PALs WASHINGTON REPORT

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Introduction

As the calendar moves to winter, Republicans are anxious to enact one of their long promised initiatives – tax reform. After releasing their tax plans in early November, Republicans hope to move the proposals through the tax-writing committees of their respective chambers – House Ways and Means and Senate Finance – and to the floor by Thanksgiving. Although the president has promised the "largest tax cut in history," congressional Republicans say their goal is to pass tax cuts that do not increase the deficit. Further, the Senate hopes to use the reconciliation process to pass tax reform, meaning only a simple majority of 51 votes is needed to pass the legislation. However, under the reconciliation process, per the Senate budget resolution, the tax reform bill cannot increase the federal deficit by more than $1.5 billion beyond a ten-year term. Further, under the "Byrd Rule," any bill passed under reconciliation instructions cannot add to the federal deficit at all beyond the budget window (which currently ends in 2027). So, any tax bill that would increase the deficit in 2028 would be subject to a point of order in the Senate, may be in violation of the reconciliation rules, and would therefore need 60 votes to pass. This stricture makes it very difficult to adopt tax cuts that would be permanent without also raising a significant amount of revenue to pay for those cuts and meet the budget. It remains to be seen if the House and Senate Republicans can successfully agree on a bill that meets these tests.

Tax Bill Implications for Banks and Housing

Although the business community generally supports tax reform, there are a number of provisions in the House GOP tax proposal that are opposed by housing stakeholders. Elimination of the tax exemption for private activity bonds, which are issued by local or state governments to provide special funding for private entities, is one example. Private activity bonds can fund mortgage loans to finance owner-occupied residential property, as well as the construction of hospitals, museums, or infrastructure projects. The concern is that elimination of the tax exemption would increase borrowing costs and limit the ability of state and local governments to provide funding for affordable housing and other activities. Some observers also believe that a provision in the House bill that would eliminate the state and local tax deduction, and restrict the permissible amount of property tax deductions, could further decrease the benefit of homeownership. Jaret Seiberg, a housing and banking expert, recently wrote that the House tax reform bill favors renters, and that limits on the mortgage interest deduction may reduce the incentive for taxpayers to buy a house. (The Senate bill retains the mortgage deduction but does eliminate the state and local tax deduction and repeals the deductibility of property taxes). Opposition to the House treatment of the traditional mortgage interest deductions is shared by the National Association of Realtors, which has expressed concerns about the tax plan. Further, House Republicans' decision to not include a homeownership tax credit has led the National Associations of Homebuilders to also oppose the bill in its present form. Lastly, the House plan would eliminate the deduction for large bank FDIC insurance premiums, but would keep it for institutions under $10 billion in assets. The Senate bill includes a similar provision.

Flood Insurance Update

House Majority Whip Steve Scalise (R-La.) and House Financial Services Committee Chairman Jeb Hensarling (R-Texas) are working to build support for legislation to reauthorize the National Flood Insurance Program, which will expire on December 8. Although he originally opposed the bill, Scalise said he would support the legislation after provisions to penalize homeowners who live in areas that are flood prone, and who have received multiple insurance payouts for flood damage, were relaxed. Congress is under pressure to update and reauthorize the program in the wake of three deadly hurricanes that struck the U.S. this year. Insurance claims stemming from the storms exhausted the program's borrowing authority and led Congress to forgive $16 billion of debt to ensure that hurricane victims received benefits. House Democrats remain opposed to the bill, and it is unclear how much support for the amended measure there is within the Republican conference.

Regulatory Relief in the Senate

Senate Banking Committee Ranking Member Sherrod Brown (D-Ohio), who had broken off negotiations with Chairman Mike Crapo (R-Idaho) on a financial regulatory relief package, has now said that he would not support a package that Chairman Crapo has negotiated with a group of Democratic and Republican committee members. Crapo and Brown had spent months attempting to negotiate an agreement to scale back regulations for small lenders and some regional-sized institutions. The two were unable to reach an agreement and, as a result, Chairman Crapo turned to a number of other Democrats on the committee, including several who are up for reelection in 2018, and this week reached agreement on a deal that should not only be accepted in Committee, but should have enough support to pass on the Senate floor.

Hensarling Announces Retirement

In early November, Chairman Hensarling announced that he will not run for re-election in 2018, ending his congressional career after eight terms. "I never intended to make it a lifetime commitment, and I have already stayed far longer than I had originally planned," he wrote in a letter explaining his decision. Hensarling also wrote that he will continue to work on housing finance reform, regulatory relief, cyber security, and capital formation during the remainder of his term. Representatives Patrick McHenry (R-N.C.), Ed Royce (R-Calif.), and Blaine Luetkemeyer (R-Mo.), are among the favorites to replace Hensarling as chair of the Financial Services Committee in the next congress, assuming Republicans maintain control of the chamber.

Housing Finance Reform Hearings

Over the last month, the Financial Services Committee has held three hearings on housing finance reform. The first hearing featured FHFA Director Mel Watt and focused on "sustainable housing finance" policy and FHFA's supervision of Fannie Mae, Freddie Mac, and the FHLBanks. Many of the Republican members focused on the FHFA's credit risk transfer programs and pushed Watt to do more to pursue front-end credit risk transfers. There was also significant discussion of the qualified mortgage rule and whether it has the effect of crowding private participants out of the housing finance market. The second and third hearings involved debate over the merits of an explicit government guarantee, several proposals to reform the secondary market, expansion of credit risk transfers, small lender access to Fannie Mae and Freddie Mac, and the effects of the proposed tax reform bills on homeownership. The hearings featured housing finance stakeholders, including the American Bankers Association, National Association of Federally-Insured Credit Unions, National Association of Homebuilders, and the Mortgage Bankers Association, all of which spoke to the importance of the FHLBanks in housing finance.