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GSE Reform: Trust Funds or Slush Funds?

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Should Fannie Mae and Freddie Mac—the two government-sponsored housing enterprises (GSEs) in federal conservatorship since 2008—be required to use taxpayer money to fund housing advocacy groups' activities? Five years ago, Congress answered "yes" to this question. The requirement has been in limbo since the GSEs collapsed, but that is only because Ed DeMarco, the acting head of the GSEs' regulator, took the sensible step of stopping the payments while the GSEs are in conservatorship.

Now, advocacy groups are campaigning to have their taxpayer-funded spigot turned on and enshrined in new legislation as permanent "housing trust funds." These funds should be eliminated because:

- Housing groups use these funds to encourage banks to make more of the ill-advised home loans that contributed to the recent financial crisis, and

- There is virtually no control over any non-housing activities (such as lobbying for additional housing grants and registering voters) that advocacy groups undertake after they receive this trust fund money.

Affordable Housing Groups and Housing "Trust Funds." For years, affordable housing groups have funded their programs using a combination of state and local trust funds, federal block grants, and donations from the GSEs.[1] Many of the federal grants have come through the Department of Housing and Urban Development (HUD), which allocates approximately $2 billion annually to states and more than 600 localities nationwide.[2] In contrast to this direct source of federal money, state and local trust funds depend on a variety of dedicated revenue sources, such as local real estate taxes, bonds, or fees. It has been a longtime goal of housing groups to bolster their funding through a *national* housing trust fund that is guaranteed federal tax dollars each year.

Although their activities do vary, a common task among these advocacy groups has been to secure mortgages for people who would not otherwise qualify for loans. A 1995 *Chicago Sun Times* article, for example, detailed a series of low-income housing programs provided by the Association of Community Organizations for Reform Now (ACORN)[3] and several other Illinois-based housing groups:

> You've got only a couple thousand bucks in the bank. Your job pays you dog-food wages. Your credit history has been bent, stapled and mutilated. You declared bankruptcy in 1989. Don't despair: You can still buy a house.[4]

The article goes on to describe several housing programs that provided a wide range of "housing services." For instance, one Chicago nonprofit helped families buy homes by negotiating with banks to lower down payment requirements and

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"loosen underwriting standards," while another city-funded program provided direct subsidies to real estate developers. State and local housing trust funds are used to fund these activities as well as (virtually) anything that loosely fits into the category of assisting people in low-income areas.

Until the housing market crashed in 2007, these activities raised few concerns, but they do not look so benign in the wake of the financial crisis. Regardless of how much housing trust funds contributed to the crisis, there is no doubt that this money paid activists to encourage lenders to make risky loans. These activities are sure to increase if a *national* housing trust fund begins operating.

HERA (Almost) to the Rescue. Affordable housing advocates nearly got their dedicated national trust fund in 2008 when the Housing and Economic Recovery Act (HERA) created the national Housing Trust Fund (HTF) and the Capital Magnet Fund (CMF). In both cases, the law imposed a 4.2 basis point (0.042 percent) tax to equip the funds. Annually, the tax would place 0.042 percent of the principal balance of the GSEs' "total new business purchases" into the funds.

For example, if the funds had been operating in 2010, when the GSEs bought $856 billion in new mortgages, then $360 million (0.042 percent) would have gone into the funds (65 percent to the HTF and 35 percent to the CMF).

HERA called for annual allocations to the HTF and the CMF to be disbursed by the HUD Secretary and the Treasury Secretary, respectively. The HUD Secretary was given some latitude to determine which states would receive funds, but the Treasury Secretary was given the authority to distribute grants from the CMF directly to specific nonprofits.[5] CMF grants would still be disbursed through a competitive process, but this system would further politicize the housing market by injecting yet another government agency into it. Luckily for U.S. taxpayers, HERA gave the director of the Federal Housing Finance Agency (FHFA) the authority to delay contributions to these funds.

The GSEs were deemed insolvent and placed into conservatorship under the FHFA in 2008, so the acting FHFA director, Ed DeMarco, suspended the allocations. Advocacy groups are calling for a new FHFA director who would be more sympathetic to their cause, and they have even filed suit claiming that DeMarco is in violation of the law because he has not yet allocated the funds.[6]

Affordable Housing Advocates Influence Corker–Warner. Advocacy groups have praised a new Senate proposal that expands the two trust funds.[7] S. 1217, sponsored by Senators Bob Corker (R–TN) and Mark Warner (D–VA) shifts the allocation of these funds to a newly created government agency called the Federal Mortgage Insurance Corporation (FMIC) and also increases the trust fund tax rate to between 5 and 10 basis points.

Rather than merely tax the FMIC's new business purchases, the bill would apply the tax to a larger base of money. Specifically, Corker–Warner would tax "the outstanding principal balance of eligible mortgages collateralizing covered securities." The tax—and the trust fund allocations—would automatically grow each year unless the FMIC stops operating. Both the HTF and the CMF would remain under the direction of the HUD and Treasury secretaries, respectively, and the bill would divert 80 percent of

1. Housing trust funds have been in existence since (at least) the 1980s. Currently, there are more than 600 state and local housing trust funds. Mary E. Brooks, "Housing Trust Funds," Center for Community Change, 2007, http://www.lisc.org/docs/experts/2007/eo_01_09_2007_housing_t_funds.pdf (accessed October 26, 2013).
2. *Federal Register*, Vol. 75, No. 209 (October 29, 2010), p. 3.
3. ACORN is now technically defunct, but local ACORN affiliates are still operational, having renamed themselves because the ACORN name was so controversial.
4. Bill Rumbler, "Help for Home Buyers; Putting Loans Within Reach," *Chicago Sun Times*, Homelife section, p. 16, April 28, 1995.
5. HTF money was to be distributed in the form of block grants. HERA also mandated that by 2010 the annual amount for each state had to be *at least* $3 million.
6. See John L. Ligon, "Housing Finance Nominee: Expect Big Government Housing Policies Doomed to Fail," The Heritage Foundation, The Foundry, May 3, 2013, http://blog.heritage.org/2013/05/03/fhfa-director-nominee-expect-big-government-housing-policies-doomed-to-fail/.
7. See Center for American Progress, "Corker-Warner Housing Finance Bill an Important Start but Falls Short on Serving America's Families," June 26, 2013, http://www.americanprogress.org/issues/housing/news/2013/06/26/68162/corker-warner-housing-finance-bill-an-important-start-but-falls-short-on-serving-americas-families/ (accessed October 23, 2013).

the tax to the HTF and 20 percent to the CMF. The end result would be even more money being doled out as block grants for programs that are difficult to monitor and nearly impossible to properly evaluate.

Instead, lawmakers should:

- Ensure that no taxpayer money flows to the HTF or CMF while the GSEs are under FHFA conservatorship.
- Not create, continue, or expand "trust" funds to advance affordable housing goals. These funds serve only to further politicize the lending and home-building markets.
- Not mandate that the Treasury Department duplicate HUD's housing policies. There is no good reason that any government agency should duplicate the policies of another.
- Request that the Government Accountability Office formally evaluate the success of existing housing trust funds before Congress writes an even larger check for more of these activities.

Keep the Spigot Turned Off. DeMarco should be praised for keeping the spigot to the housing trust funds turned off while the GSEs are in conservatorship. Ultimately, these types of funds should be eliminated. Rather than expand these funds by taking even more money from taxpayers, perhaps it is time to question their effectiveness.

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