

CRS Report for Congress

The New GSE Affordable Housing Funds: The Housing Trust Fund and the Capital Magnet Fund

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Summary

One key feature of the Housing and Economic Recovery Act of 2008 (P.L. 110-289), which was signed into law on July 30, 2008, is the requirement that two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, contribute a percentage of the value of their total new business purchases to two new affordable housing funds. The Congressional Budget Office estimates that these two funds, the Housing Trust Fund and the Capital Magnet Fund, could together receive approximately \$624 million in FY2012, the first year in which they will be fully funded. The Director of the Federal Housing Finance Agency (FHFA), a new agency created by P.L. 110-289 to be a unified regulator for the GSEs, is required to suspend contributions to the affordable housing funds in the case of GSE financial trouble.

In FY2009, the GSE contributions are to be used to support the HOPE for Homeowners program, also created by P.L. 110-289. This support is to be reduced and support for the Housing Trust Fund and the Capital Magnet Fund increased until in FY2012 the HOPE program gets 25% and the affordable housing funds get 75% of the total contributions. Of the share allocated to the affordable housing funds, the Housing Trust Fund is to receive 65%, and the Capital Magnet Fund is to receive 35%. The Secretary of the Department of Housing and Urban Development is to develop a formula to allocate the Housing Trust Fund money to the states. The U.S. Treasury is to develop a competitive grant process to distribute the Capital Magnet Funds to community development financial institutions and nonprofit housing corporations.

A critical issue behind the GSE contributions to the affordable housing funds is the rationale for using the GSEs as the funding source. The justification is that the GSEs have special charters from Congress that give them special treatment, such as exemption from state and local income taxes and the ability to borrow up to \$2.25 billion from the U.S. Treasury. In return for these privileges, the GSEs' charters limit their business activities to purchasing home mortgages and supporting affordable housing. Opponents of GSE contributions to affordable housing funds are concerned that the cost of the contributions would be passed on to mortgage borrowers and that the contributions could create an incentive for advocates of the funds to encourage the GSEs to grow beyond what is financially sound.

On September 7, 2008, the Federal Housing Finance Agency put Fannie Mae and Freddie Mac under its conservatorship, and the Treasury agreed to provide up to \$100 billion in emergency funding to each. On November 13, 2008, FHFA informed Fannie Mae that it should suspend its contributions until further notice. It is unclear what long-term effect these developments will have on the affordable housing funds.

This report will be updated as events warrant.

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The New GSE Affordable Housing Funds: The Housing Trust Fund and the Capital Magnet Fund

Introduction

Over the last several years, low-income housing organizations, led by the National Low Income Housing Coalition, have advocated for the establishment of a national affordable housing trust fund. Proponents argued that an affordable housing trust fund would provide a permanent source of dedicated funding for affordable housing activities that would not be subject to the annual appropriations process. Legislation to create an affordable housing trust fund has been introduced in every Congress since the 106th Congress. On July 30, 2008, the Housing and Economic Recovery Act of 2008 (P.L. 110-289) was signed into law and created two affordable housing funds using contributions from Fannie Mae and Freddie Mac. This report details the structure of the affordable housing funds and their funding mechanism. It also provides a discussion of the rationale for requiring Fannie Mae and Freddie Mac to contribute to affordable housing funds and outlines current issues that may affect the funds. This report will be updated as events warrant.

Background on Affordable Housing Trust Funds

For several years, a coalition of low-income housing organizations has advocated for the establishment of a national affordable housing trust fund. Proponents of a trust fund wanted a permanent funding stream that would not be subject to the annual appropriations process, would not come out of other housing programs, and would be dedicated to affordable housing activities for low-income households. The idea of an affordable housing trust fund was not new; several states and localities have already adopted their own state and local trust funds. However, organizations such as the National Low Income Housing Coalition, one of the leading proponents of a national affordable housing trust fund, argued that a federal fund should be established to complement these state and local efforts.¹

Opponents of a national housing trust fund argue that the federal government already provides funding for affordable housing through other programs and that a national housing trust fund could be duplicative of these programs. In recent years,

¹ For details on the campaign for a national affordable housing trust fund, see the National Low Income Housing Coalition's website, "National Housing Trust Fund Campaign," available at [<http://www.nlihc.org/template/page.cfm?id=40>].

opponents have also pointed to concerns about growing federal budget deficits as an argument against establishing a national affordable housing trust fund.

Legislation to establish a national affordable housing trust fund has been introduced in every Congress since the 106th.² One major question surrounding the creation of an affordable housing trust fund has been how the program would be funded. Early legislation proposed using a portion of receipts from the Federal Housing Administration (FHA), but diverting FHA receipts to a housing trust fund would count as new spending and would be subject to annual spending limits, including the Pay-As-You Go rule (PAYGO).³

Later legislation proposed using contributions from Fannie Mae and Freddie Mac, two government-sponsored enterprises (GSEs), as a potential funding source. Since the GSEs are private entities, using contributions from Fannie Mae and Freddie Mac would not count as new government spending. There is some disagreement over whether it is appropriate for the government to require the GSEs to contribute to affordable housing funds. Opponents of GSE contributions argue that the GSEs should not be asked to balance public policy objectives against the interests of their shareholders. Proponents point to the special privileges that GSEs receive and the housing goals that they already have to justify their contributions to affordable housing funds.

Government-Sponsored Enterprises

The government-sponsored enterprises are the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBanks). Congress chartered Fannie Mae and Freddie Mac as stockholder-owned, government-sponsored enterprises with the mission of supporting home ownership by enhancing mortgage market liquidity and providing assistance to lower-income families and underserved areas. By law, the GSEs cannot make loans directly to property owners. Instead, Fannie Mae and Freddie Mac purchase mortgages from lenders and package them into mortgage-backed securities (MBS) that they either hold in their portfolios or sell to investors.⁴

The 12 Federal Home Loan Banks make up a third collective housing GSE with a similar mission. The FHLBanks are owned by member organizations (originally

² For a legislative history of affordable housing trust fund proposals, see the National Low Income Housing Coalition's website, "Details about the National Housing Trust Fund Campaign," January 31, 2007, available at [http://www.nlihc.org/detail/article.cfm?article_id=3834#prop], or see Appendix 1.

³ See CRS Report RL34300, *Pay-As-You-Go Procedures for Budget Enforcement*, by Robert Keith for more information on Congressional budgeting rules, including PAYGO.

⁴ See CRS Report RS21663, *Government-Sponsored Enterprises (GSEs): An Institutional Overview* by Kevin R. Kosar for more information about GSEs.

savings and loan associations). FHLBanks' member organizations pledge mortgages as collaterals to obtain loans (called advances) from the FHLBanks.⁵

As part of the GSEs' special nature as private entities with public charters, they receive several advantages that private sector firms do not. These advantages include the right to borrow from the U.S. Treasury and exemption from state and local income taxes.⁶

GSE Affordable Housing Obligations. In exchange for the privileges that GSEs receive, the government requires them to balance profitability with support for certain affordable rental and home ownership housing activities. Historically, the Department of Housing and Urban Development (HUD) had the authority to set goals to ensure that Fannie Mae and Freddie Mac served low-income families and underserved markets.

The FHL Banks have three missions: providing liquidity to member institutions, contributing to housing and community development, and, temporarily, repaying debt for losses incurred during the savings and loan failures of the 1980s. To meet the second goal, each FHL Bank funds an affordable housing program with a statutory contribution of 10% of its annual net earnings to low- and moderate-income housing.

The Housing and Economic Recovery Act (P.L. 110-289)

On July 30, 2008, the Housing and Economic Recovery Act of 2008 (P.L. 110-289), was signed into law. P.L. 110-289 attempts to address trouble in the U.S. housing market by creating some new programs to help home owners at risk of foreclosure and by making a number of changes to existing aspects of the housing finance industry. The legislation makes major changes to Fannie Mae and Freddie Mac, including creating a new regulator with broader oversight powers, requiring that regulator to create new affordable housing goals, and creating an explicit duty to serve underserved markets.

P.L. 110-289 also requires Fannie Mae and Freddie Mac to contribute to two new affordable housing funds. Projects funded by the affordable housing funds will not count toward the duty to serve underserved markets. The affordable housing funds are discussed in detail below.

⁵ See CRS Report RL32815, *Federal Home Loan Bank System: Policy Issues*, by Edward Vincent Murphy for background on the FHLBanks.

⁶ See CRS Report RS21663, *Government-Sponsored Enterprises (GSEs): An Institutional Overview*, by Kevin R. Kosar for more information on GSE privileges.

The New Affordable Housing Funds

P.L. 110-289 authorizes the creation of two affordable housing funds using contributions from Fannie Mae and Freddie Mac. The first, the Housing Trust Fund, is to provide formula-based grants to states to increase the supply of affordable housing, especially rental housing, for extremely low- and very low-income households.⁷ The second affordable housing fund, the Capital Magnet Fund, will be administered by the Treasury Department's Community Development Financial Institutions (CDFIs) Fund and is to provide competitive grants to Treasury-certified community development financial institutions and qualified non-profits to support low-income, very low-income, and extremely low-income housing and economic development activities. Community development financial institutions are organizations that provide loans and financial services in underserved communities.

Contributions to GSE Affordable Housing Funds

P.L. 110-289 requires both Fannie Mae and Freddie Mac to contribute 4.2 basis points (.042%, or .042 cents) for each dollar of the unpaid principal balances of their new business purchases to the affordable housing funds each year. New business purchases are mortgages that are purchased by the GSEs in a given year, whether the GSE holds them in its own portfolio or packages and sells them to other firms through a securitization process. The Director of the new GSE regulator, the Federal Housing Finance Agency (FHFA), is to temporarily suspend either GSE's contributions if he finds that the contributions are (1) contributing to the GSE's financial instability, (2) causing the GSE to be undercapitalized, or (3) preventing the GSE from successfully completing a capital restoration plan.

Each year, the first 25% of the contributions is to go to a HOPE for Homeowners Reserve Fund for as long as such a fund is in existence. HOPE for Homeowners is a new program created by P.L. 110-289 to help homeowners at risk of foreclosure.⁸ In FY2009, all of the GSE contributions are to provide additional funding to reimburse the Treasury for the cost of the HOPE for Homeowners program, and none of the contributions will go to the affordable housing funds. Between FY2010 and FY2011, a declining portion of the GSE contributions is to continue to go to the HOPE for Homeowners program, while an increasing portion is to go to the affordable housing funds. Of the funds that are allocated to the affordable housing funds, 65% is to go to the Housing Trust Fund and 35% to the Capital Magnet Fund. Beginning in FY2012, all funds other than the first 25% that is diverted to the HOPE for Homeowners Reserve Fund are to go to the affordable housing funds. Of the additional funds that are to be diverted to the HOPE for

⁷ Extremely low-income households have incomes at or below 30% of area median income, and very low-income households have incomes at or below 50% of area median income. Low-income households have incomes at or below 80% of area median income.

⁸ HOPE for Homeowners is a new program in which some borrowers at risk of foreclosure can refinance their existing loans into FHA-insured mortgages. For more details on this program and other features of P.L. 110-289, see CRS Report RL34623, *Housing and Economic Recovery Act of 2008*, by N. Eric Weiss, Darryl E. Getter, Mark Jickling, Mark P. Keightley, Edward Vincent Murphy, and Bruce E. Foote.

Homeowners program between FY2009 and FY2012, any excess funds remaining after the HOPE for Homeowners program ends are to revert back to the affordable housing funds. **Figure 1** and **Figure 2** illustrate the phase-in of funding for the affordable housing funds and the allocation of that funding to the Housing Trust Fund and the Capital Magnet Fund, respectively.

Figure 1. Phase-In of Funding for Affordable Housing Funds, FY2009-FY2012

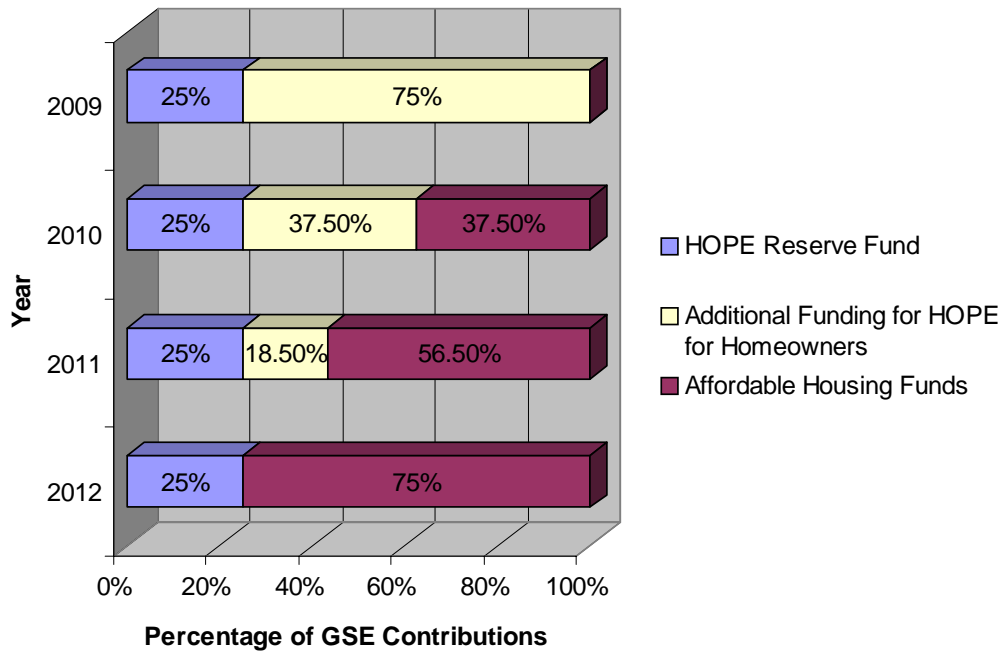
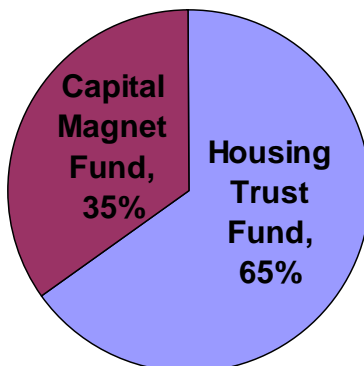


Figure 2. Share of Affordable Housing Funds Going to the Housing Trust Fund and the Capital Magnet Fund



According to estimates prepared by the Congressional Budget Office (CBO), the affordable housing funds could together receive \$283 million in FY2010, \$446 million in FY2011, and \$624 million in FY2012, the first year in which the housing funds receive their full share of GSE contributions. These estimates assume that the GSEs' new business purchases will grow between 4% and 6% per year, the same rate at which CBO expects outstanding mortgage debt to grow for the nation as a whole.⁹ On September 7, 2008, FHFA announced that it was placing both Fannie Mae and Freddie Mac under conservatorship. It is unclear how this move will affect the GSEs' new business purchases, and hence their contributions to the affordable housing funds, going forward.

Although P.L. 110-289 designates only the GSE contributions as a dedicated funding source for the affordable housing funds, it includes language stating that other funds can be appropriated or transferred to the affordable housing funds through other legislation.

Housing Trust Fund

As noted earlier, 65% of the monies allocated to the affordable housing funds go to the Housing Trust Fund, which is to provide formula-based grants for states to increase housing opportunities for extremely low- and very low-income renters and home owners. The Secretary of HUD is required to develop a formula for allocating the monies in the Housing Trust Fund among the states¹⁰ within 12 months of the law's enactment. The allocation formula is to be based in part on the following factors:

- the relative number of affordable standard rental units available to extremely low-income renter households in the state (this factor is given "priority emphasis");
- the relative number of affordable standard rental units available to very low-income renter households in the state;
- the relative number of extremely low-income renter households living with incomplete kitchen or plumbing facilities, more than one person per room, or paying more than 50% of income on housing costs in the state; and
- the relative number of very low-income renter households paying more than 50% of income on rent in the state.

⁹ U.S. Congressional Budget Office, *Cost Estimate: H.R. 3221, Housing and Economic Recovery Act of 2008*, July 23, 2008, p. 3, available at [<http://www.cbo.gov/ftpdocs/95xx/doc9597/hr3221.pdf>], and *Cost Estimate: Federal Housing Finance Regulatory Reform Act of 2008*, June 9, 2008, pp. 3, 5-6, available at [http://www.cbo.gov/ftpdocs/93xx/doc9366/Senate_Housing.pdf].

¹⁰ The term "states" includes the fifty states, the District of Columbia, and the territories and possessions of the United States, including Puerto Rico, the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, and the Trust Territory of the Pacific Islands.

The sum of these factors will then be multiplied by the relative cost of construction in the state to arrive at a grant amount. Each state is to receive a minimum annual grant of \$3 million.¹¹ Once states have received their formula grants, they can then designate for-profit or non-profit organizations such as housing finance agencies, housing and community development entities, or tribally designated entities to administer the funds.

Grantees and sub-recipients can use grants from the Housing Trust Fund to support both renter and home ownership housing activities. Grants can be used for the production, preservation, rehabilitation, or operation of rental housing. By law, all funding used for rental housing must benefit families that are extremely low- or very low-income.¹² At least 75% of the grant amounts for rental housing must be used for the sole benefit of extremely low-income families or families with incomes at or below the poverty line for a family of its size. No more than 25% of the grant amounts for rental housing can be used for the sole benefit of very low-income families.

Grants from the Housing Trust Fund may also be used for the production, preservation, and rehabilitation of home ownership housing, or for related home ownership costs such as down payment assistance, closing cost assistance, and interest-rate buy-downs. By law, both the home and the home buyer must meet certain requirements,¹³ and the funds must be used to benefit families who are extremely low- or very low-income. No more than 10% of the Housing Trust Fund formula grants allocated to a state may be used for home ownership activities.

The law contains a provision stating that if Congress creates any other affordable housing trust fund in the future that is dedicated solely to providing grants to support affordable rental and home ownership housing, the funds in the Housing Trust Fund would be transferred to the new fund.

Capital Magnet Fund

The remaining 35% of the monies devoted to the affordable housing funds is to be directed to the Capital Magnet Fund. The Capital Magnet Fund will be administered by the Department of the Treasury's existing Community Development Financial Institutions Fund. The Secretary of the Treasury is to use the Capital Magnet Fund to award competitive grants to community development financial institutions (CDFIs) and qualified non-profit organizations. Community

¹¹ The \$3 million minimum grant amount applies only to the 50 states and the District of Columbia.

¹² As noted earlier, very low-income households are households that have an income at or below 50% of area median income. Extremely low-income households have an income at or below 30% of area median income.

¹³ The home must be available for purchase by extremely low- or very low-income families who will use the home as a principal residence and are first-time home buyers, meaning that they have not owned a home in the prior three years. Home buyers must also complete a pre-purchase financial counseling requirement. The home is subject to initial purchase price and resale restrictions.

development financial institutions typically provide loans and financial services in under-served neighborhoods. By law, non-profits receiving grants must have the development or management of affordable housing as one of their principal purposes. No recipient or its affiliates can receive more than 15% of the eligible grant money available from the Capital Magnet Fund each year.

The Capital Magnet Fund is meant to leverage private capital and support for investment in housing for low-, very low-, and extremely low-income households, and to support investment in economic development activities and community service facilities. Specifically, grants from the Capital Magnet Fund can be used to develop, preserve, rehabilitate, or purchase affordable housing for low, very low-, or extremely low-income families, and for economic development activities or community service facilities such as day care centers or health clinics. Eligible uses of grant money include capitalizing a revolving loan fund, an affordable housing fund, or a fund to support economic development activities; providing loan loss reserves; and providing risk-sharing loans. No single organization may receive more than 15% of the grants available from the Capital Magnet Fund in a year. The Secretary is directed to take into account geographic diversity and measures of economic distress when awarding grants, and, in order to leverage the grant money, to seek to fund projects that will have total costs that are at least ten times the grant amount.

Restrictions on Use

Restriction on Eligible Activities. Money from either fund cannot be used for political activities, advocacy, lobbying, counseling services, travel expenses, or preparing or providing advice on tax returns. The Secretary can set a limit of up to 10% of a state or state-designated entity's Housing Trust Fund grant amount that can be used for the cost of administering the programs funded by the grant; using funds for other outreach or other administrative costs of the grantee or fund recipient is prohibited.

Restrictions on Sub-Recipients. As noted earlier, states can designate for-profit or non-profit organizations such as housing finance agencies, housing and community development entities, or tribally designated entities to administer the formula grants from the Housing Trust Fund. The state or state-designated entity can then award funds to sub-recipients. Sub-recipients of Housing Trust Fund grant amounts must have relevant experience. More specifically, an organization receiving funding for a rental housing project must have experience owning, constructing, rehabilitating, managing, or operating affordable multifamily rental projects. An organization receiving funding for home ownership is required to have experience in designing, constructing, rehabilitating, or marketing affordable home ownership housing, or providing assistance with down payments, closing costs, or interest rate subsidies. Recipients also have to demonstrate general financial experience and expertise and familiarity with the requirements of any related federal, state, or local housing programs that will be used in conjunction with grants from the Housing Trust Fund.

Recipients of grants from the Capital Magnet Fund must be community development financial institutions certified by the Treasury or non-profit

organizations with the development or management of affordable housing as a principal purpose, according to the statute.

Requirements and Oversight. P.L. 110-289 requires states or the state-designated entities that administer grants from the Housing Trust Fund to develop an allocation plan that describes how the grant money will be distributed. The plan must explain how the allocation of funds will be based on priority housing needs, and it must include performance goals. The states and state-designated entities are to make their allocation plans available for public comment and consider any public comments they receive. Recipients of grants from the Capital Magnet Fund must establish reporting and auditing requirements with the Capital Magnet Fund to ensure that funds are properly used.

Grants from the affordable housing funds do not count toward the GSEs' affordable housing goals or their duty to serve underserved markets. Projects that use grants from the affordable housing funds can be counted towards these goals for the portion of the project that does not use affordable housing fund grant money.

Any funds not committed for use by a grantee within two years will be recaptured by the affordable housing funds and reallocated.

The grantees (states or state-designated entities in the case of the Housing Trust Fund; grant recipients in the case of the Capital Magnet Fund) are responsible for overseeing the proper use of the funds and obtaining reimbursement for improperly used funds. Future grants are to be reduced by the amount of any unreimbursed improperly used money.

Issues Surrounding GSE Contributions to the Affordable Housing Funds

This section discusses the rationale for requiring GSEs to support the affordable housing funds. It also discusses factors that could affect the GSE contributions to the affordable housing funds, including the Director's ability to suspend contributions and the government takeover of Fannie Mae and Freddie Mac.

Why Should the GSEs Support an Affordable Housing Fund?

Few dispute that the GSEs have historically received substantial benefits from their unique relationship with the federal government. There has been debate over how the advantages of GSE status are divided among those who might benefit: lenders, mortgage borrowers (and which borrowers), holders of the GSE bonds and mortgage-backed securities, GSE stockholders, and GSE employees. Most analysts believe that not all of the benefits have gone to borrowers.¹⁴

¹⁴ CRS Report RS22307, *Limiting Fannie Mae's and Freddie Mac's Portfolio Size*, by N. Eric Weiss summarizes both sides of the arguments. For an example of a government (continued...)

The Fannie Mae and Freddie Mac charters state that the purposes of the enterprises are as follows:

- (1) to provide stability in the secondary market for residential mortgages;
- (2) to respond appropriately to the private capital market;
- (3) to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and
- (4) to promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.¹⁵

HUD has found that the GSEs are not leading the market in purchasing mortgages on owner-occupied and rental affordable housing and on housing in underserved areas as mentioned in their charters.¹⁶ This has led to calls for the GSEs to purchase more mortgages that finance affordable housing and housing in underserved areas, while balancing risk and profitability considerations.

P.L. 110-289 makes major changes to the GSEs that are aimed at addressing the concern that they are not meeting the objectives laid out in their charters. Beginning in 2010, P.L. 110-289 instructs the Director of FHFA to modify the GSEs' annual affordable housing goals to require the GSEs to purchase mortgages on homes for three distinct categories of households: low-income families, very low-income families, and families that reside in low-income areas. The prior housing goals required the GSEs to set one target for the purchase of mortgage on homes owned or rented by low- and moderate-income families. P.L. 110-289 does not distinguish between the GSEs retaining a mortgage and selling it in a mortgage-backed security. The establishment of the affordable housing funds is another change that is aimed at

¹⁴ (...continued)

analysis, see Andreas Lehnert, Wayne Passmore, and Shane M. Sherlund, *GSEs, Mortgage Rates, and Secondary Market Activities*, Board of Governors of the Federal Reserve System, Working Paper 2006-30, September 8, 2006. A contrasting view is presented in Freddie Mac, *The Systemic Risk Debate*, 2007, available at [http://www.freddie.mac.com/corporate/about/policy/reg_reform/systemic_risk_debate.html].

¹⁵ The charter language setting the purpose for creating the enterprises is identical. Fannie Mae's language is at 12 U.S.C. 1716, P.L. 101-73, 103 Stat. 435; Freddie Mac's language is in P.L. 101-73, 103 Stat. 429, 12 U.S.C. 1451 note. Both were amended by P.L. 102-550, 106 Stat. 3994 and 106 Stat. 4002.

¹⁶ Department of Housing and Urban Development, *Regulatory Analysis for The Secretary of HUD's Final Rule on HUD's Regulation of The Federal National Mortgage Association (Fannie Mae) and The Federal Home Loan Mortgage Corporation (Freddie Mac)*, Chapter III. Available at [<http://www.hud.gov/offices/hsg/gse/ra-chapter3.pdf>].

addressing the GSEs' affordable housing mission. The Housing Trust Fund is to provide funds to attempt to increase the supply of owner-occupied and rental affordable housing through grants. The Capital Magnet Fund is to also set aside funds for CDFIs to support affordable housing and related economic development activities.

Some of those opposed to the creation of GSE affordable housing funds argue that it is unfair to require a privately owned company to balance the interests of stockholders against public policy. Others opposed to the GSE affordable housing funds are concerned that the funds would be another cost of doing business and that, like other costs in any competitive market, they would be passed onto consumers (mortgage borrowers in this case) or reduce dividends to stockholders. P.L. 110-289 includes language prohibiting the GSEs from passing on the cost of the housing funds to others. However, in a market where mortgage interest rates, mortgage terms, and home prices change as frequently as the mortgage market, it might be difficult to identify the reason for a specific interest rate or price change. Finally, concern over GSE portfolio risk taking has led some regulators and others to call for limits on the size of the GSEs' portfolios; some GSE affordable housing fund opponents have argued that using GSE contributions to support affordable housing funds could give proponents of the funds an incentive to encourage GSE growth beyond what is financially sound.

Current Issues

Financial Uncertainty. With increases in mortgage delinquencies since the middle of 2007, the GSEs' capital positions have deteriorated. The GSEs' regulator found both GSEs adequately capitalized during each quarter of 2007, but noted significant declines in the amount of capital held as a percentage of that required by their regulator. In November and December 2007, Fannie Mae increased its capital by selling \$7.9 billion in preferred stock, and Freddie Mac sold \$6 billion in preferred stock. Fannie Mae raised an additional \$7.4 billion in new capital in May 2008.¹⁷ These actions were widely viewed as motivated by losses on mortgages that the GSEs had guaranteed.

This raises the issue of under what circumstances the GSEs' contributions to the affordable housing funds could be suspended. P.L. 110-289 requires the Director of FHFA, the GSEs' new unified regulator, to temporarily suspend contributions by either GSE if he finds that the contributions (1) are contributing or would contribute to financial instability, (2) are causing or would cause a GSE to be classified as undercapitalized, or (3) are preventing or would prevent a GSE from successfully completing a capital restoration project. However, the legislation does not define how long a "temporary" suspension could last, nor does it specify criteria for the Director to rely on in making such a finding.

¹⁷ Office of Federal Housing Enterprise Oversight, "Report to Congress: 2008", April 15, 2008, pp. 2, 31, 51, available at [<http://www.ofheo.gov/media/annualreports/ReporttoCongress2008.pdf>], and "OFHEO Announces First Quarter 2008 Minimum and Risk-Based Capital Classification for Fannie Mae and Freddie Mac," press release, June 9, 2008, available at [<http://www.ofheo.gov/media/capclass/1Q2008CapClass.pdf>].

Conservatorship. P.L. 110-289 also gave the Director of FHFA temporary emergency authority to take over the GSEs if he determined that such an action was necessary to protect taxpayers, stabilize financial markets, and prevent disruptions in mortgage availability. On September 7, 2008, FHFA decided to exercise that authority and placed both Fannie Mae and Freddie Mac under its conservatorship.¹⁸ This move could affect the affordable housing funds in two ways.

First, as discussed above, the legislation requires the Director of FHFA to suspend contributions to the affordable housing funds in the case of GSE financial trouble. At the time the GSEs were placed under conservatorship, they were generally believed to face uncertain financial futures. On November 13, 2008, FHFA informed Fannie Mae that it should suspend its contributions until further notice.¹⁹ This suspension of contributions will not directly affect the affordable housing funds until they are set to begin receiving allocations in FY2010, because all of the GSE contributions in FY2009 were slated to go to the HOPE for Homeowners program discussed earlier.

Second, the long-term plan for the GSEs remains unclear, but some policymakers have stated that the GSEs' portfolios should be forced to shrink beginning in 2010. The amount of the GSEs' contributions to the affordable housing funds is based on the volume of their new business purchases, not on the size of their portfolios. However, if shrinking the size of GSEs' portfolios leads the GSEs to purchase a smaller volume of mortgages, then the affordable housing funds could receive less funding than originally believed. Alternatively, the GSEs could continue to maintain or increase their volume of new business purchases, but still shrink their portfolios by packaging the mortgages they buy and selling them as mortgage-backed securities to other investors. This scenario would not reduce contributions to the affordable housing funds. The legislation allows the Housing Trust Fund and the Capital Magnet Fund to receive funding from sources other than the GSE contributions, but as of the time when Fannie and Freddie were placed under conservatorship, the GSE contributions were the only identified funding source for either the Housing Trust Fund or the Capital Magnet Fund.

As noted above, the affordable housing funds are not due to begin receiving contributions until FY2010. In FY2010 and FY2011, a decreasing percentage of the GSE contributions is to continue to fund HOPE for Homeowners. Because the affordable housing funds share the contributions with HOPE for Homeowners in the first three years, any decrease in GSE contributions would lead to even less money for the affordable housing funds. However, because the affordable housing funds do not receive funding in the first year, it is possible that the GSEs' financial outlook would have improved by the time the affordable housing funds are due to begin receiving allocations in FY2010.

¹⁸ See CRS Report RS22950, *Fannie Mae and Freddie Mac in Conservatorship*, by Mark Jickling for a fuller discussion of the details of the conservatorship.

¹⁹ United States Securities and Exchange Commission filing, Form 8-K, Federal National Mortgage Association, November 18, 2008, available at [http://www.sec.gov/Archives/edgar/data/310522/000129993308005442/htm_30041.htm].

Appendix 1. Legislative History of Housing Trust Fund Bills

Proposals to create an affordable housing trust fund have been included in legislation in every Congress since the 106th. This report has described the provisions of the two GSE affordable housing funds as they were authorized by P.L. 110-289. This appendix discusses the major features of previous housing trust fund proposals.

106th Congress

In the 106th Congress, Senator John Kerry and ten co-sponsors introduced S. 2997, the National Affordable Housing Trust Fund Act of 2000. This bill would have both established a National Affordable Housing Trust Fund within the Department of the Treasury and provided a dedicated funding source for the Fund. The dedicated funding source would have come from FHA Mutual Mortgage Insurance (MMI) funds above a capital adequacy level of 3%, as well as any excess funds from Ginnie Mae. Hearings on the bill were held by the Subcommittee on Housing and Transportation of the Committee on Banking, Housing, and Urban Affairs.

107th Congress

In the 107th Congress, Senator John Kerry and 28 co-sponsors introduced S. 1248, the National Affordable Housing Trust Fund Act of 2001. Like S. 2997, this bill would have authorized a trust fund and proposed the same dedicated funding source of FHA MMI funds above a capital adequacy level set at 3% and any excess funds from Ginnie Mae. Again, subcommittee hearings were held, but the bill was never sent to the full committee. In the House, Representative Bernie Sanders and 199 co-sponsors introduced H.R. 2349, also called the National Affordable Housing Trust Fund Act of 2001. This bill proposed using the same dedicated funding source of excess Ginnie Mae funds and FHA MMI funds above a capital adequacy level, but it set the capital adequacy level at 2% rather than 3%. The bill was referred to the Subcommittee on Housing and Community Opportunity, but hearings were never held.

108th Congress

In the 108th Congress, Senator John Kerry and 21 co-sponsors introduced S. 1411, the National Affordable Housing Trust Fund Act of 2003. The bill proposed the same dedicated source of funding as S. 2997 and S. 1248. S. 1411 was referred to the Committee on Banking, Housing, and Urban Affairs, but the Committee never held hearings on it. Also in the 108th Congress, the Reed Affordable Housing Fund amendment to S. 1508, a GSE reform bill, was unanimously adopted by the Senate Banking Committee. This amendment proposed a dedicated funding source of 5% of Fannie Mae's and Freddie Mac's pre-tax profits. In the House, Representative Bernie Sanders and 214 co-sponsors introduced H.R. 1102, also the National Affordable Housing Trust Fund Act of 2003. This bill also included both authorizing and appropriating language and specified a dedicated source of funding that was the same as H.R. 2349 (and the same as the Senate bills, but setting the FHA MMI fund

capital adequacy level at 2% rather than 3%). The bill was referred to the Subcommittee on Housing and Community Opportunity, but hearings were never held.

109th Congress

In the 109th Congress, proponents of an affordable housing fund concentrated their efforts on including an affordable housing fund in H.R. 1461, the Federal Housing Finance Reform Act of 2005. The bill would have required each GSE to create an affordable housing fund and to contribute either 3.5% or 5% of the prior year's after-tax income depending on the year. The bill included a sunset provision after five years, after which the GSEs would no longer have been required to make contributions. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

110th Congress

In the 110th Congress, Representative Barney Frank and three co-sponsors introduced H.R. 1427, the Federal Housing Finance Reform Act of 2007, on March 9, 2007. The bill authorized the creation of a trust fund and directed the GSEs to contribute 1.2 basis points for each dollar of their average total mortgage portfolio for five years, at which point the funding requirement would have ended. H.R. 1427 passed the House and was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Representative Maxine Waters and 13 co-sponsors introduced H.R. 1852, the Expanding American Homeownership Act of 2007, on March 29, 2007. The bill passed the House and was referred to the Senate Committee on Banking, Housing, and Urban Affairs. H.R. 1852 would have set aside a portion of FHA savings for a housing trust fund.

Representative Barney Frank and 16 co-sponsors introduced H.R. 2895, the National Affordable Housing Trust Fund Act of 2007, on June 28, 2007. H.R. 2895 was passed by the House and referred to the Senate Committee on Banking, Housing, and Urban Affairs. The bill would have created a permanent affordable housing trust fund and included guidance on how trust fund grantees should use the funds, but it did not create a permanent funding source.

Senator Jack Reed introduced S. 2391, the Government Sponsored Enterprise Mission Improvement Act, on November 16, 2007. The bill would have established an affordable housing block grant program and a Capital Magnet Fund and would have funded both through GSE contributions of 4.2 basis points for each dollar of the unpaid principal balance of their total new business purchases. The bill did not include a sunset provision. S. 2391 was referred to the Committee on Banking, Housing, and Urban Affairs.

Senator John Kerry and 23 co-sponsors introduced S. 2523, the National Affordable Housing Trust Fund Act of 2007, on December 19, 2007. The bill would have established a national affordable housing trust fund but would not have created

a dedicated funding source. S. 2523 was referred to the Committee on Banking, Housing, and Urban Affairs.

Representative Nancy Pelosi and 18 co-sponsors introduced H.R. 3221, the Housing and Economic Recovery Act of 2008, on July 30, 2007. This is the legislation that eventually became P.L. 110-289 and both authorized the affordable housing funds and created a permanent source of money for those funds. The version of the affordable housing trust fund that was created by P.L. 110-289 most resembles the proposed fund in S. 2391.