

HUD TRANSFORMATION INITIATIVE FUND
2010 Summary Statement and Initiatives
(Dollars in Thousands)

| TRANSFORMATION INIATIATIVE FUND | <u>Enacted/ Request</u> | <u>Carryover</u> | <u>Supplemental/ Rescission</u> | <u>Total Resources</u> | <u>Obligations</u> | <u>Outlays</u> |
|--|-----------------------------|------------------|-------------------------------------|----------------------------|--------------------|-----------------|
| 2008 Appropriation | ... | ... | ... | ... | ... | ... |
| 2009 Appropriation/Request | ... | ... | ... | ... | ... | ... |
| 2010 Request | <u>\$20,000</u> | <u>...</u> | <u>...</u> | <u>\$20,000</u> | <u>\$20,000</u> | <u>\$10,000</u> |
| Program Improvements/Offsets | +20,000 | ... | ... | +20,000 | +20,000 | +10,000 |

Summary Statement

HUD requests Congress to authorize an agencywide HUD Transformation Initiative Fund, to be funded by transfers from program accounts of up to 1.0 percent at the Secretary's discretion. HUD proposes to use HUD Transformation funds for four complementary purposes: Research, Evaluation and Performance Metrics; Program Demonstrations; Technical Assistance and Capacity Building; and next-generation Information Technology. Each of these transformation initiatives would receive not less than 10 percent not more than 50 percent of the aggregate transferred funds.

Transformation Initiative funds are proposed as the sole funding source for two of these purposes: the Demonstration initiative and the Technical Assistance initiative. Transformation funds for the other initiatives, in contrast, will supplement and build upon other appropriated and transferred funding designated for core purposes. Research initiative funds will supplement data collection in the Research and Technology account. Technology initiative funds will supplement system maintenance activities in the Working Capital Fund.

Additionally, HUD requests a direct appropriation of \$20 million to the Transformation Initiative Account for the purpose of combating fraud through activities otherwise eligible under the Transformation Initiative. Transformation funding for this signature initiative will supplement program-specific efforts discussed separately under the heading "Combating Mortgage Fraud."

HUD requests authority to transfer funds from the following program accounts: Tenant-Based Rental Assistance, Public Housing Capital Fund, Public Housing Operating Fund, Choice Neighborhoods Initiative, Energy Innovation Fund, Native American Housing Block Grants, Native Hawaiian Housing Block Grant, Indian Housing Loan Guarantee Fund Program Account, Housing Opportunities for Persons With AIDS, Community Development Fund, HOME Investment Partnerships Program, Self-Help and Assisted Homeownership Opportunity Program, Homeless Assistance Grants, Project-Based Rental Assistance, Housing for the Elderly, Housing for the Elderly Contract Renewals and Amendments, Housing for Persons With Disabilities, Housing for Persons with Disabilities Contract Renewals and Amendments, Housing Counseling Assistance, Payment to Manufactured Housing Fees Trust Fund, Mutual Mortgage Insurance Program Account, General and Special Risk Program Account, Research and Technology, Lead Hazard Reduction, Rental Housing Assistance, and Fair Housing Activities.

HUD proposes to submit a detailed operating plan for the Transformation Initiative to the Committees on Appropriations within 30 days of enactment and 15 days before obligating or expending the transferred funds.

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Need for a Transformation Initiative. The national economy and social system supported by America's constitutional principles are the most dynamic in the world. This dynamism requires national institutions such as federal agencies to be, if not nimble, at least adaptable and resilient. Two events in recent years clearly demonstrated this need. First, the devastation wrought by the Gulf Coast hurricanes of 2005 and the inadequate response by Federal, state and local governments contributed to losses that could have been greatly reduced. On the other hand, adapting HUD programs to the unique needs of displaced families played a major role in the national recovery effort. Second, statutory constraints on the types of mortgage products that the Federal Housing Administration could offer created an opportunity for dishonest lenders to accelerate subprime and predatory lending during the 2005-2007 period, and contributed to immeasurable and continuing losses still suffered by American families, communities, and investors today.

With these examples and others, HUD recognizes a pressing need for adaptability and change, involving both reformation and transformation. The Department's operations face serious challenges arising from internal resource and structural constraints, while the scope of housing and urban development problems facing the nation has never been greater. Traditional programs like public housing and rental vouchers and FHA mortgage insurance need to adapt to changing market conditions. HUD needs to become an innovative agency with the capacity to move beyond legacy programs, shaping new markets and methods in the production and preservation of affordable housing, greening the nation's housing stock and promoting sustainable growth in metropolitan America. This transformation should be based on sound evidence provided by rigorous research, program evaluations, and demonstrations of whether programmatic innovations actually work.

There is notable precedent for the concept of setting aside program funds for transformative research and demonstrations. In 2008, amendments (122 Stat. 1604) to the SAFETEA-LU transportation act, Congress authorized the Department of Transportation to fund the Strategic Highway Research Program (23 U.S.C. 510) by deducting up to 0.205 percent from major program accounts. The programs that are to contribute funds include the surface transportation program, the congestion mitigation and air quality improvement program, the National Highway System, the Interstate maintenance program, the bridge program, and the highway safety improvement program. The transformative research funds supplement DOT's annual direct appropriations for research.

The flexibility of the proposed funding will enable HUD to undertake an integrated and balanced effort to improve program performance. It is widely recognized that the program cylinders that constitute HUD's legacy structure intersect in numerous ways. Yet, appropriate windows of opportunity have not yet been opened between the cylinders.

HUD's four proposed transformation initiatives provide a systematic and cross-cutting approach to transformation: building a foundation of current data on performance as well as reliable evidence about program and policy results; testing new program approaches in a carefully structured and rigorously evaluated manner; diffusing innovation and supporting state and local partners in using public resources effectively; and upgrading technology and linking data to prevent waste, inform program managers and stimulate high performance.

Combating Mortgage Fraud. The request for funding under this Transformation Initiative includes a minimum of \$20 million specifically allocated for the Departmentwide Initiative on Combating Abusive and Fraudulent Mortgage Practices. This \$20 million allocation could be supplemented with additional funds from the Transformation Initiative, to be allocated as needed under this account's proposed flexible authority. These funds will be used to support efforts to combat mortgage fraud through a number of critical activities, including targeted technical assistance, data systems improvement through Information Technology, and a variety of research efforts.

Transformation Initiative activities in support of the Combating Abusive and Fraudulent Mortgage Practices Initiatives will cover four key categories:

- Development of FHA anti-fraud data tools that would be applied to all phases of the mortgage insurance process to detect misrepresentation at consumer, application, and property levels;
- Technical Assistance to support housing counseling organizations with identifying mortgage fraud and addressing fair lending issues;
- Training of industry and regulatory agencies and contract hiring to monitor state compliance with SAFE and RESPA; and

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- Research, assessment and data analysis to assist in the effective implementation of the Neighborhood Stabilization Program and the Homeowners Affordability and Stability Plan (Making Home Affordable Plan) mortgage loan modification program.

Research, Evaluation and Program Metrics

The foundation of HUD's transformational strategy is to renew a predictable stream of funding for high quality research and evaluation that can inform sound policymaking. Allocating a small increment of program funds to the Research and Technology account will enable HUD to subject programs continuously to rigorous evaluation. The Research initiative will supplement Research and Technology appropriations for the nation's basic infrastructure of housing data such as the American Housing Survey. The more careful and scientific approach enabled by the Research initiative will highlight for policymakers what works and what needs reform. Systemic research will enable HUD to monitor results and undertake timely modifications of programs and policies that fail to produce results. A component of this research and evaluation will be to develop the right set of metrics to track program performance between evaluations.

Congress established the Office of Policy Development and Research (PD&R) as HUD's independent research wing in 1965. However, the National Academy of Sciences chronicled the dramatic 1999-2007 decline in PD&R's research funding in its 2008 report, "Rebuilding the Research Capacity at HUD." The Report concluded, "In 2007, the total amount of funds obligated for non-PATH related external research was one-third of what it had been in 1999 (\$14.8 million compared with \$43.5 million). For a department that spends more than \$36 billion of taxpayer money each year on a variety of housing and community development programs, there is virtually no money available to the one-quasi independent office in the agency charged with evaluating how these program funds are spent, assessing their impact and researching ways to make programs more efficient and effective."

Over the past decade or more, HUD's failure to invest in research and evaluation contrasts sharply with its own history and the practice of other Federal agencies. During the 1970s, HUD funding for discretionary research was more than \$200 million annually (expressed in current dollars). The current total research funding of \$35 million in fiscal year 2009 represents less than 0.1 percent of HUD's total budget, and the majority of these resources are allocated to mandatory and fixed costs rather than the transformative research needed to guide the nation's housing and community development policies.

Other Federal domestic agencies spend a significantly higher share of their program funds on program evaluation. In the Department of Agriculture, fiscal year 2009 research funding of \$1.4 billion for the Economic Research Service, Agricultural Research Service, and National Agricultural Statistics Service represents 1.3 percent of the total program budget of \$105.9 billion. In the Department of Education, \$617 million in funding for the Institute of Education Sciences accounts for 0.9 percent of the \$66.6 billion total. The National Institutes of Health represents 6.2 percent of the Department of Health and Human Service's total of \$492.5 billion.

Consistent research funding will enable HUD to support:

- basic research, such as evaluating the costs and benefits of green building, the long-term performance of building materials and products, factors influencing adoption of new building technologies, the impact of housing counseling on defaults and delinquencies, the causes of homelessness, the benefits and drawbacks of resident mobility, and the prevalence and nature of mortgage fraud;
- trends analysis, such as tracking the improvement of high poverty neighborhoods, changes in homeownership or affordability of rental stock, or the pace of recovery from disasters;
- metric development to better measure program performance, energy efficiency improvements in HUD-assisted housing and overall housing stock, and intermediate outcomes of program activity;
- program evaluation, to assess the progress in new initiatives such as the Neighborhood Stabilization Program, as well as the costs of administering the voucher program, the long term effect of efforts like HOPE VI, or the impact of broader policies such as those promoting mixed income housing and inclusionary zoning; and

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- studies of housing finance, to focus on the role of different market sectors (such as FHA) in expanding affordable lending and increasing homeownership opportunities for low-income and minority families.

This range of research will improve program effectiveness and generate substantial savings over time. The report by the National Academy of Sciences called for enhancing PD&R's in-house research capacity, mostly on the belief that better-informed decision making will help prevent waste and abuse in other housing programs. HUD's proposed transformational approach to research would also inform the decisions of a broad network of public and private sector actors. A key feature of the new approach will be to partner with other federal agencies, such as the Department of Transportation, the Department of Energy, or the Environmental Protection Agency, on research topics of mutual interest.

HUD will confer with the Appropriations and Authorizing committees before finalizing the research agenda for funding under the Transformation initiative. At present, a number of fiscal year 2010 research efforts are under consideration, totaling more than \$40 million. A number of research possibilities are related to HUD's administration of public and assisted housing programs:

- Evaluation of Public Housing Asset Management;
- Housing Choice Voucher Administrative Fee Study;
- Study of voucher program regional administration initiative;
- Study of reducing energy use in the voucher program;
- Success rates for voucher tenants.

Other research opportunities about public and assisted housing have a more intensive focus on tenant outcomes and neighborhood impacts:

- Panel study of the effects of mixed income developments in HOPE VI and HOME (base year);
- HOPE VI after 15 years: lessons for Choice Neighborhoods; Baseline study and early implementation of Choice Neighborhoods Initiative; Aging in Place Demonstration (with HHS);
- Studies of Moving-to-Work innovations;
- Family Self-Sufficiency Experiment;
- Experiment to promote better access to opportunity neighborhoods by Voucher holders;
- On-going funding to track Gulf Coast Recovery;
- Sustainable Communities Research (Joint HUD/DOT research effort to advance transportation and housing linkages).

A third group of research opportunities includes homeownership markets, finance, and outcomes, as well as building technologies that reduce housing costs:

- Prime, sub-prime, and secondary mortgage market trends;
- FHA programs and other affordable lending and homeownership programs;
- Financing risks in single family and multifamily mortgage lending;
- Mortgage default, loss, and risk-based pricing;
- Pre-purchase housing counseling experiment (required by the Housing and Economic Recovery Act);
- Credit scoring and FHA's mortgage scorecard technology for automated underwriting and risk rating FHA mortgages;
- Sustainable building technology innovation;
- General housing technology research aimed at improving the safety, soundness and energy efficiency of the Nation's housing stock, while maintaining affordability.

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In addition to enabling improvements to the Department's program operations, HUD's research efforts shed light on fundamental characteristics of the nation, including demographics, housing and discrimination patterns, and a myriad of statistical and research data that help inform policy. Since 1977, HUD has assessed the extent of housing discrimination in the United States about once each decade. The most recent study, Housing Discrimination Study 2000 (HDS 2000), showed substantial declines in discrimination between 1990 and 2000 in the sales market for both African-Americans and Hispanics, declines for African Americans renters, and no change for Hispanic renters. The 2000 study also provided the first national estimate of discrimination faced by Asians and Pacific Islanders in the rental and sales market. These studies have also shown how patterns of discrimination have changed over time. Although the nature and level of discrimination has changed, it remains a substantial problem, with minorities facing consistent adverse treatment ranging from 17 percent for African Americans in the sales market to 26 percent for Hispanics in the rental market. Funding of \$9 million in 2010 and \$6 million in 2011 would enable estimation of national levels of discrimination faced by African-Americans, Hispanics, Asians and Pacific Islanders, both as renters and home buyers. The study would provide comparable data to determine changes in the level of discrimination from the 2000 study, providing key insights to inform fair housing strategies and program management.

Finally, in connection with the Combating Mortgage Fraud initiative, part of the \$20 million direct appropriation requested for the Transformation Initiative will fund an assessment of the implementation of the Neighborhood Stabilization program to ensure it addresses the needs of minority and low-income communities in modifying troubled mortgage loans. Additionally, the funds will support analysis of data from the Treasury Department's loan modification program. Findings from this research will inform technical assistance efforts, as well as development of anti-fraud data tools, discussed under the Technology transformation below.

Demonstrations of Program Approaches

The second strategic thrust of the Transformation Initiative is to enable HUD to design and execute a series of major research demonstrations. These trials of new program ideas provide a controlled mechanism to improve programs and help state and local governments develop more effective strategies for housing and community and economic development.

The Secretary's statutory authority to establish demonstrations has been suspended in annual appropriations legislation for roughly the past decade. Demonstrations are necessary to test innovative program approaches so as to improve the delivery and reduce the cost of public services. HUD requests Congress to enable the Secretary to undertake demonstrations after receiving approval from the House and Senate Appropriations chairs. Transformation Initiative funds for approved demonstrations would then be allocated to the Research and Technology account for administration by the Office of Policy Development and Research.

Demonstrations generally require funding over several years, which may cover design resources, additional program costs such as incentives for participating households, and evaluation of the impacts over several years. Since the 1990s, HUD has done relatively few research demonstrations, largely due to budget constraints. Those few demonstrations, however, have been HUD's most important and informative research on real program impacts. Those demonstrations include:

- **Jobs Plus.** This demonstration in six sites showed that carefully designed rent incentives, totaling \$6.8 million, and job supports in distressed public housing developments do improve incomes in the short- and long-term. The total cost of over \$30 million included funding from HUD, the Department of Labor, Health and Human Services, and several foundations. The cost of research and technical assistance was \$25.4 million. Lessons from this initiative are being applied in the Choice Neighborhoods proposal.

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- Moving To Opportunity. The demonstration shows that families moving from high poverty public housing to low poverty neighborhoods with a voucher have a dramatic increase in safety, neighborhood quality, and better housing leading to very large improvements in health. In the short-term, moves to low-poverty do not improve employment or education outcomes. The total cost of over \$90 million, included funding from HUD, NIH, NSF, CDC, other Federal agencies, and numerous foundations. The demonstration covered five sites, 4,608 families and 10,000 individuals. Implementation of the new voucher authority and counseling cost \$70 million, and the research cost for set-up, tracking, and interim and final evaluation was \$25 million.
- Effects of Housing Vouchers on Families. The effort showed that relative to not having housing assistance, receipt of a voucher dramatically reduces homelessness, leads to lower wages and employment in the short run and has no impact on wages and employment in the mid-term. The total cost of \$53 million included \$50 million for implementing new voucher authority, and \$3.2 million for research (set-up; tracking; interim and final evaluation).

Demonstrations can be used systematically to re-engineer and streamline business processes and procedures in HUD's programs. Demonstrations also can be used to test and evaluate new ways of delivering traditional programs.

The following examples of demonstrations are worth considering:

- HUD could establish a demonstration to measure the long-term impacts on individuals and neighborhoods associated with the creation of mixed-income neighborhoods through inclusionary zoning and other tools. Mixing incomes has been the goal of a number of programs over several decades. The impact of achieving this goal, however, has never been quantified in terms of the social and community benefits and costs. A rigorous experiment could be conducted to measure the impact of a mixed income strategy.
- HERA has mandated a demonstration to measure the impact of requiring pre-purchase counseling for certain homebuyers. The Transformation Initiative can provide the necessary funding to answer this long-standing question about the merits and size of impact of pre-purchase housing counseling at reducing defaults and delinquencies.
- HUD could add a research component to the Moving-to-Work Demonstration included in the proposed Section 8 Voucher Reform Act or another legislative reform proposal for Housing Choice Voucher. By adding a major research component to Moving-to-Work, with the funds needed to execute it, HUD could rigorously evaluate a series of alternative strategies for helping families in public housing and the voucher program make progress towards self sufficiency. The emphasis should be on comparatively low cost solutions that could be taken to scale.
- HUD, in partnership with the Department of Transportation, could conduct a large scale demonstration that marries DOT and HUD programs in order to support sustainable development that is adjacent to transit and includes a range of housing types affordable to all income groups. A HUD-DOT transit oriented development demonstration would assess a range of techniques to support compact development and address the typically high costs of housing near transit in light of rising demand for housing, services and amenities in those locations.
- HUD could experiment with administering vouchers regionally rather than locally in urban areas. The balkanization of voucher administration has made it difficult for low-income families to know about suburban housing vacancies and exercise choice in a metropolitan housing market, and has stifled innovation and accountability. A demonstration would evaluate the effects of "competing out" voucher administration in 3-5 metropolitan areas to an array of public and private entities. HUD would select one well-qualified organization (which could include a consortium of PHAs) to administer the program for each metropolitan region, opening up the administration of vouchers to a wider variety of public, for profit and non-profit entities.

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- HUD could conduct a demonstration to examine how to take Shared Equity Homeownership to scale. Shared equity homeownership is a promising approach for providing lower income families with sustainable homeownership opportunities, but most current programs are relatively small. A research demonstration could study different approaches for taking shared equity homeownership to scale, while also helping to meet pressing short-term needs for foreclosure prevention, neighborhood stabilization, the creation of jobs through new construction and substantial rehabilitation, and the creation and preservation of affordable housing near public transit.
- HUD could conduct a pilot study in three communities to advance the creation of permanent housing opportunities by communities that currently rely on short term and transitional housing to meet objectives of the Housing Opportunities for Persons with AIDS program. A demonstration would use \$4 million for program activities and \$400,000 for evaluation activities. The study would evaluate service delivery models for moving persons out of unstable housing situations or short term arrangements to more permanent supportive housing.
- HUD could demonstrate the extent to which sustainable building practices improve the durability of and affordability of new and existing homes. These factors could support innovative financing products. Solid evidence of the benefits of energy efficiency and green building could influence the market by informing the underwriting of home insurance policies and the valuations assigned in home appraisals.
- A Project-Based Operating Assistance demonstration could complement HUD's conversion of public housing to asset management. There are several problems with the current funding model for public housing compared to the multifamily model of project-based assistance grants. The separate Capital and Operating grants for public housing introduce separate administrative requirements and are subject to the vagaries of annual appropriations. Most importantly, they fail to provide PHAs with sufficient access to private capital to address the substantial backlog of capital repair needs, estimated at between \$18 and \$24 billion. Under the multifamily model of project-based assistance, funding levels would include amounts sufficient to raise debt to service capital needs, and would allow PHAs to establish replacement reserve accounts to ensure that capital improvements are sustained.
- The demonstration would test the capacity and responsiveness of private capital markets for recapitalizing the public housing stock. The Department would allow program waivers of the current Section 8 Project Based Voucher program. A demonstration covering 20,000 public housing units under a range of small and large PHAs is estimated to cost \$64 million annually, plus a one-time additional amount of \$2.5 million for evaluation. The voucher cost associated with these units is estimated at approximately \$166 million, which would be offset by \$60 million from the Operating Fund and \$40 million from the Capital Fund, as converted units would no longer be funded from the public housing account. The initial HAP contracts may last as long as 15 years and could be renewed for up to an additional 15 years. The project-based approach to funding is consistent with asset management principles, providing access to capital markets to finance the backlog of needs, improving housing conditions for tenants, increasing opportunities for income mixing, and introducing greater market discipline among the private entities that own or manage the converted properties.
- A demonstration program could ensure that construction projects assisted with Community Planning and Development funds meet minimum code or other property standards, including energy-efficiency standards. In-house expertise for on-site physical inspections currently is lacking, yet this skill set is critical in programs like the Housing Trust Fund and HOME that have property standard requirements for a specific period of affordability. This program would assess the effectiveness of training staff on construction and property standards and deploying them for this sort of technical monitoring.

Demonstrations can be used to explore large, fundamental questions about housing market dynamics and their impact on economic, social and environmental objectives. For example, the government should know to what extent transit oriented developments enhance access to opportunity. HUD seeks to make basic questions the subject of serious and rigorous demonstrations going forward.

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Technical Assistance and Capacity Building

The Transformation Initiative will enable HUD to deliver a new level of technical assistance and capacity building to Federal recipients. The initiative recognizes that human capital, technical awareness and institutional factors are critical for the success of HUD's partner organizations, whether state or local, public or private.

Enhanced and focused information and more thoughtful support for grantees will result in better program administration and a higher level of integrated planning and action, across programs and jurisdictions. Effective responses to urban and housing issues increasingly require coordination and awareness of diverse areas of knowledge: housing finance as well as land use, energy efficiency as well as healthy homes, community development as well as transportation planning, accessibility as well as job creation.

Traditionally, HUD has delivered program-oriented technical assistance to ensure that HUD grantees are fully aware of the rules governing the disparate programs. In fiscal year 2009, Congress provided \$40.5 million in line item funding for technical assistance under the following programs: \$12 million for Public Housing Capital funding; \$4.25 million for Native American Block Grants; \$3.5 million for Native American; \$300,000 for Native Hawaiian; \$2 million for Section 202 housing; \$5 million for CDBG; \$12 million for HOME; and \$1.485 million for Housing Opportunities for Persons with AIDS. HUD's fiscal year 2010 budget rolls these technical assistance accounts into one broad program technical assistance effort to be funded from the global transfers to the Transformation Initiative. HUD requests discretion for the Secretary to target technical assistance funding to those programs that need it most given the capacity of current grantees, new conditions in the program or broader economic and social imperatives (e.g., a spike in homelessness, or the impact of high energy and housing costs on housing affordability).

The Transformation Initiative will enable HUD to deliver cross-program technical assistance to help states, counties and cities (and other HUD grantees) connect the dots between disparate programs at the neighborhood, municipality, county and metropolitan scale. HUD proposes to reach out to grant recipients and other partner groups with well packaged information, case studies that serve as models and illustrate choices, and collaborative activities. Enhanced technical assistance will enable recipients to plan and implement sophisticated initiatives that anticipate, bridge and coordinate diverse factors that each are critical to success. Integrating cross-cutting knowledge with program requirements will better serve the twin components of public accountability: producing results that matter and avoiding fraud, waste and abuse.

One of the Department's current transformational efforts is the multi-year transition of public housing to asset management. Both PHAs and the Department have made significant investments in converting to the asset management model, so that funding and financial reporting now occur at the project level. HUD continues to implement project-level management reviews and performance monitoring, leading to full conversion to asset management in 2011. Technical assistance will support the critical human dimension of this complex effort.

One technical assistance effort under consideration would disseminate building technology information to builders and designers of housing in order to bridge the gap between assisted and market rate housing. Building science issues apply across the housing market, so broadly sharing research and technical information would magnify its benefits. The Partnership for Advancing Technology in Housing program demonstrated the value and effectiveness of a robust, non-commercial website to reach builders and designers of residential buildings.

The Transformation Initiative will enable HUD to build "learning networks" of innovators, local officials, experts, and philanthropic funders focused on critical issues in affordable housing and community development. The focus of an initial set of learning networks, developed in collaboration with HUD's Federal partners, could be: community implementation of a Federally supported building energy retrofit initiative; and development of urban-suburban and regional partnerships for affordable, transit-accessible housing. The approach would be similar to the URBACT program of the European Regional Development Fund, which fosters the exchange of experience among European cities and the dissemination of knowledge on all issues related to sustainable urban development.

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The technical assistance initiative will be informed by changes in the Community Development Technical Assistance competition for fiscal year 2008, which was restructured as a "Request for Qualifications" instead of a "Request for Proposals." The approach provided detailed information about the qualifications and capacity of providers relative to designated types of technical assistance. The focus of the NOFA was redirected to the management capacity of the organization, staff qualifications, and successful experience, leading to a more effective "demand-response" system for addressing client needs. The application review process for 2008 also was changed by incorporating electronic review forms, developed in-house, to speed reviews, reduce errors, and standardize the reviews across more than forty HUD offices.

HUD's effort to build on this change in direction could include developing an electronic system that encompasses the technical assistance process from submission of applications to close-out of grants. Currently, there is little or no reporting on results for most technical assistance activities conducted in the field. The system would establish accountability for results and link results to outlays. Additionally, HUD anticipates that more effective technical assistance will depend on greater coordination of the Department's program organizations, both at Headquarters and the field.

Combating Mortgage Fraud. Part of the \$20 million request under this heading for the Combating Abusive and Fraudulent Mortgage Practices Initiative will be used to provide training about fair housing issues to HUD-funded housing counseling organizations. This training will enhance their capability to identify mortgage fraud and fair lending abuse, leveraging their position of trust to address the mortgage fraud, predatory lending practices and foreclosure rescue scams that so often target groups protected by Federal law.

The funds also will enable adequate implementation of the Secure Fair Enforcement Mortgage Licensing Act (SAFE) and regulations that HUD has issued under the Real Estate Settlement Procedures Act (RESPA). The RESPA rule requires better disclosures by lenders to homebuyers through a new standard Good Faith Estimate (GFE) and a revised HUD-1 settlement statement. By January, 2010, these disclosures will begin assisting 12 million consumers annually in shopping for the best loan product, saving them about \$700 per transaction.

HUD proposes to provide comprehensive training on the RESPA and SAFE requirements for all regulatory parties and related industries: real estate agents, lenders, mortgage brokers, lawyers, and title and escrow agents, state banking, real estate and title insurance regulators, and other federal regulators. Additionally, consumer advocacy groups will need to understand the new forms to assist consumers to select the best loan.

Another portion of the funds would be used for contract hiring so that HUD can adequately monitor state compliance with SAFE in their operations of HUD-approved mortgage originator licensing programs, and for HUD's RESPA enforcement, including investigation contracts and document conversion and storage. Effective implementation of SAFE and RESPA will build a strong foundation for greater fairness in the mortgage finance industry.

Technology. In recent years, HUD's funding for Information Technology has not been sufficient to make major investments in developing, modernizing and enhancing our information systems. Instead, the department has had to maintain and operate outdated technology, in some cases in existence for twenty years or more. Reliance on these out-of-date systems has prevented the Department from taking full advantage of modern tools to capture, store, share, and disseminate information. Our aging systems were not developed to share information or to support modern tools. Furthermore, they are increasingly costly to maintain. According to a report from 2007, HUD's costs for sustaining existing systems are 43 percent higher than the "Government Workload Peer Average," contractor and outsourced application support costs are 66 percent higher than the peer average, and HUD's cost of \$232 per function point is at the 75th percentile for all government agencies.

Most of the transformation initiatives outlined above, as well as many of our traditional business processes, will benefit directly from an infusion of new technology and tools. The evolution of HUD's technology, as envisioned by this Technology Transformation initiative, will serve as a foundation for almost all of the transformational objectives outlined above. It will support current and historical data on performance provide a key source of administrative data to support the evaluation of programs and policies, and

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diffuse innovation and support state and local partners in using public resources effectively. Across the three areas of technology transformation that follow, funds for this Technology Transformation initiative will complement investments in information systems made through the Working Capital Fund.

Data transformation. The first priority is to complete a transformation of the way HUD captures and stores data. Comprehensive, timely and high quality data are essential for informing HUD's many stakeholders, both internal and external, about the efficiency and effectiveness of the Department's programs, grantees and staff. Data transformation begins with the need for HUD to standardize common data fields across program offices, an effort that has already begun. Address data offer the best example of the importance of standardization: in order to analyze the spatial distribution of fund awards, projects or outcomes across census tracts, metropolitan areas or Congressional districts, the locational data elements used to make those comparisons must be commonly defined and captured. In addition to ensuring that the data are consistent, HUD must ensure that it is collecting and storing data that enable it to evaluate programmatic and Departmental effectiveness. In other words, HUD must identify the correct inputs, activities, outputs and outcomes from its grantees and other partners.

By establishing Departmentwide data standards and ensuring it is capturing the right information from its grantees, HUD can begin the process of migrating current systems, and developing new systems, to conform to these standards. The technology infrastructure required to support these objectives must be modern and robust. HUD's Enterprise Architecture efforts to date have created a basis for reducing obsolescence, redundancy and incompatibility of systems. These efforts are continuous, and will be driven by HUD's carefully structured long-term investment planning process, with guidance from the Office of Management and Budget. The infrastructure itself, however, is only as good as the solutions that are built upon it. HUD will continue to enhance its existing systems, while at the same time developing new systems for programs that currently rely on highly manual, "low tech" methods for data collection and storage. By ensuring that all programs are supported by the latest technology, HUD can achieve the Secretary's objective for ensuring that all programs have management performance metrics that can be easily generated and evaluated on a regular or ad-hoc basis. These program solutions achieve another critical transformational objective for HUD: increasing staff efficiency by reducing the amount of time spent on manual, paper-based processing and labor-intensive analysis.

Examples of data transformation include the development of a fully integrated, scalable and robust information system for the largest program at HUD, the Housing Choice Voucher (HCV) program. This program administers over \$18 billion dollars in subsidies. Currently the HCV program has no formal business system; it uses tools like Excel spreadsheets and Access databases to administer and manage funds due to the lack of an appropriate formal business system. A new system would automate HCV policy, budget, funding, program monitoring, control, and close processes. It would be flexible to policy changes, enhance annual budget forecasting, allocate, fund, obligate, disburse, and recapture funding in a timely manner, allow funds monitoring, reporting, and control on-line in real time, allow fund closing with integrity and at ease based on system data.

Other examples of data transformation include improving the capabilities of the Integrated Disbursement Information System (IDIS) to collect data on the Housing Trust Fund program, while exploiting 21st century technology to respond to sophisticated real-time data needs of the Department and diverse stakeholders. Integrated data collection could include expanding availability of the successful Homeless Management Information System to communities undertaking activities under the competitive or formula components of Housing Opportunities for Persons with AIDS. HMIS also is being deployed to support homelessness prevention and rapid re-housing under the American Recovery and Reinvestment Act. The ability to integrate HOPWA project activities into HMIS would enable communities to better support service delivery for HOPWA beneficiaries and provide more comprehensive client level data for addressing the housing and supportive service needs of special needs populations. Integrating HOPWA reporting into HMIS would require statutory authorization to allow coordination of the differing program recipients and enable full integration by fiscal year 2012.

For the Project-Based Rental Assistance program, the Tenant Rental Assistance Certification System (TRACS) needs transformation to better address problems of late and improper payments and inaccurate contract data. Improvements could provide accurate real-time contract data, improve the contract disbursements system, better verify tenant income statements, and provide ability to forecast short-term and long-term program funding needs.

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Analytic Transformation. The second priority is to transform the way HUD uses data. From a management perspective, HUD must be highly focused on the day-to-day performance of its grantees and staff. Regular reporting on the key program inputs, activities, outputs and outcomes, for all Offices and at all organizational levels of the Department, must become the norm if HUD is to achieve its goal of becoming a data-driven agency. From a program perspective, HUD must ensure that it constantly evaluates the medium- and long-term ability of its programs to achieve desired outcomes. These same management and program evaluation goals are more clearly articulated in the Research, Evaluation and Program Metrics transformation initiative. Finally, from a planning perspective, HUD must continuously look across its programs, and ideally across agencies, to assess the effectiveness of investments at the neighborhood, city/county and state levels. Doing so will help HUD tailor its programs to complement, rather than compete with or substitute for, one another.

To support the cross-program transparency and accountability requirements of the American Recovery and Reinvestment Act of 2009, HUD will gather information from various program-specific systems, supplement that with additional data collected using modern tools and then feed the information to the official Recovery website. Moreover, this capability will serve as the foundation for a set of user tools that enable the kind of analysis envisioned above. From a management and program evaluation perspective, this "agency intelligence" solution will provide a displays of program performance--both snapshots and trends--flag areas of concern, and enable the user to obtain detailed information by characteristics such as geography or grantee. To support HUD's planning objective, geospatial mapping capabilities will enable users to overlay and analyze cross-program data to help grantees in their planning process, as well as evaluate the impact of interacting investments within and across communities. For example, public housing modernization and community development investments in the same neighborhoods could be better coordinated in terms of resources invested, activities funded, project schedules and changing neighborhood conditions resulting from program activities.

HUD needs to develop a system that addresses the formula grant life cycle from end to end, enabling a complete reengineering of the business process for Community Planning and Development programs. The automated system would automatically provide HUD and grantees with estimated allocations and final allocations of grant funds each year. The program would reduce risk of allocation errors by integrating a capacity to adapt to changes in geographical boundaries, addition of new entitlement communities and joint agreements, changes in participation by units of local government in CDBG Urban Counties and HOME consortia, as well as changes in legislation and OMB requirements. The system would accommodate census, OMB, and other external data sources necessary for formula calculations. It could generate documents such as funding announcements, award letters, and grant agreements between HUD and grantees, as well as automating the "participation decision" process and enabling grantees to upload certification documents.

To ensure that these tools are fully leveraged, HUD proposes to create an analytical center of excellence and help desk to provide greater support for data analysts throughout HUD in providing agency intelligence. This effort will address an issue that arises primarily from a deficiency of human capital and coordination rather than inadequate systems. The issue lies at the intersection of business needs, data systems and analytical skills. HUD expects that the analytical center will build a cadre of skilled analysts, increasing the Department's analytical human capital and rapid access to critical information while reducing costly and burdensome reliance on contractors for understanding the Department's own administrative data.

HUD's long-term effort to transition public housing to asset management could receive a major boost through a Public Housing Portfolio Management System that upgrades and restructures existing information systems. Information from four systems would be integrated, consistent with the best asset management practices in private industry. Enhancements would include an Operating Fund Module, implementing a more accurate and efficient web-based fund award system rather than the current PHA submissions of worksheets and paper; a Capital Fund Module that integrates a property-level capital needs assessment system (building on requirements implemented under the American Recovery and Reinvestment Act); re-tooling the Public Housing Assessment System (PHAS) to support comprehensive property-level reporting; and redesigning the PIC/Inventory Management System to accommodate asset management and integrate with PHAS. HUD proposes to fund a key "analytic transformation" effort through the \$20 million appropriation for the Transformation Initiative in connection with Combating Mortgage Fraud. HUD plans to develop anti-fraud data tools that would be applied to all phases of the mortgage insurance process to detect misrepresentation at consumer, application, and property levels. Technology will support analysis of loans, assessments of servicer compliance with FHA loss mitigation guidelines, and automation of HUD's oversight of high-

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risk lenders. The crippling effect that mortgage fraud has recently had on the economy, communities and families nationwide highlights the transformational role that properly proactive analytic tools will serve.

Communications transformation. The third priority is to transform the way HUD interacts with its many internal and external stakeholders. HUD is a deeply networked organization with many partners: the Congress, OMB, other Federal agencies, the American public, State and local elected officials, agency heads and program directors, community-based organizations, researchers, advocates, financial institutions, philanthropic organizations and developers. This network offers a tremendous level of skills and experience which, if brought to its fullest potential, can transform the landscape of America's communities. The conditions for this transformation are nearly ideal. The ever-increasing importance of regional collaboration and innovation, combined with the economic crisis that has left resources in short supply, has highlighted the critical need for clear, real-time and interactive communication and information sharing. In addition, the significant focus on public transparency and accountability has led to unprecedented hunger for data and information. Internally, HUD can no longer afford to function within its traditional program silos, but must instead find ways to break down its organizational barriers to facilitate collaboration and drive innovation.

Examples of using technology to transform communication include creating a modern Geographic Information System (GIS) tool to display data useful for planning and to demonstrate investments being made by HUD's partners. Web-based tools can leverage rapidly expanding geospatial data and evolving mapping capabilities to serve diverse needs at low cost. HUD's three existing web-mapping systems--the Empowerment Zone/Enterprise Community Locator, the Single Family Housing Revitalization Area Locator, and an internal PD&R GIS database--would be centralized and merged to use a shared geospatial database.

Another transformational effort could be to expand HUD's Electronic Income Verification (EIV) tool, developed for the Office of Public and Indian Housing, to serve Community Planning and Development programs. Providing Housing Trust Fund grantees with access to the EIV would reduce the possibility of fraud and waste while increasing the program's impact. Grantees would be able to independently verify income instead of relying on documentation supplied by beneficiaries, thereby excluding over-income tenants and ensuring adequate benefits for income-eligible beneficiaries.

Fortunately, technology has already advanced the cause of effective communications, and HUD must keep pace if it is to remain relevant in today's fast-paced environment. First, HUD must transform its website into a true web portal, where its various stakeholders can go to get the information, training or technical assistance they need quickly and in the media they prefer. Second, HUD must leverage the creative capacity of its partners by providing open access to record-level data, where appropriate, so that they may develop and disseminate the innovative analytic tools that can drive program and policy decision-making. Third, HUD must employ social networking tools to facilitate and encourage dialogue across its network, as well as within its own walls.

Combating Mortgage Fraud. The transformation of data, analysis and communication under the Technology initiative will enable a number of key efforts for the signature Combating Abusive and Fraudulent Mortgage Practices Initiative. This effort will utilize the requested \$20 million direct appropriation as well as funds transferred to the Transformation Initiative Fund. The technology components that HUD is planning constitute an integrated fraud detection strategy:

- Upgrading and expanding systems to perform criminal background checks and credit checks of potential FHA mortgage lenders and their staff.

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- Implementing a fraud prevention tool, DataVerify, to identify misrepresentation at all phases of the loan process through automated checking and analysis of multiple data sources before FHA endorses loans for mortgage insurance; using DataVerify to monitor servicers' compliance with FHA loss mitigation guidelines to ensure that the actions benefit and protect borrowers as well as the FHA Fund from unnecessary claims; and automating the oversight of high-risk and high-default lenders by flagging factors that suggest potential fraud during the loan approval process.
- Using an Automated Valuation Model to analyze and accept bids on FHA's Real-Estate Owned properties; by valuing properties under various scenarios, for example "Quick Sale" or normal sale, along with the standard "time in inventory" discount schedule, properties can be sold sooner and with better cost recovery.
- Providing contract support for on-site monitoring and quality control reviews of approximately 200 new lenders, in response to the increase from 900 to 3,000 FHA-approved lenders between 2007 and 2008; and also contracting for analysis of delinquent borrowers, for example to determine the role of income shocks in mortgage defaults, so as to improve quality control efforts and loss mitigation tools.

Process of Implementing the Transformation Initiative

HUD proposes to entrust the Transformation Initiative to a new Office of Strategic Planning and Management within the Office of the Deputy Secretary. The Office, which is described separately, would have 21 Full Time Equivalent staff focused on reinvigorating HUD's strategic planning and performance management, and providing consulting and project management expertise to address the Department's biggest challenges. Administering the Transformation Initiative Fund would be a major responsibility of the Office. The Office will allocate or transfer funds to appropriate offices and funds as appropriate for specific efforts. For example, program evaluations would be managed by the Office of Policy Development and Research.

The strategic plan will be central to HUD's ability to transform itself. The plan, which identifies the Department's key goals, objectives and measures of success, as well as the programs and support functions that support them, will serve as the "roadmap" for both HUD and the Office of Transformation Planning and Management. The strategic plan will identify the barriers to HUD's success (e.g., ineffective or inefficient operations across the Department's program management, policy development, research, human capital, procurement or IT functions). The Office will then work with all affected stakeholders to define and prioritize specific transformational projects aimed at addressing these challenges.

HUD intends to use the strategic plan as a framework for managing operations and resources. The strategic plan will be the point of departure for developing the fiscal year 2010 operating plan, including the allocation of funds to projects under the Transformation Initiative. Criteria for assessing and prioritizing potentially transformational allocations would include the connection to HUD's mission and strategic goals, the magnitude of risks faced by HUD's clients, partners and programs, the likelihood of transformative impact, the costs and benefits, and the potential to strengthen HUD's capability for long-term effectiveness. The issues of human capital transformation and process transformation are integral to these criteria, and will be embodied in a collaborative approach with program offices.

The Office of Strategic Planning and Management will make transformational allocations on the basis of the fiscal year 2010 operating plan. However, in the areas of research and program demonstrations, HUD will confer with congressional Appropriations and Authorizing committees before finalizing funding plans under the Transformation initiative.

Benefits of the Transformation Initiative

The Transformation Initiative represents a comprehensive effort to deal with the broad range of persistent problems and unexploited opportunities that HUD faces. Recent progress in several major program areas, such as implementing asset management in public housing, demolishing obsolete and dangerous housing stock, and modernizing FHA programs, has created a significant opportunity to systematically re-examine and refocus the Department's efforts on serious issues that continue to face the nation. Inadequate

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national investment in research, evaluation and data collection have for too long constrained HUD in directing a few, sometimes rigid, programs toward diverse, complex and poorly understood urban problems. Public investments in program demonstrations during the 1970s resulted in the voucher program as a more cost-effective alternative to public housing. However, the next phase of transformative research has not yet been undertaken.

A central principle underlying the Transformation Initiative is the necessity of making policy and managerial decisions on the basis of documented facts. Three of the four purposes that HUD proposes for transformation funding--research, demonstrations, and technology initiatives--are fundamentally about applying evidence-based principles. HUD expects that these components will fill critical gaps in collective understanding of both the causes of housing and urban development issues and the practical matters of how to address them effectively and with accountability to beneficiaries and taxpayers. More effective performance measurement and a Secretarial commitment to employing best practices for performance management will complete the loop.

A robust capability to deploy sound data when policymaking and managing must be accompanied by greater coordination with program partners. HUD can address none of its core mission areas alone. The Department's collaboration must be both horizontal, teaming with other Federal agencies to address issues of mutual concern, and vertical, engaging state and local governments and private for-profit and non-profit partner organizations in a coordinated attack on the challenges they face. The technical assistance funds of the Transformation Initiative, and the flexible use of those funds to span programmatic boundaries for more effective communication, are key to making these partnerships effective. At the same time, clearer communication of programmatic requirements will serve accountability well.

HUD considers the requested 1.0 percent transfer of program funds to be a justifiable, proportionate and responsible use of program funds. Just as private industries are most accountable to shareholders when they invest several percent of earnings in ongoing research and development, so HUD will best serve stakeholders by investing in an on-going transformation toward a data-driven and more responsive future.

HUD Transformation Initiative Fund

HUD TRANSFORMATION INITIATIVE FUND
 Summary of Resources by Program
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Budget Authority</u> | <u>2007 Carryover Into 2008</u> | <u>2008 Total Resources</u> | <u>2008 Obligations</u> | <u>2009 Budget Authority/ Request</u> | <u>2008 Carryover Into 2009</u> | <u>2009 Total Resources</u> | <u>2010 Request</u> |
|-------------------------|------------------------------|---------------------------------|-----------------------------|-------------------------|---------------------------------------|---------------------------------|-----------------------------|---------------------|
| Combat Mortgage Fraud . | ... | ... | ... | ... | ... | ... | ... | <u>\$20,000</u> |
| Total | ... | ... | ... | ... | ... | ... | ... | 20,000 |

| <u>FTE</u> | <u>2008 Actual</u> | <u>2009 Estimate</u> | <u>2010 Estimate</u> |
|--------------------|--------------------|----------------------|----------------------|
| Headquarters | ... | ... | ... |
| Field | ... | ... | ... |
| Total | ... | ... | ... |

The following table illustrates the maximum possible transfers into the Transformation Initiative account. It does not represent actual transfers.

HUD Transformation Initiative Fund

| Transformation Initiative Fund Programs | Amount |
|---|--------------------|
| Tenant-Based Rental Assistance..... | \$178,360,000 |
| Public Housing Capital Fund..... | 22,440,000 |
| Public Housing Operating Fund..... | 46,000,000 |
| Choice Neighborhoods..... | 2,500,000 |
| Native American Housing Block Grants..... | 6,430,000 |
| Indian Housing Loan Guarantee Fund..... | 7,500 |
| Native Hawaiian Housing Loan Guarantee Fund..... | 0 |
| Native Hawaiian Housing Block Grants..... | 100,000 |
| Project Based Rental Assistance..... | 77,000,000 |
| Housing Counseling..... | 1,000,000 |
| Housing for the Elderly (Section 202)..... | 5,220,000 |
| Housing for the Elderly (Section 202) Contract Renewals..... | 2,430,000 |
| Housing for Persons with Disabilities (Section 811)..... | 1,140,000 |
| Housing for Persons with Disabilities (Section 811) Contract Renewals | 1,360,000 |
| MMI/CHMI Fund..... | 1,181,060 |
| GI/SRI Fund..... | 0 |
| Energy Innovation Fund..... | 1,000,000 |
| Manufactured Housing Standards Program..... | 90,000 |
| Rental Assistance Program (Section 236)..... | 400,000 |
| CDBG..... | 44,500,000 |
| HOME..... | 18,250,000 |
| SHOP..... | 770,000.00 |
| Homeless Assistance Grants..... | 17,937,150 |
| HOPWA..... | 3,100,000 |
| Brownfields..... | 0 |
| FHEO..... | 720,000 |
| OHHLHC..... | 1,400,000 |
| <u>FHA Combating Mortgage Fraud.....</u> | <u>200,000</u> |
| Total Transformation Initiative funding level..... | 433,535,710 |

**TRANSFORMATION INITIATIVE FUND
Program Offsets
(Dollars in Thousands)**

| Combat Mortgage Fraud | <u>Amount</u> |
|------------------------------------|----------------------|
| 2008 Appropriation | ... |
| 2009 Appropriation/Request | ... |
| 2010 Request | <u>\$20,000</u> |
| Program Improvements/Offsets | +20,000 |

Proposed Actions

This funding will support efforts to combat mortgage fraud through a number of different critical activities including targeted technical assistance, data systems improvement through information technology, and a variety of research efforts. Examples of Transformation Initiative activities that may be implemented to combat abusive and fraudulent mortgage practices include:

- Development of FHA anti-fraud data tools that would be applied to all phases of the mortgage insurance process to detect misrepresentation at consumer, application, and property levels;
- Technical Assistance to support housing counseling organizations with identifying mortgage fraud and addressing fair lending issues;
- Training of industry and regulatory agencies and contract hiring to monitor state compliance with SAFE and RESPA; and
- Research, assessment and data analysis to assist in the effective implementation of the Neighborhood Stabilization Program and the Homeowners Affordability and Stability Plan (Making Home Affordable Plan) mortgage loan modification program.

HUD TRANSFORMATION INITIATIVE FUND
Justification of Proposed Changes in Appropriations Language

The 2010 President's Budget includes proposed changes in the appropriations language listed and explained below. New language is italicized and underlined.

For necessary expenses for combating mortgage fraud, \$20,000,000 to remain available until expended. In addition, of the amounts made available in this Act under each of the following headings under this title, the Secretary may transfer to, and merge with, this account up to 1 percent from each such account, and such transferred amounts shall be available until September 30, 2015, for (1) research, evaluation, and program metrics; (2) program demonstrations; (3) technical assistance and capacity building; and (4) information technology: "Tenant-Based Rental Assistance," "Public Housing Capital Fund," "Public Housing Operating Fund," "Choice Neighborhoods Initiative," "Energy Innovation Fund," "Native American Housing Block Grants," "Native Hawaiian Housing Block Grants," "Indian Housing Loan Guarantee Fund Program Account," "Housing Opportunities for Persons With AIDS," "Community Development Fund," "HOME Investment Partnerships Program," "Self-Help and Assisted Homeownership Opportunity Program," "Homeless Assistance Grants," "Project-Based Rental Assistance," "Housing for the Elderly," "Housing for the Elderly Contract Renewals and Amendments," "Housing for Persons with Disabilities," "Housing for Persons With Disabilities Contract Renewals and Amendments," "Housing Counseling Assistance," "Payment to Manufactured Housing Fees Trust Fund," "Mutual Mortgage Insurance Program Account," "General and Special Risk Program Account," "Research and Technology," "Lead Hazard Reduction," "Rental Housing Assistance," and "Fair Housing Activities": Provided, That the Secretary shall fund each of the four general purposes specified above at not less than 10 percent, and not more than 50 percent, of the aggregate transferred amount.

HUD Transformation Initiative Fund

HUD TRANSFORMATION INITIATIVE FUND
 Crosswalk of 2008 Availability
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Enacted</u> | <u>Supplemental/ Rescission</u> | <u>Approved Reprogrammings</u> | <u>Transfers</u> | <u>Carryover</u> | <u>Total 2008 Resources</u> |
|-----------------------------|---------------------|-------------------------------------|------------------------------------|------------------|------------------|-------------------------------------|
| Combat Mortgage Fraud | ... | ... | ... | ... | ... | ... |
| Total | ... | ... | ... | ... | ... | ... |

HUD Transformation Initiative Fund

HUD TRANSFORMATION INITIATIVE FUND
 Crosswalk of 2009 Changes
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2009 President's Budget Request</u> | <u>Congressional Appropriations Action on 2009 Request</u> | <u>2009 Supplemental/ Rescission</u> | <u>Reprogrammings</u> | <u>Carryover</u> | <u>Total 2009 Resources</u> |
|-----------------------------|--|--|--|-----------------------|------------------|---------------------------------|
| Combat Mortgage Fraud | ... | ... | ... | ... | ... | ... |
| Total | ... | ... | ... | ... | ... | ... |

COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES
2010 Summary Statement and Initiatives
(Dollars in Thousands)

| COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES | <u>Enacted/ Request</u> | <u>Carryover</u> | <u>Supplemental/ Rescission</u> | <u>Total Resources</u> | <u>Obligations</u> | <u>Outlays</u> |
|---|-----------------------------|------------------|-------------------------------------|----------------------------|--------------------|----------------|
| 2008 Appropriation | ... | ... | ... | ... | ... | ... |
| 2009 Appropriation/Request | \$2,000 ^a | ... | ... | \$2,000 ^b | ... | ... |
| 2010 Request | <u>37,000^b</u> | <u>...</u> | <u>...</u> | <u>37,000^b</u> | <u>...</u> | <u>...</u> |
| Program Improvements/Offsets | +35,000 | ... | ... | +35,000 | ... | ... |

a/ In fiscal year 2009, \$2 million was set aside in the Fair Housing and Equal Opportunity appropriation to carryout authorized activities to protect the public from mortgage rescue scams.

b/ Budget authority is for illustrative and analytical purposes, actual resources, obligations and outlays are in the parent accounts as described below.

Summary Statement

The Combating Abusive and Fraudulent Mortgage Practices Initiative draws on agencywide programs, resources and accounts. This portion of the Congressional Justifications summarizes these agencywide efforts and proposed budget items throughout the fiscal year 2010 Budget Request. Given the history of abusive lending practices, the continuing housing crisis, and the potential for increased mortgage fraud and abuse, the Administration's Budget Request includes key resources that will be brought to bear in combating mortgage abuse and fraud as part of a Federal and state inter-agency strategy.

In total, HUD is requesting \$37 million for a range of activities to prevent mortgage fraud and abuse and to support the enforcement of fair lending and consumer protection laws in order to combat abusive and fraudulent mortgage practices. This \$37 million request includes: \$12 million for the Fair Housing Initiatives Program (FHIP); \$1 million for the Fair Housing Assistance Program (FHAP); \$4 million for increased enforcement of fair lending, RESPA and Secure Fair Enforcement Mortgage Licensing Act (SAFE) Act requirements; \$4 million for staff for this effort; and \$20 million for an FHA Mortgage Fraud Initiative in the Transformation Initiatives account. The funding amount from the Transformation Initiative Fund could be supplemented with additional amounts under that account's flexible authority to allocate funds to critical activities.

Combating Abusive and Fraudulent Mortgage Practices Initiative has three-broad components:

- 1) Fair Lending and Greater Emphasis on Discrimination and Abuse in Loan Modifications. HUD anti-fraud and abuse efforts for both private market enforcement (e.g. fair housing) as well as FHA often focused on mortgage origination. Much greater emphasis needs to be placed on mortgage modifications, including fair lending discrimination issues and consumer protections.
- 2) Aggressive use of RESPA and SAFE Act to Eliminate Abusive Lending. HUD staff, capacity and enforcement under its existing RESPA authority needs to be increased, along with implementing new responsibilities under the Secure Fair Enforcement Mortgage Licensing Act of 2008 (SAFE Act).

Combating Abusive and Fraudulent Mortgage Practices Initiative

3) Protecting FHA from Fraud. FHA's market share and volume of business has skyrocketed, coupled with a large increase in loan limits. HUD needs better data systems and administration (including staff) to protect consumers, the FHA MMI fund, and protect FHA itself from becoming a vehicle for fraud by unscrupulous actors.

Background

Typically, fair lending enforcement has focused on preventing discrimination in mortgage origination. The current housing and economic crisis leaves a large segment of the population at risk of mortgage relief scams, unfair and deceptive lending practices, and anti-consumer fraud and abuse. The Federal Bureau of Investigation's (FBI) Financial Crimes Office's annual Mortgage Fraud Report issued in April 2008 stated that Suspicious Activity Reports (SARs) from financial institutions indicated large increases in mortgage fraud reporting. SARs increased 31 percent to 46,717 during fiscal year 2007.

This Initiative will respond to these related issues with key targeted activities to combat abusive and fraudulent mortgage practices. These activities include increasing funding for fair housing programs, strengthening enforcement and education related to mortgage and home purchase settlement requirements, and implementing FHA anti-fraud tools to prevent lending abuses.

This Initiative to strengthen HUD's commitment to combating mortgage abuse will be part of a multi-agency coordinated response with the Department of Justice, the FBI, Department of Treasury, the Federal Trade Commission (FTA), state attorneys general, and state and federal financial services regulatory agencies. The fiscal year 2010 Budget Request includes substantial funds and increased staffing and resources for this effort.

Fair Lending and Greater Emphasis on Discrimination and Abuse in Loan Modifications.

As the housing and economic climate continued to worsen, the potential for abuse has grown. For example, recent studies have shown that only 35 percent of independent subprime/Alt-A modifications resulted in a decrease in monthly payments. Others have found that race can have an independent effect even after controlling for borrower income and credit score and raise issues on questionable fees in foreclosure proceedings. Clearly, HUD needs to create new fair lending enforcement strategies for loan modifications.

HUD also needs to take actions to prevent proliferation of mortgage rescue scams. Recent cases brought or under investigation by the FBI, the Department of Treasury and the Federal Trade Commission highlight the types of mortgage fraud scams that have been identified: deceptive advertising and marketing tactics (e.g. firms purporting to be government agencies or affiliates); large upfront fees, or worse signing over the deed to the house, in exchange for false promises of assistance with negotiating with the homeowner's bank for loan modifications or for services that are never delivered.

Risks of being victims of mortgage rescue scams appear to be higher for minorities than for non-minorities. A November 2008 working paper by the San Francisco Federal Reserve Board found that minority borrowers were much more likely than non-minority borrowers to be in foreclosure, even when controlling for credit score, housing value change, and neighborhood characteristics. The evidence of preying on minorities, the elderly and other groups shows that the overall housing crisis and the potential for increased abuses have serious fair housing implications.

HUD will confront the growing potential for discrimination and abuse in these areas through this Initiative's coordinated approach, combining: a) increased funding through the Fair Housing Initiative Program account to assist local fair housing agencies in enforcement and education; b) increased funding for training of Fair Housing Assistance Program agencies to enhance their capacity to address lending discrimination and mortgage abuse; c) increased HUD staff, training and resources to address abusive and fraudulent mortgage practices; and d) assistance to support housing counseling organizations with identifying mortgage fraud and addressing fair lending issues.

Combating Abusive and Fraudulent Mortgage Practices Initiative

RESPA/SAFE Act.

The 2008 Real Estate Settlement Procedures Act (RESPA) rule contains new consumer disclosures which help borrowers and financial services professionals spot currently hidden inappropriate fees and costs. Funding for training and education targeting financial services industry groups would assure accurate use of the disclosures, and additional training for HUD staff in external review requirements. Also, data system improvements are needed to identify patterns of abuse, trends in noncompliance, and repeat offenders.

The Secure Fair Enforcement Mortgage Licensing Act (SAFE) of 2008 seeks to "increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud" by encouraging States and private trade groups to establish a Nationwide Mortgage Licensing System and Registry for the residential mortgage industry. HUD will play a role in the implementation of this important law. HUD is required to establish and maintain a system for the licensing and registration of loan originators in States that do not implement their own systems under the Act. HUD is also required to ensure that State systems are consistent with the Act. Effective implementation of these statutory responsibilities, as well as training for state and private organizations on the Act's requirements, is a key component of this Initiative. Additional S&E funding will also be dedicated to HUD staff training and expenses for outside education efforts.

FHA Anti-Fraud Efforts.

The Initiative also contains a key component for increased anti-fraud protections for the FHA Single Family Mortgage Insurance program. During the current housing crisis, FHA market share has increased from under 2 percent in 2006 to 30 percent in the 4th quarter of 2008. This significant expansion in the volume of FHA-insured loans reinforces the importance of taking appropriate steps to minimize any abuses within this program. The number of new participating lenders and the FHA share of single family market sales have both increased rapidly pointing to the need for increased FHA fraud protection mechanisms to protect both consumers and the FHA Insurance Fund. At the same time, the FHA single family mortgage loan limit has also greatly increased, potentially adding risk to the Mutual Mortgage Insurance Fund.

Through this Initiative, FHA will deploy fraud detection tools in its single family origination operations to better detect and deter fraudulent behavior by mortgagees, borrowers, appraisers, real estate agents and others with a vested interest in defrauding the government. This systematic approach will greatly increase the ability of FHA to detect and prevent fraud over current compliance review procedures.

Funding Breakout.

More detailed descriptions of funding uses appear in the actual Program Account budget requests.

Specifically, the \$37 million request includes the following key components:

\$12 million increase for the Fair Housing Initiatives Program (FHIP) for private enforcement efforts and consumer education and outreach. This initiative will provide funding to leading fair housing groups with experience in lending activities to develop refined methods of data-gathering, investigation, and enforcement activities to respond to new types of mortgage products and new dynamics in mortgage regulation. In addition, this initiative will provide incentives for integration of approaches undertaken by consumer protection and fair lending organizations--each of which has addressed abusive lending practices prevalent in underserved communities but historically without coordination. The \$12 million increase includes:

\$4.5 million for the FHIP Private Enforcement Initiative;

\$4.5 million for the Fair Housing Organizations Initiative;

\$1 million for training of housing counselors; and

\$2 million for local outreach efforts.

Combating Abusive and Fraudulent Mortgage Practices Initiative

\$1 million under the Fair Housing Assistance Program (FHAP) to address fair lending issues. This will support training to enhance the capacity of agencies in the FHAP to address lending discrimination and mortgage abuse, including through attendance of the National Fair Housing Training Academy's fair lending course and education and discussion at the Fair Housing Policy Conference.

\$4 million for additional staff in FHEO, the Office of General Counsel (OGC), and Housing to address abusive and fraudulent mortgage practices, including: (a) increase in FHEO's systemic fair lending division including economists, fair housing specialists, and investigators to expand fair lending efforts, especially in the context of the President's Making Home Affordable Plan; (b) OGC increase to handle increased fair lending and mortgage fraud enforcement, including increased action by Mortgagee Review Board, and Real Estate Settlement Protection Act (RESPA) enforcement; and (c) Housing to create a new Secure Fair Enforcement Mortgage Licensing Act (SAFE) office to administer the new program;

\$20 million under the new Transformation Initiative to support efforts to combat mortgage fraud through a number of different critical activities including targeted technical assistance, data systems improvement through Information Technology, and a variety of research efforts. The \$20 million request could be supplemented with additional funds under this proposed new account's flexible authority. Examples of Transformation Initiative activities that may be implemented to combat abusive and fraudulent mortgage practices include:

- Development of FHA anti-fraud data tools that would be applied to all phases of the mortgage insurance process to detect misrepresentation at consumer, application, and property levels;
- Technical Assistance to support housing counseling organizations with identifying mortgage fraud and addressing fair lending issues;
- Training of industry and regulatory agencies and contract hiring to monitor state compliance with SAFE and RESPA; and
- Research, assessment and data analysis to assist in the effective implementation of the Neighborhood Stabilization Program and the Homeowners Affordability and Stability Plan (Making Home Affordable Plan) mortgage loan modification program.

Combating Abusive and Fraudulent Mortgage Practices Initiative

COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES
 Summary of Resources by Program
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Budget Authority</u> | <u>2007 Carryover Into 2008</u> | <u>2008 Total Resources</u> | <u>2008 Obligations</u> | <u>2009 Budget Authority/ Request</u> | <u>2008 Carryover Into 2009</u> | <u>2009 Total Resources</u> | <u>2010 Request</u> |
|--|------------------------------|---------------------------------|-----------------------------|-------------------------|---------------------------------------|---------------------------------|-----------------------------|---------------------|
| Combating Abusive and Fraudulent Mortgage Practices Initiative . | ... | ... | ... | ... | \$2,000 | ... | \$2,000 | \$37,000 |
| Total | ... | ... | ... | ... | 2,000 | ... | 2,000 | 37,000 |

| <u>FTE</u> | <u>2008 Actual</u> | <u>2009 Estimate</u> | <u>2010 Estimate</u> |
|--------------------|--------------------|----------------------|----------------------|
| Headquarters | ... | ... | ... |
| Field | ... | ... | ... |
| Total | ... | ... | ... |

Combating Abusive and Fraudulent Mortgage Practices Initiative

COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES
Justification of Proposed Changes in Appropriations Language

Appropriations language is in the parent accounts for this Initiative.

Combating Abusive and Fraudulent Mortgage Practices Initiative

COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES
 Crosswalk of 2008 Availability
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Enacted</u> | <u>Supplemental/ Rescission</u> | <u>Approved Reprogrammings</u> | <u>Transfers</u> | <u>Carryover</u> | <u>Total 2008 Resources</u> |
|---|---------------------|-------------------------------------|------------------------------------|------------------|------------------|-------------------------------------|
| Combating Abusive and Fraudulent Mortgage Practices Initiative | ... | ... | ... | ... | ... | ... |
| Total | ... | ... | ... | ... | ... | ... |

COMBATING ABUSIVE AND FRAUDULENT MORGAGE PRACTICES
 Crosswalk of 2009 Changes
 (Dollars in Thousands)

| <u>Budget Activity</u> | <u>2009 President's Budget Request</u> | <u>Congressional Appropriations Action on 2009 Request</u> | <u>2009 Supplemental/ Rescission</u> | <u>Reprogrammings</u> | <u>Carryover</u> | <u>Total 2009 Resources</u> |
|-------------------------------------|--|--|--|-----------------------|------------------|---------------------------------|
| Combating Abusive and Fraudulent | | | | | | |
| Mortgage Practices Initiative | ... | \$2,000 ^a | ... | ... | ... | \$2,000 |
| Total | ... | 2,000 | ... | ... | ... | 2,000 |

HOUSING
ENERGY INNOVATION FUND
2010 Summary Statement and Initiatives
((Dollars in Thousands))

| ENERGY INNOVATION FUND | <u>Enacted/ Request</u> | <u>Carryover</u> | <u>Supplemental/ Rescission</u> | <u>Total Resources</u> | <u>Obligations</u> | <u>Outlays</u> |
|------------------------------------|-----------------------------|------------------|-------------------------------------|----------------------------|--------------------|-----------------|
| 2008 Appropriation | ... | ... | ... | ... | ... | ... |
| 2009 Appropriation/Request | ... | ... | ... | ... | ... | ... |
| 2010 Request | <u>\$100,000</u> | <u>...</u> | <u>...</u> | <u>\$100,000</u> | <u>\$75,000</u> | <u>\$75,000</u> |
| Program Improvements/Offsets | +100,000 | ... | ... | +100,000 | +75,000 | +75,000 |

Summary Statement

The Department requests \$100 million for a new Energy Innovation Fund to overcome barriers to energy efficiency in privately owned single-family homes and multifamily housing and to support promising local initiatives that can serve as models for replication in other markets. The objective of the Energy Innovation Fund is to help catalyze a home energy retrofit market in the United States, by accelerating private investment in cost-saving energy efficiency retrofits in the residential sector. Innovative strategies to improve the usefulness of existing HUD programs will lead to significant reductions in energy consumption, operating costs, and the carbon footprint of both affordable and market-rate housing. FHA will also work with HUD's new Office of Sustainable Housing and Communities to test--and where feasible bring to scale--new and innovative products such as energy efficient and location efficient mortgages.

Residential energy expenditures in the U.S. totaled \$201 billion in 2005, based on the Residential Energy Consumption Survey. Even modest gains in energy efficiency will yield significant benefits to renters, homeowners and owners of rental properties, while also supporting job creation, energy savings and climate change objectives.

The Energy Innovation Fund will support three initiatives: A Local Initiatives Fund, directed at communities with demonstrated capacity in energy efficiency retrofits; Energy Efficient Mortgage Innovation, directed at the single-family homeownership market; and Multifamily Energy Enhancement Financing, directed at the rental market. The initiatives will be funded at \$50 million, \$25 million and \$25 million, respectively.

Local Initiatives Energy Innovation Fund

The Local Initiatives Energy Innovation Fund will bring to scale a number of innovative local approaches that address these barriers to advancing energy efficiency. HUD seeks to use up to \$50,000,000 to fund 10 or more local energy funds. Funding will provide a mix of incentive grants, "demand-side" subsidies, and supply side leveraging to support the expansion or start-up of local energy retrofit funds. Energy Innovation Fund grants for local initiatives will require a minimum leverage ratio of 10:1, yielding an anticipated \$500 million in energy efficiency investments.

Energy Innovation Fund

Through targeted grants to local communities, the Local Initiatives Energy Innovation Fund would support local initiatives that include one or all of the following elements:

- incentives to catalyze investment by private sector institutions (local utilities, and banks), to include interest rate reductions, less stringent underwriting criteria, loan guarantees and reserves, strategic use of rebates, and/or support of transaction costs;
- the use of innovative collection or billing mechanisms such as utility on-bill financing or property-tax bill financing mechanism, or leasing arrangements for solar or other renewable equipment;
- the provision of a package of necessary technical services, from energy audit to post-retrofit performance monitoring, that has been found to be a key to ensuring positive results;
- innovative information and outreach efforts, that will expand consumer awareness of the potential for energy efficiency, such as "time of sale" energy performance disclosures, the use of the DOE Energy Smart Scale or similar indicators of a home's energy efficiency;
- linkage or coordination with other public sources of funds, such as the Department of Energy's weatherization program, or state Clean Energy Funds, or HUD's CDBG and HOME programs, that will allow for targeting of some of the funds to low- and moderate-income borrowers.

By targeting successful local programs that include these elements, and at the same time supporting the incorporation of new and innovative approaches where feasible and appropriate (e.g. on-bill utility financing), the Energy Innovation Fund will serve a valuable function in supporting the development of a standardized energy retrofit market in the United States.

Background. Despite a growing overall single family market share, FHA's energy efficient mortgage products serve a relatively small share of the residential market. In addition to these FHA products, the Energy Innovation Fund will leverage financing for the larger residential market--both single family and multifamily--by supporting local energy funds that can be tailored to local needs, leverage additional local resources for energy efficiency (such as utility, clean energy funds, or other resources), and support innovative financing, billing and quality assurance features.

Over the past few years, in the absence of Federal initiatives, there has been a great deal of innovation taking place at the state and local level. The Energy Innovation Fund will complement, and help bring to scale, successful models, such as:

- In Pennsylvania, the Keystone Home Energy Loan Program (HELP) provides financing for homeowners through a suite program financed by utilities or housing finance agencies. These include the Energy Star Loan program, which offers secured loans of up to \$15,000 at a fixed rate for the installation of Energy Star rated improvements to an existing home. Homeowners may also take advantage of rebates of up to \$250 for Energy Star basic or advanced improvements.
- New York offers the Home Performance with Energy Star Energy Smart Loan, which provides loans of up to \$20,000 for home energy retrofits. For multifamily developments, the Energy Smart Loan program offers \$5,000 per unit or \$2.5 million per project that incorporates comprehensive, advanced electric meters in the development.
- In Wisconsin, the Energy Conservation Corporation created Energy Finance Solutions (EFS) in 1995 as an underwriter and originator of energy efficiency loans. EFS has leveraged \$64 million to assist qualified homeowners in financing eligible energy improvements.

Energy Innovation Fund

Several successful energy retrofit funds also operate at the city level in Chicago, Portland, Austin, and other locations. Despite these successes, and despite the potential for reducing energy consumption in the building sector, energy efficiency programs have often met with disappointing results. A recent study conducted for the State of Vermont studied 18 energy loan programs in depth, and also identified over 150 loan programs for residential energy efficiency in the United States. The study found that only a "tiny fraction" of the population has been reached. Most of the programs reached less than 0.1 percent of their potential customers, suggesting that in many cases their impact is marginal. Programs that have higher participation rates tend to have networks of engaged and informed contractors, or have created "service delivery" mechanisms to provide a package of energy audit, installation, and post-retrofit monitoring and evaluation to ensure that predicted energy savings are achieved.

The study identified several barriers to more widespread use and success of these energy funds: their limited applicability to households most in need (low- and moderate-income families), the difficulty of assuring that savings will exceed payments, their limited support for intensive energy retrofits, and the inability of some programs to cover their costs. The study identifies two new areas for replication: financing linked to property tax payments, and on-bill financing through utility payments.

Energy Efficient Mortgage Innovation

FHA-insured Energy Efficient Mortgages allow homebuyers to cover the costs of energy-efficient improvements in both existing homes and new homes. In existing homes, these improvements can be made without an additional appraisal or additional income qualification. But despite the benefits offered by these mortgage products, the number of EEMs made each year is a very small proportion of the potential mortgage market. In 2007, for example, the number of FHA mortgages reported as EEMs was only 1,100, of 424,442 loans endorsed by FHA. Barriers to more widespread use of the product include: lack of consumer awareness, lack of sufficient lender incentives; and additional requirements for energy assessments and escrow funding that complicate the standard home buying transaction.

The goal of the Energy Efficient Mortgage (EEM) Innovation pilot program is to make it easier and less expensive for homebuyers and homeowners to finance energy improvements. Energy improvements reduce long-term costs to homeownership in the form of lower utility bills. In addition to making FHA EEMs easier to obtain and less expensive for homebuyers, HUD is proposing a new energy retrofit loan product, and will be working with Fannie Mae and Freddie Mac to coordinate product designs so that they are more easily understandable and accessible to lenders and borrowers.

HUD will be seeking legislative language to permit testing and potential adoption of a range of approaches to overcome these barriers. These approaches include: streamlining the current EEM and allowing greater flexibility in use of the EEM; offering a second mortgage product; and providing incentives to borrowers to take advantage of the product. HUD seeks to use \$25,000,000 of the Energy Innovation Fund to fund Energy Efficient Mortgage Innovation. The program will extend the benefits of the existing FHA Energy Efficient Mortgage (EEM) program to more homeowners through a coordinated approach that addresses supply-side, demand-side, and financing issues, while providing a mechanism for evaluating strengths and weaknesses of the initiative.

HUD proposes to test a variety of mechanisms and proposes the following efforts to enhance FHA's Energy Efficient Mortgage program:

EEM Structural Enhancements. HUD will consider proposing statutory amendments to the EEM program that would make the program available to a larger set of borrowers. Under consideration is authorizing EEMs as a second mortgage option; this could benefit a greater share of homeowners who are interested in energy improvement projects but do not want to refinance their primary mortgage. HUD is also exploring extending the EEM program to permit investors to qualify. These amendments could help to expand the level of energy efficient retrofits in the market. HUD also is considering seeking flexibility to waive Home Energy Rating assessment for EEM transactions that satisfy the Energy Star Builder Option Package for a particular geographic area, or are energy improvements recommended or prescribed by State or local governmental entities for existing housing.

Additionally, HUD will work with Fannie Mae and Freddie Mac to align FHA's EEM with Fannie Mae and Freddie Mac products, all of which have different features. Streamlining these products will reduce confusion and make EEM products more attractive and understandable for both consumers and mortgage lenders.

Energy Innovation Fund

Up-Front Premium Reduction or Interest Rate Write Down for EEMs. HUD is evaluating the use of Energy Innovation funds to reduce or offset the cost of FHA's up-front premium or origination points on EEM loans. FHA currently requires an up-front premium of 1.5 percent of the loan amount to be paid at closing, or to be financed into the mortgage amount. The 1.5 percent premium may vary as FHA implements risk-based pricing under recently enacted statutory authority.

Premium Reduction for Title I Energy Efficient Property Improvement Loans. FHA's Title I program offers both secured and unsecured chattel-loan products that HUD proposes to enhance to promote energy retrofits. In conjunction with other improvements to the Title I program, HUD is evaluating the use of Energy Innovation funds to reduce or offset the cost of premiums that FHA charges for insuring property improvement loans under the Title I Property Improvement Loan program, provided that borrowers intend to use the loan funds for energy efficiency retrofits as prescribed by a documented home energy rating. Under the current Title I program, FHA insures private lenders against the risk of default for up to 90 percent of any single loan, requiring loans over \$7,500 to be secured by the mortgage or deed of trust on the improved property. FHA charges an annual premium of \$1.00 per \$100 of the amount advanced, which may be up to \$25,000. The property improvement loan product is expected to be more cost-effective for some homeowners because it avoids the substantial closing costs associated with mortgage refinancing. The linkage of the Title I incentive to an acceptable Home Energy Rating System (HERS) rating for the property could strengthen the linkage between public investment and the intended benefits for homeowners and the environment.

Streamlining energy audits and FHA marketing. HUD is evaluating the use of a portion of the Energy Innovation funds to finance the cost of energy audits that may limit some borrowers' ability to secure an EEM. In addition, a portion of funds may be used to support a partnership with EPA and DOE to streamline energy audit procedures in conjunction with national home energy rating organizations. This collaboration will lead to a rapid deployment system for energy audits that incorporates quality control measures and links to FHA's EEMs and Title I products. Increasing the availability of certified home energy raters will reduce the cost of effective energy efficiency retrofits, while also providing consumers with information about FHA's EEMs and Title I products as enhanced under this initiative.

Evaluation. HUD proposes to use Energy Innovation funds for a comprehensive evaluation effort that will cover the implementation of the above initiatives; the effect of the incentives on consumer acceptance and uptake of EEMs and Title I loans; estimates of the initiative's impact on lowering residential energy consumption and greenhouse gas emissions; and estimates of the net public benefit of the public and private investment.

The Department will submit formal legislative language for authorization of this new program to Congress in 2009, and will work with the appropriate Committees, including the House Committee on Financial Services, the Senate Committee on Banking, Housing and Urban Affairs, and their respective subcommittees to secure necessary statutory authority.

Information Systems Enhancement. HUD proposes to use a portion of the Energy Innovation Fund for necessary upgrades and improvements to HUD's information systems to implement these changes and to better monitor, assess and track EEM and Title I loans.

Background. FHA's existing Energy Efficient Mortgage program provides additional mortgage insurance to enable a person qualified under Section 203(b), 203(k), 234(c), or 251 to purchase or refinance a principal residence and incorporate the cost of energy-efficient improvements into the mortgage. The borrower does not have to qualify for the additional loan amount. Until amended by the Housing and Economic Recovery Act of 2008 (HERA), the amount that could be financed was capped at 5 percent of the underlying loan (not to exceed \$8,000). HERA included a provision that lifted the \$8,000 cap, but a technical error in the bill must be corrected before that provision can be implemented.

The energy-efficient improvements must be cost-effective, meaning that the total cost of the improvements is less than the total present value of the energy saved over the useful life of the energy improvement. The cost of the energy improvements and estimate of the energy savings must be determined by a home energy rating which may be financed as part of the cost-effective energy package. Funds are released to the borrower from escrow after an inspection verifies that the improvements have been installed and the energy savings will be achieved.

Energy Innovation Fund

Benefits. HUD estimates that added energy-related investments resulting from additional EEMs will reduce energy consumption and costs by an average of \$683 per household annually, totaling \$10,254 per household over the useful life of the energy improvements. The energy savings are estimated to reduce greenhouse gas production by an average of 3.48 metric tons of carbon dioxide per household per year.

HUD expects that the enhancements and incentives provided by the Energy Efficient Mortgage Innovation initiative will stimulate growth in the supply and competitiveness of qualified home energy rating contractors, and increase the understanding of building science among both providers and consumers of residential construction services. The evaluation component will ensure that program implementation and impacts are understood and documented so that future policy efforts are well-designed.

Multifamily Energy Enhancement Financing

The Multifamily Energy Pilot will increase energy efficiency in the multifamily housing market. HUD seeks to use up to \$25,000,000 of the Energy Innovation Fund to fund retrofits in the multifamily sector through HUD's existing mortgage insurance programs. The program will extend the benefits of the following programs: Mortgage Insurance for Supplemental Loans for Multifamily Projects Section 241(a); Mortgage Insurance for Purchase or Refinancing of Existing Multifamily Rental Housing Section 223(f); and Mortgage Insurance for Rental and Cooperative Housing Sections 221(d)(3) and 221(d)(4).

HUD is evaluating two possible components for the Multifamily Energy Pilot: first, changes to reduce or offset the cost of FHA's mortgage insurance premium (MIP) for Section 241(a), 223(f), 221(d)(3) and 221(d)(4) loans related to energy conservation; and second, a reduction in the application and inspection fees for Section 241(a), 223(f), 221(d)(3) and 221(d)(4) borrowers seeking energy efficiency improvements under these programs. The overall intent of this initiative is to test the extent to which these incentives encourage greater levels of energy efficiency in these projects, and similar MIP incentives could be offered through risk-based pricing in the future.

Multifamily Incentives for Section 241(a), 223(f), 221(d)(3) and 221(d)(4). HUD is evaluating the potential to use the Energy Innovation Fund to reduce or offset the cost of FHA's mortgage insurance premium for Section 241(a), 223(f), 221(d)(3) and 221(d)(4) loans. Such savings could be linked to the amount of the premium Total subsidies for non-assisted and HUD-assisted properties would be capped at a level determined by the Secretary.

Reduce Application and Inspection Fees for Section 241(a), 223(f), 221(d)(3) and 221(d)(4). In addition to providing reductions in mortgage insurance premiums for significant energy investments in energy efficiency as described above, HUD proposes to amend the application and inspection fees for Section 241(a), 223(f), 221(d)(3) and 221(d)(4) loans to encourage the development and rehabilitation of energy efficient multifamily housing.

Internal Systems Enhancement. HUD proposes to use a portion of the Energy Innovation Funds for necessary upgrades and improvements to HUD's internal systems to implement these changes and to better monitor, assess and track Section 241(a), 223(f), 221(d)(3) and 221(d)(4) loans.

Other Program Enhancements. HUD also will consider additional program enhancements, such as modifying underwriting standards within existing authorities to include, for example, increasing loan coverage limits (to 90 percent from 85 percent) to enable HUD-assisted properties to cover some or all of the debt associated with energy-related investments from energy savings; increased owner distributions for projects meeting performance criteria for energy and green rehabilitation; or adjustments to utility allowance schedules for tenant-paid utilities to reflect lower utility costs for residents that result from owner investments in energy efficiency. HUD also may allocate up to \$1 million to provide technical assistance to HUD-assisted properties to leverage additional energy incentives provided by utility companies, and state and local agencies, and take advantage of federal and state tax incentives. The pilot program will be implemented in targeted markets by selected multifamily HUBs.

Energy Innovation Fund

Background. The Section 241(a) program insures mortgage loans to finance repairs, energy conservation improvements and additional improvements to multifamily rental housing and health care facilities with FHA insured first mortgages or HUD-held mortgages. Section 223(f) insures mortgage loans to facilitate the purchase or refinancing of existing multifamily rental housing. Section 223(f) permits the completion of non-critical repairs after endorsement for mortgage insurance. The Section 221(d)(3) and Section 221(d)(4) programs insure mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, elderly, and persons with disabilities.

Rationale: Census data reveals that most of the assisted multifamily housing stock was built prior to the enactment of building energy codes, which were first initiated in most states in the 1980s. Upwards of 85 percent of HUD's assisted housing inventory is in this category. For housing built prior to these standards, reducing energy consumption to achieve high levels of energy efficiency will require substantial investments in new building systems, hot water heaters, heating and cooling systems, windows, insulation, equipment, appliances, and complementary building renovations.

An opportune time to undertake investments on this scale is part of planned refinancing and recapitalization transactions. A considerable segment of the FHA-insured multifamily housing market involves refinancing and recapitalization of existing multifamily housing. These transactions typically use HUD's Section 223(f) mortgage insurance program for projects involving more substantial rehabilitation, the Section 221(d)(3), or (d)(4) program. HUD's Section 241(a) program may also be used for insuring supplemental loans on existing HUD insured and assisted properties, but the product is underutilized.

Unlike new construction projects, financed by Low-Income Housing Tax Credit (LIHTC), bonds, and other sources, FHA insured multifamily refinancing transactions have not, to date, included significant investments in energy efficiency or renewable energy. Key reasons for this include the absence of standards and incentives (or disincentives) to property owners and lenders. Additionally, in some cases, the financing terms and underwriting or asset management requirements may not support investments due to higher first costs, and, current underwriting processes do not include energy assessments or audits as part of physical needs assessments; thereby limiting the inclusion of "whole building" energy measures in capital plans.

The application of the Enterprise Green Communities underwriting criteria and targeted equity investments provided to affordable housing projects meeting such standards has had a transformative effect on the Low Income Housing Tax Credit program and the willingness of lenders and equity investors to finance affordable housing with higher first cost but with better longer term cash flow, financial stability, valuation and housing quality. The reach of the Green Communities program is particularly evident in the design and development of new construction and, to a lesser extent, substantial rehabilitation.

HUD seeks similar changes to transform the FHA multifamily insurance market not currently affected by the Green Communities initiative, or other similar programs to induce energy-related investments at the state and local level.

Energy Innovation Fund

HOUSING
ENERGY INNOVATION FUND
Summary of Resources by Program
(Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Budget Authority</u> | <u>2007 Carryover Into 2008</u> | <u>2008 Total Resources</u> | <u>2008 Obligations</u> | <u>2009 Budget Authority/ Request</u> | <u>2008 Carryover Into 2009</u> | <u>2009 Total Resources</u> | <u>2010 Request</u> |
|------------------------|------------------------------|---------------------------------|-----------------------------|-------------------------|---------------------------------------|---------------------------------|-----------------------------|---------------------|
| Local Initiatives | | | | | | | | |
| Energy Innovation Fund | ... | ... | ... | ... | ... | ... | ... | \$50,000 |
| Energy Efficient | | | | | | | | |
| Mortgage Innovation .. | ... | ... | ... | ... | ... | ... | ... | 25,000 |
| Multifamily Energy | | | | | | | | |
| Enhancement Financing | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>25,000</u> |
| Total | ... | ... | ... | ... | ... | ... | ... | 100,000 |
| | | | | | | | | |
| <u>FTE</u> | <u>2008 Actual</u> | <u>2009 Estimate</u> | <u>2010 Estimate</u> | | | | | |
| Headquarters | ... | ... | ... | | | | | |
| Field | <u>...</u> | <u>...</u> | <u>...</u> | | | | | |
| Total | ... | ... | ... | | | | | |

**HOUSING
ENERGY INNOVATION FUND
Program Offsets
(Dollars in Thousands)**

| Local Initiatives Energy Innovation Fund | <u>Amount</u> |
|---|-----------------|
| 2008 Appropriation | ... |
| 2009 Appropriation/Request | ... |
| 2010 Request | <u>\$50,000</u> |
| Program Improvements/Offsets | +50,000 |

Proposed Actions

The Local Initiatives Fund will address the broader housing market, both single and multifamily, by leveraging private sector (utility and other third party) financing to stimulate the development of model residential energy efficiency retrofit initiatives in specific markets. The fund will support promising models that are being initiated at the local level, and help expand them to additional markets. These local models can be tailored to local needs, climate conditions and building types, and can leverage utility, private foundation or bank financing in ways that are difficult to do at a national level. Funding will provide a mix of incentive grants, demand-side subsidies, and supply-side leveraging to support the expansion or start-up of local energy retrofit funds. The Local Initiatives Fund will support local market development initiatives that include: energy efficient or green retrofit investment funds; incentives to catalyze investment by private sector institutions (local utilities, and banks) in selected markets; leveraging other public sources of funds; and streamlined delivery of energy audits and related technical services. The Fund could also support a variety of innovative financing programs that are being tested locally, such as utility bill financing or financing through local property tax bills.

HOUSING
ENERGY INNOVATION FUND
Program Offsets
(Dollars in Thousands)

| Energy Efficient Mortgage Innovation | <u>Amount</u> |
|---|-----------------|
| 2008 Appropriation | ... |
| 2009 Appropriation/Request | ... |
| 2010 Request | <u>\$25,000</u> |
| Program Improvements/Offsets | +25,000 |

Proposed Actions

The Energy Innovation Fund will be used to develop an Energy Efficient Mortgage (EEM) Innovation pilot program that will extend the benefits of the existing FHA EEM and Title I Energy Efficient Property Improvement loan programs to more homeowners. In developing the EEM Innovation HUD will consider several options for financial incentives. HUD also may use a portion of the Energy Innovation Fund to finance the cost of energy audits, to the extent that this expense may be a barrier to some borrowers securing an EEM. HUD will also explore a Federal partnership with national home energy rating organizations to streamline energy audit procedures, and with an emerging home performance remodeling industry to ensure quality installation of recommended energy conservation measures.

HOUSING
ENERGY INNOVATION FUND
Program Offsets
(Dollars in Thousands)

| Multifamily Energy Enhancement Financing | <u>Amount</u> |
|---|-----------------|
| 2008 Appropriation | ... |
| 2009 Appropriation/Request | ... |
| 2010 Request | <u>\$25,000</u> |
| Program Improvements/Offsets | +25,000 |

Proposed Actions

HUD will develop a Multifamily Energy Pilot (MEP), which may include financial incentives for borrowers in the following FHA Multifamily programs: Mortgage Insurance for Supplemental Loans for Multifamily Projects, Section 241(a); Mortgage Insurance for Purchase or Refinancing of Existing Multifamily Rental Housing, Section 223(f); and Mortgage Insurance for Rental and Cooperative Housing, Sections 221(d)(3) and 221(d)(4). The MEP program will target property owners and developers seeking energy efficiency improvements in multifamily rehabilitation projects.

HOUSING
ENERGY INNOVATION FUND
Justification of Proposed Changes in Appropriations Language

The fiscal year 2010 President's Budget included proposed changes in the appropriations language listed and explained below. New language is italicized and underlined, and language proposed for deletion is bracketed.

For an Energy Innovation Fund to enable the Federal Housing Administration and the new Office of Sustainable Housing and Communities to catalyze innovations in the residential energy efficiency sector that have promise of replicability and help create a standardized home energy efficient retrofit market, \$100,000,000, to remain available until September 30, 2013; Provided, That \$25,000,000 shall be for the Energy Efficient Mortgage Innovation pilot program, directed at the single family housing market; Provided further, That \$25,000,000 shall be for the Multifamily Energy Pilot, directed at the multifamily housing market; Provided further, That \$50,000,000 shall be for the Local Initiatives Fund so as to leverage additional public and private sector capital to stimulate the development of model residential energy efficient retrofits in ten or more communities; Provided further, That selected communities shall have demonstrated capacity to conduct energy efficient retrofit activities, and no community shall receive more than \$10,000,000.

Explanation of Changes

New Initiative.

Energy Innovation Fund

HOUSING
ENERGY INNOVATION FUND
Crosswalk of 2008 Availability
(Dollars in Thousands)

| <u>Budget Activity</u> | <u>2008 Enacted</u> | <u>Supplemental/ Rescission</u> | <u>Approved Reprogrammings</u> | <u>Transfers</u> | <u>Carryover</u> | <u>Total 2008 Resources</u> |
|---|---------------------|-------------------------------------|------------------------------------|------------------|------------------|-------------------------------------|
| Local Initiatives Energy Innovation Fund | ... | ... | ... | ... | ... | ... |
| Energy Efficient Mortgage Innovation | ... | ... | ... | ... | ... | ... |
| Multifamily Energy Enhancement Financing | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> |
| Total | ... | ... | ... | ... | ... | ... |

HOUSING
ENERGY INNOVATION FUND
Crosswalk of 2009 Changes
(Dollars in Thousands)

| <u>Budget Activity</u> | <u>2009 President's Budget Request</u> | <u>Congressional Appropriations Action on 2009 Request</u> | <u>2009 Supplemental/ Rescission</u> | <u>Reprogrammings</u> | <u>Carryover</u> | <u>Total 2009 Resources</u> |
|--------------------------------------|--|--|--|-----------------------|------------------|---------------------------------|
| Local Initiatives Energy Innovation | | | | | | |
| Fund | ... | ... | ... | ... | ... | ... |
| Energy Efficient Mortgage Innovation | ... | ... | ... | ... | ... | ... |
| Multifamily Energy Enhancement | | | | | | |
| Financing | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> | <u>...</u> |
| Total | ... | ... | ... | ... | ... | ... |