CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 30, 2007

H.R. 3965
Mark-to-Market Extension and Enhancement Act of 2007

As ordered reported by the House Committee on Financial Services on October 31, 2007

SUMMARY

H.R. 3965 would extend the Multifamily Assisted Housing Restructuring and Affordability Act of 1997 (MAHRA) for one year to September 30, 2012. The bill contains several provisions that would affect loans and loan guarantees made by the Department of Housing and Urban Development (HUD). The bill also would change how rents are set and how HUD makes payments to property owners.

CBO estimates that enacting H.R. 3965 would increase direct spending by $137 million in 2008 because the bill would modify the terms of existing federal loans and loan guarantees—reducing the present value of expected cash flows for such loans. We also estimate that implementing the bill would have a discretionary cost of $227 million over the 2008-2012 period, assuming appropriation of the necessary amounts.

H.R. 3965 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA) because it would extend an existing preemption of state and local law. CBO estimates, however, that the mandate would impose no costs on state, local, or tribal governments. The bill contains no new private-sector mandates as defined by UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3965 is shown in the following table. The costs of this legislation fall within budget functions 370 (commerce and housing credit) and 600 (income security).

ESTIMATED BUDGETARY EFFECTS OF H.R. 3965

	By Fiscal Year, in Millions of Dollars				
	2008	2009	2010	2011	2012
CHANGES IN DIRECT SPENDING					
Expand Debt Restructuring Eligibility					
Estimated Budget Authority	77	0	0	0	0
Estimated Outlays	77	0	0	0	0
Nonprofit Debt Relief					
Estimated Budget Authority	60	0	0	0	0
Estimated Outlays	60	0	0	0	0
Total Changes in Direct Spending					
Estimated Budget Authority	137	0	0	0	0
Estimated Outlays	137	0	0	0	0
CHANGES IN SPENDING SUBJECT TO APPROPRIATION					
Moderate Rehabilitation Rents					
Estimated Authorization Level	50	46	43	39	35
Estimated Outlays	30	48	44	41	37
Late Subsidy Payments					
Estimated Authorization Level	4	4	4	4	4
Estimated Outlays	4	4	4	4	4
Exception Rents					
Estimated Authorization Level	*	1	2	2	2
Estimated Outlays	*	1	2	2	2
Total Changes in Spending Subject to Appropriation					
Estimated Authorization Level	54	51	49	45	41
Estimated Outlays	34	53	50	47	43

Note: * = less than $500,000.

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 3965 will be enacted near the beginning of calendar year 2008, that the full amounts authorized will be appropriated for each year and that outlays will follow historical patterns. Components of the estimated costs are described below.

Background

In 1997, MAHRA was enacted to address financial problems in the Section 8 program that provides affordable housing assistance. At that time, over 4,000 multifamily properties with mortgages insured by the Federal Housing Administration were receiving project-based rent subsidies under Section 8 of the United States Housing Act of 1937. The original rental contracts for those properties typically ranged from 15 to 40 years and most properties had units with rents that exceeded the rents for comparable units that did not receive rent subsidies.

The mark-to-market process usually involves reducing a property's rental rates to market levels and then either modifying or refinancing the existing mortgage for an amount that could be supported by the new lower rates. Specifically, HUD prepays all or a portion of the owner's existing mortgage debt through a partial payment of claim (PPC) and then issues a secondary mortgage to recover some of the PPC. Property owners can defer payments on the junior debt while the first mortgage remains outstanding unless some excess project income remains after the owner pays all other expenses. At least 75 percent of any excess income must be applied to the second mortgage and the full amount is due when the first mortgage is terminated or the property is sold.

Direct Spending

Because several provisions of the legislation would change the expected cash flows associated with existing federal loans and loan guarantees, those changes constitute a modification of the existing loans. Under credit reform procedures, the costs of loan modifications are estimated on a present value basis and recorded as changes in direct spending in the year in which the legislation is enacted. In total, CBO estimates that enacting H.R. 3965 would increase direct spending by $137 million in 2008.

Expand Debt Restructuring Eligibility. Under section 7 of the bill, properties that are otherwise eligible for debt restructuring, but have rents that are at or below those for comparable market units, would be eligible to have their insured mortgages restructured. The provision would allow HUD to exercise this authority for up to 10 percent of all units for which mortgage restructuring is completed. Based on information provided by HUD, CBO estimates that about 30 properties per year (out of 1,400 properties that would be newly eligible) would have their debt restructured under this provision.

Based on HUD data, CBO estimates that the average unpaid principal balance for properties eligible for the mark-to-market process is about $2 million. The average PPC for properties that have had their debt restructured is about 80 percent of the unpaid balance and the repayment rate on the new secondary mortgages averages about 2 percent per year. On average, CBO estimates that for those properties that would have defaulted on their loans, restructuring mortgage debt would save about $1 million per project on a present value basis. However, restructuring debt for properties that would not have otherwise defaulted, would cost about $1 million per project on a present value basis.

Because the properties made eligible by this provision would either receive rent increases or maintain current rent levels upon expiration of their Section 8 contracts, CBO expects that they would have low default rates in the absence of debt restructuring. As a result, CBO estimates such restructurings would cost $77 million in 2008 on a present value basis.

Nonprofit Debt Relief. Both section 9 and section 10 of the bill would increase the number of properties that receive debt relief. In total, CBO estimates that enacting those provisions would cost $60 million in 2008 on a present value basis.

Section 9 would expand the period of eligibility for qualified nonprofits to receive debt relief when acquiring a property that has been through the mark-to-market debt restructuring process. Under current law, HUD can forgive or assign a property's secondary mortgage if the property is acquired by a qualified nonprofit entity and HUD's guidelines require that any transactions resulting in debt relief must occur within three years of debt restructuring. The provision would extend that period to the later of five years or two years after the date of enactment.

HUD has completed 57 such transactions to date, the majority of which were completed in the past few years. Based on HUD data, CBO estimates that the federal government loses about $700,000 of expected secondary mortgage payments (on a present value basis) per property as a result of such debt forgiveness. This loss is partially offset by HUD's requirement that the seller of a restructured property pay at least half of any cash-out proceeds at the time of sale as a partial repayment of the second mortgage (such payments have averaged about $290,000).

About 1,000 properties that are beyond the current three-year window would be eligible for debt relief if acquired by a qualified nonprofit. Based on the program's recent experience, CBO estimates that about 5 percent of those properties would be transferred to a qualified nonprofit and have their debt forgiven or assigned. Thus, CBO estimates that expanding the period of eligibility for nonprofit debt relief would cost $25 million in 2008 on a present value basis.

Similarly, section 10 would allow debt relief if a qualified nonprofit becomes the general partner of a limited partnership that owns a property (general partners may hold as little as one-half of one percent interest in the limited partnership.) In some instances, CBO expects that becoming the general partner would be a more attractive transaction for a qualified nonprofit than acquiring title to the property. Based on information from HUD and industry groups, CBO estimates that this provision would roughly double the number of transactions resulting in debt relief. CBO estimates that allowing debt relief for such transactions would cost $35 million in 2008 on a present value basis.

Spending Subject to Appropriation

CBO estimates that implementing provisions of H.R. 3965 would have a discretionary cost of $227 million over the 2008-2012 period, assuming appropriation of the necessary amounts.

Moderate Rehabilitation Rents. Section 11 would change the manner in which rents are determined upon contract renewal for properties assisted through the Moderate Rehabilitation (Mod Rehab) program which provides a rental subsidy to properties that have been previously rehabilitated. Currently, rents for such properties are renewed at the lesser of existing rents (adjusted by an operating cost factor), 120 percent of the fair market rent (as determined by HUD), or comparable market rents, which are generally higher than the other options. The provision would allow rents for those properties to be renewed at comparable market rents.

About 29,000 units are currently assisted through the Mod Rehab program and owners may choose to leave the program when their contract expires and instead receive enhanced tenant-based vouchers. A common reason for opting out of the Mod Rehab program is that the rents under that program are often below market rates and tenants with enhanced vouchers would pay market rent. Based on data provided by the Government Accountability Office (GAO) and HUD, CBO estimates that approximately 5,000 units have left the program each year since 1998.

Allowing rents under the Mod Rehab program to be set at market levels would increase the estimated cost of rental assistance if the owner of that property would not have otherwise opted to leave the program to take tenants with enhanced vouchers. Based on HUD data, CBO estimates that about 70 percent of Mod Rehab units have rents that are about 25 percent below market rates. Increasing the rents to match market rates would have an annual cost of about $2,500 per unit for each year that the property would have stayed in the program. Assuming an attrition rate similar to the past few years and appropriation of the necessary amounts, CBO estimates that this provision would cost $200 million over the 2008-2012 period.

Late Subsidy Payments. Section 13 would require HUD to make Housing Assistance Payments (HAP) for project-based rental assistance by the first business day of each month. If a HAP payment is not made within 30 days of the due date, HUD would be required to pay the property owner simple interest on the amount of such payment at a rate determined by the Secretary of Treasury. Interest payments would be made from amounts made available for the management and administration of HUD. Based on data from GAO, CBO estimates that approximately 6 percent of HAP payments are more than 30 days late with an average delay of about 60 days. Assuming an average interest rate of 5.7 percent, CBO estimates that the payment of interest for late HAP payments would cost about $20 million over the 2008-2012 period, assuming availability of the necessary amounts.

Exception Rents. Under current law, HUD can set rents above 120 percent of the fair market rent (FMR) for up to 5 percent of all units subject to debt restructuring. Section 6 would increase this authority for up to 9 percent of all such units. Based on HUD data, CBO estimates that such exception rents are, on average, about 14 percent higher (or $870 per year) than they would be if limited to 120 percent of the FMR, and that the expansion of this authority would affect about 500 units per year, on average. CBO estimates that expanding the exception rent authority would cost $7 million over the 2008-2012 period, assuming availability of the necessary amounts.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 3965 would extend an existing preemption of state and local law. Under current law, state and local governments may not have laws that conflict with federal regulations governing how surplus funds are distributed from housing projects that receive assistance under the mark-to-market program. Extending that preemption would be an intergovernmental mandate as defined by UMRA. However, because the preemption would simply limit the application of state and local law, the mandate would impose not costs on state, local, or tribal governments.

In general, state, local, and tribal governments that participate in affordable housing projects and programs would benefit from activities authorized in the bill. Any costs those governments incur to comply with program conditions would be incurred voluntarily. The bill contains no new private-sector mandates as defined in UMRA.

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