



# CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

July 13, 2005

## **H.R. 1461** **Federal Housing Finance Reform Act of 2005**

*As ordered reported by the House Committee on Financial Services on May 25, 2005,  
with a draft amendment regarding the affordable housing funds provided to CBO  
on July 12, 2005*

### **SUMMARY**

Enacting H.R. 1461 would establish a single regulator—the Federal Housing Finance Agency (FHFA)—for government-sponsored enterprises (GSEs) involved in the home mortgage market. GSEs are privately owned, Congressionally chartered financial institutions created to enhance the availability of credit in the economy. The GSEs that would be regulated by FHFA under the bill include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBs). These GSEs were created to increase the availability of credit for home mortgages.

FHFA would be an independent agency within the federal government with the authority to oversee the safety, soundness, and housing mission of these GSEs. Under H.R. 1461, FHFA would be authorized to collect fees from the GSEs and to spend such fees to pay for its operating costs. Because the GSEs would be compelled by the government to pay those fees, the amounts collected and spent should be recorded on the federal budget as governmental revenues and outlays, respectively. CBO estimates that the operations of FHFA would cost about \$100 million a year starting in 2007 and that fees collected by the agency would cover that spending.

The legislation also would require Fannie Mae and Freddie Mac to contribute a specified portion (3.5 percent in 2007 and 2008; 5 percent in 2009, 2010, and 2011) of the previous year's after-tax income, generally as reported to the Securities and Exchange Commission (SEC), to new affordable housing funds created by the bill. These contributions would occur over the 2007-2011 period and would be used for two purposes. First, 25 percent of the funds deposited in the affordable housing funds would be used to pay some of the interest on Resolution Funding Corporation (REFCORP) bonds that would otherwise be paid by the U.S. Treasury. Second, the remaining 75 percent of the funds would be used to provide

grants and other types of financial assistance to increase home ownership among low-income households and investment in community development. Because these entities would be compelled to spend specified amounts of funds to meet specific governmental purposes, the collections and spending of the affordable housing funds should also be recorded on the federal budget. Spending from the funds should be recorded as federal outlays, and deposits to the funds should be shown as governmental revenues.

As a result of the fees that would be collected and spent by FHFA and the transactions of the affordable housing funds, CBO estimates that enacting this legislation would increase direct spending by \$1.6 billion over the 2007-2010 period and by \$3.0 billion over the 2007-2015 period. We further estimate that the collection of the fees by FHFA and the creation of the affordable housing funds would increase federal revenues by \$2.0 billion over the 2007-2010 period and by \$3.0 billion over the 2006-2015 period.

Finally, CBO estimates that implementing H.R. 1461 would result in net savings of about \$17 million in discretionary spending over the next five years, assuming that appropriations are reduced to reflect the changes in regulatory structure that would be established in the legislation. Those savings would result from a reduction in the regulatory responsibilities of the Department of Housing and Urban Development (HUD).

H.R. 1461 contains several intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the aggregate costs to state, local, and tribal governments would be minimal and would not exceed the threshold established in that act (\$62 million in 2005, adjusted annually for inflation).

The bill also would impose several private-sector mandates as defined in UMRA on Fannie Mae, Freddie Mac, and the FHLBs. CBO estimates that the aggregate direct cost of those mandates would exceed the annual threshold established by UMRA (\$123 million in 2005, adjusted annually for inflation) in each of the first five years the mandates are in effect.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

For this estimate, CBO assumes that H.R. 1461 will be enacted by the end of fiscal year 2005, that FHFA would become operational beginning in fiscal year 2007, and that appropriation actions consistent with this bill will occur. The bill's estimated budgetary impact is shown in Table 1. The costs of this legislation fall within budget function 370 (commerce and housing credit).

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**TABLE 1. ESTIMATED BUDGETARY IMPACT OF H.R. 1461 WITH PROPOSED AMENDMENT**

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	By Fiscal Year, in Millions of Dollars				
	2006	2007	2008	2009	2010
<b>CHANGES IN DIRECT SPENDING</b>					
Estimated Budget Authority	0	380	400	560	590
Estimated Outlays	0	200	390	460	580
<b>CHANGES IN REVENUES</b>					
Estimated Revenues	0	440	410	580	590
<b>CHANGES IN SPENDING SUBJECT TO APPROPRIATION</b>					
Estimated Authorization Level	1	-3	-5	-5	-5
Estimated Outlays	1	-3	-5	-5	-5

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## **BASIS OF ESTIMATE**

The budgetary impact of the bill would stem mostly from the establishment of a new regulator for the GSEs and from the creation of the affordable housing funds of Fannie Mae and Freddie Mac.

### **Background on GSE Regulation**

Currently, HUD is responsible for setting affordable housing goals for Fannie Mae and Freddie Mac and ensuring that these two GSEs meet such goals. HUD's oversight activities are funded from the agency's annual appropriation. (In 2004, HUD spent about \$4 million to perform those oversight responsibilities.) In addition, the Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency within HUD, currently oversees the financial safety and soundness of these two GSEs. OFHEO is funded through annual assessments collected from Fannie Mae and Freddie Mac; the collection and spending of those assessments are subject to appropriation actions. In 2005, OFHEO was authorized to collect and spend about \$60 million to perform its duties.

The FHLB system, which consists of 12 regionally based banks, is currently regulated by the Federal Housing Finance Board (FHFB). FHFB is an independent agency that oversees the financial safety and soundness of the FHLBs as well as their mission compliance; it is funded

through annual assessments collected from the earnings of the FHLBs. The collection and spending of these annual assessment are not subject to appropriation action. In 2005, FHFB anticipates that assessments and spending will total about \$36 million.

Under this legislation, beginning in 2007, FHFA would assume all of the responsibilities associated with oversight of the GSEs' housing mission, which are currently under HUD's jurisdiction. Additionally, enacting H.R. 1461 would abolish OFHEO and FHFB one year following its enactment, and their functions and current staff would be transferred to FHFA. The legislation also would establish an Inspector General within FHFA.

### **Direct Spending and Revenues**

CBO estimates that the collection and spending of fees by FHFA would increase direct spending and revenues by about \$980 million over the next 10 years.

We also estimate that enacting the affordable housing fund provisions of H.R. 1461 would increase direct spending and revenues by \$2.0 billion over the same period. CBO assumes that Fannie Mae and Freddie Mac would begin making deposits to their affordable housing funds in 2007, and that payments to REFCORP and spending for grants and other types of financial assistance from the funds also would begin in 2007. The estimated impact of the bill on direct spending and revenues over the 2007-2015 period is shown in Table 2.

**FHFA Fees and Spending.** While many of the activities currently performed by HUD, OFHEO, and FHFB would continue under H.R. 1461, enacting this legislation also would establish some new authorities, such as the authority to liquidate a troubled or insolvent GSE and the authority to limit the portfolio holdings of the GSEs (that is, the amount of mortgages that are held instead of repackaged and then sold as mortgage-backed securities) to ensure financial soundness. In addition, the GSEs would not be able to undertake any new program or business activity without prior approval from the Director of FHFA. Also, section 106 of this legislation would authorize the Director of FHFA to assess fees on the housing-related GSEs each year to obtain funding for reasonable costs and expenses associated with FHFA's responsibilities. Those fees paid by the GSEs should be classified as governmental revenues because they would be imposed through the exercise of the government's sovereign power. The expenditure of the fees collected by FHFA would be government spending.

**TABLE 2. ESTIMATED IMPACT OF H.R. 1461 ON DIRECT SPENDING AND REVENUES WITH PROPOSED AMENDMENT**

	By Fiscal Year, in Millions of Dollars									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>FHFA Fees</b>										
Estimated Budget Authority	0	100	100	100	110	110	110	110	120	120
Estimated Outlays	0	100	100	100	110	110	110	110	120	120
Estimated Revenues	0	100	100	100	110	110	110	110	120	120
<b>Affordable Housing Funds</b>										
Estimated Budget Authority	0	380	400	610	640	670	0	0	0	0
Estimated Outlays:										
Fund Payments of										
REFCORP Interest	0	100	100	150	160	170	0	0	0	0
All Other Payments	0	100	290	360	470	490	330	0	0	0
Total Estimated Outlays	0	200	390	510	630	660	330	0	0	0
Estimated Revenues	0	340	310	480	480	510	-80	0	0	0
<b>Treasury Payments of</b>										
<b>REFCORP Interest</b>										
Estimated Budget Authority	0	-100	-100	-150	-160	-170	0	0	0	0
Estimated Outlays	0	-100	-100	-150	-160	-170	0	0	0	0
<b>Total Impact of H.R. 1461</b>										
<b>with Proposed Amendment</b>										
Estimated Budget Authority	0	380	400	560	590	610	110	110	120	120
Estimated Outlays	0	200	390	460	580	600	440	110	120	120
Estimated Revenues	0	440	410	580	590	620	30	110	120	120

NOTE: Positive (negative) changes in revenues correspond to decreases (increases) in budget deficits. Positive (negative) changes in direct spending correspond to increases (decreases) in budget deficits.

*Revenue Effects of the Fees Assessed by FHFA.* CBO estimates that FHFA would require annual funding in the neighborhood of \$100 million, approximately the amount that will be spent under current law to oversee the GSEs in 2005. Under the bill, the first assessment by FHFA would occur in 2007, and CBO estimates that resulting collections would total \$980 million over the 2007-2015 period. We expect that the fees assessed by FHFA would be roughly the same amount currently paid to OFHEO and FHFB. CBO estimates that any increase in costs stemming from the new responsibilities of FHFA would be offset by savings from merging the technical and administrative functions of OFHEO and FHFB.

The new collections under the bill should be treated as governmental revenues in the budget. Because the new fees paid by the GSEs to FHFA would be approximately equal to the amounts they would pay to OFHEO and FHFH under current law, taxable incomes of Fannie Mae and Freddie Mac or of other entities in the economy would not change significantly.

*Spending Effects of the Fees Assessed by FHFA.* CBO expects that such spending would begin in 2007 after FHFA is established. We estimate that, in most years, FHFA would spend the total amount of fees it collects from the GSEs. Thus, enacting this provision would increase federal outlays by about \$410 million over the 2007-2010 period and by about \$980 million over the 2007-2015 period.

**Affordable Housing Funds.** Section 128 of this legislation would establish affordable housing funds at both Fannie Mae and Freddie Mac. To support such funds, each of these GSEs would be required to contribute 3.5 percent of the previous year's after-tax income in 2007 and 2008 and 5 percent of such income in the following three years, provided that the GSE is adequately capitalized and has generated after-tax income for the year. Under the legislation, these contributions by the GSEs would occur over the 2007-2011 period and would be used to pay some of the interest on REFCORP bonds and to provide assistance to support home ownership and community development. During 2011, the Director of FHFA would be required to report to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs on whether the affordable housing funds should be extended or modified.

*REFCORP Bonds.* The Resolution Trust Corporation (RTC) was created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) in the aftermath of the savings and loan crisis of the late 1980s as a means of liquidating insolvent institutions. FIRREA also established REFCORP to finance the operations of the RTC by issuing bonds. REFCORP issued about \$30 billion in noncallable long-term bonds that mature between October 2019 and April 2030. The annual interest payable on those bonds through 2019 is \$2.6 billion. (Interest payments will decrease from 2020 through 2030 as the bonds mature.)

The bulk of the interest on these bonds is paid by the U.S. Treasury. Under FIRREA, and later under the Gramm-Leach-Bliley Act of 2000, the FHLBs are required to pay some of the interest due on these bonds. To the extent that these payments from the FHLBs are not sufficient to pay the interest due on the bonds, the U.S. Treasury is required to pay the remaining amounts due. (In 2004, for example, the Treasury paid \$2.2 billion of the interest due.) Enacting H.R. 1461, would require Fannie Mae and Freddie Mac to use 25 percent of the amounts deposited in the affordable housing funds to pay for some of the interest on REFCORP Bonds. Thus, CBO estimates that the amount of interest paid by the Treasury would decrease over the 2007-2011 period by about \$680 million.

*Grants and other Financial Assistance.* The remaining 75 percent of the deposits to the affordable housing funds could be used to provide grants and subsidies to state and local agencies, nonprofit groups that are dedicated to increasing home ownership for extremely low- and very low-income families, and community development financial institutions that support investment in regions with a significant population of households below the poverty level. The funds could be used, for example, to contribute to loan loss reserves, provide down-payment assistance, and subsidize the cost of certain home loans.

The funds' resources could not be used to purchase mortgages or pay other corporate expenses other than maintaining the fund. Because the affordable housing goals that would be established by section 125 of this legislation could only be met by Fannie Mae and Freddie Mac through the purchase of certain types of mortgages, the new affordable housing funds would not directly contribute to meeting those goals. (However, any mortgages that are made possible by the funds and are subsequently purchased by the GSEs could be used to meet the new affordable housing goals.) In addition, the GSEs could count any returns on investments made using fund monies toward their required allocation to the affordable housing funds. For this estimate, CBO does not assume that future assessments would be reduced by investment earnings.

The Director of FHFA would promulgate the regulations governing how the GSEs administer the affordable housing funds. The Director also would appoint a board consisting of 7, 9, or 11 persons, including the Director and the Secretaries of HUD and Agriculture, that would advise the Director on criteria for appropriate uses of the funds and review reports submitted by Fannie Mae and Freddie Mac to determine compliance with the regulations governing the funds.

*Budgetary Treatment of the Affordable Housing Funds.* The allocations to the affordable housing funds should be considered governmental revenues because the bill mandates their expenditure for governmental purposes. Although the funds would remain in the possession of the GSEs, they are removed from private control and converted to government use through an exercise of sovereign power. The deposit of specific amounts into the new funds would be compulsory, not voluntary. Likewise, expenditures from the funds would be a form of federal spending because the affordable housing funds could be obligated only for purposes specified in the bill. FHFA would enforce the requirement for deposits into the affordable housing funds and would oversee spending of those funds to ensure compliance with federal purposes.

*Revenue Effects of the Affordable Housing Funds.* The estimated revenue effect of establishing the funds consists of two broad components. First, the levy on after-tax net income (3.5 percent in 2007 and 2008; 5 percent in 2009, 2010, and 2011) would be accounted for as a revenue when credited to the affordable housing funds. The total combined

after-tax income for these GSEs has averaged \$10 billion over the past five years. Assuming that future income would continue around this average and increase by CBO's forecast of the growth in gross domestic product (GDP), CBO estimates that in 2006 the GSEs would have available about \$11 billion in after-tax income. The first assessment for the affordable housing funds would be mandated to occur in 2007 and would total an estimated \$380 million. Over the 2007-2011 period, assessments would total an estimated \$2.7 billion.

Second, the spending of amounts from the affordable housing funds for both payments to REFCORP and financial assistance to affordable housing programs would generate deductions against taxable corporate profits for the two GSEs. If the GSEs' taxable profits were reduced as a result of the affordable housing program, they would pay lower corporate income taxes. If the GSEs passed through some of the assessments to customers in the form of higher fees, other taxable incomes in the economy would presumably be lower. Therefore, CBO estimates that the payments from the affordable housing funds would reduce total taxable incomes in the economy and thus diminish federal tax receipts by \$680 million over the 2007-2012 period (25 percent of the amount of the payments from the funds). Under the amendment, however, payments from the affordable housing funds to REFCORP would result in savings to the Treasury that are equal to the revenue loss caused by lower taxable incomes.

*Spending Effects of the Affordable Housing Funds.* Expenditures from the funds should be treated as direct spending of the federal government. CBO expects that such spending would begin in 2007. We estimate that enacting this provision would increase federal outlays by \$1.2 billion over the 2007-2010 period and \$2.0 billion over the 2007-2015 period.

The bill requires that amounts allocated to the affordable housing funds be committed for use within two years. CBO estimates that the lag between the recording of federal revenues and the spending of amounts in fund would result in a net reduction in the federal deficit of about \$390 million over the 2007-2010 period. Over the 2007-2015 period, however, CBO estimates that enacting the affordable housing provision would be deficit-neutral; total revenues would equal total direct spending over that period.

### **Other Effects on Spending**

Enacting H.R. 1461 also could further affect direct spending and revenues because this bill would provide for civil and criminal penalties against GSEs or a party affiliated with them for various violations of law. While enacting the legislation would expand the number of possible violations, CBO has no reason to expect that the amount of fines assessed would significantly increase under the bill. In fact, prior to the large fine paid by Freddie Mac in 2003 (\$125 million) and the amount paid by one of its former employees (\$125,000), no fines had been collected from any of the housing-related GSEs.



Section 115 of the bill would direct GSEs to register their capital stock with the SEC under the Securities Act of 1934. Registering under this act involves standardized disclosure of certain financial information but does not include any payment of fees associated with other securities laws.

Under current law, GSEs are exempt from registering their capital stock with the SEC. However, Fannie Mae is currently registering with the SEC voluntarily, and Freddie Mac intends to do the same in the near future. In addition, the FHLBs are expected to register by August 2005. Based on information provided by the SEC, CBO estimates that implementing section 115 of H.R. 1461 would impose no significant costs on the SEC.

In addition, enacting this legislation would abolish FHFB and thus the receipts collected and spent by this regulatory body would no longer appear in the budget beginning in 2007. Because collections and spending by FHFB are about equal, eliminating FHFB would have no net budgetary effect.

### **Spending Subject to Appropriation**

**Changes in HUD's Regulatory Responsibilities.** Beginning in 2007, CBO estimates that implementing the bill would reduce HUD spending by about \$5 million a year because FHFA would take over HUD's current GSE-oversight responsibilities.

**GAO Studies and Audits.** Enacting H.R. 1461 would require GAO to conduct several studies and audits over the next five years, including a study that would examine the practices used by the GSEs to set guarantee fees and an audit of the methodology used by FHFA to calculate changes in housing prices. Based on information from GAO, CBO estimates that GAO would incur costs of about \$3 million over the next five years to carry out its responsibilities under this legislation. The bill also would require GAO to conduct annual audits of the financial transactions associated with the new regulator. However, the costs associated with the annual audits could be funded through the assessments collected by FHFA.

**Elimination of OFHEO.** After OFHEO is abolished, beginning in 2007, the collections received and spent by this regulatory body will no longer appear in the budget. Because collections are about equal to spending, the elimination of OFHEO would have no net budgetary effect.

## **ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS**

Several provisions of H.R. 1461 would preempt state law and thus constitute intergovernmental mandates as defined in UMRA. Those provisions would allow FHFA to act outside the authority of state law in some circumstances and would preempt state statute-of-limitation and contract laws. Those preemptions would primarily occur in the unlikely instance that FHFA serves as the receiver or conservator of a regulated entity. CBO estimates that the aggregate costs to states of complying with these mandates would be minimal and would not exceed the threshold established in UMRA (\$62 million in 2005, adjusted annually for inflation).

## **ESTIMATED IMPACT ON THE PRIVATE SECTOR**

H.R. 1461 would impose several private-sector mandates, as defined in UMRA, on Fannie Mae, Freddie Mac, and the FHLBs. CBO estimates that the aggregate direct cost of those mandates would exceed the annual threshold established by UMRA (\$123 million in 2005, adjusted annually for inflation) in each of the first five years the mandates are in effect.

### **Affordable Housing Funds**

The most costly mandate is the requirement that Fannie Mae and Freddie Mac establish and manage affordable housing funds that would be used to pay some of the interest on REFCORP bonds and to provide grants and other financial assistance to support increased home ownership for low-income families and increased investment in low-income areas. The bill would require the GSEs to contribute a specified percentage of their annual after-tax income for the preceding year to the funds in each of the years from 2007 through 2011. (That percentage would be 3.5 percent in 2007 and 2008 and 5.0 percent in the subsequent years.) Based on their historical net earnings, CBO estimates that the direct cost of those mandatory contributions would be approximately \$380 million in 2007. Assuming continued growth in net earnings for those GSEs, the cost of those contributions could increase to more than \$600 million in 2011.

## **Regulatory Functions**

The bill would establish a new federal regulator for Fannie Mae, Freddie Mac, and the FHLBs. Under current law, those GSEs pay assessments to their regulators. Under the bill, they would pay assessments for the operation of their new regulator—the Federal Housing Finance Agency. The duty to pay those fees would be a private-sector mandate, but CBO expects that the new fees would not differ significantly from the amounts the GSEs would otherwise pay to their current regulators.

The bill also would authorize FHFA to liquidate an insolvent GSE, to increase the amount of capital GSEs must hold, and to limit the portfolio holdings of the GSEs to ensure financial soundness. In addition, the GSEs would be required to receive approval from FHFA before beginning any new program or activity. Such new authority would impose private-sector mandates on the GSEs when it is utilized. The cost to the GSEs would depend on how the regulations governing such authority are implemented. Because that information is not available, CBO cannot determine the cost of those mandates.

In addition, the bill would impose new mandates on the housing-related GSEs by requiring them to report in a timely manner the discovery of certain fraudulent financial transactions and by requiring Fannie Mae and Freddie Mac to submit an annual report to FHFA on certain charitable contributions. According to industry sources, the direct cost of providing those reports would be minimal.

## **Registration of Capital Stock**

The bill also would require the housing-related GSEs to register at least one class of their capital stock with the SEC under the Securities Act of 1934. Registering under this act involves standardized disclosure of certain financial information but does not include payment of fees associated with other securities laws. According to the SEC, Fannie Mae has registered, Freddie Mac intends to do so in the near future, and the FHLBs are expected to register by August 2005. Therefore, the direct cost to the GSEs to comply with the mandate would be minimal.

## **PREVIOUS CBO ESTIMATE**

On June 30, 2005, CBO transmitted a cost estimate for H.R. 1461, as ordered reported by the House Committee on Financial Services on May 25, 2005. That version of the bill would require Fannie Mae and Freddie Mac to permanently establish affordable housing funds for the purpose of providing grants and other types of financial assistance to support home ownership and community development. CBO estimates that under H.R. 1461, over the

2006-2015 period, revenues would increase by about \$5.1 billion and direct spending would grow by \$5.4 billion, for a net increase in the deficit of almost \$300 million.

On July 12, 2005, CBO transmitted a cost estimate for H.R. 1461, as ordered reported by the House Committee on Financial Services on May 25, 2005, with a draft amendment regarding the affordable housing funds provided to CBO on June 24, 2005. That version of the bill would require Fannie Mae and Freddie Mac to use a portion of the sums in the affordable housing funds to pay some of the interest on REFCORP bonds. The June 24, 2005, version of the legislation, like the bill that was ordered reported, would require these GSEs to contribute 3.5 percent of their after-tax income to the affordable housing funds in 2007 and 5 percent a year to those funds over the 2008-2011 period. The July 12, 2005, version of the bill would change the after-tax contributions to 3.5 percent for 2007 and 2008 and 5 percent over the 2009-2011 period.

**ESTIMATE PREPARED BY:**

Federal Costs: Susanne S. Mehlman

Revenues: Mark Booth

Impact on State, Local, and Tribal Governments: Sarah Puro

Impact on the Private Sector: Paige Piper/Bach

**ESTIMATE APPROVED BY:**

Robert A. Sunshine

Assistant Director for Budget Analysis

G. Thomas Woodward

Assistant Director for Tax Analysis