families were expected to transition back onto the programs from which they were initially displaced. However, the FY2007 supplemental appropriations act (P.L. 110-28) extended the period of DVP availability to December 31, 2007. There are remaining questions regarding what will happen to families who were homeless before the storm and those whose homes are still under construction. Provisions included in H.R. 1227 and S. 1668, The Gulf Coast Hurricane Housing Recovery Act (discussed below) would further extend the length of time families could receive DVP assistance. (For more information about DVP see CRS Report RL33173, *Hurricane Katrina: Questions Regarding the Section 8 Voucher Program*, by Maggie McCarty.)

FEMA began providing short-term rental assistance to disaster victims just after Hurricanes Katrina and Rita struck; after six months, in February of 2006, FEMA began to convert the short-term assistance to longer-term rental assistance (up to 18 months). The assistance has been extended twice more since then. On February 28, 2007, President Bush extended the assistance for an additional six months. On April 26, 2007, the President announced that HUD would assume administration of the program, and assistance would be extended through March 1, 2009. After an initial delay, HUD assumed administration of FEMA's rental assistance program on December 1, 2007, for the 28,000 people that were still being served.⁵⁸ A floor amendment added to H.R. 1227 would provide for otherwise income-eligible families still receiving rental assistance or living in trailers to transfer into the Section 8 voucher program upon expiration of their FEMA assistance.

Although HUD has assumed administration of FEMA's rental assistance program, FEMA has continue to administer the trailer program; in November 2007, over 50,000 families affected by the hurricanes resided in trailers.⁵⁹ FEMA has begun offering tenants an opportunity to purchase their trailers, and beginning in January

⁵⁶ (...continued)
pr07-051.cfm], accessed April 30, 2007. Hereinafter "HUD News Releases."

⁵⁷ *Continuing Progress: A 1-Year Update on Hurricane Recovery and Rebuilding*.

⁵⁸ See HUD New Release, "Rental Payments Continue for Remaining Katrina/Rita Households in Rental Housing: FEMA-HUD Disaster Housing Assistance Program (DHAP) Launched Dec. 1, 2007," December 4, 2007, available at [<http://www.hud.gov/news/release.cfm?content=pr07-176.cfm>].

⁵⁹ See FEMA News Release, "Myths & Facts: Travel Trailers," November 8, 2007, available at [<http://www.fema.gov/news/newsrelease.fema?id=41647>].

2008, HUD and FEMA will work to transition eligible families out of trailers and into rental housing in the private market.

Under the FEMA and HUD joint agreement, beginning in March 2008, both families receiving rental assistance and those living in trailers will be required to pay a portion of the cost of their housing. Each month, the amount they are required to contribute will increase, with an exemption made for elderly and disabled families.⁶⁰

Legislation

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. Key provisions are summarized below.

CDBG-related provisions would

- authorize and fund a pilot program in Louisiana to acquire certain individual properties for the purpose of aggregating them and making them available for development.
- prohibit FEMA from withholding hazard mitigation funds from Louisiana on the basis of a provision in the Louisiana Road Home program that penalizes families who do not agree to live in the state.
- require quarterly reports from GAO on CDBG spending.
- make other changes to the treatment of CDBG funds for purposes of (1) individual eligibility for other disaster-related assistance and (2) meeting match requirements in other programs.

Public and Assisted Housing related provisions would

- require HUD to conduct a survey of displaced New Orleans public housing residents to determine their interest in returning.
- require the Housing Authority of New Orleans (HANO) to make available for occupancy by August 1, 2007, the greater of 3,000 public housing units or a number of units sufficient to house families wishing to return.
- prohibit HANO from demolishing or disposing of public housing without a plan to replace each unit with a public housing (or other comparable) unit.
- guarantee a right of return to all New Orleans public housing residents wishing to return.
- place restrictions on the demolition and disposition of other public housing units in the disaster areas and require PHAs to offer a right of return for displaced families.

⁶⁰ See HUD News Releases.

- authorize such sums as necessary to rehabilitate, repair, and/or redevelop public housing in New Orleans, including the cost of providing supportive services to tenants.
- authorize the extension of the Disaster Voucher Program through January 1, 2008, and permit families to transfer their DVP vouchers to the regular voucher program upon expiration of the DVP program.
- clarify the allocation of FY2007 Section 8 voucher renewal funding for disaster-affected areas.
- direct the Secretary to approve feasible proposals to preserve project-based rental assistance connected to damaged privately owned multifamily rental properties.
- authorize such sums as necessary to supply replacement vouchers for public housing or private multifamily project-based rental assistance units that will not be rebuilt.
- authorize such sums as necessary to create 4,500 new project-based vouchers for use in supportive housing for the homeless, seniors and persons with disabilities in the Hurricane-affected regions, 3,000 of which would be available for the state of Louisiana, upon request.

Other provisions would

- authorize a transfer of funds from FEMA to HUD to be used to reimburse landlords for damages incurred as a result of their participation in FEMA's city lease program.
- give the Secretary of HUD the authority to either take title of or make insurance payments on behalf of certain FHA-insured single-family properties that did not have hazard or flood insurance.
- provide for otherwise income-eligible FEMA housing assistance recipients to transfer to the Section 8 voucher program upon termination of their FEMA assistance.
- require GAO to study the distribution of federal funds to Gulf Coast states.
- commend Americans for the rebuilding efforts.

Several of these provisions proved controversial during both committee markup and floor consideration. Amendments were considered, but rejected, that would have struck the authorization of additional vouchers and would have limited the amount of funds authorized for rebuilding public housing.

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, including a pilot program to use CDBG funds for development in Louisiana, a requirement that the Housing Authority of New Orleans make at least 3,000 public housing units available to residents, and the extension of the Disaster Voucher Program (to June 30, 2008), together with the right of tenants to convert DVP vouchers to regular vouchers. The bill was referred to the Senate Banking Committee, which held a hearing on September 25, 2007.

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-income individuals and families who struggle to afford housing.⁶¹ Affordable housing remains beyond the reach of many, however. According to the Harvard Joint Center for Housing Studies, in 2005, 8.2 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 22.3%).⁶² While moderate-income renters were not immune from severe rent burdens, low-income renters faced the greatest burdens; over 85% of severely cost burdened renters were in the bottom quintile of the income distribution.⁶³ Further, HUD, in its most recent report on worst case housing needs, found that in 2005, 5.99 million unassisted, very low-income renters either paid more than half their income in rent or lived in severely substandard housing.⁶⁴ This was an increase from 5.01 million renters in 2001, from 4.76% of all households to 5.50%.⁶⁵ 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.⁶⁶ 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, but Congress appropriated over \$2 billion more than was recommended by the President for FY2008.

⁶¹ Housing is generally considered affordable if it costs no more than 30% of a family’s income.

⁶² Joint Center for Housing Studies of Harvard University, *The State of the Nation’s Housing 2007*, June 2007, pp. 25, 37 available at [<http://www.jchs.harvard.edu/publications/markets/son2007/son2007.pdf>].

⁶³ *Ibid.*, p. 37.

⁶⁴ 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>].

⁶⁵ *Ibid.*, p. 13.

⁶⁶ *Overview of the President’s 2009 Budget*, p. 5, available at [<http://www.whitehouse.gov/omb/budget/fy2009/pdf/budget/overview.pdf>].

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 has been declining. With fewer fees to offset the cost of the HUD budget, the President and Congress have had to find additional dollars to keep the overall budget at the same level. (For more information see CRS Report RL34022, *The Department of Housing and Urban Development: FY2008 Appropriations*, coordinated by Maggie McCarty.)

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 the abolishment of the existing Section 8 housing choice voucher program and its replacement 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 changes⁶⁷ have all worked together to limit growth in the cost of a voucher within the structure of the current program. The other rationale for 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 109th 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), has been introduced in the 110th Congress. The bipartisan bill is sponsored by Chairwoman Waters of the subcommittee of jurisdiction in the House. It 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

⁶⁷ For more information, see CRS Report RS22376, *Changes to Section 8 Housing Voucher Renewal Funding, FY2003-FY2006*, by Maggie McCarty.

vouchers in each of the next five years. On July 12, 2007, the bill was approved by the full House. (For more information, see CRS Report RL34022, *Section 8 Housing Choice Voucher Program: Issues and Reform Proposals in the 110th 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 2007 proration was 83%, meaning that agencies received 83% 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 requires 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 also contained a requirement that PHAs convert to a new type of management, called asset-based management, by 2011. Currently, PHAs are able to centrally manage their public housing stock, meaning a PHA can 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. 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 2008, they must prove that they have converted to asset-based management by the deadline set by HUD.

There have been two main controversies surrounding this process, with the first concerning the deadline. HUD's initial guidance stated that PHAs must prove that

they have converted to asset-based management by April 15, 2007 in order to stop their losses in the first year.⁶⁸ A subsequent draft notice published by HUD stated that the deadline was October 15, 2007.⁶⁹ HUD then published a statement on its website that the April 15 deadline was the correct deadline. PHA advocacy groups actively lobbied for HUD to use the October 15, 2007 deadline, and asked Members of Congress to support legislation requiring HUD to use that deadline.⁷⁰ On April 10, 2007, HUD announced that it was postponing the deadline to October 15, 2007.⁷¹

The second controversy surrounds how PHAs should demonstrate that they have converted to asset-based management. HUD published preliminary guidance in September 2006.⁷² PHA industry groups have argued that HUD's guidance is "overly prescriptive," and have lobbied for HUD to make modifications, particularly in relation to fee schedules HUD has proposed.⁷³ 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 opportunity to look into the issue further."⁷⁴ On September 25, 2007, the House Financial Services Committee approved H.R. 3521, Public Housing Asset Management Improvement Act of 2007. The bill would prohibit HUD from publishing a management fee schedule before FY2011 and without first undertaking negotiated rulemaking, and it would extend exemption from asset-based management requirements from agencies with 250 or fewer units to those with 500 or fewer units. Several of these provisions were included in the FY2008 appropriations law (P.L. 110-161).

HOPE VI Reauthorization. The HOPE VI program provides competitive grants to PHAs for the demolition and/or revitalization of distressed public housing.

⁶⁸ HUD, PIH Notice 2006-14, Operating Fund Program Final Rule: Transition Funding and Guidance on Demonstration of Successful Conversion to Asset Management to Discontinue the Reduction of Operating Subsidy, issued March 22, 2006.

⁶⁹ HUD, "Public Housing Operating Fund Program; Revised Transition Funding Schedule for Fiscal Year 2008 Through Fiscal Year 2012," 71 *Federal Register* 68404, November 24, 2006.

⁷⁰ Letter from Council of Large Public Housing Authorities, National Association for Housing and Redevelopment Officials, and Public Housing Authorities Directors Association to HUD Secretary Alphonso Jackson, dated December 6, 2006.

⁷¹ HUD's website, accessed April 18, 2007, at [<http://www.hud.gov/offices/pih/programs/ph/am/>].

⁷² 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.

⁷³ 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>].

⁷⁴ "Committee Chairs Weigh In on Asset Management Implementation," National Low Income Housing Coalition, Memo to Members, vol. 12, no. 3, January 19, 2007.

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 Mikulski and Senator 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."⁷⁵

A House HOPE VI reauthorization bill — The HOPE VI Improvement and Reauthorization Act of 2007 (H.R. 3524)⁷⁶ — was approved by the full House on January 17, 2007. The bill is sponsored by Representative 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."⁷⁷ (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-income

⁷⁵ 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>].

⁷⁶ 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.

⁷⁷ 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].

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.⁷⁸ 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.⁷⁹ The mortgages on a further 2,328 HUD properties, representing 237,000 housing units, are expected to mature by 2013.⁸⁰ 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).⁸¹ 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.⁸²

In 1997, the Multifamily Assisted Housing Reform and Accountability Act (MAHRA, P.L. 105-65) created the Mark-to-Market program.⁸³ 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-

⁷⁸ 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.

⁷⁹ National Housing Trust, *HUD-Assisted, Project-Based Losses by State*, March 2, 2005, available at [http://www.nhtinc.org/prepayment/State_Loss_Report.pdf].

⁸⁰ 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>].

⁸¹ ELIHPA was part of the Housing and Community Development Act of 1987 (P.L. 100-242).

⁸² 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>].

⁸³ Mark-to-Market is codified at 42 U.S.C. §1437f, note.

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.

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.

The Section 202 Supportive Housing for the Elderly Act (H.R. 2930) was approved by the House on December 5, 2007. The bill 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 would also allow refinancing if 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. The bill 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), payment of developers fees, and for equity returns to nonprofit sellers. In addition, H.R. 2930 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).

A provision was added during House Financial Services Committee markup that would allow Section 202 project owners to give a preference to homeless elderly applicants. Another addition to the bill 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 the conditions. (For more information on the Section 202 program, see CRS Report RL33508, *Section 202 and Other HUD Rental Housing Programs for the Low-Income Elderly*, by Libby Perl.)

Other Preservation Legislation. H.R. 44, the Stabilizing Affordable Housing in the Future Act, has been introduced in the 110th Congress. The bill would require HUD to maintain rental assistance contracts on multifamily units it manages or owns due to mortgage default or foreclosure. In cases where HUD-owned or HUD-managed property is no longer able to be rehabilitated, H.R. 44 would permit HUD to contract with owners of other properties to make project-based rental assistance payments for existing tenants. Another provision would require that in cases where HUD disposes of multifamily properties, the property must be appraised according to industry standards (another bill in the 110th Congress, H.R. 655, would do the same).

Another bill, 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 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. While 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).

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 program (SRO). Unlike the ESG program, the three competitive grant programs focus on transitional and permanent supportive housing for the homeless. (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 110th Congress, two 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.

The two bills, H.R. 840 and S. 1518, are similar in that they 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. 840 and the Community Homeless Assistance Program in S. 1518 (the President has also urged the consolidation of these three programs in his last six 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. H.R. 840 would authorize the homeless assistance grants at \$2.5 billion for FY2008, and S. 1518 would provide an authorization level of \$2.2 billion. However, in S. 1518, permanent housing contracts would be renewed 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,” although each would do so in a different way. 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. H.R. 840 would include in the definition persons who are sharing housing due to economic hardship and those living in hotels, motels, or campgrounds due to a lack of alternative accommodations. H.R. 840 would also include in the definition those individuals residing in transitional housing, not just transitional housing for the mentally ill, as in current law. In addition, H.R. 840 would include substandard housing in the list of accommodations in which a person would be considered homeless (the list also includes cars, parks, abandoned buildings, and bus or train stations).

S. 1518 would also expand the definition of “homeless individual” to include individuals and families who are sharing housing, but unlike H.R. 840, 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.

Both S. 1518 and H.R. 840 would allow more funds to be used for homelessness prevention activities. Under current law, only ESG funds can be used for homelessness prevention activities; the other three homeless assistance grants cannot be used for prevention. H.R. 840 would allow up to 3% of Continuum of Care Program funds to be used to prevent homelessness, and would remove the ESG restriction that not more than 30% of funds be used to prevent homelessness. 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, at least 40% would be available for activities such as rental assistance and housing relocation for persons at risk of homelessness.

S. 1518 would also create a separate process for rural communities to apply for grants, while in the House bill, rural communities would be part of the same application process in the Continuum of Care Program as non-rural areas. S. 1518

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. Unlike the Community Homeless Assistance Program, however, rural communities would be able to serve persons who do not meet HUD's definition of "homeless individual;" the bill 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.

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