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THE WHITE HOUSE

WASHINGTON

November 26, 1974

MEETING WITH ROY L. ASH

Wednesday, November 27, 1974

2:00 p.m. (60 minutes)

Oval Office

From: ~~Roy L. Ash~~

I. PURPOSE

To make decisions regarding the FY 76 budget of the Department of Housing and Urban Development.

II. BACKGROUND, PARTICIPANTS, AND PRESS PLAN

A. Background: The FY 76 budget submitted by the Department of Housing and Urban Development has been reviewed by OMB and, at the Director's review for HUD, by other members of the White House staff. The results of this review have been communicated to HUD. This meeting will focus on the issues raised by the HUD FY 76 budget that require Presidential review or determinations.

B. Participants: Roy L. Ash, Paul O'Neill, Dale McOmber

C. Press Plan: David Kennerly photo.

III. TALKING POINTS

Paul O'Neill, will you begin our discussion of the issues raised by the FY 76 budget for the Department of Housing and Urban Development?

THE WHITE HOUSE

WASHINGTON

NOV 26 1974

MEMORANDUM FOR: THE PRESIDENT
FROM: Roy L. Ash
SUBJECT: 1976 Budget decisions: Department of
Housing and Urban Development

The agency request and my recommendations with respect to 1976 Budget amounts for the Department of Housing and Urban Development are presented in the tabulation attached (Tab A). A summary of the principal budget decisions reflected in my recommendation is provided as background information (Tab B).

Three key issues have been identified for your consideration. The most important of these involves the number of units to be approved under the subsidized housing programs. This issue will be the subject of a joint HUD-OMB options paper which will be submitted to you shortly. Details on the other two issues appear under Tab C, and are summarized below.

New Community Guarantee Program

HUD recommends the approval of guarantees for two new community projects in 1976, and approval of additional guarantees for seven previously approved projects. The Department believes that failure to continue the program would cause political problems, and that new approvals are necessary to satisfy implicit commitments made for projects already in the pipeline. HUD also believes that failure to provide additional guarantees would make it much more difficult to save existing new community projects where the Federal Government faces a sizeable contingent liability.

OMB recommends that no new projects be approved during 1976, and that increased guarantees for existing projects be contingent on OMB review and approval of strict criteria for such increases. This recommendation reflects

our concern about increasing the potential Federal liability under a program in which experience to date has been poor.

Decision: Approve HUD recommendation _____

Approve OMB recommendation _____

Mortgage Insurance Premiums

HUD is planning to change the premium under the only major mortgage insurance program which is covering its costs: the basic homeownership (Section 203) program. No premium changes are planned for the actuarially unsound insurance programs which cost the taxpayers over \$850 million in fiscal year 1974.

OMB believes that subsidized mortgage insurance is an inefficient (and probably ineffective) means for promoting housing objectives. We recommend changing premiums under all programs so that each will be actuarially sound in the future. This will minimize Federal outlays.

Decision: Approve HUD recommendation _____

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Attachments

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Attachments

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

1976 Budget

Summary Data

	(\$ millions)		Employment, end-of-period	
	<u>Budget authority</u>	<u>Outlays</u>	<u>Full-time Permanent</u>	<u>Total</u>
1974 actual.....	4,161	4,787	15,021	16,999
1975 January budget.....	6,197	5,550	14,156	15,605
enacted	7,401	5,702	xxxx	xxxx
outlay reduction.....	---	-93	xxxx	xxxx
supplemental recommended (agency req.: +85)	---	---	xxxx	xxxx
OMB recommendation.....	7,401	5,609	14,829	16,950
1976 planning ceiling	6,361	6,764	xxxx	xxxx
agency recommendation	6,829	7,216	15,656	17,080
OMB recommendation	6,191	6,599	14,829	16,703
Transition period				
agency recommendation				
OMB recommendation				
1977 OMB estimate	6,745	7,524	14,829	16,703

F

TAB B

1976 Budget
Department of Housing and Urban Development

Summary of Major Recommendations

Background

The principal features of Secretary Lynn's 1976 Budget request stem from the Housing and Community Development Act of 1974. This Act:

- . Authorizes a new block grant program for community development;
- . Authorizes a new Lower Income Housing Assistance Program as the primary vehicle for providing subsidized housing;
- . Requires a new land-use component in the planning process of comprehensive planning grant ("701") recipients; and
- . Expands eligibility for FHA mortgage insurance, and permits less-than-100% coverage for insured mortgages.

The Secretary acknowledges that, in several cases, increased funding has been requested in order to maintain the favorable political climate which he believes made passage of the 1974 Act possible.

Major Program Issues

The primary issue raised by Secretary Lynn's 1976 Budget request concerns the number of units to be approved under the new Lower Income Housing Assistance Program. The Secretary recommends that the budget provide for 406,000 units in both 1975 and 1976, mainly on political grounds. OMB recommends that approvals be kept as close to zero as politically feasible for both programmatic and budgetary reasons. Given the importance of this issue, OMB and HUD are developing a Presidential Options Paper addressing the key programmatic, budgetary, and political considerations which have a bearing on it. This paper will provide the basis for a decision on the level of subsidized housing activity.

Two other major issues are discussed separately under Tab C.

1. Suspension of the New Communities Program.
2. Changes in mortgage insurance premiums.

Other Issues where HUD and OMB have not Reached Agreement

Counseling. The Department recommends initiating a new \$2 million program to provide default counseling to homebuyers under the Section 235 program. Counseling is required by the 1974 Act, and Secretary Lynn maintains that a HUD evaluation finds counseling to be cost-effective. OMB believes the HUD evaluation has serious weaknesses and does not justify a new program. Instead, OMB recommends that HUD continue to support counseling on a demonstration basis under its Research Program. OMB

Community Development Loan Guarantees. HUD recommends that the 1974 Act's provision authorizing Federal guarantees for local borrowing be implemented as part of the block grant program. The Department maintains that failure to implement this provision would embarrass both the Secretary and the Administration, since HUD officials agreed to provide these guarantees in the course of legislative bargaining over the 1974 Act. HUD adds that the guarantee authority is virtually unusable and, hence, failure to implement would save nothing and needlessly antagonize the Congress. OMB recommends against implementation on the grounds that block grant recipients have adequate access to credit without Federal help. Should pressure develop to make the authority usable (as OMB expects), the program would require a significant commitment of staff time, and could increase outlays by \$10-20 million in 1976.

Staffing. For 1976, HUD has requested only a modest (2%) increase in full-time permanent employment which would restore the 1975 staffing reduction. OMB's workload projections do not support either the current 1975 ceiling or the 1976 request, and a lower ceiling is recommended for both years. HUD and OMB staff are attempting to reconcile these differences. In any event, since staffing requirements will be heavily influenced by the level of activity under the Subsidized Housing Program, OMB believes a decision on this issue should be deferred for the time being. OMB

Tentative Agreements Between HUD and OMB

1. Community Development Block Grants. Although HUD originally requested a \$200 million increase for block grants in 1976 (1975 level: \$2.5 billion), the Department indicates that it will not oppose the OMB recommendation (+\$50 million) which would provide an equal or higher funding level for each of the various recipient categories.

2. Public Housing Modernization and Operating Subsidies. HUD has agreed to funding levels of \$450 million and \$525 million for operating subsidies in 1975 and 1976, respectively. These

amounts will permit implementation of a new Performance Funding System and continuation of a Research and Demonstration Program. Modernization would be continued at its "historical" \$20 million level.

Despite agreement on funding levels, the growth of operating deficits in public housing projects remains a serious problem which, given current policies, is likely to require substantially increased Federal resources over time. Fundamental policy changes are warranted, and can be achieved only if responsibility for bringing them about is placed squarely on the Secretary's shoulders.

3. Tandem Plan. Neither the HUD nor the OMB recommendation would continue the Tandem Plan beyond June 30, 1975.

4. Flood Insurance. Both HUD and OMB recommend a significant (\$25 million/50%) increase in funding for engineering surveys under the Flood Insurance Program. The payoff from such surveys (in terms of insurance premiums and reduced disaster relief payments) far exceeds the cost.

5. Payments to the Federal Financing Bank. For tactical reasons, both HUD and OMB recommend against including an appropriation request to make payments to the Bank in the HUD budget.

Issues on which HUD would like to Defer a Decision

Comprehensive Planning Grants. HUD initially proposed a major land-use initiative within the "701" program, requiring a sizeable increase in funding (to \$150 million). The Department indicates that, at this time, it will not oppose OMB's recommendation to continue the "701" program at \$50 million (reduced from \$100 million as part of the 1975 Budget restraint effort) in 1976. However, HUD believes a final decision on funding should be postponed until decisions have been made on broader land-use and planning consolidation questions.

Research. Although the Department initially recommended \$75 million for research, it indicates a willingness to accept \$65 million (the enacted 1975 level, subsequently reduced to \$57 million) provided OMB stipulates that HUD's Research Program has not been cut disproportionately to other research programs. In the absence of such an assurance, HUD wishes to defer a decision.

Other Items which could Affect the HUD Budget

HUD is developing a position on a number of items which could prompt the Secretary to increase his 1975 and 1976 Budget

requests. These items, for which the OMB recommendation makes no allowance, are listed below:

1. Congressional add-on's included in the Supplemental Appropriations Bill (outlays of \$110 million, plus mandatory reinstatement of the Sections "235" and "236" housing programs).

2. New programs included in the 1974 Act, despite Administration objections (specified authorization levels: 1975 - \$1,065 million; 1976 - \$264 million).

3. HUD's 1975 legislative program (which has not been submitted to OMB, as yet).

4. Activity during the July 1 - September 30, 1976 transition period.

TAB C

Issue Paper

Department of Housing and Urban Development
1976 Budget
New Community Guarantee Program

Statement of Issue

Should HUD encourage new applications and make additional guarantee commitments under the New Communities Guarantee Program?

Background

Under Title VII of the 1970 Housing Act, the New Communities Administration (NCA) guarantees bonds issued by private and public developers to finance the development of new communities. As of June 30, 1974, guarantee commitments had been approved for 14 new community projects, totaling \$336.5 million. Of this amount, the Federal Government's actual contingent liability (guaranteed bonds already issued) is \$252.5 million. Two additional projects, financed by the New York State Urban Development Corporation, are also involved in the program.

During FY 1974, the NCA has concentrated on implementing a new financial reporting system and on assessing the overall condition of all projects approved in prior fiscal years. This assessment provides evidence that virtually all new communities are in a serious financial position.

Alternatives

- #1. Approve two new guarantee commitments in FY 1976, and provide additional guarantee commitments for four previously-approved projects in 1975 and three in 1976 (HUD request).
- #2. Terminate the New Communities Program.
- #3. Approve no new projects in FY 1976, and allow additional guarantee commitments for existing projects in FY 1975 and 1976 only after review and approval of criteria (OMB recommendation).

Analysis

<u>Cumulative Bond Commitments/Outlays</u> <u>(\$ Millions)</u>	1974		1975		1976	
	<u>Bonds</u>	<u>0</u>	<u>Bonds</u>	<u>0</u>	<u>Bonds</u>	<u>0</u>
Alt. #1 (HUD request)	337	-4	369	.8	474	-1
Alt. #2	337	-4	337	.8	337	-1
Alt. #3 (OMB recommendation)	337	-4	369	.8	389	-1

The HUD New Communities Guarantee Program was intended to encourage investors to provide long-term financing to new community developers. In addition, the program was designed to stimulate innovations and to foster economic and social integration. A recent HUD evaluation study, designed to determine the legitimate justifications for Federal support to new communities, concludes that:

- There is little need for the Federal guarantee--any advantages to the developer in terms of reduced borrowing costs due to the availability of the guarantee are offset by the burden of Federal requirements and red tape.

- Little innovation has been, or is likely to be, stimulated by the guarantee alone.

- Few costs or benefits are associated with the program.

Another study of new communities, financed by HUD, suggests that residents perceive new communities in much the same way as residents of any other planned unit development.

Approved new community projects have experienced serious financial problems over the past 2 years, primarily due to the inadequacy of original feasibility studies. This situation has been exacerbated by the general downturn in market conditions, high interest rates, utility shortages, problems with local government approvals, and environmental controls. The immediate status of projects in implementation ranges from technical default (where, in one case, HUD has had to make a quarterly interest payment, although it has not foreclosed) to the more usual month-to-month tight cash flow problem. Most recently, one project has come close to shutting down its operations for lack of operating capital. HUD expects to make additional guarantee commitments to prevent the closeout.

HUD's request for additional guarantee commitments on behalf of existing projects is based on the optimistic assumption that NCA staff can design financial "work-out" solutions until general market conditions improve. The request also assumes that a portion of the discretionary funds in the Community Development Block Grant Program will be earmarked for use in new community projects. HUD staff admit that failure to get significant grant assistance may make defaults inevitable and lead to additional outlays of about \$5.5 million in FY 1975, and \$11.9 million in 1976.

HUD Request: Alternative #1. The Department would increase the potential Federal liability under the New Communities Program by

\$137 million. The request assumes improvements in management control systems, and takes an overall optimistic view of the future. The Department feels obligated to approve at least two new projects in FY 1976, already in the pipeline, as a result of investments made by developers in the preparation of applications.

OMB Recommendation. Alternative #3. OMB staff believe that additional guarantees for existing projects should be based on strict criteria for assessing long-term feasibility--a short-term "buy out" will only delay the inevitable while increasing the Federal liability. HUD should not issue additional guarantee commitments until such criteria have been reviewed and approved. OMB believes that the Federal exposure should not be increased at this time, given the suggestive evidence that such exposure will garner few, if any, benefits. In addition, much of the pressure for approving projects derives from the encouragement, if not tacit approval, given by NCA staff to developers in the early stages of inquiry. HUD should be directed to discontinue this policy.

HUD's reaction to the OMB recommendation is that a temporary suspension would be a mistake, and would create political problems for the Administration. HUD believes a suspension would arouse congressional anger and possibly lead to action to mandate the program. In addition, HUD thinks legal and moral problems may be created.

Issue Paper

Department of Housing and Urban Development
1976 Budget
Mortgage Insurance Premiums

Statement of Issue

Should premiums under HUD's mortgage insurance programs be changed to make these programs actuarially-sound and reduce government losses?

Background

All active mortgage insurance programs charge the same annual premium (equal to 0.5 percent of the unpaid balance), despite substantial differences in default and loss rates, as shown below:

<u>Single Family Program</u>	<u>Lifetime Default Rate</u> (%)	<u>Loss Per Claim</u> (%)	<u>Gross Loss Rate</u> (%)
203--Basic program	8	45	3.5
235--Subsidy program	20	28	5.6
221--Low/moderate income	15	56	8.3
223(e)--Declining areas	30	79	23.7

(Most multifamily mortgages in default receive forbearance of payments before being assigned to HUD, so their gross loss rates are questionable compared to single family loss rates.) As a result, mortgagors under the basic mortgage insurance programs (1-4 units under Section 203 and multifamily units under Section 207) subsidize mortgagors under the other programs, which are actuarially-unsound. Moreover, losses under the actuarially-unsound programs have been so substantial in recent years that they have turned FHA into more than an \$800 million annual drain on the budget, despite surpluses in the basic homeownership insurance program. The inadequacy of the 0.5 percent premium is reflected in the lifetime loss rates by major program, shown below:

1973 Insurance-in-Force and Reserves
(Dollars in Millions)

<u>Program</u>	<u>Insurance- in-Force</u> (\$)	<u>Reserves</u> ^{1/} (\$)	<u>Lifetime</u> ^{2/} <u>Loss Rate</u> (%)
203--Basic single family	50,385	388	-0.8
221--Moderate income	11,327	-1,094	9.7
223(e)--Declining areas	1,323	-194	14.7

<u>Program</u>	<u>Insurance- in-Force</u> (<u>\$</u>)	<u>Reserves</u> ^{1/} (<u>\$</u>)	<u>Loss Rate</u> ^{2/} (<u>%</u>)
235 & 236--Interest subsidy	12,828	-940	7.3
Other programs	12,292	-102	0.8
Total	88,155	-1,942	-2.2

1/ Excess of insurance reserves over estimated reserve requirements.

2/ Reserves as a percent of insurance-in-force.

HUD intends to revise the premium under basic homeownership programs in order to generate interest in the new coinsurance program. The new premium would be 1 percent at insurance origination, and 1/2 percent of the unpaid balance for the first 7 years when around 87 percent of the losses occur. Using a discount rate of 10 percent, this would represent an increase in premiums.

In order to make the actuarially-unsound programs sound, a 1 percent origination premium, plus 3/4 percent annually for the life of the mortgages would be necessary, except for the declining areas program which would require the maximum 1 percent at origination and in each year thereafter, plus tighter underwriting standards. Since over \$30 billion of actuarially-unsound insurance already has been written, the maximum 1 percent rate would have to be charged at origination and thereafter on all new insurance for receipts to offset net outlays under insurance already in force.

Alternatives

- #1. Maintain the current 0.5 percent premium for all programs.
- #2. Change only basic (Section 203) program premium (HUD request).
- #3. Change all premiums to make each program actuarially-sound (OMB recommendation).
- #4. Increase all premiums to 1 percent to offset outlays.

Analysis

The impact of setting premiums to make all programs actuarially-sound is shown below (assuming a \$20,000 mortgage):

<u>Program</u>	<u>Origination Premium</u> (<u>\$</u>)	<u>Thereafter</u> (<u>\$</u>)	<u>Total Premiums</u> (<u>\$</u>)
203--Basic single family	200	1,200	1,400
221--Low/moderate income	200	2,250	2,450
223(e)--Declining areas	200	3,000	3,200

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FHA's rationale for mortgage insurance includes the expansion of residential credit and assistance to marginal homebuyers. A premium increase would reduce the use of FHA's programs, and thus be unpopular within the housing industry, but would increase private insurers' volumes. Changing only the basic program's premiums could reduce insurance written from \$14.5 billion annually to \$13.8 billion annually. Increasing the premiums on actuarially-unsound insurance would reduce volume further to \$13.6 billion and a 1 percent premium would lower insurance written to \$12.8 billion annually.

The partially offsetting effect of increased premiums and reduced volumes is reflected in the following outlay estimates:

<u>Outlays</u> <u>(\$ Millions)</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Alt. #1 (no change)	863	750	550	400	300	200	200
Alt. #2 (HUD req.)	863	750	520	374	278	182	186
Alt. #3 (OMB rec.)	863	750	502	348	244	140	136
Alt. #4 (1% premium)	836	750	510	305	150	-5	-60

Alternative #1 (no change) would continue the familiar system and would be preferred by most groups. Cross-subsidation would help hold down Federal outlays.

Alternative #2 (change basic premium only) would make coinsurance more attractive. In the short run, outlays would be reduced as premiums are collected earlier in the life of the mortgage.

Alternative #3 (actuarially-sound) would be opposed by all groups, but would be the most equitable insurance solution. No net outlays would occur on newly written insurance.

Alternative #4 (1 percent premium) would be opposed by all groups, except PMI's who would prefer less FHA competition. The increase would be inequitable to all programs (except 223(e)) and is especially unfair to programs now actuarially-sound at 0.5 percent. This alternative provides a way to make the FHA break even for both new and previously written insurance.

HUD Request: Alternative #2. HUD is now planning to revise the basic premium, although there is some resistance within HUD to this course of action. HUD probably would oppose Alternative #3 (all actuarially-sound) and strongly oppose 1 percent premiums (Alternative #4).

OMB Recommendation. Alternative #3. OMB believes that subsidized mortgage insurance, in addition to being very expensive, is an inefficient (and probably ineffective) means for helping families obtain adequate housing. OMB recommends making each major program actuarially-sound as the most equitable and efficient insurance solution.