



July 21, 2010

Comments of the National Low Income Housing Coalition
Notice and Request for Information: Public Input on Reform of the Housing Finance
System [EDocket Number: TREAS-DO-2010-0001; HUD-2010-0029]

Introduction

On April 22, 2010, the Department of the Treasury (Treasury) and the Department of Housing and Urban Development (HUD) published seven questions seeking input on the establishment of a more stable and sound housing finance system.

The National Low Income Housing Coalition (NLIHC) is pleased to have an opportunity to respond. NLIHC is a non-profit policy advocacy and research organization dedicated solely to achieving socially just public policy that assures people with the lowest incomes in the United States have affordable and decent homes. Our members include non-profit housing providers, homeless service providers, fair housing organizations, state and local housing coalitions, public housing agencies, private developers and property owners, housing researchers, local and state government agencies, faith-based organizations, residents of public and assisted housing and their organizations, and concerned citizens. NLIHC does not represent any sector of the housing industry; instead, NLIHC works only on behalf of and with low income people who need safe, decent, and affordable housing, especially those with the most serious housing problems.

Given its focus on the housing problems of the lowest income people, NLIHC is primarily interested in rental housing policy. NLIHC has long been a proponent of “balanced” housing policy and was an early critic of the public policy/social message emphasis in both the Clinton and second Bush Administrations on homeownership for as many people as possible at any cost. Not only did the intense emphasis on homeownership as the preferred form of tenure lead the country into financial ruin, it also led Americans to lose an understanding of what housing really means. Housing needs to be understood much more as the place where one is sheltered and carries out family life, and much less as a financial asset and a source of wealth building. It is from this perspective that we offer these comments.

Background

Our current economic and housing problems have raised questions about the U.S. housing finance system. Early casualties of the crisis were Fannie Mae and Freddie Mac (the GSEs), which were created by Congress to assure stability and liquidity in the secondary market for residential loans. However, as the housing market came under pressure, so did Freddie and Fannie. The Federal Housing Finance Agency, their regulator, placed both enterprises in conservatorship in September 2008. Since that time, the federal government has provided billions in support for the enterprises and the housing market: \$145 billion in direct investments in Fannie Mae and Freddie Mac, \$149.7 in debt purchases, and \$775.6 billion in Mortgage Backed Securities (MBS) purchases. Arguably, these investments were necessary to maintain a viable mortgage finance system in the face of the collapse of the non-governmental secondary market; however, the conservatorships and the federal government's mortgage related investments have resulted in a situation where the federal government, through its support for Freddie and Fannie, has had to back about 75% of all single-family mortgages originated in 2009.

However, Freddie and Fannie are not the only federal participants in the housing finance system; the Federal Home Loan Banks, the Government National Mortgage Corporation (Ginnie Mae), FHA, the USDA and the VA are all instruments of the federal government in achieving housing policy objectives. In addition, the federal government plays a significant role in housing through tax policies, including the mortgage interest deduction (MID), the Low Income Housing Tax Credit (LIHTC), Mortgage Revenue Bonds (MRBs) and other housing related tax credits and deductions. A complete review of the federal government's role in housing finance must consider all aspects of the federal government's involvement.

With this extensive commitment of resources to the housing finance market, the question now becomes: what should be the future role of the federal government in housing finance and how does that role, if any, fit into federal housing policy generally? The questions presented by Treasury and HUD provide an opportunity to address these issues.

Responses to Questions

Question 1. How should federal housing finance objectives be prioritized in the context of the broader objectives of housing policy?

NLIHC offers four core principles to guide federal housing finance reform:

1. *The federal housing finance system is a tool to achieve federal housing policy, not an end unto itself.*
2. *Federal subsidies to the housing sector should be directed to meeting the needs of those with the most serious housing problems first.*
3. *All segments of the housing finance sector have a duty to contribute to solving the most serious housing problems.*
4. *Federal policy should not favor one form of tenure over another; rather, federal policy should incentivize balance in the housing market and the full range of needed housing choices in every community.*

The federal housing finance system is a tool to achieve federal housing policy, not an end unto itself.

NLIHC believes the role of the federal government in housing policy is to make good on the promise of the Housing Act of 1949, of “a decent home and a suitable living environment for every American family.” This can be accomplished by directly operating housing, by providing subsidies to projects or individuals to reduce the cost of developing and operating housing, and by assuring a well-functioning and robust housing finance system that provides access to capital as its needed. But a well-functioning housing finance system is not a goal in and of itself. To the extent that the federal government lends its resources directly or indirectly to support the housing finance system, these actions must be assessed and justified in terms of how they advance the overall goal of a decent home and a suitable living environment for every American family.

Federal subsidies should address greatest need.

In the United States today, there are 9.2 million extremely low income (ELI) renter households (incomes of 0-30% of their area median) and only 6.1 million rental homes they can afford (paying no more than 30% of their income for their housing). For every 100 extremely low income household in the United States, there are just 37 rental homes that are affordable and available to them.¹ As a result, these households pay precariously high portions of their income for the homes, leaving little left for other necessities.

The 2010 *State of the Nation's Housing* report from the Joint Center on Housing Studies concludes that in 2008, 54% of all households in the bottom income quintile paid over half of their income on rent and utilities. For renters the number was 59%.² In both cases, this represented a 19% increase from 2001.³ No matter the age, household composition, or employment status of the households, households at the bottom of the income distribution have to pay unacceptably high portions of their meager income for their homes. And despite growing vacancies, with declining incomes and employment there is no evidence households have an increased ability to pay or that rent burdens are declining. If anything the opposite trend is observable.⁴

The consequences of this scarcity of affordable and available housing are dire for the families most directly affected. High housing cost burdens mean fewer dollars to spend on other necessities. High housing costs mean never saving money and having no cushion for emergencies. High housing cost burdens mean risk of eviction and frequent moves. The shortage of affordable rental homes for extremely low income households is the principle cause of homelessness in the United States.

¹ Pelletiere, D. (2009). *Preliminary assessment of American Community Survey data shows housing affordability gap worsened for lowest income households from 2007 to 2008*. Washington, DC: National Low Income Housing Coalition.

² Joint Center for Housing Studies, Harvard University. (2010). *State of the Nation's Housing*. Cambridge, MA: Author.

³ Using a lower income threshold NLIHC found that nearly three quarters (71%) of ELI renter households spent over half of their incomes for housing in 2007, and the average ELI renter spent 83% of household income on housing. Pelletiere, D. (2009).

⁴ Joint Center (2010) and Collison, R.& Winter, B. (2010). *U.S. Rental Housing Characteristics: Supply, Vacancy, and Affordability*. HUD PD&R Working Paper 10-1.

A stable home is the platform for success in all other spheres of individual and family life. Children cannot succeed in school if they do not have a stable place to go home to when school is out. Adults cannot succeed in the workforce or in civic life if they do not have a stable place to go home to at the end of the workday. Someone cannot recover from illness in the absence of a stable home. People with chronic disabilities are consigned to institutions or the streets if they lack access to stable homes. All the other interventions policy experts and professionals devise to help low income people improve their social and economic well-being are for naught if we first do not make sure they have safe, decent, and affordable homes.

The major cause of this shortage of affordable housing can be viewed as a classic market failure. Even though providing for a stably housed citizenry serves the greater social good, without some form of collective action or government intervention decent, safe housing cannot be reliably built or operated at a price that the very lowest income workers, or many people who are disabled or elderly, can afford. The United States has been losing low cost rental housing at an accelerating rate. Of the units renting for less than \$400 in 1997, 15% were lost to demolition, disaster, or neglect. For units with rents between \$400 and \$600, the rate was just 10%, and the rate was under 5% for units with rents over \$600.⁵ Neither market forces nor public policy has stopped this decline or filled this gap to date.

In FY 2009, the Federal government spent \$300 billion to support housing and the mortgage markets. Eighty percent subsidized homeownership, and the remaining 20% supported rental housing. The majority of the homeownership subsidy is provided through tax expenditures, while most of rental housing support is provided through the HUD budget.⁶

Moreover, the tax advantages provided for homeowners are skewed to benefit higher income households. First, a taxpayer has to have sufficient income to benefit from filing an itemized return in order to take a tax deduction at all. Only a third of all households claimed the mortgage interest deduction in 2009. Second, the bigger one's mortgage, the greater one's deduction, so people with the most expensive homes get the most generous subsidy. Of those who took the deduction, 76% of the subsidy went to

⁵ Joint Center for Housing Studies, Harvard University. (2010). *State of the Nation's Housing*. Cambridge, MA: Author.

⁶ Congressional Budget Office. (2009, November 3). *An overview of federal support for housing*. Washington, DC: Author.

households with incomes of \$100,000 or more; 32% went to households with incomes of \$200,000 or more. Similar skewing in favor of the financially well-off is found in the real property tax deduction.⁷

A truer picture of the Federal commitment to housing would also count the nearly \$2 trillion in support for mortgage credit and other insurance through Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, FHA, Ginnie Mae, VA and Rural Housing Services loans, and the National Flood Insurance Program.

Despite this considerable federal involvement and investment in the housing sector, there is still a persistent structural deficit of rental housing that the lowest income people can afford. This is a problem that the private housing market has not and cannot solve alone. Subsidies are needed to meet the gaps between what people can afford to pay and the costs of developing and operating the housing. Clearly, as demonstrated above, the federal government provides large subsidies for housing, but these subsidies are not being directed to where they are needed the most and where they would do the most good. Housing finance reform must address this regressive approach to allocating housing subsidies.

All segments of the housing finance sector should contribute to solving the most serious housing problems.

Housing, like health care, is so essential to human well-being that any profit seeking enterprise in housing must be grounded by social responsibility that is assured by government regulation.

In this vein, in 1992, Congress directed Fannie Mae and Freddie Mac to take a more active role in assuring the availability of affordable housing by establishing “affordable housing goals” that the GSEs were required to meet. There is little agreement as to the effectiveness of these goals,⁸ however, and many observers would do away with them entirely. Certainly the affordable housing goals made little difference in addressing the affordable housing shortage for the lowest income people.

⁷ Joint Committee on Taxation. (2010, January 11). *Estimates of federal tax expenditures for fiscal years 2009-2013*. Washington, DC:Author.

⁸ Federal Housing Finance Agency. (2010, February 1). *The housing goals of Fannie Mae and Freddie Mac in the context of the mortgage market: 1996-2009. Mortgage Market Note 10-2*. Washington, DC:Author.

In July 2008, Congress enacted additional reforms for the GSEs and added a further affordable housing obligation including contributions to the National Housing Trust Fund and the Capital Magnet Fund.⁹ The National Housing Trust Fund is specifically designed to address the shortage of rental housing for the lowest income people. Of course, these contributions were suspended before they ever started when Fannie and Freddie went in conservatorship in the fall of 2008.

Whatever form Fannie and Freddie take in the future, the obligation to contribute to the National Housing Trust Fund must be renewed and expanded.

Just as important, all federally regulated financial institutions, which benefit from the federal government bearing some of the risk of their transactions, have a similar obligation and should be required to make similar contributions. There should be revenue-generating requirements on all financial institutions, including, but not limited to, the next generation of secondary market entities. The federal government provides private financial institutions with low cost funds through a variety of sources. The most important of these are lenders' ability to borrow from the Federal Reserve and the Federal Home Loan Banks and to acquire low cost deposits based on federal deposit insurance. A 5 basis point annual fee on outstanding low-cost funding balances could raise several billion dollars per year for the National Housing Trust Fund. Congress could also levy a fee on the securitization of mortgages by any capital markets participant.

In this vein, the Federal Home Loans Bank's Affordable Housing and Community Investment Programs should be continued as they currently provide direct support for housing for low and moderate income families.

Federal policy should not favor one form of tenure over another.

Federal housing policy and in particular federal support for the housing market has clearly favored homeownership over rental housing for much of the last 75 years, as indicated by the skewed nature of federal housing subsidies reviewed above. Not only has a disproportionate share of subsidies gone to homeownership, subsidies provided to homeowners through the tax code are an entitlement. Someone who fits all the eligibility criteria automatically receives the subsidy regardless of the consequences for

⁹ The Housing and Economic Recovery Act of 2008 also established a "duty to serve" for the GSEs, explicitly to serve three underserved markets: manufactured housing, affordable housing preservation, and rural areas.

the federal budget. Subsidies to renters through direct spending by HUD or other federal agencies are limited to the amount of annual appropriations. Most people who are eligible for rental assistance do not receive it because of a lack of funding. A generous estimate puts the proportion of those eligible for direct federal housing assistance who actually receive any such assistance at 24%.¹⁰ One need only note that waiting lists for public or assisted housing are years long to understand that these are “first come, first serve” programs. In contrast, no one waits in line to claim housing subsidies through the tax code.

Federal housing policy should be based on the simple reality that every community has members at all stages of the life cycle, at all income levels, and in all forms of family constellations. Every community needs a variety of housing options: owned and rented, single family and multifamily, assisted and supportive homes, sized for single persons and large families. Forms of housing that expand housing choice such as two-to-four unit multifamily homes and manufactured housing should be encouraged. To the degree that any form of housing is subsidized, these subsidies should be provided based on a priority that ensures that those with the greatest need are served first.

Assuring that all members of a given community have homes they can afford in and a real choice of neighborhoods will require strict enforcement of fair housing and lending laws, and full implementation of the duty to affirmatively further fair housing as a condition of receiving direct and indirect federal subsidies.

It is important to state that NLIHC is not against homeownership. Although its benefits have been overstated, it is still the preferred form of housing tenure by the majority of Americans. The best way to help a family become ready for homeownership is to make sure they can have the opportunity to succeed at renting. When renting is affordable, it offers low income families housing stability and time to save money to buy a home in the conventional market. A rental housing market that functions well for everyone is a necessary element of a well-functioning homeownership market.

Question 2. What role should the federal government play in supporting a stable, well-functioning housing finance system and what risks, if any, should the federal government bear in meeting its housing finance objectives?

¹⁰ Joint Center.

The role of the federal government in supporting a well-functioning housing finance system should be to make certain the system for the provision of decent housing and fair access to fairly priced credit is robust over the entire economic cycle, everywhere in the country (including rural areas), and across all segments of the housing market.

Much of this role can be done through vigorous enforcement of fair lending and fair housing laws as well as an expansion and enforcement of the Community Reinvestment Act and would require the federal government to take no actual risks. However, there are certainly risks that are both necessary and proper for the federal government to bear.

The risks that the federal government should be expected to bear are twofold. First the federal government must assume the inherent risk of housing poor or otherwise financially marginalized households. This risk is essentially addressed by providing the correct subsidies in the correct amount to the correct party in a manner that makes the subsidy useful in the housing finance context. But this is not always easy; for example, in the case of the LIHTC, an indirect subsidy that incentivizes the private housing finance system to produce housing for lower income families, additional subsidies, generally in the form of project-based Section 8 assistance, are needed to make the projects affordable to those with very low (50% of area median or below) and extremely low incomes (30% area median or below). However, because the Section 8 program funding is subject to the annual appropriations process, lenders financing LIHTC projects are reluctant to underwrite projects based on the Section 8 income stream. This appropriations risk needs to be assumed by the federal government to assure that privately funded affordable housing can move forward.

Second, the federal government should be a credible backstop, bearing the risk of providing necessary credit to American households and firms in the event of a catastrophic systemic failure of the private housing finance system. Beyond this, risk should be borne by private entities in best position to identify and manage the risk, primarily lenders but also borrowers within the context of strong consumer protections.

The second risk, the broader failure of the financial system, though not the subject of NLIHC's area of expertise, is certainly a concern and will clearly require regulations and requirements for the private sector designed to avoid and offset this risk.

Question 3. Should the government approach differ across different segments of the market, and if so, how?

The purpose of federal housing policy must be considered separate from and paramount to the support of the housing finance industry or the support of specific tenure or structure types. Choice about the types of tenure and structure to be financed should not be directed by federal housing policy and should be devolved as much as possible to individual households, developers and local governments as long as the overarching goal of providing decent affordable housing and fair access to credit within a robust financial system is being met.

However, financing needs differ from market location to market location, across the range of prospective residents, structures, and the mix of uses, and, of course, over time. The federal support for the housing finance system must be flexible enough to address the variety of different financing needed to meet the objectives of a decent affordable home, equal access to credit and a robust housing market over time and place.

In stark contrast to this proposed approach, federal housing policy, including federal housing finance policy, has clearly favored homeownership over rental housing for much of the last seven decades. Given the bias toward owned single-family detached units that has persisted in federal level financing interventions and support for decades and the critical need for affordable rental housing, in the near term the federal government must increase its focus on directly subsidizing this housing where needed and by promoting a multifamily financing market directed at providing this much needed housing, particularly smaller multifamily projects.

Another example of market failure is often related to geography. In rural areas, private lending institutions often do not have a sufficient presence and familiarity to provide competitively priced credit. Federal policy and actions should actively address this disparity.

Also, it may be justifiable for the federal government to introduce some bias within the system to maximize the capacity of mission driven, public or non-profit housing providers to achieve tangible results in solving the nation's housing woes. Public and non-profit housing organizations that are not motivated by profit are more likely to engage in housing development and operation that will serve low income people over the long term.

Finally, the federal government has a role in influencing the housing choices of individuals, investors and local authorities in the area of energy efficiency and environmental impact. Tax credits and favorable mortgage terms for homeowners and owners of multifamily properties that encourage energy efficiency should be continued and expanded. Similarly, the federal investment should not simply encourage investment in housing. One of the manifestations of the housing bubble was the growth in the square footage of individual homes. The demand for bigger homes with more expensive amenities was in part fueled by federal housing subsidies through the tax code and the provision of subsidized credit. Creating a bias for smaller mortgages (relative to local housing costs) in the federal support for mortgage finance would help right size houses and reduce the energy that each house consumes.

Question 4. How should the current organization of the housing finance system be improved?

NLIHC has long had significant concerns with the focus of government involvement in the housing finance system. These interventions have often been focused on providing credit and employment in the field of real estate by boosting the number of transactions and increasing the investment in real estate by otherwise adequately housed households. As a result, the current system is too focused on financial and industrial policy not housing outcomes.

NLIHC sees reforms tending to move away from requiring specific transactions or transaction types and other goal setting for the industry to a system that more strongly requires fair provision of credit for all and relies on user fees on individual housing finance transactions or the profits or revenues of firms involved in housing finance to assist the federal government in directly providing quality housing or rental assistance to low income households.

Question 5. How should the housing finance system support sound market practices?

The federal housing finance system should support sound market practices through direct regulation of loan practices and terms, consumer education and counseling and strenuous oversight of the loan origination and securitization practices of all market participants. We should not rely on the federal presence merely as a market participant

to ensure that the market uses prudent and fair lending practices, as was the case in the recent past, for example, with the reliance on the GSEs to set underwriting standards. In addition, while securitization is an important component of any functioning market, the ability of an originator to pass on the entire credit risk of the mortgages they originate should be curtailed.

Ultimately, federal intervention in housing finance should be seen as a means not an end. In other words, federal objectives in housing finance cannot support the housing finance industry or specific financial markets or products. Nor can the objective be the promotion of financial leverage in the production of housing, increasing or maintaining the price of housing for sale, or boosting the number of transactions in the housing market.

Question 6: What is the best way for the housing finance system to help ensure consumers are protected from unfair, abusive, or deceptive practices?

The federal government must first assure fair access to credit nationwide. No community, whether defined geographically or by demographic, social, or economic characteristics, or person should be without access to fairly priced credit.

Moreover, the federal government should adopt the most robust anti-predatory lending laws possible, modeled after state laws that offer the best possible protections. Under no circumstances should the federal government pre-empt more protective state statutes.