EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

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2/9/95

LEGISLATIVE REFERRAL MEMORANDUM

Total Page(s): _____

TO: Legislative Liaison Officer - See Distribution below:

FROM: Janet FORSGREN (for) Janet L. Forsgren
Assistant Director for Legislative Reference

OMB CONTACT: Anna BRIATICO 395-7887
Legislative Assistant's line (for simple responses): 395-7362

SUBJECT: HOUSING AND URBAN DEVELOPMENT Proposed Testimony on HUD's Native American Programs

DEADLINE: 2 p.m. Friday, February 10,1995

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President.

Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: Attached is proposed testimony for Secretary Cisneros before the Senate Committee on Indian Affairs on February 14, 1995.

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STATEMENT BEFORE THE
SENATE COMMITTEE ON INDIAN AFFAIRS

WASHINGTON, D.C.
FEBRUARY 14, 1995

by
Henry G. Cisneros
Secretary
U.S. Department of Housing and Urban Development

Mr. Chairman and Members of the Committee, thank you for holding this hearing today and for your strong support for HUD's goals, priorities, and legislative initiatives.

We especially want to thank you, Mr. Chairman for your leadership as a strong advocate for Native Americans, Alaska Natives and Native Hawaiians. We especially appreciate your efforts in recent years to preserve funding for HUD's Native American programs in the face of proposed cutbacks. People that care about the quality of life of Native Americans are well served by your chairmanship.

We are very pleased to work closely with you and your staff and with the Members of the Committee on these issues. I am delighted to be here today to discuss Indian housing and community development needs and the Department's ongoing study of those needs, as well as the proposed budget for Native American programs.

Before I begin the details of our proposed budget, I would like to share with you the innovative approach the Department has taken in Native American programs over the last several years.

INDIAN HOMEOWNERSHIP: *THE FIRST GENERATION*

The Department's focus on Native American programs in Fiscal year 1994 was called "**Consultation '94**". In a series of twenty-seven meetings held throughout the country, Consultation '94 brought together Indian and Alaska Native tribal representatives, Indian housing authorities, and national Indian organizations to discuss with HUD changes which would improve the delivery of our programs. As a result of that consultation process, the Department streamlined its procedures and reduced regulations for major programs by close to 50%.

Consultation '94 also reinforced something the Department already knew: there is a strong need and desire for homeownership in Indian Country. While the HOME program, and the Mutual Help Homeownership Opportunity program to a more limited extent, have brought homeownership to Indian Country, it has been limited to low- and moderate-income families. In FY 1994, the Department implemented the Indian Loan Guarantee Program pursuant to Section 184 of the Housing and Community Development Act of 1992, bringing the opportunity for true homeownership to a newly emerging middle class of Native Americans who desire to continue living on reservations.

Because homeownership is a relatively new concept in Indian Country, the Office of Native American Programs has developed a follow-up initiative to Consultation '94 called "**Indian Homeownership: THE FIRST GENERATION**" for FY 1995. We have focused on bringing this Department together with the Departments of Agriculture, Interior and Veterans' Affairs, as well as other federal agencies who are involved with housing and related issues, to develop a comprehensive presentation to Tribal governments, Indian housing officials and Native American housing associations. The objectives are to educate, to consult, to overcome barriers and to develop a unified plan for making homeownership a reality in Indian Country.

INDIAN HOMEOWNERSHIP: *THE NEXT GENERATION*

Fiscal year 1996 will bring the Department and Indian Country even closer the the reality of homeownership and choice in housing. As I will elaborate later, the Department's Reinvention Blueprint allows Tribal governments the greatest opportunity ever to plan for the future while meeting current housing needs in the way which is most appropriate for their reservation. Many tribes have needed the flexibility in funding to create the infrastructure of their environment before meeting even basic housing needs. The Community Opportunity Fund in concert with the Affordable Housing Fund will provide that flexibility. There are also tribes who have had the resources to have in place all that is necessary to move forward into individual homeownership for tribal members. The Blueprint provides them the additional opportunities available through the Indian Loan Guarantee Program.

No matter what a tribe's current level of need, the Department's Reinvention Blueprint for Native American Programs will provide the opportunity for moving into the "**NEXT GENERATION.**" Through the creation of the several funds which will be administered as block grants, tribes are afforded greater flexibility in creating physical as well as administrative infrastructure to meet the housing needs of their tribal members.

In addition, the next logical step in expanding the concept of homeownership in Indian Country is to create a financial infrastructure not only to provide lending for homeownership, but to create economic development and commercial financing opportunities by and for Indians. The Native American Financial Services Organization (NAFSO), which was introduced in FY 1995, will provide ongoing assistance to the secondary market for residential mortgages and economic loans for individual families, financial institutions and other borrowers by increasing the liquidity of such mortgage investments. The NAFSO will do this by providing technical assistance and other services to Native American Financial Institutions created pursuant to provisions of the Community Development Financial Institution Fund.

CULTURALLY RELEVANT HOUSING

Native American residents have long called for a home which was more relevant to their life styles and reflected their traditions and cultures. For many years, a misconception has existed that IHAs were not permitted to develop housing which met these desires.

Over the past five years, HUD has taken a number of steps to dispel the myth that it was impossible to build a home which is culturally relevant to its Native American resident. A number of regulatory revisions have been made which stress the authority of an IHA to make its own design and construction decisions. A regulatory requirement for citizen participation was added to the regulations in 1990.

In 1994, ONAP established a Departmental Cultural Design Award to be presented each year in several categories. The first awards will be presented in the Spring of 1995. This award is formal recognition of excellence as determined by a process of selection that reflects the accomplishments of outstanding IHAs and Tribes who clearly recognize the benefits to be derived from including cultural relevancy in the design of homes and facilities for Native Americans. In presenting awards, we will be doing more than merely honoring the recipients, we will be setting forth standards for others to follow in the future.

This program promotes *cultural flexibility* to tribes in moving into the *NEXT GENERATION* in housing opportunities.

ASSESSMENT OF NATIVE AMERICAN HOUSING NEEDS AND PROGRAMS

It has long been felt that thee were no accurate data regading housing needs among Native Americans and Alaska Natives. Therefore, in January, 1993, the Department initiated the ***Assessment of American Indian Housing Needs and Programs***. The purposes of this study were to: (1) evaluate the housing problems and needs of American Indians and Alaska Natives, (2) assess the effectiveness of existing federal housing programs in meeting those needs, and (3) compare alternative approaches and suggest ways in which federal policy regarding the housing of Native Americans could be improved.

The major findings of this study indicate that:

- o Housing problems of American Indians and Alaska Natives (AIAN) remain considerably more severe than those of non-Indians in all parts of America (particularly so in reservations and other AIAN areas), but the character of those problems varies importantly in different types of environments;

o HUD programs have made a substantial contribution toward improving housing conditions in AIAN Areas and appear to be relatively well managed. However, they do lack the statutory flexibility to allow for the use of resources as effectively as they might; and

o Reform of federal housing assistance should concentrate on consolidating existing programs into block grant mechanisms in a manner that gives tribes and their housing authorities broader latitude in planning and implementation to address local housing needs as they see them, while holding them more accountable for performance.

As you will see in the Blueprint, the Department has taken these findings, as their recommendations, very seriously.

HUD's REINVENTION BLUEPRINT FOR NATIVE AMERICAN PROGRAMS

The Department's Reinvention Blueprint stresses a Federal commitment to cities, affordable housing, economic development and to the housing needs of its poorest and most vulnerable citizens. Included in this plan is a strong desire to pursue the same commitment for Native American communities. The Department's Blueprint provides an opportunity to enhance living conditions in Indian country in a manner unprecedented in past federal/tribal relations.

Over the past few years, HUD has developed a close working relationship with Tribal governments, Indian housing organizations and the Native American community. As a result, HUD programs have become a particularly valued asset to Tribal communities. There is a strong feeling that this relationship should not only continue, but do so in a manner which is even more productive, cooperative and results-oriented.

Solving the Problem not the Symptom

The Reinvention gives HUD an opportunity to address a very serious problem which inhibits the improvement of life in Indian country in all federal programs. That is, most programs do an acceptable job of addressing basic human needs, such as shelter, health care and food. However, they do not, for the most part, address the underlying need for the development of Tribal infrastructure, economic opportunities, legal systems, etc., the lack of which precipitates the need for massive federal funding.

For example, HUD has recently implemented the Indian Loan Guarantee Program, a much needed program to assist in guaranteeing privately financed single family home loans made to Native American families. However, a major obstacle to full utilization of this program now appears to be the most basic requirement of having Tribal laws and codes to support a modern lending system. As a result, some communities are not yet able to participate even though they have Tribal members ready and willing to seek private financing.

Consolidation of Programs to Better Target Resources

Today, Tribes and Indian housing authorities share in many HUD programs: Indian Housing (rental and homeownership), Modernization, Vouchers, Youth Sports, Drug Elimination, Tenant Opportunity Program, Family Investment Centers, Family Self Sufficiency, Community Development Block Grant, Emergency Shelter Grants, HOME. HOPE, the Indian Single Family Loan Guarantee Program, the FHA 248 insurance program, etc.

While many larger Tribes take great advantage of all of HUD's programs, the vast majority of tribal communities are smaller and quickly become overwhelmed by the number of programs available. The nature, timing and administration of these many diverse programs inhibits the process of comprehensive planning. Because most of HUD's programs are competitive in nature, with no guarantee for funding, Tribes frequently find their Plans unachievable a short time after they are developed.

The Department's Blueprint, which ultimately creates three separate funds: a) Housing Certificates for Families and Individuals; b) Affordable Housing Fund; and c) Community Development Block Grant Fund, is precisely the type of program consolidation which will allow tribal communities to focus more precisely on their key problems, yet retain the flexibility to adjust quickly to changing local conditions.

It is anticipated that all three funds will have a Native American Program component administered separately from the non Indian portion of the fund in order to better respond to the unique and different characteristics which are found in the Nation's Native communities.

Furthermore, the separate administration of programs specifically for Indian Country allows HUD to implement the Federal Government's long-standing goal and desire to provide Tribal governments with the maximum flexibility and relieve the Department of the necessity to impose some of the more narrowly focused goals found in the non-Indian portion of the programs.

In addition, to the three large funds, it is proposed that the Indian Single Family Loan Guarantee Program will remain a separate program to serve the needs of individual homebuyers seeking private financing for home purchase and construction. Although a very new program, Indian Loan Guarantee is quickly integrating itself into the Tribal housing environment. The nature of the program, which involves a federal guarantee for the private financing of housing, is structurally different from the grant oriented programs of the Affordable Housing Fund and, therefore, should remain separate.

APPROPRIATIONS

In general, the Native American component to each of the funds will reflect that fund's over-all purpose and objectives. However, the Native American portion will be tailored specifically for Tribal governments and communities. Eventually, it is recommended that appropriations for Native American programs, be developed on an actual dollar basis rather than the percentage basis which currently exists in some programs.

However, to accommodate the transition process, in FY 1996 and FY 1997, Tribes will continue to receive a percentage share of the Affordable Housing Fund (no less than one percent) and of the Community Opportunity Fund (no less than one and one-half percent). Specific funding will also be targeted to Indian housing new construction in the Capital Fund sub-category of the PH/IH Transformation Fund.

By 1998, the Department would recommend a specific dollar figure for Native American programs within each Fund. The primary justification for this approach is that with the shifting and consolidation of programs, there is little relevancy between today's set-asides and expected funding levels under the fund approach. For example, the IH program currently funds the off-site sanitation facilities which accompany the construction of new housing units through the Indian Housing Program. In order to provide for continued funding for this function, the Department will need to continue to address these funding needs through the Affordable Housing Fund or the Community Opportunity Fund.

FY 96 BUDGET PROPOSAL

Fiscal year 1996, will be an exciting year for Indian Country. The new program configuration will give tribes the flexibility they have lacked in the past to take the holistic approach to housing on reservations, as well as providing the funding necessary to develop and undertake comprehensive plans for the future. In addition to increasing funding for the new construction of approximately 3,000 traditional Indian housing units, I have pledged no less than 1.5 percent each of the Affordable Housing Fund and the Community Opportunity Fund to go to tribes. This will provide an unprecedented $23.1 million from the Affordable Housing Fund and $69.75 million from the Community Opportunity Fund for moving into *THE NEXT GENERATION*.

As I mentioned earlier, the Department has chosen to maintain the Indian Loan Guarantee Program as a separately funded program. It does not readily fit into the formula driven Affordable Housing Fund because guarantees are issued on an individual demand basis. It does not fit into the Federal Housing Administration model because statutorily the Indian Loan Guarantee Fund is established and funded separately from the FHA insurance fund. While we have not increased the budget request for capatalizing this program in FY 1996, a reformulation of the credit limit will allow the guarantee of approximately 150 more home loans; bringing the total number of families realizing homeownership to over 400.

The attached table reflects the current FY 1995 and the proposed FY 1996 funding levels by individual program within the Blueprint Fund structure. Programs which are currently distributed among both public and Indian housing authorities either by formula or competition are estimated on past years funding.

Native American Finance Authority

The Department proposes to continue its efforts in support of legislation creating the Native American Finance Services Organization (NAFSO). The importance of NAFSO is dramatically increased as a result of the Department's Blueprint. NAFSO would become the foundation upon which a true Native American lending community is developed and as a catalyst in the secondary lending market. When this legislation is enacted, it potentially could be funded through the Affordable Housing Fund.

U.S. Department of Housing and Urban Development

February 14, 1995

FY 1996 Budget Summary
(000s)

Category	96 Actual	96 Budget	Change
PIH/IH Transformation Fund			
PIH Operating Funds			
Operating Subsidies	60,000	60,000	- 0 -
COMPAC	10,000	10,000	0
PIH Capital Funds			
Development	282,000	297,000	15,000
Amendments	10,000	-0-	-10,000
Modernization	170,000	170,000	
Tenant Opp Program	2,000	2,000	- 0 -
Family Invest Ctrs	3,000	-0-	- 3,000
Affordable Housing Fund		23,090	23,090
HOME	14,000	-0-	-14,000
Indian Loan Guarantee	3,000	3,000	- 0 -
Homeless Block Grant			
Emergency Shelter Grants	1,668	1,668	- 0 -
Community Opportunity Fund			
CDBG	46,000	69,760	23,760
Housing Certificates for Families and Individuals			
Incremental Rental Assistance	15,500	15,500	- 0 -

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Washington, D.C. 20503-0001

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2/28/95

LEGISLATIVE REFERRAL MEMORANDUM

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TO: Legislative Liaison Officer - See Distribution below:

FROM: Janet FORSGREN (for) Connie J Bowers for
Assistant Director for Legislative Reference

OMB CONTACT: Anna BRIATICO 395-7887
Legislative Assistant's line (for simple responses): 395-7362

SUBJECT: HOUSING AND URBAN DEVELOPMENT Legislative Specs on FHA Corporation

DEADLINE: COB Friday, March 03,1995

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President.

Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: PLEASE NOTE -- This is the fourth part of the HUD Reinvention proposed legislative specifications (FHA Corporation). Additional specifications will also be circulated to relevant agencies and offices. Comments on this [redacted] part are due by COB, Friday, March 3rd. If we do not hear from you by 5:30 p.m., we will assume that you concur with the specifications. Thanks.

Lynn
I'll just keep passing these on to you FYI.

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RESPONSE TO
LEGISLATIVE REFERRAL MEMORANDUM

LRM NO: 490
FILE NO: 82

If your response to this request for views is simple (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet.

If the response is simple and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant.

You may also respond by:

(1) calling the analyst/attorney's direct line (you will be connected to voice mail if the analyst does not answer); or
(2) sending us a memo or letter.

Please include the LRM number shown above, and the subject shown below.

TO: Anna BRIATICO 395-7887
Office of Management and Budget
Fax Number: 395-6148
Branch-Wide Line (to reach legislative assistant): 395-7362

FROM: ______________________________ (Date)

______________________________ (Name)

______________________________ (Agency)

______________________________ (Telephone)

SUBJECT: HOUSING AND URBAN DEVELOPMENT Legislative Specs on FHA Corporation

The following is the response of our agency to your request for views on the above-captioned subject:

_____ Concur

_____ No Objection

_____ No Comment

_____ See proposed edits on pages _________

_____ Other: ______________________

_____ FAX RETURN of ____ pages, attached to this response sheet

DRAFT 2/27/95

FEDERAL HOUSING CORPORATION CHARTER ACT

Description of the Mission, Role and Structure of the New Corporation

Introduction

Across America, millions of families struggle to get their chance at the American dream of homeownership. Thousands of communities fight to attract private capital to restore their shrinking, aging stock of affordable apartment buildings and to modernize obsolete and inefficient community hospitals. For the last 60 years, FHA has played a critical role in meeting these unmet needs, stepping in where the private sector would not or could not serve. But today's FHA is outdated, inefficient, bureaucratic and increasingly ill-equipped to manage prudently a Fortune 100-sized insurance company with a $380 billion portfolio of insurance-in-force backed by the U.S. taxpayer. By creating a new government-owned Federal Housing Corporation, Congress could transform today's FHA into a streamlined, entrepreneurial model of how government can efficiently accomplish public purposes and be held accountable for producing results. To protect the taxpayers' interests, the new Federal Housing Corporation would be subject to rigorous oversight of its safety and soundness and constant monitoring of its success at serving those people and communities that the private sector leaves behind.

Meeting Unmet Needs

Young families, lower-income borrowers, minorities, residents of underserved urban and rural areas, and moderate-income families in high cost areas all strive to make their modest wealth and income go far enough to purchase a home. Improvements in the ability of the private sector to serve these markets still leave millions of families, that have sufficient steady income to support a mortgage, unable to buy their own homes through conventional financing.

Meanwhile, the nation's principal supply of affordable housing is found in its older housing stock, often in smaller properties owned and managed by individuals or small businesses. The capital needs of this stock are difficult for the private housing finance markets to serve. The U.S. went from a surplus of 400,000 affordable units in 1979 to a shortage of 4.1 million units in 1989. In the absence of significant new affordable housing development, the restorable existing stock becomes a vital resource for low- and moderate- income residents and special needs populations, but private investors are reluctant to take the lead in restoring such properties.

Finally, community hospitals are a vital element of healthy neighborhoods. Many of our nation's urban and rural hospitals suffer from obsolete and inefficient facilities, but they have great difficulty finding private lenders to finance capital projects.

The Federal Government's Role in Expanding Access to Credit

The National Housing Act of 1949 established national housing policies, including: (1) private enterprise shall be encouraged to serve as large a part of the total need as it can; and (2) governmental assistance shall be utilized where feasible to enable private enterprise to serve more of the total need. These policies still govern the federal government's role in the mortgage credit markets today.

The federal government has certain inherent advantages -- most importantly a lower cost of capital -- that reduce its cost of doing business below that of the private sector. Compared to private mortgage insurers, the federal government borrows funds less expensively, must set aside fewer reserves, pays no taxes, and has no duty to return a profit to its shareholders. This lower cost of doing business allows the federal government to insure loans at no cost to the taxpayer that would be unprofitable for the private sector to insure.

Figure 1 below illustrates how this advantage allows the federal government to expand access to mortgage credit.

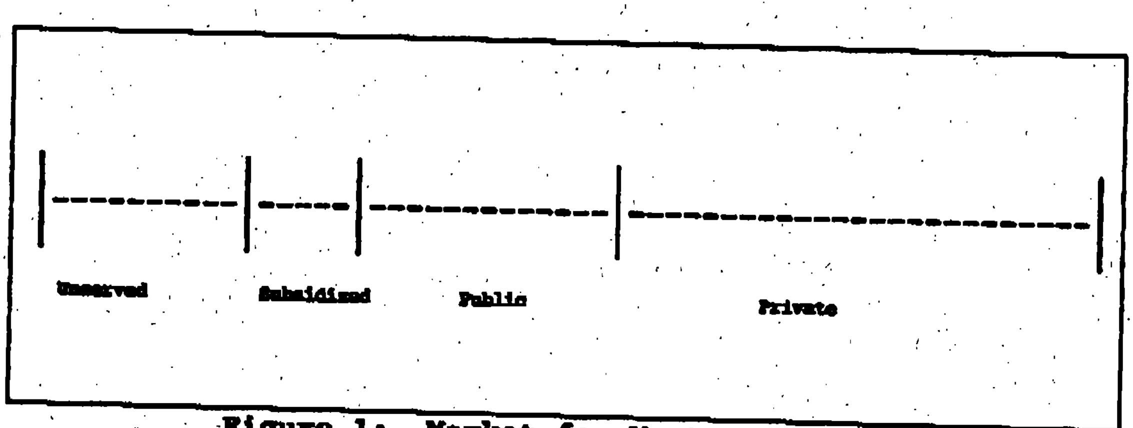

Figure 1: Market for Mortgage Credit

If the axis represents the risk associated with any type of credit enhancement, the "private" market represents that risk which the private sector can underwrite and still make a profit, given its costs of capital and doing business. The "public" market represents that risk that the public sector can assume on a self-sustaining basis, given its lower costs of capital and doing business. The federal government can also cross-subsidize between the public market and the "subsidized" market -- which represents portfolios of loans to higher risk borrowers that cannot be insured on a self-sustaining basis, even for the government. Finally, the "unserved" market represents those borrowers who the credit markets do not currently reach. Some of these borrowers may in fact be less risky than those who are served, but because they do not fit the profile of traditional borrowers or have characteristics untested by the private market, the risk of these loans cannot yet be accurately assessed.

The federal government can play four roles in this market:

- **Expand access to capital to "public" market borrowers who otherwise would not be served.** For example, approximately two-thirds of FHA's single family borrowers are first-time homebuyers, most with too little wealth to meet private sector underwriting standards.

- **Pioneer new markets where risk is uncertain.** The government's experience in those markets creates a track record with which the private sector can learn to manage risk, allowing the private sector to serve more and more of the need.

- **Maintain a broad-enough-based portfolio to support incidental losses associated with opening new markets.** If, of 100 loans to a category of borrower, one can anticipate that 95 will repay and five will default, and if premium income for that portfolio will pay the claims for four of those loans but not the remaining one, the private sector would not make even one of those 100 loans. If FHA is able to earn sufficient income from the remainder of its portfolio to support that additional claim, its presence in the market has made homeownership available to 95 borrowers who otherwise would be unserved.

- **Provide stability to mortgage markets during economic downturns.** During a regional downturn like that which occurred in the oilpatch states during the mid-1980s, private credit left the market. The availability of FHA-insured mortgages allowed some buyers to sell their homes and other families from losing their homes and their savings. As a result, FHA moderated the severity of the economic downturn.

<u>The Federal Government's Special Role in the Multifamily Mortgage Credit Markets</u>

In the multifamily mortgage credit market, as in the single family markets, the federal government must pioneer new products and markets, reach borrowers outside the reach of the private market, and provide stability. However, unlike the system of finance for home mortgages, the private system of finance for multifamily housing, particularly affordable rental housing, has major holes. Thus, the federal government's role in rental housing finance is <u>also</u> to help develop the market infrastructure to allow the private market to serve more and more of the need.

Securitization requires standardization, large volumes and high processing costs. These characteristics are incompatible with loans for smaller properties, loans requiring multiple layers of subsidy and financing, and other complex, one-of-a-kind solutions frequently used in mutlifamily finance. Even when the appropriate vehicle is found to reach the secondary markets, the capital is not consistently available, as even capital for market-rate rental housing is diverted cyclically to alternative investments in pursuit of higher yields and/or lower perceived risk.

Federal credit enhancement can help bring private investors into multifamily markets that they would otherwise not serve and make possible financing for:

- Housing in inner cities and rural areas;
- Development and redevelopment of large projects beyond the capacity of local governments or financial institutions to finance on their own;
- Small businesses and individual entrepreneurs who own and operate much of the country's affordable housing in smaller properties;
- One-note loans providing construction and permanent, long-term, fixed-rate financing;
- Securitization of non-conforming loans or non-conforming pools to facilitate CRA-type lending by local financial institutions; and
- Lending to stimulate investment in local housing markets to combat the effects of local and national cyclical economic forces.

<u>The Federal Government's Special Role in the Hospital Mortgage Credit Markets</u>

The growing private sector health care capital market also leaves a significant niche unserved. Although the construction of health care facilities, including hospitals, community health centers, and nursing homes, is expected to grow at an annual rate of 5% during the next several years, without the credit enhancement afforded by federal mortgage insurance, private lenders are reluctant to provide financing for certain types of projects.

For 26 years, FHA has operated, at a significant surplus, an insurance program for the renovation and construction of hospitals and refinancing of hospital capital projects in older inner-cities and small rural communities. The infusion of capital that these modernization projects bring to their communities promote local economic development, employment, neighborhood stabilization and improve the quality and accessibility of affordable health care in these communities. The federal government, with FHA's expertise in mortgage finance in FHA and the Department of Health and Human Services' expertise in health care finance can operate a unique partnership for processing and underwriting hospital mortgage insurance and managing risk by monitoring portfolio and individual hospital performance.

<u>The Need for Reinvention of Today's FHA</u>

Although today's FHA has the lower cost of doing business that comes from operating in the federal government, much of that advantage is squandered by inefficiencies that flow from its bureaucratic operations and constraints. Rather than accomplishing the maximum public purpose, FHA risks exposing the taxpayer to unnecessary losses. For example:

- FHA's operations and product design are prescribed by legislation and further refined through regulation. FHA's product mix is established in the federal budget process. Rather than managing for results, this <u>overprescription</u> results in an inability to respond to changing market conditions.

- FHA <u>lacks the technology</u> it needs and cannot spend the resources to get the technology even when those expenditures would produce greater savings.

- FHA <u>lacks the skills</u> it needs to manage a complex insurance portfolio of $380 billion of insurance-in-force and cannot acquire the talent or spend resources to train its workers.

- FHA <u>cannot reallocate resources or staff</u> as market needs or emerging problems require, without going through lengthy administrative and budgetary processes. The changes come too late or are so difficult to achieve it is not worth trying.

It is necessary to reengineer virtually every process and procedure in the organization; to design new and relevant products for today's markets and unmet housing needs; to acquire the skills, expertise, and technology to bring FHA into the 21st Century; and to forge partnerships with the public and private partners who can help FHA use its scarce resources more efficiently, manage risk more prudently, and reach those whom the current delivery system does not reach.

Some of these steps could be accomplished in FHA's current structure; but, with the existing resources, processes and procedures, it would take at least a decade -- a decade during which FHA losses would grow, its capacity would shrink, and the American people would get fed up with government that was unable to accomplish its goals effectively. At the end of the decade, the organization finally built would again be outdated.

A government corporation under the Government Corporation Control Act provides the appropriate structure to approach decisions in a business-like fashion while taking advantages of the lower cost of government capital and ensuring that public purposes remain paramount. FHA was an independent corporation for many years, but when HUD was created, all of FHA's operations were consolidated with HUD's other programmatic activities. FHA's need to run a business-like operation and the structure established to coordinate HUD's programmatic objectives have never fit well together. The HUD Secretary must retain the ability to coordinate federal housing policy, by retaining policy direction of the new corporation, but can allow the new corporation to operate under a structure more appropriate to a corporation's business activities.

<u>The Role of the Private Sector in Accomplishing This Mission</u>

The private sector cannot operate its business with the cost of capital, tax exemptions, and smaller reserves of the federal government, nor can it operate without a fiduciary duty to maximize its return to its private shareholders. However, the private sector does have significant advantages in efficiency, flexibility, and incentives to manage risk well. The ideal solution is to design partnerships to exploit the relative advantages of each sector. FHA's current risksharing demonstration is based on this principle. The new corporation would conduct a significant portion of its new origination business on this basis as well.

Risksharing allows the federal credit enhancement to be applied to transactions by other public and private partners who also bear risk. By use the partner's delivery system, the federal government can reach markets it otherwise would not reach, benefit from its partner's knowledge of markets or geographic areas, and rely on the partner's greater flexibility and efficiency. Properly designed, risksharing with adequately capitalized institutions also allows the federal government to trust that the partner's incentive to protect themselves against loss will result in lower exposure for the federal government.

Description of the New Federal Housing Corporation

Governance

The Corporation established under this Charter would operate under the policy direction and oversight of the Secretary of the Department of Housing and Urban Development, ensuring that its policies could be coordinated with other aspects of federal housing policy. It should be overseen by a Cabinet level official reporting to the President both to ensure adequate accountability to the President and the Congress.

The Corporation's Chief Executive Officer would be appointed by the President and confirmed by the Senate, like HUD Assistant Secretaries and the heads of comparable financial organizations like the FDIC, GNMA, OCC, OTS, etc.

Accountability

The Corporation would be held accountable for reaching its dual objectives of accomplishing its public purpose mission and operating a self-sustaining operation in a safe and sound manner, minimizing risk to the taxpayer. A system of accountability unprecedented for a government agency would be established.

First, the Secretary of HUD would have responsibility for establishing programmatic goals to ensure that the Corporation accomplished its public purpose mission. The Secretary would monitor the Corporation's performance against those goals and report on its activities to the President and the Congress. The Secretary also would approve an annual business plan setting for the business lines and products that the Corporation expected to operate and their anticipated performance.

Second, the Office of Federal Housing Enterprise Oversight would be named as the safety and soundness regulator of the new Corporation. The regulator would have full examination authority and would monitor the adequacy of the Corporation's capital to protect against unanticipated losses in the portfolio, using a risk-based capital adequacy model. The regulator also would establish estimates of performance of projected books of business for use in reporting net credit subsidy in the federal budget under credit reform.

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FEDERAL HOUSING CORPORATION
CHARTER ACT

Explanation of the Legislation

Title XXX: Federal Housing Corporation Charter.

This Title transforms the Federal Housing Administration into a wholly-owned, self-sustaining, government corporation. This Act establishes the structure of the Federal Housing Corporation (the "Corporation" or "FHC"), sets forth the Corporation's powers and authorities, establishes public purpose and safety and soundness performance measures and a system of oversight and accountability, provides for a transition period, and provides for the repeal and termination of certain programs formerly under the jurisdiction of the Secretary.

Section 101: Short Title

This section would entitle this Title, the "Federal Housing Corporation Charter Act."

Section 102: Findings

This section would enumerate findings justifying the incorporation of the Federal Housing Corporation. Findings would include:

- An assessment of unmet housing and housing credit needs of families, communities, and certain markets, and the relationship between housing and vibrant communities;

- A statement about the persistence of housing and lending discrimination in the nation, and the need to assure that housing credit provided by a government corporation is made available on a non-discriminatory basis.

- An assessment of the health care facility financing needs of particular communities, and relationship between health care facilities and community development and empowerment.

- A statement of the historical role FHA has played in the housing finance arena, including its pioneering and market stabilizing role;

- A statement of the role FHA plays today in the system of housing finance, and the housing needs served by FHA

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today;

- An assessment of the weaknesses of FHA today and an evaluation of the impact of those weaknesses on the ability of FHA to fulfill its unique mission;

- A description of the housing finance system, how it has matured and changed, and its continuing weaknesses and strengths in meeting the needs of certain Americans and in providing capital for affordable rental housing;

- A statement of the potential critical role to be played by instrumentalities of the federal government in the housing finance system;

- A statement recognizing the need to benefit low- and moderate-income families, and recognizing the importance of business diversity in order to maintain self-sufficiency during an era of scarce federal appropriations for government programs, while acknowledging the cost that would be incurred by limiting the government role to serving only low-income families;

- A statement that, to carry out such a role, the federal government entity must be structured differently: it must be flexible and entrepreneurial without reducing accountability, by building mechanisms to monitor the corporation's accomplishment of its public purposes and its ability to manage risk prudently and prevent losses.

Section 103: Establishment of Corporation.

(a) In general --. This section would create the Federal Housing Corporation as a distinct government corporation within the Department of Housing and Urban Development (the "Department"). The Corporation would be wholly owned by the federal government, pursuant to the provisions of the Government Corporation Control Act, and would have succession until dissolved by an Act of Congress. The Corporation would be subject to the policy direction and performance oversight of the Secretary of the Department (the "Secretary").

(b) Corporate Offices.-- The Corporation would be required to maintain an office in the District of Columbia, and would be deemed a resident thereof. The Corporation may additionally establish offices in such other places as it deems necessary or appropriate in the conduct of its business.

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Section 104: Purposes

The purposes of the Corporation would include the following:

- To stimulate homeownership and rental housing opportunities through the provision of credit enhancement and related activities.
- To address the unmet housing credit needs of American families and communities.
- To address the unmet health care facility credit needs of particular communities.
- To supplement and expand private sector activity by better serving underserved markets, testing new products, and filling gaps in the provision and delivery of mortgage credit.
- To deliver housing credit enhancement and provide other services in a nondiscriminatory manner, and to administer its business in a manner which affirmatively furthers fair housing.
- To promote liquidity and provide stability to the housing finance market, by continuing to provide credit enhancement on a sound basis during times of regional economic fluctuation.
- To engage in research and development of new products designed to promote housing credit to underserved markets.
- To collect and provide information relevant to the provision of housing credit to American families and neighborhoods.
- To increase the capacity of localities, states, and private and nonprofit entities in delivering housing credit to American families and communities.

Section 105. Corporate Governance

This section would create a system for corporate governance, placing the locus of powers and authorities within a Chief Executive Officer, under the direction and authority of the Secretary of the Department.

(a) **Chief Executive Officer:** All powers of the corporation

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would be vested in a Chief Executive Officer, appointed by the President, with the advice and consent of the Senate, and who would serve at the pleasure of the President. The CEO would designate one or more deputy chief executive officers, whose powers would be prescribed by the CEO. The general deputy would serve as the CEO in the event of death, absence, resignation, disability of the CEO. The CEO would be required to be experienced in the business of the Corporation and in the needs of underserved borrowers and communities, and would be compensated at the same level as the President of the Government National Mortgage Association, or Level IV of the Senior Executive Service.

(b) Authority of the Secretary: The Corporation would be subject to the authority and direction of the Secretary, as to both policies and performance. The Secretary's oversight would ensure that the public purpose performance requirements are met, the purposes of the Corporation are accomplished, and the Corporation operates in a financially safe and sound manner.

(c) **Advisory Board:** This subsection would provide the Secretary with the authority to establish an advisory board, at the Secretary's discretion. If established, the advisory board would provide advice to the Secretary as to the policies of the Corporation, and would be authorized to examine the Corporation's performance vis a vis the public purpose requirements. The purpose of establishing such a board would be to:

1) obtain guidance from participants in the mortgage markets;

2) assess the needs of consumers of single-family and multifamily housing, as well as the needs of communities and housing providers;

3) Obtain information as to the activities of the private market, in order to better assess how to complement and partner with private entities.

4) Coordinate the role of federal housing, banking, and other credit agencies in delivering housing credit to families, communities and markets underserved by the private mortgage markets.

Members of the advisory board would include market participants, consumers, representatives of communities, and representatives of federal banking, housing and credit providing agencies.

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Section 106: Management and Personnel:

(a) Appointment of employees and officers -- The CEO would be given the authority to appoint officers and employees of the Corporation, as the CEO determines necessary to carry out the functions, powers, and duties of the Corporation.

FHA cannot hire staff quickly or effectively. It cannot procure outside skills quickly, as needed to respond to changing markets. It cannot spend a nickel on staff to save a dime in its portfolio. Finally, FHA's staff is included in the Department's overall FTE staffing ceilings -- resulting frequently in management choices that inhibit FHA's ability to manage its risk prudently and hamstring the fulfillment of FHA's mission, mandates, or effective operation.

As a government corporation responsible to the American taxpayer for prudent risk management, the FHC must have highly skilled staff that can respond to ever-changing market conditions in an entrepreneurial manner. Additionally, the Corporation will need to maximize market efficiencies by availing itself of certain talent through procurement for specific functions better performed by the private sector.

This section will identify the specifics of the Corporation's personnel system. The system will provide the CEO with appropriate flexibility, yet will ensure the fair, equitable, and non-discriminatory treatment of staff. Most of the civil service protections and benefits of Title V of the United States Code will be retained. The Corporation's salary schedules may mirror the comparability system retained by other federal banking regulatory agencies. Additionally, modifications to the civil service statute will be made to ensure that the Corporation can hire, deploy, and terminate employees quickly, fairly, and effectively.

(c) Former HUD employees transferred to the FHC --

This subsection would delineate the treatment of employees whose last regular employment prior to employment by the Corporation was the Department of Housing and Urban Development. Such employees will be given priority consideration for positions at the Corporation for which they are determined to be qualified. Federal retirement and health benefits will continue in the Corporation as if the employee was merely transferred to another federal agency.

(d) Former HUD Office of Housing/FHA employees not transferred to the FHC--

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This section will describe the treatment of former FHA employees not transferred to the Corporation. In general such employees will be given priority consideration for available positions for which they are determined to be qualified at the Department.

Section 107: Procurement

This section would require the CEO to establish standards governing the procurement of goods and services. Generally, the Corporation will comply with the Federal Property and Administrative Services Act, except for certain exceptions noted in this section. Currently, FHA is hampered in its ability to procure goods and services. While propriety in procurement is imperative, excessive regulation coupled with elongated bid processes and evaluations have essentially defeated FHA's ability to maximize efficiencies through procured talent and skills. In general, the federal procurement system precludes expedited operations, which are critical to a financial institution operating in complex mortgage and financial markets. The absence of speed in procurement results in losses to the government. For example, the inordinate length of time it took (nine months) to hire a financial advisor in connection with FHA's multifamily note sales resulted in unnecessary losses due to interest rate increases.

The Corporation's procurement policies will be structured to ensure that the Corporation takes advantage of private sector efficiencies quickly and competently. In fact, the Corporation intends to engage in public/private partnerships, matching government efficiencies and economies of scale with private and other state and local public sector expertise. In this manner, the costs of providing housing credit to the underserved markets in this nation will be minimized. With relief from certain restrictive components of the Federal Property and Administrative Services Act ("FPASA"), the Corporation can streamline and downsize the federal government while increasing its accountability.

Therefore, this section will explain in detail the Corporation's procurement system. Such system will follow the broad mandate of the FPASA -- including promoting competition, justifying prices, promoting fairness, and preventing waste and abuse. At the same time, the FHC's procurement system will be sufficiently and appropriately flexible to respond rapidly to changing market conditions.

Section 108: General Powers of the Corporation

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Background

The Corporation's powers would include any and all powers necessary to effectuate its purposes, and to accomplish its mandated activities. These powers would include, therefore, powers related to insuring mortgages and mortgage pools, managing assets and disposing of property, and otherwise providing housing credit and credit-related services, products, and information. Additionally, the Corporation would possess the general corporate powers appropriate and necessary for independent government corporations.

This section will enumerate the powers of the Corporation in connection with all lines of business and activities to be undertaken by it. In general, the new Corporation will be structured, through its powers, to be more entrepreneurial, streamlined, downsized, and accountable. The Corporation's overall business will be self-sustaining.

Specifically, the powers would include the following, subject only to the corporation's ability to meet the performance requirements set forth in sections 109 and 110, and the provisions of section 117:

1) Corporate Name: To adopt, alter, and use a corporate seal, and to sue and be sued in its corporate name;

2) Corporate Self-Governance: To adopt, amend, and repeal by-laws, and other written administrative guidance;

3) Credit Enhancement: To enhance and make commitments to enhance credit, including commitments to lend, insure, reinsure, advance, incur liabilities, pool loans, reinsure, risk share, and securitize;

4) Business Activities -- Purchase and sale of property and obligations: To purchase and otherwise acquire, including through foreclosure or eminent domain, to sell and otherwise dispose of, and to use and otherwise deal in and with, real and personal property and assets and obligations;

5) Business Activities -- Agreements: To execute contracts and other agreements in its own name, with parties including any State, the District of Columbia, the territories and possessions of the United States, or with any political subdivision thereof, and Indian tribes;

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6) Business Activities -- Asset Management: To take any actions necessary to manage its existing portfolio of property, assets, and obligations, including the improvement of assets, the disposition of assets, and the restructuring of debt;

7) Custody and Investment of Funds: To hold its funds in its own accounts with the Secretary of the Treasury, or with another financial or depository institution, subject to the requirements of the Government Corporation Control Act; and to invest its funds in Treasury obligations;

8) To determine the character of and the necessity for the obligations and expenditures of the Corporation, and the manner in which such obligations will be incurred, allowed, and paid;

9) Lines of Business: To create subsidiaries, distinct insurance funds, or otherwise segregated business activities or accounts;

10) To qualify any person or party to engage in business with the Corporation, and to enforce, and to impose penalties for the breach of, obligations and other commitments made by such persons or parties.

11) To create and supply any product or service consistent with the corporate purposes, to charge reasonable fees and prices for such products and services;

12) To take actions necessary to administer its business in a manner which is nondiscriminatory and which affirmatively furthers fair housing;

13) To invest in capital, such as systems and technology, at any time after the effective date of this Act, in order to expedite the Corporation's ability to function as a going concern, and to enhance its ability to engage in the business contemplated by this Act; and

14) To have and exercise all powers necessary or appropriate to effect any of the purposes of the Act.

Section 109. Public Purpose Performance Requirements; Public Purpose Overseer; Sanctions.

This section would establish a series of mandatory public purpose performance requirements which must be met each year and would establish the Secretary as the overseer of the

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Corporation's public purpose performance. Additionally, this section would establish transition performance requirements to cover the period until the overseer develops more appropriate measures and requirements for future years.

FHA's current inefficiencies stem, in part, from prescriptive requirements that limit its abilities to fulfill its mission prudently. Performance has been measured not upon results obtained, but often, upon whether prescriptive requirements have been fulfilled. Recognizing that a results-oriented focus leads to increased accountability, Congress enacted the Government Performance Results Act of 1993 (the "GPRA"). The Corporation is designed to be a model of an accountable government activity envisioned in the GPRA.

To provide the utmost accountability to the taxpayer, the Corporation will, for the first time in FHA's history, be measured for effectiveness based upon its results, in two distinct areas: 1) fulfillment of the public purpose requirements will ensure that the Corporation effectively uses its special government status to produce public benefits, while minimizing competition with the private sector; and 2) achieving the safety and soundness requirements will ensure that the Corporation's mission is accomplished without exposing taxpayers to undue risk of loss.

In 1992, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act. This Act placed public purpose and safety and soundness requirements upon two housing GSEs: the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation. The GSE public purpose goals were established, in part, in response to Congress's recognition that the GSEs were assigned in their respective charters an affirmative obligation to facilitate the financing of affordable housing for low- and moderate income families while maintaining a strong financial condition and a reasonable economic return. Congress believed that public purpose business could be good and profitable business.

The requirements established under this section are similar to those established in 1992 in connection with the GSEs. However, they also differ significantly, in both the substantive focus of the requirement (what is measured) and the level of performance demanded (the proportion of business devoted to public purposes). The difference is partially attributed to the fact that the GSE business will be different from that of the Corporation: GSEs are secondary market enterprises. Hence, the Corporation will be charged in its mission to serve markets underserved even by the GSEs. Second, the difference reflects

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the different ownership structure of the Corporation vis a vis the GSEs: namely, the GSEs are privately owned with private shareholders, while the Corporation will be a wholly owned government corporation, accountable to American taxpayers. Therefore, to the extent that both the Corporation and the GSEs are required to reach markets underserved by the conventional market through similar performance requirements, the level of performance required of the publicly accountable FHA will be higher than that required of the privately owned GSEs.

(a) **Public Purpose Requirements.** This subsection will establish a number of performance requirements ensuring that the Corporation provides housing credit or credit enhancement which benefits families, communities, and markets underserved by the private mortgage markets. The level of performance that will be required under each requirement will be no less than FHA's level of performance in connection with each measure during 1994.

(1) **Underserved areas:** This performance requirement would measure the Corporation's provision of credit or services to certain underserved geographic regions. Analyses of mortgage flows demonstrate that mortgage originations and mortgage declines are related to the income or race of a neighborhood. Recognizing the need for more lending in these areas, the Department recently refined the underserved areas goal for the GSEs to measure credit provided to low-income and minority census tracts. For example, geographic areas typically underserved by the private mortgage markets include portions of central cities, suburban areas, and rural areas.

(2) **Underserved homebuyers:** This requirement would measure performance in connection with credit or services provided to certain families who otherwise find it difficult to attain homeownership, such as first-time homebuyers, minorities, immigrants, young households lacking savings, and low-income households. The entire market, including FHA, must do better to enable families to achieve the dream of homeownership.

(3) **Underserved rental markets:** This requirement would measure the Corporation's performance in connection with providing credit or services that benefit renters and rental markets. Currently, the stock of privately owned affordable rental housing is dwindling, through age, deterioration, lack of capital, and inadequate replacement. Multifamily housing finance is complex, lacks standardization, and each financing package must be structured to meet the needs of individual neighborhoods. This requirement, therefore, could

measure products or services benefitting large families and very low-income families, or small properties or properties located in underserved neighborhoods.

(4) **Low- and Moderate-income families:** This requirement would measure the Corporation's provision of credit or services, in both the single- and multifamily arenas, to low- and moderate-income families and individuals.

(b) Transition Period Public Purpose Requirements.

Because more analysis will be needed in order to determine the appropriate focus and level of each requirement, the transition period public purpose requirements will reflect proxies for each requirement set forth in (b). The following requirements will be established as transition period public purpose requirements.

(1) Underserved Areas: Credit or services benefitting low-income and minority census tracts.

(2) Underserved Homebuyers: Mortgage credit afforded to "first-time homebuyers".

(3) Underserved Renters or Rental Markets: Mortgage credit or benefits afforded to very low-income families; and

(4) Low- and moderate-income families: Mortgage credit or benefits afforded to low- and moderate-income families.

The level of performance required for each transition period requirement will be no less than the level of performance achieved by FHA in 1994.

(c) Authority of the Secretary--

This subsection will establish the Secretary as overseer of the Corporation's public purpose performance. As overseer, the Secretary will be authorized to make such rules and guidelines as will be necessary and proper to ensure that this section and the purposes of the Corporation are accomplished. In establishing the public purpose requirements, the Secretary will consider national housing needs; economic, housing, and demographic conditions; the performance of the Corporation in prior years; the size of the FHA-eligible conventional market serving families and communities identified as underserved; and the need to maintain the financial safety and soundness of the Corporation.

(d) Enforcement of Public Purpose Requirements:

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This subsection would establish the procedures to be used by the Secretary upon the Secretary's determination that the Corporation failed to make a good faith effort to comply with the requirements of this section. Specifically, the Secretary would be authorized to take appropriate actions if --

(1) the Corporation fails to make a good faith effort to comply with the requirements of this section;

(2) the Corporation fails to make a good faith effort to submit or complete reports required by the Secretary in conjunction with determining compliance with this section; and

(3) the Corporation engages in or is about to engage in conduct that violates the charter of the Corporation.

Section 110: Financial Safety and Soundness; Transition Period Requirements; Safety and Soundness Regulator; Sanctions

Background: Currently, FHA prepares an audited financial statement prepared in accordance with generally accepted accounting principles (GAAP). In FY 1993, FHA received its first clean opinion on its financial statements since the Chief Financial Officer's Act was enacted. However, Congress primarily assesses FHA's financial performance by reference to two static measures: the capital ratio of the Mutual Mortgage Insurance (MMI) Fund and the multifamily loss reserve.

In 1990, Congress required that the MMI Fund, in which most of FHA's single family business is conducted, be subject to an independent actuarial study each year and achieve a capital ratio of 1.25% by the year 1992 and 2.0% by the year 2000. In FY 1993, a Price Waterhouse actuarial study found that the MMI Fund had a capital ratio of 1.44% and would achieve a ratio of 3.40% by the year 2000.

FHA also prepares an annual evaluation of the health of its multifamily insurance portfolio and sets aside for financial statement purposes a reserve against anticipated losses. In FY 92, the multifamily loss reserve was $11.9 billion dollars against approximately $43.5 billion in insurance-in-force. In FY 93, the loss reserve dropped to $10.3 billion dollars against a portfolio of $43.9 billion in insurance-in-force. All actual losses in the current multifamily program are supported by a permanent indefinite appropriation.

The Corporation's overall business will be self-sustaining. However, given the past performance of some of FHA's lines of business, the changes proposed in its product line, the commitment to serving markets underserved by the private mortgage markets, and the magnitude of its potential operations, public acceptance of a new corporation with broad and flexible insurance authorities requires a system to ensure that safety and soundness will be adequately monitored and reported independently of the Corporation directly to the Secretary, the President, and Congress.

Safety and soundness, as measured by the safety and soundness regulator, will include the measurement of actuarial soundness as well as additional indicators of financial integrity. The measures will be applied to both single-family and multifamily business, and will allow those lines of business that generate more revenue to support less profitable lines of business, provided that the overall capital requirements are met. The safety and soundness regulator will therefore measure the actual risks of the Corporation's business, the safety of its operations and management, and the required level of capital sufficient to support the entire corporation's business, including multifamily business.

This section establishes the safety and soundness performance measurements as well as the safety and soundness regulator who will monitor that performance.

(a) Financial Accountability and Safety and Soundness Goals:

This section would set forth a system for establishing financial safety and soundness performance requirements designed to ensure that the Corporation is capable of covering anticipated expenses and losses and protecting the taxpayer against unanticipated losses. Specifically, in addition to maintaining reserves against anticipated losses for outstanding books of business, the Corporation would be required to maintain a certain level of additional capital, as determined under a risk-based capital adequacy model developed by the Safety and Soundness regulator, described in (c). Although the model will evaluate individual business lines against capital standards appropriate for the risk of that activity, the capital adequacy of the Corporation will be determined based on the activities of the Corporation as a whole, rather than on a business-by-business basis.

(b) Transition Period Financial Accountability and Safety and Soundness Requirements.

This subsection will require the safety and soundness regulator to apply two transition period safety and soundness measures:

1) To the extent that any new loan originations are made by the Corporation in connection with pre-existing insurance funds, the Corporation shall comply with existing statutory requirements in connection with those funds as of the date of enactment of this legislation.

2) The safety and soundness regulator shall develop interim capital standards to be used in connection with the business entered into by the Corporation under new credit enhancement authorities provided in this Act, which standards shall be used for determining the Corporation's compliance with the requirements of this section until such time as the risk-based capital adequacy model is completed.

(c) Financial Safety and Soundness Regulator--

(1) This subsection would establish the Director of the Office of Federal Housing Enterprise Oversight ("OFHEO") as the Financial Safety and Soundness regulator of the Corporation.

(2) The powers of the safety and soundness regulator would include --

(A) Development of a risk-based capital adequacy model;

(B) Development of interim capital standards;

(C) Performance of regular examinations of the Corporation's risk management structure and techniques;

(D) Analysis of historical data on the performance of mortgages insured by the Corporation; and

(E) Development of models which assess the performance of the Corporation's entire outstanding portfolio and reserves, through simulations which would assume both the Administration's economic forecast and severe economic conditions.

(d) Enforcement Provisions:

This subsection would establish the procedures to be used by the safety and soundness regulator upon the regulator's determination that the Corporation failed to achieve the capital requirements established by the safety and soundness regulator. Specifically, the regulator would be authorized to issue cease and desist orders if --

1) the Corporation fails to make a good faith effort to comply with the requirements of this section or to submit or complete reports required by the safety and soundness regulator in conjunction with determining compliance with this section;

2) the Corporation engages in or is about to engage in conduct that threatens to cause a significant depletion of the core capital of the enterprise; and

3) if the Corporation fails to take certain affirmative actions, required by the safety and soundness regulator in response to specific conditions to be enumerated in this paragraph, to remedy undercapitalization.

(e) Funding:

This subsection would establish the mechanism that will fund the safety and soundness regulator's operations in connection with the Corporation.

(f) Reports:

(1) This subsection would set forth the types of reports required to be submitted to the safety and soundness regulator by the CEO.

(2) This subsection would set forth the types of reports required to be submitted by the safety and soundness regulator to the CEO, the Secretary, the President and the Congress, and the timetables required in connection with submitting reports sufficient for purposes of the President's budget.

Section 111. Budget Process; Federal Credit Reform

This section will set forth the procedures and timetables pursuant to which the Corporation's practices will be deemed to conform to the Federal Credit Reform Act in lieu of all other requirements under such Act.

Background: Title V of the Congressional Budget Act, the Federal Credit Reform Act of 1990, requires the advance budgeting of all estimated costs arising from direct loan obligations and loan guarantee commitments made after 1991. Compliance with this Act ensures that Congress is accountable in any one year for the entire cost that will be incurred in federal credit programs over the life of the credit or credit guarantee. This Act was intended to ensure that future losses would be supported through the revenues of the credit programs or through contemporaneous appropriations. Government business-type programs that generate sufficient revenues to cover obligations do not rely upon appropriations; compliance with the Federal Credit Reform Act's goals in such cases becomes an exercise in conforming the program's business accounting with the budget process of the Federal government.

The new Corporation is intended to be self-sufficient. The safety and soundness regulator's primary role will be to determine whether or not, at any given time, there is sufficient capital reserved for the outstanding books of business. However, it is imperative that the methods used for assessing the adequacy of the capital reserves are not inconsistent with the methods used by the President to estimate credit subsidy for purposes of reflecting the Corporation's activity in the federal budget. Operating a business under two conflicting regimes could result in decisionmaking that would inhibit the Corporation's ability to accomplish its public purpose mission. Therefore, this section sets forth a process by which the estimates of performance used by the safety and soundness regulator for purposes of determining capital adequacy under the Administration's economic assumptions will be the estimates of performance reflected in the President's budget.

(a) President's approval of risk-based capital adequacy standards or model.

This subsection will provide that prior to the commencement of business under new insurance authorities during the Transition period, set forth in Section 120(b), the President will approve the interim capital standards. Prior to the safety and soundness regulator's utilization of a risk-based capital adequacy model, the President will approve the model.

(b) Annual Budget Reporting Requirements

This section will set forth the timetable for submission of an annual budget (including the annual business plan) by the Corporation to the safety and soundness regulator to enable the safety and soundness regulator to promptly transmit to the President for purposes of the federal budget, estimates of performance based upon the risk-based capital adequacy model or the interim capital standards, as applicable.

(c) Annual Credit Reform Subsidy Estimates

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This section will set forth the process pursuant to which the President will determine an annual credit subsidy estimate for the Corporation based upon estimates of performance developed using the risk-based capital adequacy model or interim capital standards applied to the Corporation by the safety and soundness regulator. The safety and soundness regulator will provide estimates of performance to allow two subsidy rates to be calculated: (a) the subsidy rate associated with estimated losses and profits resulting from new business in that fiscal year; and (b) the subsidy rate associated with reestimates of losses and profits resulting from the Corporation's outstanding portfolio.

Both subsidy rates will be "unified." Although the safety and soundness regulator will assess the performance of, and apply appropriate capital standards to, individual business lines of business, the credit subsidy rate will be applied to the Corporation as a whole. Such unified subsidy rates will permit the Corporation to engage in varied business lines so long as its overall performance satisfies the strict risk-based capital adequacy standards defined by the safety and soundness regulator. This approach will enable the Corporation to serve underserved and untested markets, while operating on a self-sustaining basis, covering future losses, and minimizing risks to the government and the taxpayer.

Section 112. Authorization of Appropriations.

(a) Annual appropriations of retained earnings:

The Corporation will be self-sustaining. However, in order to be self-sustaining, it must retain the ability to invest any of its earned revenue back into its reserves or to support more targeted service to markets and borrowers underserved by the private market. In this section, the Corporation will be authorized to receive, and there will be appropriated indefinitely, an annual appropriation of the Corporation's negative subsidy in any year to its reserves. This appropriation is not an appropriation of federal dollars, per se, but rather, an accounting mechanism to permit the Corporation to run its business on a year-to-year basis, unconstrained by fiscal year artifices. This appropriation will boost the Corporation's safety and soundness by allowing it to build reserves to cover losses resulting from any current or future business. Because of the nature of the housing credit business, it will be critical for the Corporation to place its yearly earnings in reserves dedicated for these purposes. Any displacement of such funds would jeopardize the Corporation's ability to function as a housing credit business, to honor its commitments, and to operate

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as a going concern beyond each fiscal year.

(b) Appropriation to cover certain activities that conflict with Corporation's ability to be self-sustaining.

(1) The Corporation will be authorized to receive appropriations necessary to cover the costs of engaging in certain activities mandated or authorized by statute enacted after the effective date of this Act, if such activity is not expected to be self-sustaining, and if such activity has not been anticipated by the Corporation. This section will prohibit the Corporation from engaging in any such activity mandated unless it receives sufficient appropriations.

Section 113. Capitalization and Guaranty

This section would establish a mechanism for the initial capitalization of the Corporation. This section will designate the sources of capital to serve as initial capital. This section will also state that obligations of the Corporation will be backed by the same level relationship to the U.S. Treasury as are obligations today's Federal Housing Administration.

Section 114. Evaluation of Potential Partners and Other Participants.

To maximize its efficiency and the benefits accruing to families and communities underserved by the conventional mortgage markets, the Corporation will rely upon private and other public partners and business participants in different capacities. One type of partnership will be risk-sharing arrangements, under which FHA shares the risk of default with another well-capitalized institution. FHA currently retains demonstration multifamily risk-sharing authority which allows it to enter into agreements with state and local housing finance agencies, government sponsored enterprises, and others.

The risk-sharing partnerships in which the new Corporation will engage will cover both the single-family and multifamily arenas, with current partners and new partners. Partners would include: private mortgage insurers, state and local housing finance agencies, government sponsored enterprises, including Fannie Mae, Freddie Mac, and the federal home loan banks, and other private and public entities determined by the CEO to be capable of such arrangements. Such risk-sharing arrangements have permitted FHA under certain circumstances to delegate processing, underwriting, and asset management and disposition functions to partners, resulting in financial and administrative savings to the government, and further insulating taxpayers from losses.

This section would require the Corporation to establish guidelines to be used in evaluating the capacity of potential partners and other participants. These guidelines will be consistent with the following goals:

(1) To ensure that partners and participants are fully capable of fulfilling obligations to the Corporation;

(2) To ensure that partners and participants are sufficiently capitalized and retain sufficient creditworthiness to cover future obligations;

(3) To ensure that the general business of partners and participants does not conflict with the mission of the Corporation;

(4) To maximize efficiency and effectiveness in product delivery and operations; and

(5) To minimize losses.

Section 115: Corporate Guidelines and Practices

This section would prescribe a system for establishing business rules, guidelines, and practices, which would be developed by the Corporation. To prudently address business concerns, within the context of a rapidly changing housing finance arena, the Corporation would retain the ability to continually revise its rules, guidelines, and practices. To accommodate this flexibility, the Corporation would be exempt from most of the rulemaking requirements of the Administrative Procedures Act. Additionally, in connection with their respective roles as overseers or regulators of the Corporation's performance requirements, the Secretary and the OFHEO director would be exempt from most of the rulemaking requirements of the Administrative Procedures Act. Finally, this section would specify that any rule or regulation issued by the Secretary with respect to the Department will not apply to the Corporation unless the Secretary specifically finds that application of such rule or regulation to the Corporation is consistent with the Corporation's achievement of its mission.

Section 116: Oversight and Reporting Requirements.

Most of the oversight specified in this section is derived from the Government Corporation Control Act. These requirements are in addition to internal procedures the Corporation would

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undertake to minimize risk and ensure the integrity of operations. For example, the Corporation will establish an internal audit office.

(a) Audit of Financial Statements -- The Corporation would be required to submit to the Secretary, the President, and Congress, an annual audit of financial statements, performed by an qualified independent third party.

(b) GAO Audit-- The Corporation would be required to submit any financial, operations, or other information, as needed, to the Comptroller General of the United States, pursuant to the existing federal audit powers possessed by the Comptroller General.

(c) Annual Budget -- The Corporation would be required to submit an annual business-type budget to the President of the United States, to the Secretary, to the safety and soundness regulator, and to Congress.

(d) Annual Business Plan.--

The Corporation would be required to submit an annual business plan to the Secretary and to the safety and soundness regulator. The business plan would specify the product and operational strategy of the Corporation, including plans to address compliance with the performance requirements.

(e) Quarterly Reports.

This subsection will require the CEO to submit quarterly reports as to financial information and business volume to the safety and soundness regulator and the President, and will explain that submission of such reports will satisfy the apportionment requirements of the Antideficiency Act.

(f) Annual Report on Performance -- The Secretary and the safety and soundness regulator would submit an annual report to Congress on the Corporation's performance as measured by the performance requirements.

Section 117: Limitation on Business Activity

The Corporation will be subject to two overall business limitations:

(1) a maximum mortgage amount, which will be set at the statutorily imposed limit; and

(2) a total new business volume limitation, which shall be defined as no higher than x by the last day of the fifth calendar year following the commencement of new business under new authorities pursuant to Section 120(b)(2).

Section 118: Civil Money Penalties and other Sanctions.

This section would specify the array of sanctions available to the Corporation for the purpose of sanctioning partners and other participants who failed to comply with program requirements or with the terms of their obligations to the Corporation.

Section 119. Applicability of Other Federal Statutes.

This section will provide that, unless otherwise specified in this Act, the Corporation will comply with all applicable statutes. Exemptions will be listed in this section based upon a finding that compliance with such statute is incompatible with the Corporation's ability to accomplish its purposes in a safe and sound manner.

Section 120: Transition Period.

(a) In general. This section will define a transition period for the operations of the new Corporation. The transition period will commence upon the date of incorporation, which shall be the effective date of this Act. During the transition period, the Corporation will phase out operations under existing insurance authorities, invest in new capital systems and infrastructure, develop a detailed business plan and rules and guidelines governing the Corporation's new business operations, accommodate the transfer of former FHA employees to the new Corporation, and hire employees skilled in the new business to be undertaken by the Corporation. During this transition period, the Corporation will continue to issue mortgage insurance and enter into risk-sharing arrangements under existing authorities and begin to undertake new business under the authorities set forth in this Act.

(b) Business activities during the Transition Period.

(1) Continuation of business under authorities existing prior to the date of incorporation:

Upon the Secretary's delegation to the CEO, pursuant to Section 121, of pre-existing authorities and powers, the Corporation may engage in new business only to the extent that such business is authorized under such pre-existing authorities.

(2) **Commencement of new business under new authorities**

This paragraph would create "triggers" pursuant to which the Corporation's ability to engage in new business would be determined. Once the triggers are met, the Corporation could enter into new business under both new and old authorities. The Corporation would be authorized to enter into new business under authorities contained in this Act only upon the following:

(A) A business plan must be approved by the Secretary;

(B) The safety and soundness regulator must establish a risk-based capital adequacy model or appropriate interim capital standards;

(C) The President must approve the risk-based capital adequacy model, or appropriate interim capital standards, if applicable, prior to initial usage by the safety and soundness regulator;

(D) The Secretary, in conjunction with the CEO, determines that the Corporation's staff, systems, and administrative infrastructure are sufficient to carry out its operations.

Section 121. Transfer Authorities, Continuation of Contracts, Orders, Proceedings, and Regulations.

(a) **Delegation from the Secretary.**-- The Secretary would be authorized to delegate to the CEO any of the functions, powers or duties of the Secretary (with respect to the Federal Housing Administration), including the ability to be compensated, to receive appropriations, and to deal with any assets or liabilities of any fund authorized under the National Housing Act. The purpose of this delegation would be to permit the Corporation to operate selected existing FHA programs during the transition period until the businesses of the new Corporation can be fully established.

(b) **Continuation of Contracts** -- This subsection would permit the Corporation to continue all contracts, agreements, and other privileges, which pertain to the business of the Corporation after the date of enactment and which were formerly executed with the Department as if the Corporation had executed such contracts, agreements and other privileges.

Section 122. Termination of Single Family National Housing Act Programs.

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This section will require the Secretary, in conjunction with the CEO, to make a determination as to the ability of the Corporation to operate fully as a going concern. No business operating under the existing insurance funds will be permitted to cease until this determination has been made. This section will also repeal, as of the date of the termination of new business under the MMI Fund, the pre-existing requirement that the MMI fund achieve specified capital ratios. Additionally, if necessary for budget neutrality, this section will provide for the transfer of funds to the MMI Fund on such date.

Section 123. Termination of Multifamily National Housing Act Programs.

This section will authorize the termination of new business under the General Insurance and Special Risk Insurance Funds.

Section 124: Amendments to the Charter of the Government National Mortgage Association

This section will amend the charter of the Government National Mortgage Association to reflect the changes made to FHA, so that GNMA can continue to its secondary market function as the primary method of accessing capital to finance mortgages insured by the federal government. Specifically, GNMA would be authorized to guaranty securities backed by: (a) mortgages fully insured by the new Corporation; (b) mortgages fully insured by the new Corporation and other well-capitalized financial institutions on a risk-sharing basis; (c) the portion of mortgages or pools of mortgages that are insured by the new corporation; and (d) other products otherwise credit-enhanced by the Corporation. In addition, net income of GNMA may be transferred to the MMI fund to ensure it meets statutorily-required capital standards or to the new insurance funds of the new corporation. Finally, GNMA's charter will be amended so that the provisions of federal rulemaking, procurement and personnel statutes applicable to GNMA mirror those applicable to the new Corporation.

Section 125: Evaluation by the Secretary

Upon the third anniversary of the Corporation's commencement of new business under authorities contained in this Act, the Secretary shall submit an evaluation of the Corporation's activities to the President and Congress. The evaluation shall include the following:

1. Whether the Corporation's charter provides the necessary powers and authorities for the Corporation to

accomplish its public purpose mission in a safe and sound manner; and

2. To assess whether the business activity limitations set forth in Section 117 are consistent with the Corporation's ability to fulfill its public purpose mission in a safe and sound manner. This assessment shall determine the impact of these limitations upon the Corporation's current and anticipated future business activity.

The Secretary shall make recommendations based upon the results of the evaluation for any changes determined to be necessary to the Corporation's charter.