FEDERAL DEPARTMENTS

- Agriculture
- Commerce
- Defense
- Education
- Energy
- Health and Human Services
- Homeland Security
- Housing and Urban Development
  - Timeline
  - Further Reading
  - HUD Scandals
  - Public Housing and Rental Subsidies
  - Housing Finance and the 2008 Financial Crisis
  - Community Development
  - Low-Income Housing Tax Credit
- Interior
- Labor
- Social Security
- Transportation
- Other Agencies and Programs

HUD Scandals

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The $65 billion Department of Housing and Urban Development has been plagued by mismanagement and scandal in recent decades. Numerous HUD secretaries have used their power to enrich themselves or to confer special benefits on people with political and financial connections. This essay looks at HUD mismanagement during the tenures of four HUD secretaries under three recent presidents:

- Samuel Pierce, 1981-1989, Ronald Reagan's only HUD secretary
- Henry Cisneros, 1993-1997, Bill Clinton's first HUD secretary
- Andrew Cuomo, 1997-2001, Bill Clinton's second HUD secretary
- Alphonso Jackson, 2003-2009, George W. Bush's second HUD secretary

A root cause of HUD scandals is that the department has a large number of costly subsidy programs, and each involves a tangled web of stakeholders. Many HUD programs divide responsibilities between federal, state, and local policymakers, and they involve private interests such as developers and financial companies. The multiplicity of interests and the complexity of the programs create opportunities for people in the public and private sectors to take personal advantage of programs.

The recent meltdown in the U.S. housing and financial markets makes it crucially important to understand the distortions created by HUD's programs and the political drivers of its decisionmaking. HUD policies played an important role in the meltdown, and this essay sheds light on why some of HUD's bad policies were put in place.

Federal housing policies illustrate some broader realities of federal intervention. When making decisions, policymakers usually have political and self-interested ends in mind, not the broad general interest of the public. Also, lofty interventionist visions—such as using the government to boost home ownership—often fail because of the imbalances they create in private markets. Housing was traditionally a private and local concern without federal involvement. The scandals and policy errors discussed here provide good reasons to start dismantling HUD and ending the housing subsidies that have caused so much damage.

The Pierce Years, 1981–1989

For proponents of public housing, the Reagan years are considered dark days. The Reagan administration sought to reduce traditional subsidies for public housing and to focus on providing more flexible housing benefits to tenants. But HUD reform was a low priority of the Reagan administration, and that disregard contributed to the major scandals that enveloped the department in 1980s.

Those scandals owe a lot to the mismanagement and corruption of Samuel Pierce, Reagan's only HUD secretary. A major review undertaken by Pierce's successor as secretary, Jack Kemp, uncovered "significant problems" of fraud, theft, mismanagement, and influence-peddling in 94 percent of HUD's budget.[1] Estimated losses from this abuse ranged from $2 billion to $6 billion.[2]

Pierce took a disinterested approach to HUD—often watching soap operas with younger aides during work hours—and allowed HUD to become a "dumping ground" for political appointees who used their positions for personal gain.[3] He assigned a HUD staffer to work full-time on a book to be called "The Pierce Years," which ended up as an 87-page glossy pamphlet printed at taxpayer expense.[4] Pierce enjoyed the perks of office—for example, taking five taxpayer-funded trade junkets to the Soviet Union, which resulted in very little business being generated.[5]

When Pierce did make hands-on management decisions, it often resulted in friends and politically connected business persons getting favorable HUD treatment, as these examples illustrate:

- Pierce backed a $4.5 million HUD grant to convert an aircraft carrier into a museum, a project that was championed by his former law firm clients. The grant was approved shortly after Pierce's former client, Larry Fisher, met with Pierce to solicit his help.[6] Fisher was a wealthy real-estate developer and a large Republican donor.
- Pierce overrode the recommendations of the department's top civil servants to push through a project in Durham, North Carolina, that was sought by Charles Markham, the mayor of the city and a former law-firm associate of Pierce.[7] The deal included a $2.3 million grant, $11.8 million in rent subsidies, and HUD-backed mortgage insurance.[8]
- Pierce helped his friend and Republican Party supporter, jazz musician Lionel Hampton, obtain a 20-year, $21 million rent subsidy for a housing project in Newark, New Jersey.[9]

However, those sorts of personal favors were small potatoes compared to the systematic abuses engineered by Pierce and his top assistants. One of the costliest scandals involved HUD's section 223(f) coinsurance program, which was kicked off in 1983 and aimed at rehabilitating multifamily housing units. The program was lucrative for favored mortgage lenders—such as the Washington, DC firm DRG—but it put taxpayers on the hook for 85 percent of the value of any losses on mortgage loans. The program put mortgage lenders in charge of overseeing the entire process—from underwriting to foreclosure and disposition—and it allowed them to collect excessively high fees.

The end result of the program was that participating lenders overmortgaged projects in order to collect the high fees. In his book, *HUD Scandals*, former HUD official Irving Westfield writes:

By the middle of 1988, five years after the program was inaugurated, participating lenders had coinsured 846 loans. The amount of the mortgages was $4.8 billion. By 1998, led by the highest-flying firm in the business, DRG, the program went off course—106 loans, having an outstanding principle and accrued interest amount of $700 million, were in default. The largest coinsurer in the program, DRG, which had 272 coinsured mortgages, contributed 79 defaults and a half billion dollars in losses. The program was in free-fall descent—65 of DRG defaults had occurred in 1988. By March of 1990 the dollar volume of defaults had reached $1.6 billion, and HUD was rushing to shut the program down.[10]

A year after the 223(f) coinsurance program was initiated, a mid-level HUD official warned in a memo: "This is the most fraud-prone system ever spawned by HUD, but we have been overruled so many times in matters of compliance that I have given up registering protests."[11] Two years later, a regional HUD administrator wrote to his superiors in Washington that he was "convinced that financial problems of national proportions are inevitable unless something is done."[12] However, the department's political overseers were not interested in such naysaying.

In 1984, after HUD investigators determined that DRG was inflating appraisal values of properties in order to collect higher fees, the firm's activities were restricted. DRG promptly hired a particularly powerful lobbyist to get the restrictions lifted: former HUD secretary under Gerald Ford, Carla Hills, who would later serve as U.S. Trade Representative under George H. W. Bush. In May 1985, a few weeks after meeting with Hills and her team, Pierce lifted the restrictions on DRG.

Another appalling scandal at HUD during Pierce's tenure involved the Section 8 moderate rehabilitation program. "Mod-rehab" was launched in 1979 as a modest program to finance repairs to housing units for rent to low-income tenants. The program originally contained a "fair-share" provision, which meant that funding was awarded to state and local public housing authorities on the basis of population and demographics.

In 1984, Congress allowed HUD to waive the fair-share provision and make allocations subjectively by means of a panel consisting of Pierce's executive assistant, the assistant secretary of housing, and the undersecretary of the department. But as Pierce's executive assistant, Deborah Dean, later told the *Wall Street Journal*, "[Mod-rehab] was set up and designed to be a political program … I would have to say we ran it in a political manner."[13] Dean was at the center of the abuse, and she was initially sentenced to 21 months in prison on 12 counts of corruption, bribery, and perjury in 1994.[14] Five of the counts were later reversed on appeal, and her sentence was eventually reduced to three years of probation, including six months of home confinement.[15]

Under the program, "a trove of rent subsidies, tax credits and consulting fees, totaling millions of dollars on each housing project, flowed to GOP faithful and their associates."[16]

HUD became a sort of graduate school for ethics-challenged officials to master the complexities of housing programs such as mod-rehab, and then join the private sector and use their connections at HUD to cash in.[17]

Using congressional testimony, HUD documents, and interviews, the *New York Times* compiled a lengthy list of those benefiting from their political connections to HUD in the 1980s. Some earned substantial consulting fees for persuading Pierce and his top aides to approve federal subsidies, while others used their connections to secure HUD subsidies for their own projects. The following is just a sampling:[18]

- Philip Winn, assistant secretary at HUD: a cofounder of the Winn Group, which secured HUD backing for a housing rehabilitation project in Colorado. The Winn Group received $133 million in federal rent subsidies and $29 million in federal tax credits.
- Philip Abrams, undersecretary at HUD: a cofounder of the Winn Group, he also earned $100,000 in consulting fees from HUD.
- Lance Wilson, executive assistant to Pierce: a member of the Winn Group, involved in five projects that secured $92 million in HUD subsidies. Vice president at the PaineWebber Group, Wilson became an adviser to HUD on bond sales. He was convicted on one felony count in 1993.[19]
- Maurice Barksdale, assistant secretary at HUD: received $300,000 in consulting fees for helping with securing HUD approval of eight or nine projects.
- Michael Karem, deputy assistant secretary at HUD: received $360,000 for consulting on three subsidized projects.
- James Watt, secretary of the interior: received $420,000 for helping clients secure subsidies for three HUD-related projects.
- Joseph Strauss, special assistant to Pierce: received $1.7 million in consulting fees for helping win HUD subsidies for various projects. He worked with James Watt.
- Gerald Carmen, head of General Services Administration: earned $2.3 million in the sale of tax credits for a subsidized project.
- Frederick M. Bush, leading fund-raiser in the George H.W. Bush presidential campaign: received $600,000 for consulting on a dozen subsidized projects.
- Edward Brooke, former senator from Massachusetts: received $183,000 for consulting and legal work on two housing projects.

In 1990, a report adopted unanimously by the House Government Operations Committee concluded, "At best, Secretary Pierce was less than honest and misled the subcommittee about his involvement in abuses and favoritism in HUD funding decisions. At worst, Secretary Pierce knowingly lied and committed perjury during his testimony."[20] An independent counsel investigation into HUD activities under Pierce's watch was instituted in 1990 and wrapped up in 1996. Pierce himself was not indicted based on his agreement to admit that "he created an atmosphere at HUD that allowed influence-peddling to go on."[21] In all, the independent counsel investigation into HUD corruption on Pierce's watch yielded 17 convictions, including convictions of three former HUD assistant secretaries.

Reflecting on Pierce's tenure, Irving Westfield writes, "Integrity of public processes was replaced by partisan favoritism and the fragile bond of trust between the electorate and appointed officials was shattered."[22] In reality, the "bond of trust" with federal policymakers is often an illusion. Many HUD programs—and programs in other agencies—are often just tools that officials use for personal and political gain.

The Cisneros Years, 1993–1997

In the Clinton administration, a primary mission of HUD was to increase home ownership rates, especially among minorities and low-income families. That mission was carried out through HUD subsidy programs and through the two government-connected mortgage finance giants, Fannie Mae and Freddie Mac. In 1992, HUD was given regulatory authority over these government-sponsored enterprises, and it began pushing the two firms into the subprime lending business. We now know that these political decisions on housing that were made in the 1990s helped fuel the housing bubble and subsequent crash in the early 21st century, so it is worth looking into the leadership of HUD during those years.

Henry Cisneros served as President Bill Clinton's HUD secretary from 1993 to 1997, when he resigned to deal with allegations that he lied to the FBI about payments he made to a former mistress. Cisneros plead guilty in 1999 and was fined $10,000, avoiding a possible prison sentence.

Cisneros oversaw a politicized HUD that mobilized to help fend off the Republicans, who gained a congressional majority in the 1994 election. The resurgent GOP initially sought to eliminate HUD as part of a plan to rein in federal spending and reduce budget deficits. HUD was one of the Republican targets, and department officials fought back in numerous ways to ward off proposed reforms.

HUD held a series of "standing up for communities" rallies, financed by taxpayers, which encouraged local officials and special interest groups to lobby against Republican budget cuts. One piece of propaganda distributed by HUD's New York office warned that the budget cuts "would dramatically expand America's underclass" and that "thousands of families, many with children, would end up homeless."[23] HUD also sponsored a National Tenants Organization convention in Puerto Rico to defend the department. But that event was so political that even a HUD translator refused to take part and walked out of the proceedings in protest.[24] According to HUD's inspector general, an NTO official responded that "he really didn't care whether HUD translated or not because the point was to get rid of Newt Gingrich."[25]

When Cisneros left HUD, he was lauded for the increase in homeownership rates that occurred on his watch. Part of his apparently winning strategy, Cisneros noted, was HUD's "ability to convince lenders, builders and real estate agents that there was money to be made in selling housing to low- and moderate-income individuals."[26] Part of this "convincing" involved HUD-initiated legal action against mortgage lenders who declined higher percentages of loans for minorities than whites. As a result of such political pressure, lenders begin lowering their lending standards, which was another contributing factor to the housing meltdown in the 2000s.[27]

A key weapon in the Cisneros arsenal was the Clinton administration's changes to the Community Reinvestment Act. The CRA was passed in 1977 and updated in 1995 to pressure lenders into making more loans to moderate-income borrowers by allowing regulators to deny merger approvals for banks with low CRA ratings. Even complaints brought by activists, such as the leftist group ACORN, were now counted against a bank's CRA rating. The result was that banks began issuing more loans to otherwise uncreditworthy borrowers while purchasing more CRA mortgage-backed securities.[28] As housing finance expert Peter Wallison noted, "The most important fact associated with the CRA is the effort to reduce underwriting standards. … Once those standards were relaxed … they spread rapidly to the prime market and to subprime markets where loans were made by lenders other than insured banks."[29]

The Clinton administration's National Homeownership Strategy, prepared under Cisneros's direction, brought together public and private housing market participants to coordinate plans to achieve record homeownership. This plan advocated "financing strategies, fueled by creativity and resources of the public and private sectors, to help homebuyers that lack cash to buy a home or income to make the payments."[30] This is an important point to underline: the Clinton administration pursued a range of policies to put people who could not afford them into homes. Interestingly, HUD removed this Strategy document from its website in 2007 after the housing bubble burst.

Writing about the Clinton plan in 2008, financial expert Joseph R. Mason noted:

> The Strategy certainly helped some renters achieve the dream of homeownership. But the Strategy was also fundamentally misused to extend more credit to prime borrowers, fueling home price inflation. That home price inflation led builders to build ever more developments, using creative financing to leverage their bets on home price appreciation in the bubble environment, ultimately resulting in record foreclosures in the present marketplace.[31]

Cisneros planted another seed for the housing bubble and its subsequent burst by putting Fannie Mae and Freddie Mac under constant pressure to facilitate more lending to "underserved" markets.[32] While Cisneros's own HUD administration acknowledged that mortgages financed by Fannie and Freddie in "underserved" areas have a higher risk of default, it did not see that "there need be any safety and soundness impediment" to the policy.[33] It was under Cisneros's direction that HUD agreed to allow Fannie and Freddie credit toward its "affordable housing" targets by buying subprime mortgages.[34]

After eight years of introducing economic distortions into housing markets, Henry

Cisneros spent most of his post-HUD career making money in housing markets, as many ex-HUD officials do. In 2000, Cisneros formed a housing development company in partnership with KB Homes, and he became a KB director. The KB board also included the former CEO of Fannie Mae, James Johnson. The *New York Times* noted that "it made for a cozy network."[35] Indeed, Fannie Mae bought or backed many of the mortgages that were in the developments of KB Homes.

In 2001, Cisneros joined the board of Fannie Mae's biggest client: the now notorious Countrywide Financial, the company that was center stage in the subprime lending scandals of recent years. When the housing bubble was inflating, Countrywide and KB took full advantage of the liberalized lending standards fueled by Cisneros's HUD. In addition to the money he received as a KB director, Cisneros's company, in which he held a 65 percent stake, received $1.24 million in consulting fees from KB in 2002.[36]

When Cisneros stepped down from Countrywide's board in 2007, he called it a "well-managed company" and said that he had "enormous confidence" in its leadership.[37] Clearly, those statements were baloney—Cisneros was trying to escape before the crash. Just days before his resignation, Countrywide announced a $1.2 billion loss, and reported that a third of its borrowers were late on mortgage payments.[38] According to SEC records, Cisneros's position at Countrywide had earned him a $360,000 salary in 2006 and $5 million in stock sales since 2001.[39]

The Cuomo Years, 1997-2001

Andrew Cuomo joined the Clinton administration as an assistant secretary of HUD in 1993. He replaced Cisneros as secretary in 1997, where he remained until the end of Clinton's second term. Cuomo followed the same approach as his predecessor—seeking personal publicity while pandering to special interest groups by encouraging those who were not suited for home ownership to nonetheless move into homes.

Cuomo began cultivating his self-promotion at HUD as assistant secretary. In 1993, he organized a lavish conference costing taxpayers $235,360 to announce a new anti-poverty program, and he flooded attendees with sloganeered shopping bags, HUD buttons, and glossy brochures. One observer called it a "rah-rah rally for Andrew Cuomo."[40] Cuomo doubled the number of top-level staff members under him, and in one of his years as assistant secretary, he spent almost a $1 million on travel. According to the *Wall Street Journal*, the lavish spending on "image-making … strained HUD budgets so much that officials have devised plans to pay some bills by diverting money from projects intended to help people."[41]

Being assistant secretary was a good job, but Cuomo wanted the top spot. He got his chance when Cisneros announced his intention to resign shortly after Clinton was reelected in 1996. Seattle Mayor Norm Rice was thought to be Clinton's first choice to replace Cisneros, but he was knocked out when HUD launched an investigation into his possible misuse of a federal loan. The investigation, which was launched a week after the 1996 election, had been approved by Cuomo's office. The result was that Clinton went with Cuomo as secretary. Rice was later cleared, but the timing of the investigation and a leak to the press suggested involvement by Cuomo.[42]

A HUD employee characterized Cuomo's tenure "as all show and very self-promoting. He always was a politician."[43] In 2000, Cuomo's HUD administration issued 302 press releases in 331 working days. Most of these releases contained headlines touting Cuomo, not the president. In a move reminiscent of Samuel Pierce, Cuomo spent $900,000 in taxpayer money on a brochure detailing his own accomplishments.[44]

When it became apparent Cuomo would run for governor of New York, he made 25 official HUD visits to the state—21 more than any other state. In his final year as HUD secretary he also announced $170 million in HUD money for economic development along the Erie Canal. Another former HUD employee noted, "It was about me, me, me, me. If he didn't get a headline out of it, he didn't want to hear about it."[45]

One thing Cuomo didn't like to see were criticisms of HUD by the department's inspector general, Susan Gaffney. Gaffney, who had a very good reputation, was subject to a smear campaign by Cuomo's staff that aimed to undermine her and force her out.[46] Cuomo was reported to be angry with Gaffney over some of her audit reports that reflected poorly on him. One audit suggested that HUD's determination of which cities were designated

"empowerment zones" under a billion-dollar program were subject to political manipulation.[47] An aide to Cuomo told a reporter, "That was his baby—when the audit report came out, he went crazy."[48] Another report by Gaffney's office found widespread mismanagement in billions of dollars of HUD contracts.[49]

Like Cisneros, Cuomo's main policy legacy was to promote federal subsidies and regulations that distorted housing markets, particularly in the direction of weakening safeguards against excessive risk. For example, Cuomo successfully advocated that Congress raise the ceiling on Federal Housing Administration–insured mortgages while lowering down-payment requirements.[50] Those moves help set the stage for higher FHA-insured mortgage default rates in later years.

Cuomo also supported efforts to have home sellers funnel money to nonprofit groups to help pay for buyers' down payments and closing costs. These "down payment assistance" loans ended up having default rates twice that of standard FHA-insured mortgages.[51] Cuomo portrayed his efforts as helping to increase homeownership rates for minorities, but he also had an interest in not upsetting mortgage industry officials who would later help finance his gubernatorial campaign. He also worked hard to receive support from leftist housing advocate groups, such as ACORN.[52]

During the Cuomo years, mortgage industry officials and housing advocates wanted Fannie Mae and Freddie Mac to purchase higher volumes of riskier loans that were offered to less credit-worthy borrowers. Cuomo's HUD continued to pressure Fannie and Freddie to increase the portion of their portfolios consisting of loans to moderate-income borrowers. Cuomo applied pressure by having HUD publicly "investigate" whether Fannie and Freddie were sufficiently in compliance with government fair-lending standards designed to prevent discrimination.[53]

We know now that Fannie and Freddie's expansion into low-quality mortgages was a huge mistake. A decade ago, numerous financial analysts saw the problems coming, but policymakers ignored their concerns and did not change their policy course. Here is a prescient observation by a *New York Times* reporter in 1999:

> In moving, even tentatively, into this new area of lending, Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn, prompting a government rescue similar to that of the savings and loan industry in the 1980s.[54]

Unfortunately, the housing and financial debacles of 2008 and 2009 were far larger than the savings and loan mess. But with Cuomo, fiscally prudent policies took a backseat to his political aspirations.

The Alphonso Jackson Years, 2001–2009

The Bush administration's HUD combined some of the Reagan era's internal corruption with some of the Clinton era's politicized push for increased homeownership rates. The Bush administration proposed tighter oversight of Fannie and Freddie, but it did little to end the mortgage giants' subsidies or implicit taxpayer backing. The housing bubble expanded and then burst on its watch, and Bush's HUD deserves a share of the blame.

Alphonso Jackson was named a deputy secretary at HUD a few months into President George W. Bush's first term. He became the acting secretary in late 2003, and permanent secretary in April 2004. He replaced Mel Martinez, who resigned to run for an open Senate seat in Florida. Jackson resigned in April 2008 in the midst of allegations that he had used his official power to benefit friends and Republican Party loyalists. He remains under federal investigation.

Jackson's troubles began in 2006 when he told an audience that he killed a potential HUD contract after the contractor told Jackson he didn't like President Bush. Jackson later claimed to have made the story up. A HUD inspector general's report found that Jackson did instruct staff to favor friends of the president when awarding HUD contracts, but it did not find concrete evidence that his orders were followed.[55]

A *Washington Post* investigation of HUD contracting under Jackson found that "the proportion of contracts awarded to small black- and Hispanic-owned businesses … rose from 6 percent to nearly 35 percent. The proportion of contracts open to full competition decreased from 71 percent to 33 percent."[56] The practice of awarding HUD contracts to Republican-friendly minority firms was common under Jackson, and the *Post* story provided numerous examples.

A number of examples of apparent cronyism at HUD have caught the eye of investigators. Major contracting work from the department was apparently given to friends of Jackson. In one instance, a no-bid contract was given to Jackson friend, Michael Hollis, to run the Virgin Islands Housing Authority. Hollis earned $1 million as the executive administrator of the housing authority, plus an undetermined amount from serving as an advisor to Smith Real Estate Services, which received $3.5 million from HUD for work at the VIHA. Anonymous HUD officials told a *National Journal* reporter "there was no indication that Hollis had any experience running a public housing agency before arriving in the Virgin Islands."[57]

Investigators are also looking into Jackson's role in getting his golfing buddy, William Hairston, $485,000 in contract work with the troubled Housing Authority of New Orleans, which had been taken over by HUD in 2002. Another aspect of this investigation is that HANO awarded a $127 million redevelopment contract to an Atlanta firm, Columbia Residential, which owed Jackson between $250,000 and $500,000 for "past services" as a "partner/consultant."[58] In other words, it appears that Jackson might have been looking to receive payment for helping to steer a HANO contract to Columbia Residential.

When Jackson resigned in 2008, he was in the midst of another controversy regarding sweetheart deals for friends, this time involving the Philadelphia Housing Authority. PHA Executive Director Carl Greene sued HUD, claiming that it tried to punish PHA by withholding funds after PHA refused to sell land to Jackson's friend, music mogul Kenny Gamble, at "rock-bottom prices."[59]

Then in June 2008, *Conde Nast Portfolio* reported that influential members of Congress and other government officials had received very favorable mortgage loans from Countrywide Financial.[60] Countrywide had a special VIP program that sought to influence important housing officials in the federal government and Fannie Mae by offering them mortgages with reduced fees and other perks. The list of beneficiaries included Alphonso Jackson, who was on a select list known as "Friends of Angelo" or "FOA," named after Countrywide Chairman and CEO Angelo Mozilo.

In December 2003, while he was acting secretary of HUD, Jackson applied to Countrywide for a $308,000 mortgage to buy a vacation home in Hilton Head, South Carolina. Jackson's loan came through a week before President Bush named him HUD secretary. Even before that, Jackson had refinanced a mortgage with Countrywide through the VIP program. Former Countrywide loan officer, Robert Feinberg, says that both of Jackson's loans came with special discounts.[61]

When asked if he received breaks on the loans, Jackson said, "Not to my knowledge. If I did, it certainly wasn't discussed with me."[62] However, a March 2009 report by the Republican staff of the House Committee on Oversight and Government Reform concluded that Countrywide made VIP borrowers aware of the preferential treatment. The report noted "At times, Friends of Angelo used their preferred status to refer friends or family members to the VIP department. Sometimes the Friends of Angelo expected their friends and family to receive the same preferential treatment."[63]

The same month Jackson sought the VIP mortgage for his vacation house, his daughter, Annette Watkins, had a mortgage processed through the same special program. According to the House report, "Jimmie Williams [Countrywide's Washington lobbyist] contacted Countrywide Senior Vice President Perry on Watkin's behalf because 'Jackson suggested his daughter talk with Countrywide.'"[64]

In 1999, Countrywide, which had become the nation's largest residential housing lender, reached an exclusive agreement to sell Fannie Mae billions of dollars in mortgages in exchange for lower "guarantee" fees that Fannie charged originators when it bought their loans. The success, and then failure, of both entities became intertwined as Fannie purchased large amounts of subprime loans and securities, which allowed subprime lenders like Countrywide to grow their businesses. When the subprime market collapsed in 2007, Countrywide collapsed as well. It was bought at a fire sale price by the Bank of America, while a broken Fannie Mae was taken over by the federal government.

This point is crucial. Many commentators put the blame for the subprime meltdown on the shady or overly aggressive mortgage originators, such as Countrywide. But it was ultimately Fannie and Freddie that drove the system. First, as the GSEs purchased more loans from mortgage lenders, the lenders were able to originate more and more loans. Second, the GSEs' increasing purchases of subprime loans brought them into competition with private-label issuers that traditionally specialized in these loans. According to Peter Wallison:

> The increased demand from the GSEs and the competition with private-label issuers drove up the value of subprime and Alt-A mortgages, reducing the risk premium that had previously suppressed originations. As a result, many more marginally qualified or unqualified applicants for mortgages were accepted, and these loans joined the flood of junk loans that flowed to both the GSEs and the private-label issuers beginning in late 2004.[65]

It was under Secretary Jackson that HUD decided in 2004 to increase Fannie and Freddie's "affordable" housing goals while allowing the financial giants to continue the Clinton-era policy of counting subprime mortgages as credit toward meeting that goal. Despite Fannie's 81-percent increase in lending to minority families in 2003, Jackson chastised the organization for its "failure to lead."[66] Jackson's pressure on the GSEs came despite the fact that regulators were growing increasingly concerned with subprime lending. The *Washington Post* found that "housing experts and some congressional leaders now view those decisions as mistakes that contributed to an escalation of subprime lending that is roiling the U.S. economy."[67]

Another indication that risky lending got out of control under Jackson is that default rates on loans insured by HUD's Federal Housing Administration hit record highs and continued to worsen as of early 2009.[68] At the height of the housing bubble, Jackson advocated reducing the down-payment requirements on FHA-insured loans to zero. With private subprime lenders having reduced FHA's share of the housing market to 3.3 percent in 2004, Jackson stated that he was "absolutely emphatic about winning back our share of the market."[69] The bubble burst, and FHA is now picking up the subprime slack—and currently insures one in three new mortgages—a precarious situation for taxpayers going forward.[70]

Alas, like previous secretaries, Jackson was too busy enjoying the perks of office to worry about taxpayers' exposure to a possible housing downturn. Jackson had a taxpayer-provided chef and full-time security detail. In his tenure, $7 million was spent on a new auditorium and cafeteria at HUD's headquarters, and his personal office spent $100,000 to obtain oil portraits of Jackson and four previous HUD secretaries.[71]

Conclusion

During much of the 20th century, the "public interest theory of government" held sway. The idea was that policymakers—particularly federal policymakers—acted with the best interests of the general public in mind. However, America's experience with a large and scandal-plagued federal government in recent decades has shown that the public interest theory has little real-world explanatory power. Ill-conceived laws get enacted all the time, and government officials often put career advancement, turf protection, and other personal factors ahead of the public interest.

HUD's history of scandal and corruption fits this pattern. While government officials and advocates for housing subsidies usually paint a romanticized portrait of HUD's programs, the truth is that federal housing intervention has often done far more damage than good. The housing and financial meltdowns of recent years can be partly traced to the distortions injected into markets by federal housing regulations and subsidies through HUD and other agencies. We have learned that when the government intervenes in the housing industry, politically driven decisions lead to corruption and economic distortion, not efficient public policies. The federal government should begin withdrawing from housing markets, including dismantling the Department of Housing and Urban Development.

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[4] Edward T. Pound and Jill Abramson, "Mishandling HUD: Pierce May Have Kept Hands Off, but Projects of Pals Sailed Through," *Wall Street Journal*, July 12, 1989, p. 1.

[5] Edward T. Pound and Jill Abramson, "Mishandling HUD: Pierce May Have Kept Hands Off, but Projects of Pals Sailed Through," *Wall Street Journal*, July 12, 1989, p. 1.

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[8] Edward T. Pound and Jill Abramson, "Mishandling HUD: Pierce May Have Kept Hands Off, but Projects of Pals Sailed Through," *Wall Street Journal*, July 12, 1989, p. 1.

[9] Edward T. Pound and Jill Abramson, "Mishandling HUD: Pierce May Have Kept Hands Off, but Projects of Pals Sailed Through," *Wall Street Journal*, July 12, 1989, p. 1.

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