RSC Republican Study Committee

Rep. Jeb Hensarling (R-TX), Chairman
Russ Vought, Executive Director
132 Cannon House Office Building
Washington, DC 20515

www.house.gov/hensarling/rsc ph (202) 226-9717 / fax (202) 226-1633

Legislative Bulletin……………………………………..……July 23, 2008

Contents:

H.Res. 1363 – Providing for consideration of House amendments to the Senate amendments to H.R. 3221 - American Housing Rescue and Foreclosure Prevention Act

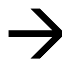
---

H.Res. 1363 – Providing for consideration of House amendments to the Senate amendments to H.R. 3221 - American Housing Rescue and Foreclosure Prevention Act (*Frank, D-MA*)

This Legislative Bulletin features a one-pager of takeaway points on the composite housing/GSE bill that the House is scheduled to consider on Wednesday the 23rd, as well as some background and analysis on each of these main points of the legislation. H.Res. 1363 will allow for one motion to amend the latest Senate version of H.R. 3221 with a 694-page House amendment. Only two hours of debate will be allowed. This procedure would shut down all possibility of amending the new House language in any way, including via motion to recommit.

NOTE: While this Bulletin is based on review of actual text, because such text was made available at 6:30pm the night before floor consideration, not every detail of the bill is summarized here. Perhaps the most sweeping changes to housing law in a generation were circulated to offices just 16 hours prior to floor consideration and will be given just two hours of debate time.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718



ONE-PAGE TAKEAWAY POINTS FOR HOUSING COMPOSITE BILL

$300 Billion Taxpayer Bailout of Mortgage Lenders and Borrowers. The bill would create a new, voluntary program for borrowers and existing mortgage loan holders to allow the Federal Housing Administration (FHA) to provide up to $300 billion in new loan guarantees (mortgage insurance) to refinance mortgages on properties at risk of foreclosure. Some conservatives may be concerned that this provision would put the taxpayer at grave financial risk, grow the size of government, reward bad behavior, punish good behavior, weaken retirement savings, and be an unconstitutional overreaction to a problem that is more limited and regional than the media portray and that is already fixing itself through market corrections.

Affordable Housing Trust Funds. The bill would require the GSEs to contribute 4.2 cents per $100 of the value of their mortgage portfolios to TWO new affordable housing funds to transfer money to the low-income-housing activities of nonprofits like ACORN and La Raza nationwide. Although the haste with which this legislation is being moved through Congress is based largely on the impression that the GSEs are financially in trouble, this provision would siphon money away from the GSEs and further put them in financial straits.

Taxpayer Equity in Fannie and Freddie. The bill would provide unlimited authority to the Treasury, through 2009 at its discretion and in agreement with the GSEs, to purchase equity in the GSEs. This equity-buying authority would be subject to the federal debt limit (which would be raised by $800 billion to accommodate this authority), and the assistance would be considered mandatory spending when granted by the Treasury. Some conservatives may be concerned about the federal government owning a portion of private companies and about the constitutionally questionable act of placing an unlimited mandatory spending decision of this nature into the hands of an executive agency, not Congress. CBO estimates the cost of this provision and the borrowing authority discussed subsequently at $25 billion over two years.

Borrowing Authority for Fannie and Freddie. The bill would give the Treasury unlimited authority through 2009 to lend funds to the GSEs. Some conservatives may be concerned that such authority would further expose the taxpayer to greater financial risk, while creating a dangerous precedent for bailouts of private entities.

Community Development Block Grants. The bill would appropriate $4 billion in additional Community Development Black Grant (CDGB) funds for communities to buy, rehabilitate, and resell foreclosed homes. Some conservatives may question the constitutionality of the federal government buying, fixing up, and selling homes.

Fingerprint Registry. The bill, as part of the federal licensing requirements for mortgage lenders, would require that anyone related to the selling and servicing of mortgages be fingerprinted for a federal database. Some conservatives may be concerned that this requirement is a massive invasion of privacy without reasonable justification.

Federal Housing Administration Reform. The bill would permanently increase the availability of FHA loan guarantees and prohibit FHA from using risk-based pricing for one year for the mortgage guarantees it offers. Some conservatives may be concerned that the FHA increases would allow FHA insurance to be obtained by more people who are not the true targets of FHA and crowd out the private market. Further, conservatives have supported risk-based premiums in the past and thus would likely oppose this one-year moratorium.

"World Class" Regulator for Fannie and Freddie. The bill would establish a more robust regulator—the Federal Housing Finance Agency (FHFA)—for government-sponsored enterprises (GSEs) involved in the home mortgage market (Fannie Mae, Freddie Mac, and the Federal Home Loan Banks) and increase the conforming loan limits for the GSEs. Conservatives have assertively argued for years that the creation of a more robust regulator for the GSEs would help constrain them to the bounds of their respective charters, prevent questionable accounting practices, and otherwise keep the GSEs on sound financial footing (eliminating the need for a taxpayer-backed bailout). However, some conservatives may object to the need to increase the GSE conforming loan limits, which expands their purview.

Tax Increases. The bill contains two multi-billion-dollar tax increases and a controversial credit-card reporting provision.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718

BACKGROUND and ANALYSIS OF KEY ISSUES in HOUSING BILL

GSE Reform

Government-Sponsored Enterprises (GSEs)

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are government-sponsored enterprises (GSEs) created to facilitate a *secondary* mortgage market. That is, GSEs are privately owned, congressionally chartered financial institutions created to enhance the availability of credit for residential mortgages—particularly lower-income home mortgages. As the Republican staff of the House Budget Committee described GSEs, "they are shareholder-owned, for-profit companies whose operations are fully funded by private capital sources."

Under their charter, GSEs exist to buy mortgages from lenders in the *primary* mortgage market and package them into securities (mortgage-backed securities) for sale to investors. With the old loans off their books, lenders in the primary market can then make additional loans to consumers. The GSEs also guarantee that they will step in to make payments to investors if homeowners fail to meet their mortgage payments. Currently, the GSEs are regulated by the Department of Housing and Urban Development's Office of Federal Housing Enterprise Oversight, commonly known as OFHEO.

GSEs also purchase assets (mainly these same mortgage-backed securities) for their own investment portfolios in order to provide profits to their shareholders. Often, these assets have nothing to do with their core mission of providing liquidity to the primary residential mortgage market for lower-income buyers. Fannie and Freddie own or guarantee about $5.2 trillion of U.S. home mortgages, nearly half of those outstanding.

Fannie Mae and Freddie Mac's charter came with significant government subsidies not enjoyed by their private sector competitors, including a $2.3 billion line of credit with the U.S. Treasury (i.e., borrowing at below-market rates), an exemption from state and local taxes, and an exemption from certain Securities and Exchange Commission (SEC) registration requirements (including fees as publicly traded companies). In addition, as a result of these government subsidies, Fannie Mae and Freddie Mac benefit from an *implicit* guarantee that the debt they issue is backed by the full-faith-and-credit of the U.S. Treasury, making GSE debt instruments almost as attractive to investors as government bonds.

GSEs thus make their money on the difference between their relatively low borrowing costs (investors loan the GSEs money at lower interest rates because of the implied backing of the federal government) and the investment returns on their assets.

In 2003, Freddie Mac admitted that it had used improper accounting policies to create the appearance of steady earnings growth and issued a restatement of financial results. OFHEO imposed a $125 million fine and pursued civil actions against several former Freddie Mac executives. Similarly, in 2004, OFHEO issued a public report that was highly critical of accounting methods at Fannie Mae. OFHEO charged that Fannie Mae has not followed generally accepted accounting practices, allowing Fannie Mae to present investors with an artificial picture of steadily growing profits, and, in at least one case, to meet financial performance targets that triggered the payment of "cookie jar" bonuses to company executives.

Such recent accounting failures led many lawmakers and commentators to conclude that current regulatory framework of OFHEO governing the GSEs is inadequate. Hence, conservatives have called for the federal government to provide for a stronger regulatory framework.

"World Class" Regulator for Fannie and Freddie

Background and Previous Conservative Efforts. The GSEs current regulator (OFHEO) has not held the GSEs to the same standards of loss-protection to which other financial institutions are held by other regulators. For example, as the Budget Committee notes, most commercial banks have capital-to-assets ratios (reserves of cash) of about 5%. The GSEs, though they have a more risks than banks, are only required to have a capital-to-asset ratio of about 2.5% (though in reality they have about 1.5%).

Although the GSEs' problems have been mounting for years (*The Wall Street Journal* editorial page noted recently that it has been calling for reining in the GSEs since 2002), the current housing market has accelerated and accentuated these problems. The increased number of overstretched owners, the increased number of pre-foreclosure write-downs, the increased number of foreclosures, and the slowing demand for real estate have combined to significantly devalue their mortgage-backed assets and put tremendous pressure on the GSEs already-thin reserves. Investors have thus lost some confidence in the GSEs, causing their stock prices to tumble (down about 80% over last year).

The GSEs have also used their implicit federal backing and perceived lower risk to expand their activities and expenditures far beyond their congressional charter. Recently, the Politico reported: "If you want to know how Fannie Mae and Freddie Mac have survived scandal and crisis, consider this: Over the past decade, they have spent nearly $200 million on lobbying and campaign contributions. But the political tentacles of the mortgage giants extend far beyond their checkbooks. The two government-chartered companies run a highly sophisticated lobbying operation, with deep-pocketed lobbyists in Washington and scores of local Fannie- and Freddie-sponsored homeowner groups ready to pressure lawmakers back home."

National Public Radio recently reported that, "In the first three months of the year alone, Fannie Mae and Freddie Mac spent a combined total of about $3.5 million on lobbying and hired 42 outside firms." According to the Center for Responsive Politics, Fannie Mae and Freddie Mac have been such prolific donors to political parties, candidates, and PACs that they are the #1 and #3 top contributors in the mortgage industry and rank in the Top 100 political donors of all time. The GSEs are also prolific donors to nonprofits.

Conservatives for years have demanded that the GSEs be reined in through a more robust regulator. In fact, many conservatives publicly declared that they would have supported legislation creating this more robust regulator and stricter standards for the GSEs, if not for the inclusion of an Affordable Housing Trust Fund (discussed below) in the legislation. The GSEs could have already been subject to stricter standards and a new regulator (likely eliminating the need for a GSE bailout) if the Democrat Majority had not so consistently insisted that the Affordable Housing Trust Fund, which itself would unnecessarily siphon away resources from the GSEs, be attached to any GSE reform bill.

Republican Alternatives. Accordingly, Rep. Scott Garrett (R-NJ) has introduced a "clean" GSE reform bill which would create a stronger regulator and more responsible capital standards for the GSEs—without an Affordable Housing Trust Fund provisions. In addition, RSC Chairman Jeb Hensarling (R-

TX) is developing legislation to fully privatize the GSEs—removing their federal charter and thus terminating the implicit backing of the federal government for the GSEs.

New Regulator. The bill under consideration on the House floor this week would establish the Federal Housing Finance Agency (FHFA) to regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs) and replace OFHEO. The new independent agency would be headed by a Director, appointed by the President and confirmed by the Senate, for a term of five years. In addition, the bill would require the appointment of three deputy directors; one to supervise the GSEs, one to oversee the FHLBs, and the other to focus on the affordable housing mission of the GSEs (see below).

Safe and Sound. The new regulator would have to ensure that regulated entities operate in a "safe and sound manner," maintain adequate capital and internal controls, and contribute to "liquid, efficient, competitive, and resilient national housing finance markets that minimize the cost of housing finance."

Corrections. If a GSE failed to meet the new standards (as detailed in the bill), FHFA would issue a plan to correct the deficiency and would be charged with either freezing an entity's total assets or requiring an increase in its capital stocks, if the plan was not adhered to (in the case of a GSE being undercapitalized).

Charitable Contributions. The GSEs would have to publicly report the annual amount of charitable contributions to nonprofit organizations made in the previous fiscal year. The report would have to identify the name of the nonprofit and the amount of the individual contribution if over a "designated amount" (to be set by the regulator).

Assessments. The new regulator would collect annual assessments from the GSEs to provide for its costs and expenses and any enforcement proceedings against them and to punish them for being undercapitalized. These assessments are not to be construed as government funds (although the amounts collected and spent are recorded for federal budget purposes as receipts and outlays). This provision effectively frees the regulator from the appropriations process, ensuring a certain level of independence.

Executive Compensation. The new regulator could require a GSE to withhold compensation to its executive officers for any fraudulent act or omission, breach of trust or fiduciary duty, insider abuse, or violation of any law, regulation, or order.

Capital Adjustments. The new regulator could adjust the risk-based capital requirements and provide for minimum capital levels to ensure the safety and soundness of the GSEs. The Director could, by order, increase minimum capital levels on a temporary basis, if the regulated entity has violated prudential standards or if an unsafe or unsound condition exists. The regulator could also review on a periodic basis the assets and liabilities of each GSE, and if necessary, require by order the disposal or acquiring of an asset or liability.

New Business Activities. The GSEs would have to receive approval from the new regulator *before* undertaking any new programs or business activities *(though any current ones, some of which may be inconsistent with the GSEs charter, would be grandfathered in*). The regulator would be required to note such an application in the Federal Register and allow for a period of public comment. Approval would then be granted on the basis of whether the new activity is consistent with the GSEs' chartering statutes, the safety and soundness of the enterprise, the public interest, and the efficiency of the mortgage finance system.

Conforming Loan Limits. The conforming loan limits (loans that are to be sold to the GSEs must "conform" with these limits) would be set at:

- $417,000 for a single-family residence,
- $533,850 for a two-family residence,
- $645,300 for a three-family residence, and
- $801,950 for a four-family residence

These limits would have to be increased or decreased each year depending on a new housing index the new regulator would be directed to establish by surveying the housing market.

In addition, the bill would allow for the GSEs to further increase the loan limit in "high cost areas" where the median price for such size residences exceeds the conforming loan limit. The adjustment would be up to the lesser of 150% of the loan limit (in 2005, $540,000 was 150% of the single-family conforming loan limit) or the area median home price and would apply only to mortgages that are the basis for securities sold by the enterprises. Some conservatives may be concerned that this provision will lead to an overly broad application of "high-cost area," lessening the cost (via federal subsidies) of housing for consumers who are not necessarily low- or middle-income and crowding out private competitors. Others have argued that the high-cost adjustments are needed in certain areas where real estate is extremely expensive and "middle class" is defined by higher incomes than in the rest of the country.

Low-Income Family Goals. The new regulator would have to set annual single-family and multi-family goals for the GSEs to purchase mortgages benefiting low-income families and families living in low-income areas (defined in the bill). In addition, the bill would add a duty for the GSEs to serve "underserved markets," including in rural areas, by developing certain loan products and flexible underwriting guidelines. GSEs would be required to provide the regulator with sufficient information to determine if minorities are charged a different interest rate than are non-minorities.

Affordable housing goals are already a part of current law to ensure that the GSEs, which benefit from substantial federal subsidies, are not driven solely by profit but also a commitment to expand housing to low-income families in low-income areas. However, the GSEs have typically not met their goals, and the current regulatory structure has lacked the power to force compliance.

Current Regulator Abolished. The Office of Federal Housing Enterprise Oversight (OFHEO), the GSEs' current regulator, would be abolished six months after this bill's enactment, with all its functions transferred to the new regulator (FHFA). All regulations, orders, resolutions, and determinations made by OFHEO or a court would remain in force, and become enforceable by FHFA. Some conservatives may be concerned that this six-month gap may allow or encourage GSEs to expand into new activities before the new regulations take effect.

Treasury Secretary Paulson's GSE Plan

Taxpayer Equity in, and Borrowing Authority for, the GSEs

On July 13, 2008, the Treasury Department released a proposal designed to immediately stabilize the GSEs after their stock prices plummeted. One aspect of this proposal, which has been incorporated into this composite housing legislation, would provide temporary authority to the Secretary of the Treasury through the end of 2009 to purchase any amount of obligations and other securities issued by

the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBs). In other words, the federal government could become part owner of one or more GSE, upon agreement with such GSE (and could terminate such ownership at any time). Such purchasing would have to be necessary to "provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer."

This equity-buying authority would be subject to the federal debt limit (which would be raised by $800 billion to accommodate such authority), and the assistance would be considered mandatory spending when granted by the Treasury. Thus, if considered under regular order, this legislation would violate PAYGO if not offset. Some conservatives may be concerned about the federal government owning a portion of private companies, about making explicit the backing of the GSEs by the federal government, and about the constitutionally questionable act of placing an unlimited mandatory spending decision of this nature into the hands of an executive agency, not Congress.

Also part of the Treasury Department proposal of July 13th, and incorporated into this composite bill, is a provision giving the Treasury Department unlimited authority through the end of 2009 to lend funds to the GSEs. The Federal Reserve has recently granted both Fannie Mae and Freddie Mac access to the Fed's so-called "discount window," which will provide the companies short-term loans, in exchange for collateral. This step was approved by the Federal Reserve System itself and did not need to be approved by Congress. Under current law, the Secretary has permanent authority to purchase debt securities issued by the GSEs up to a total of $2.25 billion from each. Some conservatives may be concerned that such authority would further expose the taxpayer to greater financial risk, while creating a dangerous precedent for bailouts of private entities.

This borrowing authority, combined with the equity authority, reflects a significant reversal of years of efforts by the Bush Administration to distance the federal government from the GSEs. If all the authority were fully implemented, the federal government would directly fund, lend to, and own a portion of Fannie Mae and Freddie Mac. (The Federal Home Loan Banks, for now, remain sufficiently capitalized and thus would likely not have to trigger these new authorities.)

The Congressional Budget Office (CBO) estimates the expected federal cost (taking into account the probability of various possible scenarios) from the equity-buying and borrowing authority would be $25 billion over fiscal years 2009 and 2010. Many conservatives may regard this $25 billion figure as a gross underestimation of what the real figure will be. Currently, the GSEs are capitalized at about $80 billion (as compared to mortgage-backed assets of over $5 trillion). It's difficult to see how a $25 billion equity purchase this year will truly be sufficient for the GSEs.

Affordable Housing Trust Funds

While most conservatives have supported the notion of creating a single regulator overseeing the GSEs and reining them in from exceeding their congressional charters, conservative opposition to GSE reform legislation in recent years has centered largely on the Affordable Housing Fund.

The bill would require the GSEs to contribute 4.2 cents per $100 of the value of their mortgage portfolios (the unpaid principal balance of its total new business purchases) to TWO new affordable housing funds created by the bill to support the low-income-housing activities of nonprofits like ACORN and La Raza nationwide. 65% of this effective tax on the GSEs would be for now-infamous Housing Trust Fund; 35% of this tax would be for a Capital Magnet Fund.

Housing Trust Fund.

Grants, which would first pass through the states and then be passed onto housing-related entities, could be used only for:

- the production, preservation, and rehabilitation of rental housing for extremely and very low-income families;
- the production, preservation, and rehabilitation of housing for homeownership (including downpayment assistance, closing cost assistance, and assistance for interest-rate buy-downs) for extremely and very low-income first-time home buyers; and
- public infrastructure development activities in connection with housing activities funded above.

Grant funds could be provided only to organizations, agencies, or entities (including for-profit, non profit, or faith-based entities) with a demonstrated capacity for carrying out eligible housing activities, and that make assurances to the grantee (as required by the regulator) that they will comply with the requirements of the program. All funds would have to be used or committed within two years of the grant date, or be subject to recapture.

The regulator would have to set forth prohibited uses of grant amounts, which would have to include use for:

- political activities;
- advocacy;
- lobbying, whether directly or through other parties;
- counseling services;
- travel expenses;
- preparing or providing advice on tax returns;
- administrative, outreach, or other costs of the grantee or any recipient of such grant amounts (except those for carrying out the program required under this section).

There is no language prohibiting funds from the Housing Trust Fund from going to entities, like ACORN, whose employees or volunteers have been indicted or pleaded guilty for vote fraud. Such language appears in the bill for the Community Development Block Grant funds.

Capital Magnet Fund.

The Capital Magnet Fund would be used by the Secretary of the Treasury to carry out a competitive grant program to attract private capital for, and increase investment in, the development, preservation, rehabilitation, or purchase of affordable housing for low-income families, as well as economic development activities or community service facilities that serve to stabilize or revitalize a low-income area. Eligible grantees would be community development financial institutions or nonprofits developing or managing affordable housing. The list of prohibited activities mirrors those for the Housing Trust Fund above.

Conservative Concerns. Many conservatives have noted the irony in the fact that, although the haste with which this legislation is being moved through Congress is based largely on the impression that the GSEs are financially in trouble, the Affordable Housing Trust Fund would siphon money away from the GSEs and potentially put them in financial straits.

Many conservatives have regarded the required GSE contributions to the Fund as a tax on publicly-traded corporations. Arguably, since the GSEs constitute a duopoly, they have a heightened ability to pass this "contribution" on to consumers—thus making housing *less* affordable rather than more.

Furthermore, despite the provisions of the Affordable Housing Fund section that restrict the use of grants, many conservatives in the past have expressed concerns that the Fund could still be used by liberal entities to displace other funds. Money is fungible, so that if a group cannot use Fund grants for political activities, it could certainly have more money freed up for political activities because of the injection of Fund grants.

The largest organizations (and thus the most able to commit resources to apply for federal grants) who work on affordable housing issues include, for example, ACORN (widely known for voter fraud), National Council of La Raza (allegations of voter fraud in the Bob Dornan-Loretta Sanchez election of 1996), and Housing Works (led a demonstration against Senator Rick Santorum for his anti-needle exchange and pro-abstinence voting record). These entities unquestionably, and sometimes unabashedly, engage in partisan, liberal political activities.

ACORN, the Association of Community Organizations for Reform Now, is actually an umbrella organization for more than 75 entities, most of which are run out of a single office in New Orleans. Among these entities are unions, schools, radio stations, home mortgage counseling centers, tax advising centers, voter-mobilization organizations, lobbying firms, and even a furniture company. For example, the Service Employees International Union Local 880 once listed its contact email as seiu880@acorn.org (it changed its email address when the Employment Policies Institute highlighted this address in a report). Estimates of ACORN's annual operation budget range from 30 to 40 million dollars. The Employment Policies Institute reports that large amounts of money move back and forth from various elements of the ACORN network all the time.

Furthermore, a recent report by the Consumers Rights League documented how ACORN has:

--threatened lenders in order to secure financial resources for itself;
--lobbied extensively and successfully for the lowering of lending standards (which have contributed significantly to the current increase in foreclosures nationwide);
--worked to obtain mortgages for illegal workers; and
--maintained consistent coordination between its tax-exempt and its political (non-tax-exempt) activities.

ACORN workers have also *pleaded guilty* to voter fraud this year, confirming that these voter fraud accusations are not just the fantasies of conservative minds.
http://www.freerepublic.com/focus/f-news/1995724/posts

To see a letter that RSC Members sent to then-Majority Leader Tom DeLay (R-TX), opposing the Affordable Housing Fund, go here:
http://www.house.gov/hensarling/rsc/doc/GSE%20slush%20fund.pdf.

NOTE: A coalition of conservative groups and individuals, including the American Conservative Union, Americans for Tax Reform, the National Taxpayers Union, Americans for Prosperity, the Competitive Enterprise Institute, the Council for Citizens Against Government Waste, and FreedomWorks, sent a letter to President Bush this week, encouraging him to veto any bill that has Affordable Housing Trust Fund language in it.

Federal Housing Administration and Foreclosure Provisions

$300 Billion in Loan Guarantees for Mortgage Lenders and Borrowers

FHA History. The Federal Housing Administration (FHA) was created in 1934 (and became a part of the Department of Housing and Urban Development—HUD—in 1965) to provide mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. The FHA insures mortgages on single family, multifamily, and manufactured homes and hospitals. The FHA is reportedly the largest insurer of mortgages in the world, having insured over 34 million properties since its inception. FHA mortgage insurance protects lenders against loss if the homeowner defaults on his mortgage loan.

FHA operates entirely from self-generated income (proceeds from the mortgage insurance paid by homeowners), which is placed in an account that is used to operate the program. The FHA currently has 4.8 million insured single family mortgages and 13,000 insured multifamily projects in its portfolio.

For more information about the FHA, visit its homepage here: http://www.fha.gov/.

The bill would create a new, voluntary program for borrowers and existing mortgage loan holders to allow the Federal Housing Administration (FHA) to provide up to $300 billion in new loan guarantees (mortgage insurance) to refinance mortgages on owner-occupied principal residences at risk of foreclosure. It is not clear who would initiate participation in the program—lenders or borrowers. The existing loan must have been originated prior to January 1, 2008, and no mortgage contract could be refinanced under this program before October 1, 2008, or after September 30, 2011.

Only those borrowers who have a monthly (total) mortgage debt to monthly income ratio above 31% as of March 1, 2008, would be eligible for the program. Borrowers would have to certify that they have not *intentionally* defaulted on their existing mortgage in order to get into this program and that they did not provide false information in order to obtain the original mortgage. (Though what is the likelihood that someone who has already committed fraud to then file a truthful statement about it?)

Participating lenders would have to write-down the value of the original mortgage to no more than 85% of the newly appraised value of the home. The borrower in the program would then get a new mortgage that is no more than 90% of the newly appraised value of the home, which would be used to pay off the original lender. The remaining 5% (the difference between the new 90%-of-value mortgage and the 85%-of-value write-down) would consist of a 3% upfront insurance premium to FHA and presumably a 2% origination fee to the new lender (the actual origination fee is left to the discretion of FHA). All prepayment penalties and related fees would have to be waived.

The new mortgage would have to be 30-year fixed-rate, with a maximum loan amount that is 132% of the maximum FHA loan amount (currently $729,750). Borrowers would have to pay an annual mortgage insurance premium of 1.5% of the remaining insured principal balance of the mortgage. If the borrower sells or refinances within a year, 100% of the profits would go to the federal government. This percentage would phase-down to 90% in the second year, 80% in the third year, 70% in the fourth year, and 60% in the fifth year, and 50% thereafter.

In order for participation in this program to be complete, the claims of second lien holders (second mortgages and home equity loans) must be wiped out. The Oversight Board (created by this legislation) could set a fixed dollar amount that any second lien holder would receive as compensation and could require the borrower to share a percentage of future profits on the home with second lien holders (subject to the profits exceeding required payments to the government). The Board could also prohibit borrowers from taking out second mortgages during the first five years they are in the program.

The Oversight Board would be instructed to create "flexible" underwriting criteria, including a prohibition on rejecting borrowers solely because of their credit scores or because they defaulted on their existing mortgage. Borrowers could have a total monthly debt-to-income ratio of up to 50% (up from the current 43% maximum), if they have made six consecutive payments in an amount not less than their new mortgage payment.

Constitutionality. Some conservatives may question whether the "rescue" of borrowers and lenders from financial contracts gone bad qualifies as a proper role of the federal government under the U.S. Constitution. The government normally protects the integrity of contracts; it does not facilitate the renegotiation of them based on terms of its choosing.

Taxpayer Exposure. The FHA "rescue" portion of the bill would increase the taxpayer's exposure by $300 billion. CBO has likely underestimated the cost of such exposure to be just $1.7 billion over five years, despite the fact that CBO concedes that default rates for this program are likely to be higher than current FHA default rates, since lenders will seek to off-load their worst-performing loans onto the FHA.

Growth of Government. The FHA currently manages a portfolio worth about $180 billion, according to the Republican staff of the Financial Services Committee. How could the FHA handle a $300 billion increase in its portfolio—a 167% increase—without massive expansion of its operations, staff, office space, and budget?

Punishing Good Behavior. The FHA "rescue" portion of the bill would punish taxpayers who have paid their mortgage on time or who responsibly delayed buying a home by forcing them, as taxpayers, to pay to bail out those borrowers who made risky financial decisions or committed fraud, and those lenders who lowered their standards and also made risky financial decisions. This bailout would create a moral hazard by encouraging excessively risky behavior in the future.

Rewarding Bad Behavior. The FHA "rescue" portion of the bill would carve out a specific reward for those borrowers who committed mortgage fraud yet did not get convicted (because those convicted under state or federal law within the last seven years would not be eligible for the mortgage trade-in program). Although people would have to certify that they have not committed mortgage fraud, what value are certifications of honesty from people who have already lied?

No Protections Against Intentional Default. There is no way to ensure that people did not intentionally default on their mortgage in order to participate in the mortgage trade-in program. While certifications of non-deliberate-default would be required, one again could question the validity of certifications. Would someone who intentionally defaulted admit it?

Government Overreaction. It is also important to note how many homeowners and renters are already making due, often by adjusting their behavior to pay their bills. 25 million households own their home

without an existing mortgage, 35 million households rent, and 42 million households are adhering to the terms of their existing mortgages. According to the Mortgage Bankers Association, in the fourth quarter of 2007, 91.7% of borrowers were paying on time, 6.3% of borrowers were late in making a mortgage payment (but not in foreclosure), and only 2.0% of borrowers were in foreclosure. An estimated 1.35 million homes went into the foreclosure process last year (up from 705,000 in 2005), and 1.44 million more are predicted for 2008. While these are not insignificant numbers, should the 91.7% be expected to shoulder the burden of the 6.3% (or the 2.0%), especially when many of these homeowners made a conscious decision to bet on the continued appreciation their home values and/or committed mortgage fraud?

Furthermore, much of the housing turmoil is concentrated regionally. 44.7% of all foreclosures are located in seven states: Arizona, California, Colorado, Florida, Indiana, Minnesota, and Nevada. However, despite clear dips in these and other states, houses are still worth more now than they were four years ago. Should taxpayers really be put on the hook for $300 billion?

Not Truly Voluntary. Although the mortgage trade-in portion of this bill is being described as "voluntary" by the Democrats, since borrowers and lenders cannot be forced to participate, once they do participate—and hundreds of thousands will—the taxpayer would have no choice of whether to be on the hook for the new mortgages, the borrower paying his mortgage on time would have no choice, the renter would have no choice, and the investor in mortgage-backed securities would have no choice.

Threatens Retirement Savings. The mortgage trade-in programs requires new mortgages to be guaranteed at no more than 90% of newly assessed value, meaning a 10% loss for investors in mortgage-backed securities. Many 401(k) accounts, mutual funds, money markets, and defined-benefit pensions plans are indirect holders of mortgage-backed securities. In fact, according to Credit Suisse, 14% of mortgage-backed securities are owned by pensions and mutual funds that serve middle-class savers. Devaluing mortgage-backed securities weakens retirement savings (not to mention the financial health of the GSEs).

Wipe Out of Second Liens. The FHA "rescue" portion of the bill would wipe out a participating borrower's second mortgage and home equity loans (second liens) as condition of taking advantage of the mortgage trade-in. Although second lien holders would essentially be bought off with potential cash payments, it is difficult to see how this situation would not harm second lien-holders.

To read more facts and conservative talking points on the housing market, see this RSC Policy Brief: http://www.house.gov/hensarling/rsc/doc/pb_041508_housingmarket.doc.

Fingerprint Registry

The bill would require, as part of the federal licensing requirements for mortgage lenders, that anyone related to the selling and servicing of mortgages (any "loan originator," including real estate brokers who get compensation from mortgage lenders) be fingerprinted for a federal database. Some conservatives may be concerned that this requirement is a massive invasion of privacy without reasonable justification. Several leading conservative organizations have expressed opposition to this provision.

Federal Housing Administration Reform

The bill would increase the FHA maximum loan limits for single-family homes (which are set at the lesser of two benchmarks) would be increased from: (1) 95 percent of the median home price for the area to 150 percent and (2) from 87 percent to 115 percent of the GSE conforming loan limit (the size of a loan a government-sponsored enterprise like Freddie Mac may purchase), with an increase in the minimum loan limit (the "floor") from 48 percent to 65 percent of the GSE limit (the limit is $417,000 in 2007). The loan limits for 2-, 3-, and 4-unit mortgages would be aligned with the ratios used by GSEs.

Risk-Based Pricing. The FHA would be prohibited from using risk-based premium structures for single-family mortgages, for one year beginning October 1, 2008, prohibiting different interest rates to be charged depending on a borrower's credit history. Many conservatives have supported risk-based pricing in the past since it would allow the FHA to better manage its risk and thus better protect the taxpayer.

Loan Limits Increases. The bill would increase various FHA loan limits and thus make more people eligible to receive FHA mortgage insurance, thus allowing more people who are not the true targets of FHA to receive FHA loans, to become beholden to the federal government for their housing needs, and perhaps to make real estate decisions that would otherwise be out of their financial abilities.

Crowding Out the Private Market. Some conservatives have expressed concerns that this bill would expand FHA's ability to guarantee mortgages and therefore increase a federal subsidy for homebuyers. In addition, some may be concerned that this expansion will crowd out the private market. Given that the private marketplace is offering many different, affordable homeownership opportunities, one might question whether now is the proper time to expand and perpetuate a government program that was created in 1934 to broaden homeownership and increase employment in the building industry.

Community Development Block Grants

The bill would appropriate $4 billion in additional Community Development Black Grant (CDBG) funds for communities to buy, rehabilitate, and resell foreclosed homes, with a focus on failing neighborhoods. Funds could not be distributed to organizations that have been indicted for federal election law violations, or to organizations who employ or use people who have been indicted as such. (Such protections are not applied to the Affordable Housing Trust Funds created earlier in the bill.)

Constitutionality. Some conservatives may question whether the provision of taxpayer dollars for the purchase and rehabilitation of private housing qualifies as a proper role of the federal government under the U.S. Constitution.

Cost. Some conservatives may object to the $4 billion price tag for this provision at a time of soaring deficits (accentuated by other parts of this legislation). At press time, it was unclear whether the $4 billion would be offset by reductions in other appropriations.

Moral Hazard. Some conservatives may believe that this provision would essentially be a bailout for the lenders, loan servicers, and real estate speculators who made risky bets on an ever-increasing housing market and who will now be able to offload their foreclosed properties on to the federal government. Some would argue that this approach subsidizes risky investments and contributes to moral hazard by signaling to future market participants that their risks in rocky times will be assumed by the government if their investments go bad. This provision could thus incentivize foreclosures, rather than reduce them.

Fungibility: Although the language of this provision presumably will explicitly prohibit grant funds from being used for political activities, advocacy, lobbying, counseling, travel, or tax preparation services, money is fungible. Every dollar that a nonprofit like ACORN receives under this bill is one existing dollar that is freed up for political and other activities. Some conservatives may be concerned at yet another attempt to use taxpayer dollars to prop up liberal private-sector entities.

Tax Issues

Below are the major revenue-related provisions in the final bill.

- Requires banks and other institutions that make payments to domestic merchants in settlement of credit and debit card transactions to file information on such transactions with the Internal Revenue Service. This provision is aimed at closing the "tax gap" and is based on the assumption that merchants are underreporting their credit and debit transactions. ***This is a multi-billion-dollar tax increase on Americans.***

- Delays by two years the implementation of the worldwide allocation of interest and reduces the first-year implementation of this rule. In 2004, Congress gave taxpayers, beginning in tax years after 2008, the option of using a liberalized rule for allocating interest expense between United States sources and foreign sources for the purposes of determining a taxpayer's foreign tax credit limitation. ***This is a multi-billion-dollar tax increase on Americans, taking particular aim at people who have financial dealings abroad.***

- Modifies the tax treatment of second homes later converted to primary residences. The provision reduces the home sales capital gains exclusion to reflect only the time the home was used as a primary residence. ***This is a billion-dollar tax increase on Americans.***

- Increases the statutory debt limit by $800 billion (to $10.615 trillion).

- Increases from $2.00 per person to $2.20 per person (in 2008 and 2009 only) the limit on federal low-income housing tax credits that may be allocated per state.

- Provides first-time home buyers (only principal residences purchased on or after April 9, 2008 and before July 1, 2009) with a refundable tax credit equal to 10% of the purchase price of their home (up to $7,500 for married couples, phased-down for taxpayers with adjusted gross incomes above $75,000--$150,000 in the case of a joint return). Taxpayers would be required to repay any amount received under this provision back to the government over 15 years in equal installments.

- Provides home owners who claim the standard deduction with an additional standard deduction in 2008 for state and local real property taxes, up to $500 ($1,000 for joint filers).

- Allows for the state issuance of an additional $11 billion of tax-exempt housing bonds to provide loans to first-time home buyers and to finance the construction of low-income rental housing and allows qualified mortgage revenue bonds to be used to refinance certain subprime loans.

- Allows the low-income housing tax credit and the rehabilitation tax credit to be used to offset the Alternative Minimum Tax (AMT) and shield interest on tax-exempt housing bonds from the AMT.

- Employs a familiar PAYGO gimmick that would modify the timing for certain corporate estimated tax payments so that corporations have to furnish more than $19 billion more in such estimated tax payments in FY2013.

As of press time, the Club for Growth, the American Conservative Union, and FreedomWorks were publicly opposing the bill and indicated that they would score against the bill.

Reports indicate that the Administration will NOT issue a Statement of Administration Policy (SAP) on this legislation.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718

###