RURAL HOUSING IN AMERICA

HEARINGS

BEFORE THE

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HOUSING AND COMMUNITY OPPORTUNITY

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COMMITTEE ON FINANCIAL SERVICES

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RURAL HOUSING IN AMERICA

Thursday, June 19, 2003

House of Representatives,
Subcommittee on Housing and Community Opportunity,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:45 p.m., in Room 2128, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Tiberi, Renzi, Castle, Waters, Lee, Scott, and Davis.

Mr. Renzi. [Presiding.] The Subcommittee on Housing will come to order. I would like to read an opening statement.

Today, the subcommittee meets to discuss the importance of rural housing in America. I am pleased to announce that this is theubcommittee's first hearing on the subject in over a decade.

Our goal is to review these programs and look at the ways to increase the proficiency and cost effectiveness. Rural areas are often plagued by poverty, high numbers of substandard homes, affordable housing shortages, costly development and inadequate access to mortgage loans.

The Rural Housing Service funds its programs through an insurance fund which provides direct loans, guaranteed loans and grants to help families obtain and maintain affordable housing in rural areas. Today, it is estimated that rural housing programs help finance new or improved housing for 65,000 moderate low-and very low-income families each year.

However, questions have arisen in recent years about the effectiveness of rural economic development policies and creating new opportunities for rural residents, as agriculture and other resource-based economic sectors decline in their overall importance to most rural economies. A wide ranging set of often overlapping programs target rural areas and their special needs.

But according to some critics, there remains little overall coordination of these various programs to produce a coherent rural policy. Over 88 programs administered by 16 different federal agencies target rural economic development.

The U.S. Department of Agriculture administers the greatest number of rural development programs and has the highest average of program funds going directly to rural counties—approximately 50 percent. On a personal note, I was raised in southern Arizona and grew to understand that a safe and secure home is the foundation for the family unit.

My belief in the importance of home ownership remains steadfast. It is of great importance to apply these fundamental values and rural experiences to help communities develop new economic vehicles that will enable them to grow and prosper.

I look forward to hearing from all of our witnesses today to discuss the various ways I which home ownership can be strengthened for our rural communities and contribute to the overall quality of life for rural families.

At this moment, I would like to recognize Ms. Waters from the great State of California.

Ms. WATERS. Thank you very much. I know that Chairman Ney is tied up in a meeting and could not be here. But I am delighted that you are chairing this meeting. And I thank Mr. Ney for calling this hearing on an issue that really needs to be discussed and is central to the need for more affordable housing in our country.

Usually, when we discuss poor people, the focus is on urban centers. However, there are poor people in rural America across this country who need our assistance to help improve the quality of their life.

The U.S. Department of Agriculture's rural development mission is to administer programs that are designed to meet the diverse needs of rural communities. The three principal program areas are Single Family Housing, multifamily housing and Community Facility programs.

According to an American housing survey, with the assistance of the Housing Assistance Council, of the 200 poorest counties in America, all but 11 are non-metropolitan. There are 363 rural counties where the poverty rate has exceeded 20 percent.

Since these figures started being collected in 1960, Title 5 of the Housing Act of 1949 authorized the Farmer's Home Administration to grant mortgages for the purchase or repair of rural single family houses. Second, it authorized financial assistance in rural areas to farmers, owners, developers and facilities, ensuring to them various loans and financial assistance for low rent housing for farm workers.

One of the primary issues that needs to be addressed is the rental housing program. Section 515 of the Rural Housing Program provides direct loans to non-profit and for-profit developers for multifamily housing for very low-and low-to moderate-income families, elderly persons and persons with disabilities. It is important that when RHS approves an owner, who agrees not to displace residents from a development, that if an owner decides to convert the property to condominiums or luxury apartments, that residents are protected.

That is why in 1987, the Emergency Low-Income Housing Preservation Act of 1987 was enacted after a number of owners of developments that were financed before 1979 were prepaying their loans and displacing elderly and other households from their homes. The RHS rental housing portfolio contains 450,000 rented apartments and Section 515 developments. The average annual tenant income is about $8,000, which is equal to only 30 percent of the nation's rural median household income.

The General Accounting Office indicates that 100,000 families could be displaced if the Section 515 portfolio is deregulated. These families have limited means and will not be able to afford market rate rentals.

There are over 90,000 Section 515 households who do not receive rental assistance. I will be interested in hearing suggestions on ways to improve the program to ensure that the people who need it most will be served.

Thank you very much. And I yield back the balance of my time.

Mr. RENZI. I want to thank the gentlelady from California and ranking minority member, a true advocate for the families of limited means, a true fighter.

I want to recognize my neighbor over in the Cannon Building, who has taken the time to teach me a lot as it relates to housing issues, the gentleman from Georgia, Congressman Scott.

Mr. SCOTT. Thank you very much, Mr. Renzi. I appreciate your warm and kind remarks.

My distinguished colleague from Arizona, I certainly appreciate your chairing this committee. I want to thank Chairman Ney and Ranking Member Waters for holding this important hearing today as well on this important subject of rural housing in America, especially given that it has been about 10 years since this committee has had a full hearing on this important subject, as Mr. Renzi pointed out.

My district is very diverse. I represent urban, suburban and rural areas to the south and east and north of Atlanta, Georgia. The challenges of increasing home ownership and providing decent quality homes is different for each of these areas.

And from time to time, Congress should ask if a particular policy is working and if it can be improved. I look forward to the testimony from our distinguished panel of witnesses about the effectiveness of rural housing programs. And I certainly want to thank you for taking the time to come up to Congress to share with us your expertise and thoughts.

And I also want to mention an issue regarding manufactured housing, which is a large part of housing in rural America. I certainly hope that the industry and Fannie Mae can work out an assessment on available 30-year mortgages.

I do not think that rural Americans, especially the elderly, should be penalized for the past unscrupulous loan practices. There are some very serious questions I think we certainly need to take a look at and hopefully, we will get to today.

For example, how would the hypothetical block granting of Section 8 programs, which are under attack now, affect rural housing authorities? I think that is very important for us to take a look at, as we look at this issue of moving Section 8 block granting it to the states, which we hope we have effectively stopped. But I think that question needs to be answered.

Would this put a strain on other rural housing programs, for example? Also, I understand that the Farm Credit Administration provides rural housing loans.

I think we need to examine the question as to: do you find that the Farm Credit Administration programs compete with other Federal programs? And do you believe that requiring a high down payment for manufactured housing mortgages will put a strain on rural housing opportunities?

Some very serious questions. This is very timely. And I certainly appreciate the chairman and Ranking Member Waters for doing it and Mr. Renzi, for you doing a fine job of hosting this for us. Thank you very much.

Mr. RENZI. I thank the gentleman. And his expertise is well noted. And I am sure the questions you will see today contain a lot of deep substance.

I will now recognize the gentlelady from California, Ms. Lee.

Ms. LEE. Thank you very much. And I wanted to also thank the chair, in his absence, and to our chair here today and to our ranking member for this hearing and to the panelists who have come to present this testimony.

You know, oftentimes, we from urban centers—I am from Oakland, California—forget really that California actually has many, many rural communities. And that we sometimes forget also that in these rural communities, there are deplorable conditions, poor infrastructure. Many of the homes are unaffordable.

And so I think that it is a very important hearing today. And it is important for myself, being from an urban community, to really understand and learn and be reminded that what affects urban housing issues—in terms of affordability, in terms of home ownership, in terms of infrastructure, in terms of safety—also affects our rural communities. And we should have a comprehensive strategy in terms of providing for decent and affordable housing for everyone.

And that should be part of our domestic agenda. And it should be a priority.

So I just want to thank you again, Mr. Chairman, for this hearing and look forward to the testimony.

Mr. RENZI. Thank the gentlelady from California for her insights.

Move now to the gentleman from Alabama, the former prosecutor, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Renzi, Mr. Acting Chairman, as it were.

Let me welcome the members of both panels here today. And let me certainly thank, in his absence, Chairman Ney for calling this hearing.

I noted as I was watching the television feed of this in my office, that Mr. Renzi opened by saying that this is the first rural housing hearing in 10 years. I am very much struck by that. I am very much struck by that.

When Michael Harrington wrote in 1965 about the other America, he was talking about portions of our country that have been extraordinarily isolated. And he was talking about people whose needs sometimes get lost in this otherwise wonderful process of ours.

And as we think about if Michael Harrington were to write that book today or if another Michael Harrington were to write that book today about the other America, I think he would be talking in very large measure about people who are living in rural America. My 7th District of Alabama happens to contain five of the poorest counties of the United States, according to the U.S. Census Bureau. And all five of those counties are extraordinarily rural.

And as we talk about moving this economy forward, I think a large part of that conversation has to involve connecting and closing the gap between rural America and suburban and urban America. So I am happy that we have this hearing. And I am happy that it gives us a chance to talk about this pressing issue.

I will make one other point. When the administration's budget was announced several months ago, a lot of us on this side of the aisle had sticker shock.

Normally, sticker shock is because things are higher than we expect them to be. Our sticker shock was based on the fact that the commitment was much less than we thought it would be.

And as someone who represents a rural district and as someone who represents a district that is very much dependent on rural housing initiatives, two things caught my eye. The administration proposed to eliminate the RHED program, the rural housing part of HUD, and the USDA's Rural Community Development Institute, two programs that coincidentally—or maybe not so coincidentally—happen to be the only rural capacity building programs that really exist.

A budget says something about our priorities. A budget says something about what we value and what we think is important.

And what troubles so many of us on this side of the aisle and some like-minded folks on the other side of the aisle is that in so many areas but particularly when it comes to rural America, we are walking away from a very important commitment that we have made. So to the extent that this hearing gives us a chance to shine some light on that, to the extent that this hearing gives us a chance to hear some perspective on a forgotten part of America, then I very much welcome this process and yield back the balance of my time.

Mr. Renzi?

Mr. RENZI. I thank the gentleman for pointing out the contentious issues that were surrounding at least the original blueprint of that budget. And I agree with him.

I thank the gentleman from Alabama. We will move to our first witnesses. Two witnesses today on our first panel. Our first is Ms. Phyllis Fong, who was sworn in as Inspector General for the United States Department of Agriculture in December of 2002.

She is responsible for conducting and supervising audits and evaluations, as well as investigations and law enforcement efforts relating to the USDA's programs and operations. Prior to her appointment at the USDA, Ms. Fong had been an Inspector General for the U.S. Small Business Administration. She is a career member of the Senior Executive Service.

Welcome, Ms. Fong.

Our second panelist and witness today is Mr. Bill Shear. And he is the Acting Director for Financial Markets and Community Investments at the U.S. General Accounting Office.

He has directed studies and is addressing federal oversight of government sponsored enterprises, including current evaluations of empowerment zones, securitization of community development lending and Federal Home Loan Bank System's financial activities. Prior to joining GAO, Mr. Shear was a senior economist at Freddie

Mac, where he analyzed home ownership decisions and HUD's geographic purchase goals for Fannie Mae and Freddie Mac.

Welcome, Mr. Shear.

I would remind the witnesses that your written statements will be included in the record. We ask that your oral testimony be limited to five minutes. We will begin with Ms. Fong. Ms. Fong?

STATEMENT OF PHYLLIS K. FONG, INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Ms. FONG. Thank you, Mr. Chairman and members of the subcommittee. I am pleased to be here today to provide testimony about the Office of Inspector General's work at USDA's rural housing programs. With me today are Bob Young, Deputy Assistant IG for Audit, and John Novak, Acting Assitant IG for Investigations, who will help me respond to your questions.

I would like to summarize the highlights of my testimony for you at this time.

As you know, the Rural Housing Service within USDA has three primary programs: Single Family Housing, multifamily housing and Community Facility programs. OIG oversight of these programs has focused on a number of different areas over the past decade.

During the 1990's, we conducted audit work in the RHS program of multifamily housing and single family housing. Over the past several years, our audits have focused on more specific and narrowly targeted issues, most often in response to congressional and other requests.

Two of these audits have led us to identify areas where we need to provide broader audit coverage. These would include insurance coverage in multifamily housing projects and the issue of eligibility for rental assistance. In addition to our formal audit work, our desk officers continually assess program activities. Our investigation side of the house receives and pursues allegations of fraud in RHS programs.

Based on our work in these areas, we have identified six major challenges for RHS management. These challenges include: portfolio management; unallowable and excessive expenses charged to RRH projects; RRH projects leaving the program; rental assistance; allocation of funds to rural areas; and performance measures.

My prepared statement discusses all six of these challenges in some detail. So today, I would just like to focus on the two most significant issues, in our view. And those two issues are unallowable and excessive expenses and performance measures.

RRH programs can be vulnerable to fraud and abuse because of the large cashflows involved. We have worked with RHS to address these problems and to stop those who abuse the program from participating in the program.

In 1999, we issued a comprehensive report on program fraud and threats to tenant health and safety, which described the results of a nationwide review of these issues. Financial records that we reviewed revealed over $4.2 million in misused funds at apartment complexes, operated by 18 owners and apartment managers.

We identified 145 complexes that showed serious physical deterioration. Problems included leaky roofs, worn exterior siding, unsafe balconies and similar kinds of problems.

In response to these issues, RHS has been working with the owners and management agents to resolve these health and safety issues. We have found, through our audit and investigative work, that there are several kinds of common schemes used by owners and management agencies to improperly withdraw funds from complex accounts.

One such scheme involves double charging apartment complexes for management-related expenses. Another scheme involves the owner or management agent charging complexes for personal expenses.

A third type of scheme involves unallowable charges made by identity-of-interest companies. These in particular are very complex schemes. And they result from program vulnerabilities, which raise a lot of concerns.

RHS, in response to these issues, has developed some proposed program regulations to address these problems. Our assessment of the regulations as they are currently drafted has concluded that the proposal has satisfactorily addressed 4 of our 19 audit recommendations. We believe that additional work needs to be done on the remaining 15 recommendations.

On the investigative side of the house, we have run a significant number of investigations of multifamily housing programs, which have led to 25 convictions and $8 million in recoveries. And in the single family housing program, we have had 30 convictions and $2.3 million in investigative recoveries. So we do continue to see a large number of investigative allegations and referrals coming to our office.

Next, I would like to address the issue of performance measures. As you know, managers need accurate performance data to assess how effective their programs are in accomplishing their mission.

We did a review in 2001 to evaluate RD's performance data and results. And we found that in many cases the data that were included in RD's report were inaccurate or unsupported. And as a result, we found that the report was of little utility.

We believe these problems are caused primarily by RD's lack of guidelines for collecting, validating and reporting its performance results and documenting its data collection. We also found, in some cases, that the items being measured were not directly related to the program mission and that in other cases, the performance measures were not supported.

You may wonder: why is this important? Well, we reported an example of the consequences of inaccurate data in this program.

In 2001, we did an audit of the Rural Housing Service and found that RHS reported it had built over 6,500 units, when in fact it had built only 222. As a result of this inaccuracy in data and reporting, $122 million out of the total $153 million allotted to the program was not used for program purposes. Had RHS had accurate data, perhaps this money could have been directed to program purposes.

We also believe that it is important for the program to develop internal controls that are accurate and that help the program to manage its program. We did a report in 2002 that reported on some vulnerabilities in the material weakness process within RD.

So in conclusion, we believe that RHS faces a number of management challenges in its efforts to deliver safe and affordable rural housing programs. RHS itself has acknowledged these challenges. And we are working with them to develop an audit program for next year that will help them to address these issues.

Thank you.

[The prepared statement of Phyllis K. Fong can be found on page 85 in the appendix.]

Mr. RENZI. Ms. Fong, thank you so much for your insights and your statement.

Mr. William Shear?

STATEMENT OF WILLIAM B. SHEAR, ACTING DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GAO, WASHINGTON, DC

Mr. SHEAR. Mr. Chairman, members of the committee, I am pleased to be here this afternoon to discuss opportunities GAO has identified to improve management at the Rural Housing Service. My testimony today is based on two reports addressed to this committee: first, our September 2000 report on rural housing options; and second, our May 2002 report on multifamily project prepayment and rehabilitation issues.

To summarize, we have found that while the Rural Housing Service has helped many rural Americans achieve home ownership and has improved the Rural Rental Housing stock, it has been slow to adapt to changes in the rural housing environment. Also, the Service has failed to adopt the tools that could help it manage its housing portfolio more efficiently.

In particular, our work on rural housing options focused on the dramatic changes in the rural housing environment since rural housing programs were first created. These changes raise questions as to why the separately operated rural housing programs are still the best way to ensure the availability of decent, affordable rural housing.

Overlap in the products and services offered by the Rural Housing Service, HUD and other agencies has created opportunities for merging programs for sharing the best features of each program. For example, the Service's single family loan guarantee program plans to introduce its automated underwriting capabilities through technology that FHA has already developed and has agreed to share with the Rural Housing Service.

Also, even without merging programs or sharing the best features of the programs of others, the Rural Housing Service could increase its productivity and lower its overall costs by centralizing its rural delivery structure. Here I will note that a number of states, including the State of Ohio, have made steps to consolidate the number of district offices within their states.

In addition, servicing of single family loans is now conducted centrally at the St. Louis Servicing Center. However, for the most part, the Service's delivery structure remains largely decentralized.

In addition, shifts in program funds, such as those from direct loan programs to loan guarantee programs, have contributed to challenges posed by the decentralized rural delivery structure.

I will now turn to our work on multifamily issues. Here we found that the Rural Housing Service does not have a mechanism to prioritize the long-term rehabilitation needs of its multifamily housing portfolio.

As a result, the Service cannot be sure it is spending limited rehabilitation funds as effectively as possible. It also cannot tell Congress how much funding it will need in the future.

How they deal with the long-term needs of an aging multifamily portfolio is the overriding issue for the Section 515 multifamily properties. About 70 percent of the portfolio is more than 15 years old and in need of repair.

The Service's state level personnel annually inspect the exterior condition of each property and conduct more detailed inspections every 3 years. However, the inspection process is not designed to determine and quantify the long-term rehabilitation needs of the individual properties.

To better ensure that limited funds are being spent as cost effectively as possible, we recommended that USDA undertake a comprehensive assessment of the Section 515 portfolio's long-term capital and rehabilitation needs. It is our understanding that, in response, the Service plans to develop an inspection and rehabilitation protocol by February 2004. The protocol will be based on an evaluation of a sample of properties.

Mr. Chairman, that concludes my oral statement. I would be happy to answer any questions.

[The prepared statement of William B. Shear can be found on page 142 in the appendix.]

Mr. RENZI. Thank you, Mr. Shear. Both your statements are absolutely eye opening. And I am sure we have got many questions here.

Let me, for those who might be wondering, make sure we get into the record today that Under Secretary Dorr of the USDA will be attending a second day of hearings that we will be conducting on the subject matter in July, in case we are wondering about that.

Before we move on to questions, I recognize Chairman Ney is here in the room. And so we were going to finish up some questions. And then we will turn it back over to the real chairman, okay?

Let me recognize the gentleman from Alabama, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Renzi. Let me, if I can, pick up on something that both of you alluded to in your written statements.

One of the anomalies that is striking to some of us is that the actual rate of home ownership is frankly very high in rural America. I think it is around 76 percent.

At the same time that it is very high, there is significant problem with the quality of housing stock. And because of the problem with the quality of housing stock, often the homes that people own are not typically leverageable as collateral. And they cannot be used in the kinds of wealth creating manner that homes are used by some people who own homes.

Can both of you address that particular problem and what RHS can do to get a better handle on that issue? Because the problem strikes me as not necessarily the conventional one of increasing and promoting a higher rate of home ownership, as opposed to rental status, but making better use of the home ownership rate that we have got in rural America.

Mr. SHEAR. I will go first on that. Many of the problems of inadequate ability to use home ownership as a vehicle to gain wealth for those who are near the bottom, low-income people, is a very large challenge. Much of it has to do with market forces that, to a large degree, the Rural Housing Service does not have that much control over.

Nonetheless, the Rural Housing Service does deal with a number of partners to try to encourage community development in rural areas, dealing with a number of programs such as self-help housing and other programs. It might be that some of those programs may offer the best hope in terms of making sure that those low-income rural residents who are homeowners have the ability, through the community development in the communities that they live in and through self-help programs, in terms of using sweat equity and other means to try to develop more equity in their homes.

Mr. DAVIS. Ms. Fong, do you have a different perspective or an answer on that?

Ms. FONG. Based on my understanding of the work that our office has done, we have not done much in that area. And so I do not have any basis to give you an assessment at this time.

Mr. DAVIS. Let me turn to a slightly broader question that both of you touched on in your written testimony as well, and it is the utility of Rural Housing Services existing as a separate entity or the feasibility of integrating the entity into HUD. As you know from the conversations we have had about Section 8 and conversations we have had about a variety of programs, there is kind of a wholesale consideration and evaluation going on in this House of what the relative role ought to be between, say, the states and particular programs, the Federal government and particular programs and the whole structure and contours of a lot of these programs.

I want both of you to talk a little bit about the arguments for keeping RHS separate from HUD. And I will kind of give you the backdrop for these questions.

When we had the Secretary of HUD here several months ago to talk about housing, he was not—you know, one of the things that he said that kind of caught my attention and probably the attention of a lot of people in the room, was when I asked him about several rural housing programs that were being eliminated or cut, after struggling with the answers, he finally stated, you know, "I do not know a lot about rural housing."

I am not sure that is the ideal perspective I would want a HUD secretary to have. And in light of that, what is going to be the future of RHS if it is put in a different home, if it is put under HUD?

Do both of you have confidence that the program is going to be administered in the way that we want, given HUD's relative unfamiliarity with RHS and the principles behind it?

Mr. SHEAR. Since it was one of the reports which I summarized in my written statement that addresses the issue of options, I would address it in this way. The areas where it seems to make the most sense to us to have a seperate service, where the Rural Housing Service really plays a unique role and has expertise and experience, is in dealing with many of the poorest rural areas in America—Appalachia, Mississippi Delta, Colonias and Indian trust lands. I am sure I could include the areas that you alluded to in your opening remarks, as far as some of the districts in the State of Alabama.

I think that if the programs of the Rural Housing Service that are targeted particularly to those areas would move to another agency, being it HUD or some other way consolidated with the programs of another agency, that the challenges would be pretty enormous. And that is where we say, in terms of the options, that would be the hardest area.

It is in the areas where we start seeing where the Rural Housing Service is providing housing assistance that is not largely distinguishable, in terms of the areas it is serving, when it starts getting into urban sprawl, into more suburban areas and things like that, where it is harder for us to say: why would you want a separate structure?

Mr. DAVIS. So if you will just yield me an additional 30 seconds or so, Mr. Chairman, the perspective that you are expressing is that for the really acute rural housing problems—because we know in this country, rural has different meanings. There is the rural that I have got in my district, which is very poor. And there is the rural that lies outside the suburbs that can be very wealthy.

For acutely impoverished areas, your perspective is that RHS has a unique, distinct function that it can serve and that that mission may not be performed as effectively or as well if it is absorbed within HUD.

Mr. SHEAR. We would have more concerns about the ability to integrate the programs that reach into the most acutely poor areas in terms of those parts of the Rural Housing Service.

Mr. DAVIS. Ms. Fong, can you give a very, very brief answer to that same question?

Ms. FONG. We have not specifically addressed that issue. It really is more within GAO's purview to look at those kinds of crosscutting Government issues.

I would draw your attention to this: I think that Mr. Shear is absolutely right in identifying the issue of how do you define rural area versus urban area bedroom sprawl? I think that is an issue area for the policy makers to decide how do we define these programs? And I do not have a solution.

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. RENZI. Thank you, Mr. Davis.

I would like to recognize the gentlelady from the Golden Bear State of California, Ms. Waters.

Ms. WATERS. Thank you very much. I am sorry I had to leave the room for a moment for an urgent call. But I was very interested in what the Inspector General was describing as the audit and investigative work that has been done.

What bothers me about the potential risk of a program like this is mismanagement. But oftentimes, that mismanagement is because we have not done enough in training and assisted those who are involved with the program enough so that they can avoid some of these management mistakes.

The business of these managers who have secondary businesses, for example, who may have an electricity shop or a plumbing shop. And they turn out to be the same ones to supply the services, et cetera. It seems to me that that kind of stuff could be easily managed and dealt with.

Certainly, it should be disclosed. But you know, these individuals should be vetted. They should be screened in some way, so as to know who they are and to avoid backing into those kinds of situations.

Oftentimes, poor people are put at risk because the oversight and the training and the technical assistance that is needed to manage these programs is not built into the program. So what can you tell us about your recommendations? And what can you tell us about the severity of some of the things that you discovered or the lack of severity of some of the problems that you discovered?

Ms. FONG. Well, I think you have put your finger on it, that in the area of overcharging, excessive charging to the Rural Rental Housing program, there are an awful lot of allegations of fraud and mismanagement. Much of it is due to activities by so-called identity-of-interest companies, where the project manager has a friend or a relative on the outside. They manage to equity-skim the project's accounts.

We are very concerned about that. We have made a number of recommendations to address that.

RHS is in the process of developing some regulations in response to our recommendations. Our current assessment is that we need to continue to work with RHS to tighten up those regulations because there should be a way to go after this.

I also believe that in FY 2000, the Congress enacted some legislation that would have tightened up some of these restrictions, addressed some of these issues, and provided the Secretary with some authority to impose civil penalties. Once that program takes off and is implemented, that should help to address some of these issues.

Ms. WATERS. Okay. Let me raise a question about the apartments that roll off the program with prepayment. That is a problem, particularly when we have a housing market such as we have now, where the demand is so great.

And if, in fact, the rising costs of maintaining those units is such that the owners, I guess, would be better off by prepaying them and getting out altogether, then I could understand why they would do that. What incentives do we offer to keep them in the program?

Ms. FONG. That is one of the challenges that we have identified. Under the current situation, as the projects mature, it is frequently in the project owner's interest to prepay for a lot of reasons.

And so as a result of that, there is an incentive payment that is being offered by RHS to project owners to enable them to stay in the program and to make it financially feasible for them to stay in the program. The payments would be equal to the equity value in the property at the time the prepayment is planned.

Now we have not looked at how that program is being implemented. We would certainly want to look at that program or at least keep an eye on it, to make sure that these payments are being made appropriately and that, in fact, the project owners continue to be eligible to maintain the properties to provide safe and decent housing.

Ms. WATERS. Can they borrow money for the upkeep of these apartments at a very low or no interest rate?

Ms. FONG. Yes.

Ms. WATERS. How low?

Ms. FONG. I understand it is 1 percent.

Ms. WATERS. Cannot get much lower than that. Thank you very much.

Mr. RENZI. Thank you, Ms. Waters.

Recognize the gentlelady from California, Ms. Lee.

Ms. LEE. Thank you very much. Let me just ask you, Mr. Shear—and I think Mr. Davis referred to it also with regard to home ownership rate is higher in rural communities. What is it? You say it is 76 percent, which is very high.

But I am wondering, given that percentage and yet given the rates of poverty, one is—well, what is first of all the minority home ownership rate in rural America, in terms of the Latino and the African-American community? Do you have that broken down?

Mr. SHEAR. I do not have it broken down here. We can provide a statement for the record on it.

Ms. LEE. Yeah, I would be very interested to see that.

Mr. SHEAR. It is definitely, when you go into the poorest areas of America, the rural home ownership rate is much lower than 76 percent. Among African-American and Hispanic communities, it is much lower. And we can provide those statistics for the record. I just do not have them right here.

Mr. DAVIS. Ms. Lee, if you would yield for one second? I think it is 61 percent among minorities.

Ms. LEE. Sixty-one percent? That is African-American and Latino? Okay. Thank you very much.

Let me also ask, did you find and are you finding, in terms of the housing stock, that rural America significantly needs more housing stock? Or is it rehabilitation only that is a strategy that makes sense?

Mr. SHEAR. For the record, according to the 2001 American Housing Survey, the homeownership rates for African-Americans and Hispanics in non-metropolitan areas was 61 and 59 percent, respectively. With respect to your broader question, I cannot answer directly what Congress's priorities should be in terms of spending and supporting the overall quality of the rural housing stock.

With respect to the major multifamily program for the Rural Housing Service, which is the 515 program, what we observe here is that a very high percentage of the projects are around 20 years old. They are aging. They are in need of repair.

Many of them, the use restrictions due to the original rent support contracts when those projects were built, are coming due. So our focus, in terms of one of the reports that I discussed, was in terms of the 515 stock and the need to assess and to prioritize the financial and the structural condition of that stock, in order to be able to prioritize where the Rural Housing Service could direct incentive payments and other resources to try to deal with the problem of keeping quality units in this 515 stock.

Ms. LEE. Do we need more quality units in rural America?

Mr. SHEAR. Based on our work, I would say we certainly find evidence, as others that you will hear during the second panel, of certain housing needs. There are housing needs in rural and urban areas.

But certainly, in rural areas, there are many housing needs. We feel that, in terms of our analysis, we are trying to provide information and analysis that will help the Congress deal with basically how can we manage better, how can we take actions to have resources go further. What are our options in terms of policies?

But I think the ultimate question—how much should be spent on the various activities, the various needs that this body faces—that is really your leadership.

Ms. LEE. Right. But in terms of a policy option, I mean, a policy option is increasing the affordable housing stock. I mean, we do have a bill, the National Affordable Housing Trust Fund. It increases housing stock, urban and rural America.

Would that be a recommendation from you to support, given what you have learned or what you know about rural America?

Mr. SHEAR. In that we have not analyzed the particular program or other programs developed in terms of trying to strengthen the quality of rural housing, I am not in a position to really recommend that initiative versus others.

Ms. LEE. But as a policy option, do we need to increase then just the stock of affordable housing in rural America? I know we do in urban America. I am trying to learn more about rural America.

Mr. SHEAR. There certainly are very pressing housing needs in rural areas. And certainly, there are very pressing housing needs, particularly in areas where our work on the Rural Housing Service have really concentrated, to a great degree, on the poorest rural areas in America. And certainly, you have some very pressing housing needs.

What I am saying here is that there are some value judgments involved here in terms of where priorities are. But you can certainly find many rural areas where you have housing conditions that are much further from providing adequate, safe and sanitary housing, compared with many of our urban areas. There are certainly a lot of pressing needs in rural areas.

Ms. LEE. Okay, Mr. Chairman. So you are not prepared to say, as a policy option, we need to increase the stock of affordable housing as part of your recommendation.

Mr. SHEAR. Basically, I think that that is the point where I just say there are some very pressing needs. But we have not assessed specific proposals. And some of those involve value judgments where we say that we go so far. But then you as a body, in terms of Congress, have to consider what other priorities——

Ms. LEE. Okay, thank you very much.

Ms. WATERS. Will the gentlewoman yield?

Ms. LEE. Sure.

Ms. WATERS. Thank you. This line of questioning by my colleague from California is extremely interesting and important because we are still seeing on television and in magazines dilapidated dwellings that are falling down in rural America. We are still seeing places without indoor plumbing. And it was just a few years ago that we had Sugar Ditch down in Mississippi, where people had cardboard serving as siding for their homes.

Now what do you know about this? Have you been into any of these areas? And if you have, why are you not sitting there just jumping up and down about the living conditions in some of these communities?

Mr. SHEAR. In terms of the poorest areas, I would like to introduce Andy Finkel, if he could come up to the table, he has been the assistant director who has led our work on rural housing. He certainly has visited many of the areas in the poorest rural areas of America. And I think that he could give a better answer than I could.

Ms. WATERS. Okay. All right. Okay.

Mr. RENZI. Mr. Finkel, you will state your full name please for the record?

Mr. FINKEL. Andrew Finkel.

Mr. RENZI. Thank you. Proceed.

Mr. FINKEL. There are two pictures on the highlights page of our report. They are before and after pictures, actually. One is a shotgun house that a gentleman lived in for 46 years in northern Mississippi.

And the next picture is the house that he moved into with a Rural Housing Service direct 502 loan, leveraged with Federal Home Loan Bank, state and local money.

It is in a historically African-American neighborhood that they wanted to convert in northern Mississippi. And it took a lot of work with a lot of leveraging.

But there were about a half dozen new houses like that built in the development. People moved into a nice neighborhood. We also saw was that in the immediate neighborhood around it people were fixing up their houses.

To follow up on you point about people living in cardboard, we also visited the colonias on the border in Texas. And that is where we saw entire neighborhoods of homes without water, without electricity, without sewers.

Mr. RENZI. Thank you.

Ms. WATERS. Just one more and I will not take much longer.

Mr. RENZI. Yes, ma'am.

Ms. WATERS. Is there an assessment of this kind of housing in rural America? Where can we find the status and condition and a real report on the housing needs of rural America? Where is that information deposited?

Mr. FINKEL. There is a report that comes out on the status of rural american housing, I think it is the Housing Assistance Council that puts it out.

Ms. WATERS. It describes these shotgun and cardboard——

Mr. FINKEL. Exactly.

Ms. WATERS.——and dirt floors and tin roofs. Where can we get that information?

Mr. RENZI. Maybe you can provide it to the gentlelady, please?

Mr. FINKEL. Yes, we will provide it for the record.

Ms. WATERS. Okay. Thank you very much.

Mr. RENZI. Thank you, Ms. Waters.

Let me finish because I want to make sure the chairman is able to get in here and get the next panel going. I was really taken, Ms. Fong, by the inaccuracy of the data that you all found out through the audit. I think your statement said that in one instance, RHS reported that they had built over 6,500 units—page 15—and in fact it had built only 222.

This kind of an injustice, I mean, that kind of a severity of disparity of numbers in their audit almost rises or does rise to the verge of investigation type of injustices. So I am going to ask, first of all, that lack of management with the inability to access the proper data, what is your recommendation, first of all, to attack that specific issue?

Ms. FONG. I think that RHS has to take a number of steps to deal with this. You are absolutely right. Until we can be sure that the data on program performance is accurate, it is very difficult to assess how well the program is performing. And I think that cuts across every area of the program.

We have suggested to them that they look at their data collection instruments, the way that they report the data, their computer systems. There are a number of things that need to be addressed, as well as the very basic issue of how do we—or how does RHS—define success in its program?

What is the performance measure for success? And how do we measure that?

And so there needs to be some very clear thinking about this from step one all the way through the end.

Mr. RENZI. And general counsel reminds me, RHS is in a position now where the accuracy, from this point forward, will be there for us. Or what is the status?

Ms. FONG. I believe this is a multiyear process. I do not know what the status is.

Mr. RENZI. We are not there yet. Okay. We are not there yet.

I want to follow up on a line of questioning with Mr. Davis. My district is 58,000 square miles, larger than the State of Pennsylvania, including the largest Native American Indian population in America. We lost several babies last year with a late snowfall because I have got Native Americans living in tin shacks, just similar to what Ms. Waters described. We have got frostbite conditions on babies' toes going on.

In addition, I have got a situation where I go all the way down to the border of Mexico, where some of the conditions, dirt floors are common. So true poverty is still in the land of milk and honey here in America.

And so I want to ask and go back along Mr. Davis' line of questioning. When you target severe rural areas, those with the most needy of areas, what program specifically is it that we can turn to, to help in the most needy and the most critical areas where we have these kind of effects?

Mr. SHEAR. It would be the historic traditional programs of the Rural Housing Service. It would be the 502 single family program direct lending. It would be the 515 program in terms of direct lending for multifamily properties. It would be the Section 521 rental assistance.

Mr. RENZI. Okay. I am with you. You have got a list of programs, okay?

Mr. SHEAR. I would say those programs, the distinguishing feature of those programs is that they are very deep subsidy programs that are a fairly high cost per recipient. They do bring housing assistance to the poorest.

Mr. RENZI. High cost to the recipient in what area? Down payments or where?

Mr. SHEAR. High cost in terms of the Federal government's role, in terms of the budgetary impact of those programs are high.

Mr. RENZI. Oh, okay.

Mr. SHEAR. Yet they are programs that are targeted for the very poor.

Mr. RENZI. And the poor's access to those programs is?

Mr. SHEAR. I am sorry, what?

Mr. RENZI. The access to those programs, the ability to get all that money out. If it is such a high-cost program, are we using it 100 percent?

Mr. SHEAR. In terms of whether we are using it 100 percent, we have initiated some work which is looking at rental assistance payments and looking at the obligations that are made from that program. And we are looking at questions of what is happening to unliquidated balances and things of that nature.

So there is a question of whether all the resources that Congress is providing is going to those uses.

Mr. RENZI. Okay, well, unliquidated—that went over my head. Okay? And I realize I am a snot-nosed freshman, but we need to be sure that we are directing the assets, directing these high-cost monies right down at the level.

Let me give you a little softball question here and we are going to finish up. The future of where we are going, as far as the research, the auditing, the development, where do you see us going as far as the review and oversight? And we will just finish with that.

I apologize, Mr. Davis, we are going to get to the next panel.

Mr. SHEAR. In terms of that, we serve the Congress and, as you know, the majority of our work is dictated by requests from committees. If I was going to point out areas you might want us to look at—and I think, Mr. Renzi, I think that is your question—we would look at, as far as a relatively new program, the Section 538 loan guarantee program for multifamily housing.

I would look at the whole question, as the Service has shifted from more direct programs to guarantee programs, of the issues of what types of internal controls, what types of lender oversight when you use private sector lenders, are necessary. And I would also say that the self-help programs certainly look like they are having some very positive benefits in some areas. But we know there is variation. And there is a question of: are there any best practices that could be captured?

Mr. RENZI. Thank you. We are now just scratching the surface obviously of an issue that we have grabbed on to, where many injustices exist. I look forward to Chairman Ney's leadership on this issue and his commitment to future hearings on this, as we begin to delve deeper.

The chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to replace their responses in the record.

I want to thank my colleagues for their questions and their insights. And thank both witnesses—all three witnesses. Thank you.

Mr. SHEAR. Thank you very much.

Ms. FONG. Thank you very much.

Chairman NEY. [Presiding.] I want to thank Panel Two. To begin the introductions, we will defer to Congresswoman Barbara Lee to introduce Gideon Anders.

Ms. LEE. Thank you, Mr. Chairman. Let me just say how delighted I am that one of our panelists here is actually from my district and is a real expert and an individual committed to the issues with regard to affordable housing, both in urban and especially in rural communities.

Mr. Anders—Gideon Anders—is the executive director of the National Housing Law Project, which of course is headquartered in Oakland, California. Mr. Anders and the National Housing Law Project are the leading housing rights and justice organization for low-income individuals across the country.

The National Housing Law Project's mission is to advance housing justice, increase and preserve the supply of housing, improve housing conditions, expand and enforce low-income tenants and homeowners' rights and challenge the ongoing housing discrimination that many people encounter in both urban and rural areas.

I have had the opportunity to work with Mr. Anders and the National Housing Law Project on issues ranging from the need for a national housing trust fund to defending the rights of tenants under the current HUD "One Strike" policy. Mr. Anders certainly believes that housing should be a basic human right.

And I am delighted that he is here to bring his wisdom and his knowledge and his insight to this subcommittee. And I just want to thank all of the panelists for being here today. And I want to thank our chairman and our ranking member for allowing us the opportunity to listen to someone who is such a leader in rural housing from Oakland, California, Mr. Gideon Anders.

Thank you very much, Mr. Chairman. And I yield the balance of my time.

Chairman NEY. I want to thank the gentlelady and the witness. And also we will call upon Mr. Castle, who will introduce Mr. Myer.

Mr. CASTLE. Well, thank you, Mr. Chairman. I do want to introduce Joe Myer, who I have worked with for a number of years now. I see on this resume he came to Delaware in 1976. And we worked together on a lot of projects.

He is the executive director of a Dover, Delaware—which is a small town which is the capital of Delaware with a rural area around it—based housing group called NCALL, which stands for the National Council on Agricultural Life and Labor Research

Fund. He went to Elizabethtown College and then has a masters from Delaware State University.

As I indicated, I have toured a number of sites with Joe. I have also talked to Joe on a number of occasions.

He serves many different populations—the elderly, our migrant workers, seasonal farm workers—in all of our counties in Delaware. He has a very successful partnership with the U.S. Department of Agriculture to implement rural housing programs.

He has been an active participant in many other rural housing organizations, including being the founding President of the Delaware Housing Coalition, chair of the Delaware Rural Housing Consortium and Past President of the National Rural Housing Coalition. He frankly has just been as involved with this subject as anybody possibly can be.

I cannot imagine a better person to talk to us today about this. He has volunteered his time to come up and share with us. And we appreciate his being here.

I may not be here because I have a conference call I have to do at 4:00. but I really appreciate Joe being here, as well as, by the way, all the other witnesses who, based on their resumes, seemed extremely qualified as well. And I yield back, Mr. Chairman.

Chairman NEY. I want to thank you. And we will move to Mr. Davis to introduce Madeline Miller.

Mr. DAVIS. Thank you, Mr. Chairman. Let me thank you for having this hearing today as well. I have the pleasure of introducing the lady who is third from the right, Madeline Miller. Ms. Miller, you are actually not technically in my district. But you are close enough. I am going to claim you for purposes of today anyway.

Ms. Miller is a graduate of my mother's school, Alabama State University, and was born and raised in Pine Hill, Alabama. And she is here today because she is the executive director of Wil-Low Non-Profit Housing, a non-profit housing entity that serves Lowndes County and the county that is in my district, Wilcox County.

It has done extraordinarily important work in terms of providing technical assistance to low-income and moderate-income families, to enable them in everything from housing reconstruction, to financing, to the purchase of a home. And it is particularly appropriate that you are here, Ms. Miller, because as you heard from listening to the last panel, we have an interesting phenomenon in America, that we have high ownership, high home ownership in rural America.

But the quality of the homes is not what it should be. And your program has taken a very significant role in the Black Belt of Alabama, in rural Alabama, in trying to get a handle on that particular problem, so that we do not have a situation or a scenario in which people are technically homeowners but are living in conditions that are still offensive to so many of us in this room.

Your organization has taken the lead in trying to do better in that area. And I want to thank you for being here today.

Chairman NEY. I want to thank the members for introducing and welcome the panelists. And I will introduce Betty Bridges.

Betty is President of the Council for Affordable Rural Housing, which represents the interests of over 300 members that include for-profit and non-profit entities, as well as local housing authorities and financial institutions. Ms. Bridges was an official with the Farmers Home Administration in her home State of North Carolina for nearly 30 years.

Patty Griffiths is speaking today on behalf of the Housing Assistance Council, a national non-profit group working to create more affordable housing throughout rural America. She is the housing director of the Community Action Commission of Fayette County, a non-profit organization located in Washington Court House, Ohio.

I share Ross County, a neighboring county, with Congressman Hobson. And I got a glowing recommendation on you for a half-hour today. I thought it would let you know that. So Congressman Hobson says, "hello."

And also, Jack Jones is Vice President in charge of the Rural Housing Channel for Chase Manhattan Mortgage Corporation, Deerfield Beach, Florida. He is speaking today on behalf of the Mortgage Bankers Association of America, which represents 2,600 companies involved in the real estate finance industry.

James Rayburn is a homebuilder and developer from Jackson, Mississippi. He has built more than 3,000 homes and is a noted expert in creating public-private partnerships to build affordable housing. This year, he is serving as the First Vice President of the National Association of Homebuilders.

And welcome to the committee. We will start with Mr. Anders.

STATEMENT OF GIDEON ANDERS, EXECUTIVE DIRECTOR, NATIONAL HOUSING LAW PROJECT, OAKLAND, CA

Mr. ANDERS. Thank you, Chairman Ney. I appreciate you inviting us to testify today. And also to Congressman Lee, I want to really thank you for the fine introduction, which saved me about 30 seconds in my delivery today.

Thank you very much. It is a pleasure.

We have restricted our testimony today to the prepayment issues with respect to the Rural Housing Service. We are concerned about several trends that we are seeing with respect to its administration of the Emergency Low-Income Housing Program or ELIHPA preservation program.

In our view, the agency is not enforcing ELIHPA, and not preserving units that can and should be preserved. And it is failing to protect residents against displacement.

Before we address our concerns, let me just briefly reaffirm our fundamental belief that there is an absolute and continuing need to maintain an effective Rural Rental Housing preservation program that protects residents against displacement and protects and ensures that there is adequate housing in rural areas.

Frequently, Section 515 developments are the only available affordable rental housing in a community that is decent, safe and sanitary. The conversion of that housing deprives communities of a critical housing source and forces elderly, disabled and working households to relocate other communities that are tens of miles away from their current homes, jobs and families.

We have four concerns with RHS' administration of the Rural Preservation Program. The first of these is that RHS does not have sufficient funding to operate an effective preservation program.

RHS has represented to this and other congressional committees that it has sufficient funds to meet existing preservation needs. That is not true.

For at least the past 9 years, RHS has not had sufficient money to fund equity loan commitments that it has made to owners who have agreed to remain in the Section 515 program if they were provided an equity loan.

In the recent Federal Register, publication of proposed regulations seeking to alter the preservation program, the agency acknowledges that it does not have sufficient funds to meet all the equity funds that it has agreed to fund and claims to have unfounded agreements that were entered into as early as 1996.

What is troubling about this picture is that it is a self-created problem. The RHS Section 515 appropriations do not specify how much money RHS should be using for preservation, for maintenance or new construction. Those decisions are made administratively by the agency after it receives the appropriations.

We believe that the funding issue will become more significant over the next several years and that inadequate preservation funding may cripple the program. We urge that the committee to really look closely, as a result, at the needs of the agency in terms of preservation.

The second concern that we have is that RHS is not preserving all the developments that it can. It has created several loopholes by which owners can and will circumvent the prepayment and preservation process.

The most glaring example is RHS' unwillingness to extend use restrictions through the acceleration and foreclosure process. RHS takes the position that an owner who pays the balance due on a loan in response to an acceleration of the promissory note is not prepaying the loan and is free to use the property as it chooses after the loan is paid.

RHS is also using the acceleration process to avoid dealing with troubled projects. It routinely forecloses on properties that it feels it cannot handle and then leaves it up to the private market to determine what should happen to them.

We do not believe that RHS' position is justified.

The third issue is RHS does not affirmatively enforce obligations to rent units to low-income residents. In a Missouri case in which we are involved, the PHA—the Public Housing Authority—is trying to prepay and demolish a 50-unit development some 19 years after it secured the RHS 40-year loan.

When the authority began to systematically relocate residents and leave the units vacant, RHS did nothing. Even after the housing authority initiated a lawsuit challenging RHS' authority to enforce the Emergency Low-Income Housing Preservation Act, RHA did not take any action to force the housing authority to rent up the facility by completing it. As a consequence, 48 units of affordable housing have been standing empty for nearly 4 years.

The fourth issue that we are concerned about relates to RHS' capacity to coordinate and control lawsuits in which owners are challenging the validity of ELIHPA prepayment restrictions or seeking damages for their imposition. Currently, there appears to be no concerted effort on the part of RHS or its counsel to ensure that

ELIHPA, a federal law, is properly enforced. Basic arguments, such as the supremacy of federal laws over state laws, are not being advanced. And cases are being settled instead of appealed because certain legal arguments have not been made in the federal district courts where these cases are first heard.

Moreover, RHS, or at least its counsel, appear intent on settling cases even before the agency's liability has been established. Potentially, these settlements may cost the government hundreds of millions of dollars that could have been better spent on preserving the housing in the first place.

Ironically, in one case, the RHS settled instead of appealing an adverse decision. The residents have gone on to appeal the decision and have sought and secured a stay of the district court decision and sought and secured an injunction against the owners selling the development or terminating the tenants' RHS rights. It is indeed ironic that residents of a development and not RHS are appealing this case.

Before I close my testimony, Mr. Chairman, I would like to just point out a couple of issues with respect to the new regulations that RHS has recently proposed and which is one of the questions which the subcommittee has asked questions about.

The first provision that we are concerned about deals with RHS' proposal to finance future Section 515 developments with loans that are amortized over a 50-year term but which become due at the end of 30 years. In other words, the proposal would finance Section 515 loans over 50 years, but create a balloon payment at the end of 30.

In our view, this proposal violates ELIHPA. And we urge the sub-committee to direct RHS not to implement that provision and, if necessary, prohibit it from doing so.

The other provision which we have concern about is one that we referenced earlier, which proposes to allow an owner to terminate its equity loan agreements if RHS does not fund the agreement within 15 months of the time that it was entered into. In our view, as long as RHS, and not Congress, determines the amount of funding that is made available for preservation, the choice of whether to fund incentive agreements lies with the agency and no one else. It must not, therefore, be allowed to make incentive offers to owners that it later chooses not to honor.

Thank you.

[The prepared statement of Gideon Anders can be found on page 66 in the appendix.]

Chairman NEY. Thank you.

Next witness?

STATEMENT OF BETTY BRIDGES, PRESIDENT, COUNCIL FOR AFFORDABLE AND RURAL HOUSING, WASHINGTON, DC

Ms. BRIDGES. Mr. Chairman and committee members, can you hear me?

Chairman NEY. There you go.

Ms. BRIDGES. I am very pleased to represent the Council for Affordable and Rural Housing, CARH. My personal experience, as was stated by the chairman, I was a former Farmers Home Administration official for almost 30 years and a private developer of affordable housing for 10 years.

I will address the questions that were supplied by the committed and several additional points that we at CARH believe are vitally important to the future of rural housing.

I have submitted separate written remarks. But I will summarize those.

CARH members generally have a productive working relationship with RHS, the agency. But we experience a high degree of frustration at the lack of resources and the consistency from state to state. The agency is not fully able to meet its intended purpose and goals because it is organized in a manner that inhibits the sharing of information and training, thereby greatly adding to transaction cost and preventing many meritorious transactions.

It is not adequately funded to either expand or maintain its housing stock and is unable to effectively coordinate with existing resources from other agencies. And its programs are subject to artificial statutory restrictions that limit development and preservation.

All of these points are addressed in CARH's March 2003 position paper on the aging portfolio. And I respectfully request permission to have this inserted in the hearing record.

Chairman NEY. Without objection.

[The following information can be found on page 159 in the appendix.]

Ms. BRIDGES. The rural housing finance market is experiencing a paradox in that tools and resources for financing affordable rural housing have become increasingly complex and sensitive to the national financial markets. Yet, at the same time, local market conditions remain local and isolated with dispersed housing and employment patterns.

This affects both home ownership and rental housing patterns, which are both vitally important to meet rural housing needs. While home ownership is the American dream, rental housing is absolutely necessary for elderly and low-income Americans, which is the agency's client base.

In the 515 program, the average tenant income is about $8,100 a year. Nearly 60 percent of the households are elderly or disabled. We understand that there are various discussions and contracts between HUD and USDA about home ownership programs. However, we believe that S. 198 and H.R. 1913 have the greatest likelihood of achieving real progress on this point.

We understand that HUD instituted a Rural Housing Office several years ago. But we have not seen any material coordination in the field among multifamily or the voucher programs.

We understand that there are various changes at the agency, such as their recently proposed 3560 regulation, which is an important step in streamlining and modernizing the regulations.

Still, 3560 does not address certain basic problems with the program; namely, that the agency has an extremely onerous process for transferring properties within the 515 system and an even more difficult system for prepaying and refinancing outside the system. The result is what one industry commentator calls a toll road with no exits.

We appreciate, Mr. Chairman, that you proposed an amendment last year to H.R. 3995 to restore contractual prepayment rights to owners of 515 properties, just like they were restored for owners of HUD properties. Prepayment restrictions that violate contract provisions are being successfully challenged in court.

The Supreme Court's unanimous decision on a case last year characterized the statute restricting prepayment rights as a repudiation of the contract and is dishonoring an obligation. At CARH, we share the committee's interest in the 521 rental assistance—RA—perhaps the largest budget item for the agency. That program generally works well. But there is not enough funding.

The RA program really can only be analyzed in conjunction with the 515 program. Since RA cannot exist without a corresponding 515 loans, 515 loans are serviced on a budget-based method so that State office rural development staff scrutinize operating expenses. In many places, this has resulted in significantly below market rents that do not pay for ongoing maintenance costs.

We also note that other programmatic alternatives exist. The 538 program is an excellent idea. But the 538 statute makes implementation with other programs difficult.

The agency staff has been excited about the 538 closings to date. While we support that enthusiasm, we have to note that only a handful of the 538 closings have been made and are well below industry expectations.

The 538 program must be revised on a statutory level so that it is consistent with current commercial standards. And we urge further hearings on this point.

We appreciate the hard work and the good intentions of this committee, as well as RHS and RD staffs. We have identified many areas where we feel that we can work together to make progress.

Some of these points require a further federal financial commitment. But others only require structural changes to make transfers, prepayments and preservation easier.

And we urge the committee to consider these changes. I have spent my entire career working in this industry. And I hope that you will think of me and my organization, CARH, as a valuable resource.

Thank you.

[The prepared statement of Betty Bridges can be found on page 76 in the appendix.]

Chairman NEY. Thank you.

Ms. Griffiths?

STATEMENT OF PATTY GRIFFITHS, HOUSING DIRECTOR, COMMUNITY ACTION COMMISSION OF FAYETTE COUNTY, OHIO, APPEARING ON BEHALF OF THE HOUSING ASSISTANCE COUNCIL

Ms. GRIFFITHS. Thank you for the opportunity to submit testimony.

Chairman NEY. Excuse me. I think you need to move it closer.

Ms. GRIFFITHS. Is that better? Okay. Thank you for the opportunity for me to submit testimony on rural housing today to your subcommittee. And thank you, Chairman Ney, for convening this very important hearing.

My name is Patty Griffiths. I am the housing director for the Community Action Commission of Fayette County, known as CAC. We are a non-profit organization located in Washington Court House, Ohio.

I also am speaking today on behalf of the Housing Assistance Council, a national Non-profit group working to create more affordable housing throughout rural America. Established in 1971, HAC provides financing, information and other services to non-profit, for-profit, public and other providers of rural housing.

Our written testimony includes detailed responses to the questions posed by your subcommittee. But in this brief oral presentation, I wanted to focus broadly on needs and on what we are doing in Ohio with USDA Rural House Service programs.

First of all, housing and poverty. Most housing policy is focused on urban concerns, which are of course substantial and deserve attention. But needs are often just as great in rural America.

HAC's research shows that of the 200 poorest counties in the nation, all but 11 are non-metropolitan. There are 363 rural counties where the poverty rate has exceeded 20 percent since those figures were first collected in 1960.

In housing for most of the 20th century, substandard quality was the primary rural problem. While quality is still a problem today, sharply higher housing costs have made affordability, rather than poor conditions, the major problem in rural housing, especially for low-income people.

Among the 23 million non-metro households, approximately five million, or 22 percent, pay more than 30 percent of their monthly incomes for housing costs and are considered cost burdened. Of these non-metro cost burdened households, more than two million pay more than half their incomes toward housing costs.

We see these conditions also in rural Ohio. The average person in a big city may not think of Ohio as a rural state.

But in fact, Ohio has the fourth largest rural population among the 50 states, with over 2.1 million people. Of our 640,000 occupied rural housing units in Ohio, over 20 percent are occupied by families that are cost burdened.

Now I would like to turn and speak briefly about our work in Ohio. Community Action, our agency, was founded in 1965. And we have been involved in housing for many years.

We have done home weatherizations since 1967. We have developed and managed housing for the elderly, for disabled and homeless.

We provide housing counseling. We have developed several rental projects using the Low-Income Housing Tax Credit.

And we have used the major programs of the USDA Rural Housing Service, including Sections 502, 504 and 515. We also use some HUD programs.

But since 1995, our agency has helped over 100 low-income families become homeowners through USDA's self-help housing program. Right now, we are the only USDA self-help housing builder in Ohio, although we are currently hoping to expand into Ross County and into Clinton County.

Under this unique program, which is sometimes called a hand up, not a hand out, we organize groups of eight to 10 families. We help them qualify for USDA Section 502 single-family mortgages. We work with them as they put over 1,000 hours—that is per household—of sweat equity into the building of their own homes and their neighborhoods. No one moves into their homes until all the homes in the group are completed.

A skilled construction supervisor from our staff works alongside these families. And they do 65 percent of the labor.

Now these families do not just paint the walls; they actually build the walls. They put up the shingles. They put up the siding. They hang drywall. And they hang cabinets.

In our self-help work, we also have benefited greatly from the Housing Assistance Council's HUD-funded Self-Help Homeownership Opportunity Program, which we refer to as the SHOP program. We have received $850,000 in SHOP funds from HAC and $800,000 in other HAC loans.

The SHOP funding helps CAC buy the land and put in the infrastructure for our self-help homes. HAC and CAC want to thank this subcommittee for having created the SHOP program in 1996. I think our agency probably would have been out of the self-help business had it not been for the SHOP program.

The commission has also used the USDA Section 504 home repair program. We have developed and now own and manage a 24-unit USDA Section 515 rural rental apartment project.

Overall, we have had excellent success with the USDA rural housing programs. All of these Rural Housing Service resources have been vital to our ability to meet the needs in Fayette County, Ohio.

Perhaps the best way for me to illustrate our work has been its impact on the clients that we work with. I would like to tell—and end—with a brief story about one of our clients, Julie Allen.

She was a single pregnant mother who became homeless after leaving a domestic violence situation back in 1996. Our agency first housed Julie and her children in our homeless shelter.

We then helped her through supportive housing. And then she became involved in our USDA self-help housing program. And she built her own home in one of our first sweat equity subdivisions in Bloomingburg, Ohio.

Today, Julie is a homeowner. She has an excellent job. Her children are thriving.

Last December, she was a featured speaker before 800 people at the opening session of HAC's National Rural Housing Conference, speaking about how self-help housing had changed her life. I might add, she got a standing ovation at that conference.

HAC and CAC considered asking Julie to be speaking up here instead of me today, so you could hear from a person who is really receiving these services. But she is getting married Saturday and could not make it.

When I consider Julie Allen and her life, I can think of no better reason to support, continue and expand the USDA Rural Housing Service programs. Yes, they may need some changes and improvements. They definitely need more funding. But they really have had an enormous impact on the lives of millions of rural people.

Thank you very much.

[The prepared statement of Patty Griffiths can be found on page 104 in the appendix.]

Chairman NEY. I want to thank the witness for her testimony. And next, Mr. Jones?

STATEMENT OF JACK JONES, VICE PRESIDENT, CHASE MANHATTAN MORTGAGE CORPORATION, DEERFIELD BEACH, FL, ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. JONES. Good afternoon. And thank you, Mr. Chairman, for holding this hearing and inviting the Mortgage Bankers Association of America to state its views on the U.S. Department of Agriculture's Rural Housing Service programs.

My name is Jack Jones. And I am the Vice President in charge of the Rural Housing Channel for Chase Manhattan Mortgage Corporation in Deerfield Beach, Florida. I am particularly pleased to be here today representing MBA on an issue to which I have devoted the last 11 years of my professional career—providing homeownership opportunities for rural families.

MBA and Chase are strong supporters of the Rural Housing Service's mission to foster home ownership opportunities across rural America. Chase is the largest originator in the Rural Housing Service's Section 502 Guaranteed Single Family Housing Loan program, commonly called the GRH Program.

In many rural communities, the Section 502 direct and guarantee programs are the only home ownership options available to low-and moderate-income families. Last year, Chase loaned just over $900 million, which provided 11,000 rural families the opportunity to become homeowners.

Chase does this in partnership with over 2,500 community banks, mortgage bankers and mortgage brokers in all 50 states.

Unfortunately, rural areas traditionally have lacked the financial resources for home financing. For this reason, the RHS programs are vital to increase the availability of safe, decent and affordable housing for low-and moderate-income rural home buyers and renters.

RHS provides this important function for both single family and multifamily housing. In addition to the GRH program, RHS also offers the Section 538 program, which guarantees loans to developers of multifamily housing to build and/or renovate safe and decent rental units affordable to very low-, low-and moderate-income families.

Both of these programs provide private capital, guaranteed by public funds, to promote adequate access to home financing capital for rural communities.

MBA would like to recognize the good work that this administration, under the guidance of RHS Administrator Arthur Garcia, has undertaken in the last 2 years, making significant improvements to a program that was at risk of being neglected.

MBA urges these favorable changes be built upon through the following initiatives: first, guidelines under the GRH program should be amended to allow the financing of the guarantee fee on top of the appraised value of the property. Second, the population limits under the GRH program should be raised.

Third, the income limits should be raised for the GRH program and targeted in high-cost areas. Fourth, thermal standards on existing housing stock should be eliminated from the GRH program.

And fifth, clarification of Ginnie Mae authority on Section 538 loans guaranteed by RHS is needed.

MBA urges these changes for the following reasons: a key feature of the GRH program is the ability of the purchaser to borrow up to 100 percent of a property's appraised value. This feature allows the borrower to purchase a home with no down payment and finance some portion, if not all, of the costs related to closing a mortgage, including the RHS guarantee fee. The current law, however, limits the loan amount to the appraised value.

MBA urges the financing of the guarantee fee on top of the appraisal for purchases. This change would mean a greater number of rural families would be able to overcome the down payment and closing cost obstacle to home ownership. This is especially true for first-time and minority homebuyers.

Use of the GRH program is limited to communities with populations of either 10,000 or 20,000, depending on whether or not they are contained in an MSA. These definitions were created over 30 years ago and need to be updated.

MBA supports aligning the GRH population requirements with other USDA programs or other statutory rule definitions.

Currently, borrowers applying for the GRH Program are limited to a maximum household incomes of 115 percent of the area's median income, in all states except Alaska. This 115 percent limitation in 49 states does not take into account the varying levels of housing affordability across the United States.

MBA urges the Secretary of Agriculture be granted discretion to raise the family median income limits in areas designated as targeted areas and in high-cost areas, allowing financing to be extended to families making up to 150 percent of the area's median income.

Unique to the GRH program, existing homes are current required to exhibit thermal efficiencies that are contrary to the State of the housing stock in rural America. This requirement necessitates costly improvements that we believe have only nominal economic value. These thermal standards for existing homes cannot be found in any other conventional, FHA or VA home loan program and is a source of ongoing resistance to the use of the GRH program.

MBA urges Congress to provide strong encouragement to the agency to eliminate this burdensome, costly and onerous regulation.

Currently, loans made under RHS Section 538 Rural Rental Housing guaranteed program cannot be securitized by the Government National Mortgage Association, Ginnie Mae. Ginnie Mae's charter allows only the securitization of insured multifamily loans, but not guaranteed multifamily loans.

MBA urges Congress to change the Ginnie Mae charter to allow the securitization of these guaranteed loans. This change will provide greater liquidity for these loans and ensure that rural communities are not disadvantaged due to lack of access to capital.

[The prepared statement of Jack Jones can be found on page 112 in the appendix.]

Chairman NEY. I need to interrupt you just to—the time has expired, but to also let the panel know what is going on. Unfortunately, there is a 15-minute vote in progress, a 10-minute debate, another 15-minute vote, another 15. It is basically 45 to 50 minutes' worth of votes.

So what I would like to do is to go over, cast a vote. It will give a 15-minute window to be able to come back to get your testimony in of the three witnesses for the record because we would like to do that, to be able to do it.

And then I do not know if any questions can be—any time for questions. But we will be able to at least submit questions if the members would like to. So if you could indulge us, we will be at recess for about seven minutes.

Thank you.

[Recess.]

Chairman NEY. Sorry for this. It is hard to predict the votes. Let us proceed as briefly as possible as we can with the remaining witnesses. Thank you.

STATEMENT OF MADELINE MILLER, EXECUTIVE DIRECTOR, WIL-LOW NONPROFIT HOUSING INC., HAYNEVILLE, AL

Ms. MILLER. Mr. Chairman and ranking members, good afternoon. I am Madeline Miller, executive director, Wil-Low Non-Profit Housing, which is a non-profit organization incorporated in 1971 in Lowndes County, Alabama when it was spun off another non-profit organization, Friend, Incorporated.

Most of our work is conducted in Wilcox and Lowndes Counties. The organization was formed by citizens from Lowndes and Wilcox Counties who were concerned about the quality of their community housing.

That year, Wil-Low hired its first executive director and received its first grant—$38,000 from the Rural Housing Alliance.

The organization's mission then, as it remains today, is to provide technical assistance to very low-, low-, and moderate-income families and farm worker families so they can have the opportunity to acquire decent, safe, sanitary and affordable housing.

Wil-Low helps families with new construction, rehabilitation of existing owner-occupied dwellings, rental housing and housing counseling. Today, Wil-Low still operates its housing programs, consisting of new construction, rehabilitation of owner-occupied dwellings, the purchase and rehabilitation of an existing dwelling, rental units and housing counseling.

To date Wil-Low has constructed over 300 home units through both its self-help program and its contractor built home program. One hundred percent of the funding for these units was provided by Rural Housing, which means the families we work with all have incomes at or below 50 percent of the median income.

Rural Housing has made available over $2 million in funds that enables families to own their homes. We also have used their rehabilitation program, the Rural Housing 533 Housing Preservation Grant and its 504 program. A total of over 300 homes have been rehabilitated.

But there is a need for additional funds for the Rural Housing Service Rehabilitation Program, especially the Loan/Grant Program, because the numbers of homeowner-occupied dwellings that are in need of rehabilitation keeps increasing. If these homes are not repaired, family members will be forced to move in with relatives or others, creating or increasing another problem—overcrowding.

Wil-Low has successfully trained 50 on-the-job trainees in construction. In 1999, our dream became a reality. We broke ground to start construction on 20 rental units and a community building. Then, in May of 2000, the first resident moved in and today the complex is fully occupied.

The one problem is that we were only able to build 20 units. And we have over 100 applications from families who are still in need of a decent and affordable place to live.

The total cost of the project was $1,399,239, which included the entire infrastructure cost. We also operate a housing counseling program.

But there are many challenges that Wil-Low Non-Profit Housing faces. Today, Wil-Low has had to overcome in the past and is still faced with today, in an attempt to operate a successful rural housing program: recruiting eligible families; resolving credit issues; funds to do site development work for subdivision approval; sufficient funds to leverage other money; locating suitable building sites; infrastructure; acquiring gap financing; understaffing; overcoming NIMBY-ism; improving the quality of housing; and increasing outreach services to migrant and seasonal farm workers.

To help alleviate some of the substandard housing units and overcrowded living conditions, Wil-Low has the following goals outlined: single family house purchase of a 10-acre tract of land in Wilcox County, Alabama; construct 18 single-family units; also, multifamily units, 20; and also to rehabilitate 50 units; a housing counseling program to counsel approximately 300 and this would include predatory lending.

To sum this up, the only way that Wil-Low can achieve these goals and its overall goal of providing decent housing in rural Alabama is to coordinate our effort with those of other groups and organizations, such as Rural Housing. Also, for a rural housing program to be successful, we must continue to make our communities aware of the programs and services offered by Wil-Low.

Because our communities are changing, part of that awareness involves providing outreach services to migrant and seasonal farm worker families. To be a rural housing non-profit requires more than building or rehabilitating units, it also requires providing a whole host of services from jobs to counseling.

Thank you for allowing me the opportunity to speak on behalf of Wil-Low Non-Profit Housing Corporation and other non-profit organizations that are struggling to survive in order to continue providing the housing-related activities that are needed in order to improve the living conditions of residents in this county and in America.

Thank you.

[The prepared statement of Madeline Miller can be found on page 119 in the appendix.]

Chairman NEY. Thank you.

Mr. Myer? I should also note that if any witnesses have transportation problems or difficulties and unfortunately need to leave because of these votes, the members will be able to put questions to you in writing. We do appreciate your time today on the Hill. And I am sorry again for the unknown factor of the votes.

Mr. Myer?

STATEMENT OF JOE L. MYER, EXECUTIVE DIRECTOR, NATIONAL COUNCIL ON AGRICULTURE LIFE AND LABOR RESEARCH, INC., DOVER, DE

Mr. MYER. Mr. Chairman, my name is Joe Myer. I am executive director of NCALL Research, a non-profit rural housing technical assistance provider based in the great State of Delaware, represented by Congressman and former Governor Mike Castle.

I am also President—Past President and current Executive Committee Member of the National Rural Housing Coalition. And RHC is a national organization that advocates on rural housing policies and programs. And we appreciate the opportunity to testify today.

Regarding need, the 2002 Millennial Housing Commission Report states that rural communities were bypassed and left behind in the economic good times and now face rates of poverty, substandard housing, unemployment and rent burdens similar to the nation's big cities.

There are 7.8 million of non-metro population that is poor. One-quarter face cost overburden. And 1.6 million housing units are substandard.

USDA's research shows 4 million or 17 percent of non-metro households experience housing poverty. Renters in rural areas are the worst housed with 33 percent cost burdened, one million suffering from multiple housing problems and paying exorbitant portions of income for housing.

In Delaware, our rural counties and small towns have higher rates of poverty and substandard housing than the State national average. Poultry processing has fostered a dramatic increase in the Hispanic population in some of our smaller communities, like Georgetown, whose population increased from two percent Hispanic in 1990 to 32 percent in the 2000 census. This increase unfortunately took place without any appreciable increase in housing stock.

I must indicate the importance of the rural housing programs. It is the only option for decent, affordable housing for many rural families.

If we look at Section 502, single family direct, at least 40 percent of these loans go to families below 50 percent of median. It has very attractive rates. It is an excellent program.

Average income of households assisted is $18,500. The current loan level will provide financing for about 15,000 units. There is an unprecedented demand for Section 502, which totals several billion dollars.

We are very pleased with the 2004 budget request of $1.366 billion. We think it is a bargain to the government because each housing unit costs $10,000 a unit to the government.

Self-help housing has been discussed by Patty. Families trade labor and determination for housing resources. They recruit groups through non-profit organizations of six to eight families who apply for 502 loans. The families receive home ownership counseling, construction training. And they work together to build their homes and neighborhoods, much like the church and barn raisings of the past.

The family labor saves an average of more than $15,000 over the cost of a similar cost. That is an average. Sweat equity provides the opportunity for home ownership, while saving the government millions in reduced mortgage costs. Self-help families arguably are the lowest income mortgage borrowers with the best payment record.

Section 515, rental housing program, seemingly forgotten in many ways. A portfolio of 450,000 apartments with only a 1.6 percent delinquency rate, an average tenant income of $7,900 and more than half the tenants elderly or disabled.

[The prepared statement of Joe L. Myer can be found on page 126 in the appendix.]

Chairman NEY. I am sorry to interrupt. I am watching the clock ticking. If we could move on to Mr. Rayburn, just to get a few minutes in. And then if we have it, we can come back, if you do not mind.

STATEMENT OF JAMES R. RAYBURN, JACKSON, MI, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOMEBUILDERS

Mr. RAYBURN. Thank you, Mr. Chairman. My name is Bobby Rayburn. And I am a homebuilder from Jackson, Mississippi. I am the First Vice President also of the National Association of Home-Builders. And I am pleased to represent the views of some 211,000 members.

NAHB and its members place a high priority on providing safe, affordable, high quality housing for rural Americans. While progress has been made in improving housing in rural America, considerable unmet needs remain, particularly for very-low and low-income rural households.

Specifically, there is a significant need for new production of affordable housing units. And existing rental stock is aging and requires extensive rehabilitation. And access to competitively priced credit for potential home buyers, as well as builders, remains a problem in many rural areas.

Remedies are urgently needed. While there are many possible approaches to meeting the need for the production of new units and preservation of the existing housing stock, there are two common elements that are crucial to success: more resources must be committed and a range of interests beyond the Department of Agriculture must join in the effort.

Some success in providing affordable home ownership and rental housing opportunities has been achieved through the Home Investment Partnership Program and the Community Development Block Grant programs in States were efforts have been given in sufficient priority. NAHB strongly supports both of these programs, which distribute HUD funds to States and local jurisdictions through block grants. And we believe additional appropriations would be available and effective in addressing unmet housing needs in rural areas.

Other federal efforts to address rural housing needs are currently undertaken through the Department of Agriculture's Rural Housing Service. I understand that we are before the authorizing and not the appropriations committee.

But RHS programs have been severely hampered by inadequate funding, with the appropriation shortfalls most severe in Section 515, direct loan program for multifamily housing. The administration's fiscal year 2004 budget proposal includes no money for Section 515, new multifamily production projects.

Currently, there are no alternatives to the Section 515 for producing housing affordable for very low-income households in rural areas. So the absence of a new production money is a major setback.

The problems at RHS go beyond inadequate funding, however. Inconsistencies in how the projects are monitored occur from state to state. Management fees have wide variations. And it seems to be difficult to remove bad property managers and owners.

Chairman NEY. If I could interrupt. I am going to need to leave to make the—I missed the one vote because I needed to stay here. And I am going to make the final passage. And then I will be—anybody who has to leave, please feel free. I will also be more than happy to come back and listen to the last testimony, if you would like.

Mr. RAYBURN. Yes, sir.

Chairman NEY. I will do that. And if I can cast the final passage vote, I will return.

Anybody who would like to stay. If you cannot stay, we fully understand that. I will return. The committee will be in recess.

[Recess.]

Chairman NEY. If I could keep this up for a couple of weeks, I might be able to get back into my suit I wore to my homecoming senior year.

[Laughter.]

So I want to thank you for that in the House. And we will continue. How about we continue with the last witness and then we will go back to Mr. Myer.

Mr. RAYBURN. Thank you, Mr. Chairman. I will just continue where I left off, if that is all right.

In addition to RHS staff can present roadblocks to potential purchasers of existing properties who plan to improve the properties. This is the result of slow decision making and requirements that add unnecessary cost.

RHS needs a viable management and preservation strategy, which must include the ability to respond more decisively and effectively. NAHB understands that some of these issues are addressed in RHS' recently proposed regulatory changes to its multifamily programs, which are intended to streamline and consolidate 13 regulations into one, as well as address concerns raised by the Office of the Inspector General.

NAHB supports such efforts and encourages RHS to move towards simplifying its regulations in as much as possible, as well as strengthening its ability to address the portfolio responsibilities.

Even with more funding, RHS cannot do the job alone. Addressing rural housing needs is far too important to be left exclusively to one small sub-cabinet agency.

Limited coordination of partnerships efforts are underway to improve rural home ownership opportunities. Such initiatives should be greatly expanded and extended to the production of affordable rental housing.

The housing GSEs—Fannie Mae, Freddie Mac and the Federal Home Loan Banks—State housing finance agencies, the farm credit system and HUD all have responsibilities and resources to take a far more aggressive role in addressing the housing problems of the nation's rural communities. Fannie Mae and Freddie Mac are required by law to meet annual housing goals established by HUD.

Several upward provisions in these goals had little, if any, impact to improving the availability of housing credit in rural areas. In the 2000 revision of the goals, the underserved areas goal was increased from 24 to 31 percent. But there was only a limited increase in the role of Fannie Mae and Freddie Mac in rural housing finance.

During development of the 2000 rule, NAHB commented that HUD should encourage increased participation in rural areas by Fannie Mae and Freddie Mac through the use of bonus points or double credit for purchases of loans in rural areas. HUD did not include this recommendation in the final rule. But we plan to revisit this issue during the revision to the goals in 2004.

In conclusion, Mr. Chairman, NAHB thanks you for bringing this to attention and supporting the cause of rural housing. NAHB stands ready to work with this committee, RHS, HUD, the GSEs and all other supporters of rural housing to improve the programs and to develop creative solutions to maximize the use of scarce resources in addressing these critical housing needs.

Thank you, Mr. Chairman.

[The prepared statement of James R. Rayburn can be found on page 134 in the appendix.]

Chairman NEY. Thank you.

Mr. Myer?

Mr. MYER. And I will just continue on as well. In Delaware, the 515 program is the rental backbone of our communities, providing a great community asset. Waiting lists are long. Recently, more than 200 applicants showed up to rent a 24-unit Acorn Acres complex in Georgetown, Delaware. That gives you an idea of the need.

The President's budget cuts 515 to $71 million, the first time in more than 30 years that the Federal government will not provide any new rental units for rural America.

Prepayment of Section 515 properties is a threat to two-thirds of the portfolio over the next 7 years because it results in displacement of tenants and loss of low-income housing stock. Owners' incentives and resources to preserve this stock are important.

In 1994, Section 515 was funded at $540 million. It has been cut an unconscionable 73 percent and not replaced with anything. This is a great program that seems to be biting the dust.

514/516 farm labor housing is the only program that serves our nation's migrant and seasonal farm workers. The last national study done indicated there was a shortage of 800,000 units for farm workers.

Fifty-two percent of farm workers live below poverty. Seventy-five percent of all migrant farm workers live in poverty. Yet, few farm workers can qualify for normal subsidized housing.

Current funding totals $37 million, which provides 700 units of housing. We are appreciative of the $37 million. But it is far less than what is needed.

We ask for your support of the Rural Rental Housing Act of 2003. This creates a new Federal program to alleviate cost burdened substandard conditions. It would create a $250 million rental development fund, administered by USDA.

Money would be allocated to States based on need for the purposes of acquisition, rehabilitation and construction of low-income rental housing. Federal funding will be matched, dollar for dollar, by participants. USDA will make funding available to entities with a record of accomplishment in housing development.

And finally, the act will be administered at state levels most familiar with local needs. This new resource, if enacted, could finance up to 5,000 rental units a year.

We also encourage the refunding of Rural Community Development Initiative, RCDI, to support the rural non-profit delivery system. There was more than $80 million in applications for the $6 million that was available in 2000.

This is a valuable program. And it is also at risk in the Federal budget.

Mr. Chairman, thank you for this opportunity.

Chairman NEY. I want to thank you. And thank all the panel.

I have a question for Mr. Jones. As I understand it, the Appropriations Committee last year inserted a provision for no-year funding. That is for the Section 502 guarantee program.

And my understanding is the intent of this provision was by making this change, it would provide stability in the budget process for consumers, the bankers and realtors who participate in the program. The continuous operation of the program without delay or interruption of the funding also was a factor.

There was a concern by the Appropriations Committee when the administration lowered the fee for the new guaranteed loans. And the refinancing of existing loans, there would be an additional cost to that program.

The Appropriations Committee rescinded approximately $11 million from one account and transferred the funds to the Section 502 guarantee program to make up for the anticipated additional costs. And that would be so that the program funds would not be depleted before the end of the fiscal year.

So is the current level of funding for this fiscal year sufficient for the demand? The President's proposed fiscal year 2004 budget requests a program level of $2.8 billion for this program. So do you believe that the level of funding is adequate and will be sufficient for the demand?

Mr. JONES. My belief is that that level of funding will indeed be insufficient.

Chairman NEY. Please pull the microphone. Thank you.

Mr. JONES. With the decrease in the guarantee fee and other initiatives from the agency, we have seen tremendous momentum build for the Guaranteed Rural Housing Program. As a result, we will more than likely exceed the $2.75 billion this year, which is unfortunate because for the first time, we do have the opportunity for the no-year funds provision but will actually not have any funds carried forward.

We have yet to ever experience a 12-month program. Typically, the private sector knows as we begin each fiscal year——

Chairman NEY. I am sorry. You have never experienced a 12-month program?

Mr. JONES. Because funds come to us typically very late in October or early November, either through the CR process or at the time the actual appropriations bill is funded.

Chairman NEY. So because they are late, you cannot then gear up?

Mr. JONES. We never have a full year to actually see what we can do with 12 consecutive months of consistent funding. I believe this year we are going to exhaust the allocation, the $2.75 billion the agency has, which really means we will not have funds carry into the next fiscal year. And I believe the proposed fiscal year 2004 will be insufficient.

Chairman NEY. The gentlelady from California?

Ms. WATERS. Mr. Chairman, I would like to thank all of the panelists for the time that you have spent here this afternoon to share this very, very valuable information with us. I think I am coming to some conclusions about rural housing needs. And I sincerely believe that there needs to be a lot more advocacy here by members of Congress who represent all of these areas that perhaps we are not hearing enough from.

Obviously, there is a need for more money. I think this multiple family units and all of the issues with I guess the 515 program, we really do need to take a very deep and serious look at, to see what we can do. As one urban legislator, I am absolutely committed to the proposition that the urban and rural legislators should work together for rural housing and for urban housing.

I think that we could do a better job combining our efforts to make sure that we have adequate housing and housing resources in certainly the rural community.

I guess I have a lot of questions. I am going to hold them in reserve because I am going to review all of the testimony and interact with my chairman on it and other members of this committee.

But let me just raise this question of, I guess, Mr. Myer. I know that we have laws that allow for migrant farm workers to work, I guess, in this country. Maybe for particular seasons or a designated period of time, I do not know.

But do we coordinate the laws that encourage migrant farm workers to come and work with the housing resources that should be available to them if they are here working? Is there any coordination between that?

Mr. MYER. Well, I think there is some coordination. There is always room for more coordination.

But the fact is that local farm workers, their only access to housing is this 514/516 program. And then migrant farm workers that migrate to a certain area to support agriculture, their only option appears to be the 514/516 program. It is the only program that is dedicated to serving farm workers.

And again, there is an 800,000 unit need for farm workers. I am not fully sure that I answered your question.

Ms. WATERS. Well, that gives me some idea. If the need is 800,000, then it appears that what we are doing is we have laws that allow for migrant workers, but we do not match the resources for housing with the number of migrant workers who are performing the services.

Mr. MYER. The program is funded at $37 million, which provides about 700 units a year.

Ms. WATERS. Okay. That is helpful. Thank you very much, Mr. Chairman.

Chairman NEY. Another question I had—and anyone that would like to, please feel free to answer this. And then we will go to Mr. Davis for a question.

What are your general impressions and overview of the Rural Housing Service and whether the agency within the U.S. Department of Agriculture is meeting its intended purpose and goals? Any reflection on RHS?

Feel free to speak out or raise your hand or whatever you would like to do.

Mr. ANDERS. If we have an hour, sure.

Chairman NEY. I have got some time, maybe not an hour, but close to it.

Mr. ANDERS. I mean, in many ways, the agency is doing an excellent job. I mean, the agency has been around since 1949. Actually in some respects it has been around longer than that. And it has been doing a very credible job in certain areas of doing single family homes and doing multifamily housing and in doing some of the rehab loans, what you are talking about the 502, the 504 and the 515 programs, as well as the Farm Labor Housing Program.

The problem has been in the last 10 years that the agency has suffered substantial cuts in funding. And they have had to consolidate their staff.

Some of the support and infrastructure which needs to be dealt with, in terms of longevity of some of the housing programs, particularly the Rural Rental Housing Program, which we heard about earlier, there are some significant issues in terms of maintenance of the portfolio. The agency is short on staff to deal with it.

And so it is a cost issue. But I think that, by and large, the agency is doing a very good job and is meeting its purposes.

Chairman NEY. Are RHS—we are going to hear from them July 8th. But I just thought I would get anybody's observation.

Ms. BRIDGES. Even with the problems that were cited by the investigative panel earlier, the RHS is absolutely the best delivery vehicle for affordable housing in the rural areas. We have no other vehicle to deliver it. The tax credit program, as good as it is, is not sufficient in the rural areas to meet the needs of the very low-income people.

The biggest problem that we have had in the past few years is the lack of funding. At the time that we were having $500 million to $900 million allocation, we were doing great. And these problems that are addressed are a minor amount of problems. They are not large.

We have many, many, many other owners and managers that are doing an excellent job and serving thousands and thousands of families. So I strongly encourage the committee to look at the funding that could be possibly available and maybe another way of delivering the program. There are ways.

As the previous witness said, I will not repeat him, but they have lost some of their staff because of funding cuts. However, we do not need to be micromanaged in the field. We do not need that.

There are a lot of honest developers and managers out there that would do a good job if we had the funds available.

Chairman NEY. Thank you.

Mr. Jones?

Mr. JONES. I would echo the sentiments of my colleagues. I believe this agency has done a very effective job. Most recently, I would note that this administration has been willing to listen to the private sector and the needs of the private sector to really promote this program.

Without question, the GRH borrower is best served by this loan. It provides 100 percent financing, meaning no cash contribution from the applicant. And because of their low-and moderate-income status, no mortgage insurance.

But the program is only going to work if we can get the private sector interest in delivering it. And I was very much moved by Congresswoman Waters' comments regarding affordability.

Let's face it. This administration just cut the guarantee fee, making it affordable.

The agency is focusing now, as part of a greater concern, on addressing minority home ownership rates, which consistently lag behind white homeowners in rural America. The things that we talked about today—financing of the guarantee fee—allows the applicant to take full advantage of the appraisal, to finance all the closing costs without wasting one dime on the guarantee fee, which is typically put on the loan amount with HUD, VA and even in the refinance program.

All of these things are going to knock down the barriers of affordable home ownership, which I believe are everyone's objectives today.

Chairman NEY. Do I read you correctly then, you are not saying it is as much money as it is private sector involvement?

Mr. JONES. Certainly, for the guaranteed program, the private sector is critical. The private sector is actually originating, processing and servicing these loans, in lieu of RHS staff. And whatever we can do to induce the private sector to contribute its efforts to gear up to deliver this program is going to get us the most home ownership opportunities for these applicants that simply make too much money and cannot be served by the direct or other RHS loan programs, but do not have any other options.

Chairman NEY. Thank you.

Mr. Rayburn, did you?

Mr. RAYBURN. Mr. Chairman, I would like to remind this committee that in addition to being a builder and very involved with the National Association of Homebuilders, that I am from Mississippi. And several of the questions that were directed to certain earlier panel members about places in Mississippi.

I know very well where those places are. I know very well where cardboard shacks were in many cases because our company has helped to solve some of those problems.

Are there a lot of them still out there? There surely are.

We could not solve those problems with Rural Housing Service dollars and staff. We had to go elsewhere in order to do that. Because part of Rural Housing Service is doing a very good job. The better job is done on the single family side, probably for the most part around the country.

On the multifamily side, it is not. They need to come into this century and use good, sound business practices.

We probably do not have the time. But if you would like to, I would be glad to provide in written comments a couple of specific instances whereby our company was going to bring in outside, fresh, new, non-federal dollars into a couple of 515 developments, multifamily rental developments.

And because of the cumbersome, outdated requirements that the staff was putting on us, we were not able to do that, even though we had a half a million dollars funded from the Federal Home Loan Bank AHP program in the form of a grant. We were told that was fine on the front end.

On the back end, they came up with another $300,000 that needed to be done to the development. So the project is still in its deplorable condition today, with sewer running on the ground, with cabinet doors nailed shut that will not work because the management company was getting exorbitant management fees. And things like that needs to be stopped.

Chairman NEY. We would like, if you could, to give us detail after this——

Mr. RAYBURN. Be glad to, surely.

Chairman NEY.——on at least the two and anything else you would have.

Mr. Davis?

Mr. DAVIS. Thank you, Mr. Chairman. Let me thank the panel and chair for their patience. I know it is late in the day.

Let me give you all a number—let me give the panel a number—that puts some of this in a great deal of perspective from my standpoint. The 1994 fiscal year, the combination of Section 502 loans and Section 515 loans was $530 million or so. Actually, I think it was around $663 million total subsidy cost spent on rural housing programs in fiscal year 1994.

Less than $200 million in subsidy on Section 502 and Section 515 in the current fiscal year. That is a drop from $660 million down to $200 million.

Now I am not much of a math major. But that is certainly a significant drop.

Has the housing crisis in rural America abated over the last 10 years? Has it somehow gotten better than it was in 1994? Does anyone think that the housing crisis is somehow less acute now than it was in 1994?

Mr. RAYBURN. If I could answer, no.

Mr. DAVIS. In fact, it is worse in a lot of ways.

Mr. RAYBURN. It is worse. It is worse in so many cases because of the lack of infrastructure in so many communities, the lack of infrastructure that has to be gone in and put the streets, the water, the sewer in to so many different areas, causing additional increases in prices, tied back to that homeowner that you are trying to serve, and many times in the low-and very low-income category.

Mr. DAVIS. So we are making less of an investment to address a problem that is becoming more acute? Is that right? All of you are nodding your heads.

Ms. Miller?

Mr. RAYBURN. Yes, sir.

Ms. MILLER. Yes, that is right, Congressman Davis, because take for example in Wilcox County, when it comes to sewage, infrastructure system, then you only have just two towns that have actually a sewer system. You have Camden and Pine Hill.

But then if you look at the other area, there is a great need in the whole country for housing. And now that most of those counties, if the land does not perk, then you have to go into expensive, what you call, a raised bed septic tank. And that can cost anywhere from $6,000 to $10,000.

And that fee would have to be added into the cost of the family loan because they are not able to make a down payment. And well, most of the families—but you are familiar with that. I do not have to go into detail on that, how they can qualify.

Mr. DAVIS. Let me give you all another statistic that my colleagues from California alluded to earlier. We talked about what is a very real paradox, the fact that a large percentage of people in rural America own their homes, but the homes that they own are absolutely substandard.

They are houses, really, and not homes, to be very blunt about it. Another statistic, doing some quick math here, 31 percent of the housing units surveyed for the American Housing Survey in rural America, 31 percent of those occupied rental units were substandard in some way, ranging from inadequate heating to inadequate physical infrastructure, to water leakage; 31 percent of them had some very particular problem.

So once again, I think we ought to recognize that when we are talking about people having a high rate of what we would call home ownership—again, they are not living in homes. They are living in physical structures called "houses" that are not in the condition that they need to be to raise a family. Do a lot of you agree that is a regular problem?

Let me direct another question to all of you. We have heard a lot of talk in all of these hearings about the Federal government taking less of a role, whether it is as a function of devolving responsibilities on the states or devolving them on the private sector.

Let me ask some of you to comment on what you think the government can be doing right now that it is not doing. What can the government do if we, for whatever reason, end up with an administration one of these days that is committed to addressing these issues and wants to be proactive? What can the government do now that it is not doing?

Yes, ma'am?

Ms. MILLER. I think one thing that the government can do is make more funding available and can lessen some of the regulations when it comes to the rural because the regulation is steep. And then the money is not there for the rural to pay.

The housing standards are very high. Just to give you an example, if a qualifying applicant lives on a rural gravel road, they must include in their loan adequate funds to construct a concrete driveway to the gravel road. These rules apply to qualifying applicants' whether they own a car or not.

This could add between $2,000 to $3,000 to an applicant loan amount, so there is a number of rules in the regulations that can be minimized, depending on each individual situation, and the applicant still could get a well constructed, quality built dwelling.

So there is a lot of things the regulations can be minimized, but still remain at a good standard home can be built.

Mr. DAVIS. And do all of you agree that we cannot address the housing problem, particularly in rural America, without a sustained focus on job training, without a sustained focus on economic development? It is impossible to get a handle on the housing issue without looking at all the problems that accompany the issue.

Do all of you agree with that?

Ms. MILLER. I agree with that.

Mr. DAVIS. All right. Thank you, Mr. Chairman.

Chairman NEY. I want to thank you. And I appreciate the panelists for your testimony on this important issue.

I just want to echo some comments made earlier. And I come from obviously a very rural Appalachian area. And I think that in Congress, we have a large, great, diverse country. And we have to be sensitive to the concerns of urban centers, which are different, and the concerns of rural, take care of everybody we can in the sense of listening to individuals and also to try to get affordable and available housing, no matter what size of a city or a town.

I do think that we can focus more here in Congress-that is what we are trying to do—on rural. I am not sure that it has been focused enough on.

I have also told all the advocacy groups to speak up a little bit more or scream a little bit more or come around the halls. And that is no reflection on anybody here. I am just saying, I have told everybody, let's energize this issue and get it going a bit.

I give you a lot of credit for working out in the trenches to make sure people have some support and some help. And with that—did you have—and with that, I want to thank the panelists.

The chair notes some members may have additional questions for the panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these questions and to place their response in the record. I want to thank the members of the committee and the panelists.

The committee is adjourned.

[Whereupon, at 5:36 p.m., the subcommittee was adjourned.]

RURAL HOUSING IN AMERICA

Tuesday, July 8, 2003

U.S. House of Representatives,
Subcommittee on Housing and
Community Opportunity,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:07 a.m., in Room 2127, Rayburn House Office Building, Hon. Robert W. Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Bereuter, Renzi, Waters, and Davis.

Also Present: Representative Frank.

Chairman Ney. Today's subcommittee holds its second hearing to discuss the importance of rural housing in America. Two weeks ago we heard from multiple witnesses, including the Department of Agriculture's Inspector General and the General Accounting Office, concerning the Rural Housing Program, RHS. My goal is to continue to review Rural Development's programs to look into ways to increase their proficiency and cost effectiveness. I have said this to quite a few groups involved with rural housing: I think we need to energize it and get the tone level up and get people involved, and we need to do it in urban areas, we need to do it in general housing, minority housing. There is a lot of work that we need to work together on.

From our previous hearing it was evident that RHS faces a number of management challenges to carry out its mission. It is critical that USDA's Rural Development programs have access to accurate, relevant performance data and measures to assess program efficiency and effectiveness. Without timely and precise information, Rural Development will be unable to determine how well it is accomplishing its mission of delivering safe and affordable rural housing programs.

However, questions have risen in recent years about the effectiveness of rural economic development policies in creating new opportunities for rural residents as agriculture and other resource-based economic sectors decline in overall importance to most rural communities. A wide-ranging set of often overlapping programs target rural areas and their special needs, but according to some critics there remains little overall coordination of these various programs to produce a coherent rural policy. Over 88 programs administered by 16 different Federal agencies target rural economic development. The U.S. Department of Agriculture administers the greatest number of Rural Development programs and has the highest average of program funds going directly to rural counties. That is approximately 50 percent.

I look forward to hearing from our sole witness today, Under Secretary Dorr. We appreciate you coming to the Hill to discuss the various ways in which home ownership can strengthen our rural communities and contribute to the overall quality of life for rural families. So thank you for appearing before the subcommittee this morning. We look forward to working with you.

I do want to mention, too, in closing my statement that things have changed in the rural areas and so we have to adapt with that change. I was recently in Los Angeles. And I mean, I have been in the Congress 9 years. I have dealt with housing in the State legislature. But until you go out and you actually hear some of the things—I mean, there are some amazing challenges in the urban centers, absolutely amazing, and in rural, too. So there is a lot of work to be done, but we do appreciate you coming to the Hill.

Chairman NEY. I now recognize the gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman. I am just anxious to hear from our witness today. We have received quite a bit of information about Rural Housing Services and we want to know more about their preservation of multifamily housing efforts. I am a little bit concerned about the Inspector General's report. I am anxious to hear about the management of the 521 Rental Assistance program. If we have unspent money there, why do we have it when we know that the needs are so great?

I come from an urban community and I, of course, I have spent all of my time, most of my time dealing with the housing crisis as it impacts Los Angeles and urban areas. But I have come to understand that we need to do a lot more to ensure that we have adequate housing in rural communities. And if we have some administration problems or oversight or management problems, we need to get on with straightening those problems out so that we can provide more housing assistance in the rural community.

So with that, I am anxious to hear from you today and thank you for coming.

Chairman NEY. I want to thank the gentlelady for her statement. And the gentleman from Arizona. I thought I was rural, but I am New York and Los Angeles compared to some parts of your district. We appreciate you also chairing this for us the previous time.

Mr. RENZI. Thank you, Mr. Chairman. I am grateful. I am especially grateful for the fact that here we are again, in just less than 2 weeks, in the second in a series of rural housing hearings. And I represent about 58 percent of the land mass of the State of Arizona, and in particular I represent probably the fifth poorest county in America and one of the poorest regions, the sovereign State of the Navaho Nation, which parts of it compare to a Third World country.

In addition, I am privileged to represent some of the barrio regions, poor Hispanic regions of Casa Grande, Arizona. So I deal in particular with needs of the families, the basic necessities of life where we have many of our rural homes that are during the wintertime—even though Arizona is warm most of the time during the wintertime—we have had some tough situations where our children have been frostbitten, particularly this year I think. I have complained in the past, some of the tragedies that our children have gone through.

So I am very interested in particular in the housing program as it relates to the 523, the Mutual Self-Help program. I look forward to your testimony also, Mr. Dorr. Thank you for coming today.

Thank you, Mr. Chairman.

Chairman NEY. I want to thank both of our members.

Mr. Dorr, welcome.

STATEMENT OF THOMAS C. DORR, UNDER SECRETARY, RURAL DEVELOPMENT

Mr. DORR. Thank you, Mr. Chairman, members of the committee. I do appreciate the opportunity to come before this committee to share with you an update of USDA Rural Development and its related programs. I look forward to answering the questions from your July 1 correspondence both in today's testimony and by follow-up written response.

Rural Development in my view is the venture capitalist for rural America. It is with this vision in mind that we carry out our mission of, first, increasing economic opportunity and, secondly, improving the quality of life for all rural residents through programs that are administered by the Rural Housing Service, the Rural business Cooperative Service, and the Rural Utility Service.

The Rural Housing Service serves as a foundation for helping rural families build wealth through home ownership and by providing safe, decent, and affordable rental housing. Working with oversight agencies we are implementing a number of improvements to build a stronger housing program. I appreciate the opportunity to share a few of those with you today.

Last month we celebrated National Homeownership Month by hosting the first housing summit at the Press Club here in Washington. Rural Housing Services has undertaken a major consolidation of 13 Rural Development regulations, which was published in the Federal Register on June 2nd of 2003. The goal of this proposed rule is to make the multifamily housing programs more customer friendly, streamline the process, reduce cost to the taxpayers and increase the Agency's level of customer service.

The Rural Housing Service Section 515 Program, used in conjunction with the Section 521 Rental Assistance Program, provides a source of funding for the construction, repair and rehabilitation of affordable housing to families who need it most. The section 515 program helps to avert homelessness and operates with an extremely low delinquency rate of 1.7 percent.

With regard to the 514/516 Farm Labor Housing Programs, the Agency has committed a total of $46 million to fund 27 proposals in fiscal year 2003 and we will produce 925 units. Of these units, 696 are off-farm which receive nearly 100 percent rental assistance.

The Multifamily Guaranteed Loan Program, which is known as Section 538, serves moderate-income families that typically do not qualify for very low-income rental housing, but still they cannot afford the expense of home ownership. It should be noted that 80 percent of the Section 538 projects contain tax credits, which means that the housing serves people making less than 60 percent of the area's median income.

A proposed rule was published on June 10th to allow the Rural Housing Service to buy back guaranteed loans from the investor as well as to reduce the minimum level of rehabilitation work from $15,000 per unit to $6,500 per unit on loans for acquisition and rehabilitation. In March of this year, we began the formation of a multifamily housing advisory group to oversee completion of a comprehensive assessment of our multifamily housing portfolio. The study will provide data and analysis for evaluation of the entire portfolio.

Prepayments continue to challenge Rural Housing's ability to retain needed affordable housing in rural America. Over 64 percent of our borrowers are eligible to prepay their loans because of expiring use restrictions. We continue to look for creative solutions to address limitations that have resulted in litigation from borrowers who wish to exit the program. The capital assessment will assist us in determining the likelihood of a property to be prepaid based on market data analysis.

Rural Development has also taken significant steps toward automating its multifamily portfolio information as well as modernizing the forecasting of rental assistance usage.

Rural Housing Service has formed a working group to seek improvements to the rental assistance forecasting process. We plan to implement this improved process by November 1st of this year. Rural Development continues to work closely with GAO and other oversight agencies to improve program delivery. Many of the issues raised in oversight reviews will be addressed through issuance of the final rule 3560 and the implementation of the rental assistance forecasting tool.

I want to make this point: Rural Development is uniquely qualified to meet the housing needs of rural America through our network of nearly 800 field offices across the United States and by incorporating cross-cutting programs offered by the Rural Housing Service, the Rural Utility Service, as well as the Rural Business Service. It is our intent to make significant progress on the administration and servicing of multifamily housing programs, thus enabling us to run a strong, viable housing program.

With your continued support, Rural Housing Service looks forward to working with Congress to provide decent, affordable housing to low- and moderate-income rural Americans.

Mr. Chairman, this now concludes my oral testimony. We would like to submit a lengthier testimony for the record. I look forward to answering any questions you or the committee may have.

Chairman NEY. Without objection, the complete written statement will be submitted for the record.

[The prepared statement of Thomas C. Dorr can be found on page 196 in the appendix.]

Chairman NEY. I would also note that, as usual procedure, members may have certain questions and we will keep the record open for 30 days for members to ask questions to be submitted in writing and also returned by the witness. I will have some questions that we will submit for the record to you.

I wanted to ask about—there was just two areas it has shown, I think it was 1981, which would have been 3 years after the program began—trying to remember which program it was—but one of the programs that began in 1981, and it showed that really the portfolio wasn't being assessed correctly way back at that time, rental assistance. And so it was kind of getting off to a non-accurate, calculated start 3 years after its inception. Do you have any comments on that, on that program?

Mr. DORR. We have two major issues that we have to deal with in this multifamily housing Program. One of them is the rental assistance issue, and the other is what we generically term our "capital needs assessment," which essentially is to determine the housing stock that we have available, and, in the rental programs, where it is needed, the quality of it, and whether or not there are things we can and should do to make sure they are properly placed.

On the rental assistance side of the issue, my understanding is that in 1982, up and through 1982, new construction rental assistance projects were automatically authorized a 20-year rental assistance contract. There was a formula developed determining how many of the units in a project would qualify for rental assistance. There was a commitment made for rental assistance for up to 20 years. On renewed projects, the contracts were 5 years. It has taken some time to essentially try to ascertain what has gone on in that, but the short of it is that after a fair amount of digging—which let me make one other very quick point—when I was appointed last August, the No. 1 priority on my list was to get a handle on these multifamily programs. So we have been working aggressively, trying to answer these questions since last September. But the bottom line is that we determined that there was a large amount of unliquidated obligated rental assistance to a number of projects.

I will give you an example. On March 15th of this year, if my memory serves me correctly, we still had approximately 111 months of unliquidated rental assistance on contracts that were written in 1978 for 20 years. Five-year contracts that were written in 1999, also that would expire September 30th of this year, on March 15th still had 21 months of unliquidated rental assistance. What I determined was that our systems were not fully automated and our algorithms and calculations to determine how much rental assistance should be obligated to these projects, quite frankly, weren't as accurate as they should be. We have determined as a result, that we have $700-plus million of obligated unliquidated rental assistance, of which about 500 million plus is tied to these 20-year-old plus contracts. We are in the process now of trying to ascertain a fix to that because there are contracts which these are tied to, and there is a lot of difficulty to rework those contracts to fix the issue.

Chairman NEY. Thank you. The gentlelady from California.

Ms. WATERS. I will yield to the gentleman from Alabama so that he will have more time to deal with the rural housing concerns in his area.

Mr. DAVIS. Thank you, Ms. Waters. Thank you for yielding.

Mr. Dorr, let me thank you for being here today. Let me, if I can, turn to something that you said was I believe your priority of the section 515 multifamily housing units. As I understand the section 515 units, their primary purpose I suppose is to rehabilitate and to renovate a lot of the housing stock that exists right now in rural housing areas. Is that essentially correct?

Mr. DORR. The 515 program essentially was a construction program, started out years ago. And we built affordable housing for low income households, or those that had diminished resources in rural America, frequently dealing with single family parents or the elderly, or young couples who quite frankly didn't have the resources either.

Over the years that program has grown, and projects were built. And to that were tied rental assistance contracts. Rental assistance contracts have become quite onerous and they have become a large portion of our budget. At this point, although I think we are this year building something in the neighborhood of $24 or $25 million worth of new 515 projects in the 2004 budget, we are simply focusing on trying to spend funds for rehabilitation and repair so that we can maintain and keep these projects in the program.

Mr. DAVIS. Let me tell you one thing that I have noticed regarding the funding for the program. Obviously I am not going to try to compare the current budget climate with 1994, but there have been some significant decreases over a period of time. For example, in fiscal year 1994 there was a 540 million appropriation under this program. It is down to 115 million in the last fiscal year. I think there is a marginal increase to 116.5 or something for the current fiscal year.

I understand a lot of the conceptual problems that you have outlined regarding the way this program functions; but as a general rule, would you agree that the mission of this program has been compromised by some of the funding cutbacks over the last 10 years; it would be easier to do your job if you had more money instead of less money?

Mr. DORR. It is always easier to run any household or any program if have you more money than less money. I think one of the dilemmas with this program was that rental assistance grew so expansively that people were, generally speaking, looking to the source of resources to keep the new construction side going as well.

My feeling is that we are on the threshold of determining a better tool to project rental assistance that should mitigate some of this growth in rental assistance requirements. That leaves everyone involved some flexibility to determine how they wish to handle the new construction or the rehabilitation preservation issues.

This administration is very committed to the preservation of this housing stock in rural America. We understand the critical need for it. And so I would not suggest that we couldn't use more money, but I would also suggest that we are getting a handle on certain management issues that may make things more clear when we get finished.

Mr. DAVIS. Let me ask you a fairly basic question. What do you consider the main thrust of section 515 to be right now? If you had to delineate what are the one or two most important goals, what would they be? Give me some indication consistent with that of exactly how this appropriation of 116 million is going to be apportioned between those goals.

Mr. DORR. Number one, we are very sensitive to the needs of those who need housing in rural America. Number two, we are very focused on stewardship and management issues. As a result, we hope to be able to develop the kind of efficiencies and administrative efforts that make the program viable, strengthen it, and keep it doing what it is supposed to be doing over a long period of time. I don't see that that would change.

Mr. DAVIS. How much input—and my time is about to run out, but let me ask you one final question. One of the criticisms that I often hear of this program, a lot of the other various rural housing programs around the country, is that there is not a lot of effort to integrate the opinion or to solicit inputs from a lot of the people who do local housing work on the ground, people who are connected with various housing advocacy organizations, people who run the various public housing units in a lot of rural areas.

Can you talk with me about whether you think that is a problem—if the Chair would indulge me enough to finish my question and you can answer it—can you tell me if you would agree that that is a problem, not getting adequate input from people on the ground, and what your Department is doing to address that concern?

Mr. DORR. Well, that is a great segue. I just happened to be in your district last week. I was at EPS with Ralph Paige down at the Federation of Southern Co-ops facility. We went over to one of our projects, Windy Hills.

Mr. DAVIS. You didn't give me a call. I am disappointed.

Mr. DORR. This was an effort that Reverend Paige and I put together over a period of months. It was not designed to be anything other than to get-to-know-one-another and look at the issues. I am from a rural area. Until 2 years ago I spent all my life in rural Iowa in a small town of 1,200 people. I know what housing is all about in these rural areas. I have had some direct involvement with my own with folks in my local community. I was very impressed with Windy Hills. There is no question that they could always use more resources, but in the case of Windy Hills and a number of others, we are spending a lot of time putting together task forces of State directors, multifamily directors, to get direct input from them on how better to handle and manage these programs in ways that make them not only effective but sensitive to the families and the folks that live in these communities.

I don't know what it has been like in the past. My sense is that there were probably some management issues that should and could have been dealt with. But I can truthfully say that our team under Mr. Garcia and the folks at Rural Housing and the folks at USDA Rural Development are very, very interested in making sure these programs work and work effectively.

At our Rural Housing Summit we inked an MOU with HUD to specifically work with the four corners area of the Colonias to make sure we collaborate effectively in areas where we have programs that overlap or we know of folks that have other needs. It is a long-winded answer and I apologize, but we are in fact very serious about getting on-ground input and doing it on a regular basis.

Mr. DAVIS. Thank you, Mr. Chairman.

Chairman NEY. Thank you. Mr. Renzi.

Mr. RENZI. Thank you, Mr. Chairman.

Mr. Dorr, thank you for your testimony. I was real fortunate, I grew up in southern Arizona, along the Mexican border. Came from a family where we were taught "never rent," whether we had the money or not. I didn't come from the lap of luxury, but we were taught not to rent. Do whatever you can to buy a house, hang on to the house even if you are house poor, borrow from the equity in the house, and then eventually use that equity either to have your own business or whatever to prosper and grow a family. I got a family of 12 children so I needed to borrow a lot of equity in order to pay grocery bills.

But I want to segue into Congressman Davis's thoughts. That mentality that I was taught at a young age in my family and that economic model of owning a home, having an appraiser come out and appraise the home, borrowing against the equity, trying to move myself up, is that the kind of model you are seeing? I know you have been around and seen a lot in your travels. Is that same mentality shared particularly in the regions that we are talking about?

GAO came out and said that Mississippi Delta, Appalachia, the Colonias on the Mexican border, and Native American trust lands—I have got two of the four in the worst rural and most severe rural housing quality programs in our country, those four regions. I know Congressman Davis shares one of those regions, too. So could you tell me, that mindset that I just described with you, are you seeing that around the country?

Mr. DORR. Well, that is an interesting question. And I think generally speaking, yes, there is a mindset that home ownership and equity in a home goes a long way toward building communities, building and securing strong families and strong family relationships.

I will tell you my experience with the minority community coming from Iowa was fairly minimal until I got in this position. And I think the one thing that I have observed is that the minority community, generally speaking, probably have been disadvantaged because of a lot of historical reasons. You know, I have some observations on that, but I think it is an issue that needs to be resolved. I think we need to be more aggressive in making sure that minorities have the same opportunities of home ownership and equity building, just like those of us that had the opportunity to do it.

The Section 523 Self-Help Program is one of the most interesting and effective programs we have. And we are doing everything we can to run that program long and hard; because through grant programs working with nonprofits, it enables young couples, single parents, families and singles, to actually expend sweat equity and ultimately move into their own home and move into it with an equity position. I concur with your observation.

Mr. RENZI. When you look at some of the travels that you have had in the South, in particular what kind of impediments are you seeing when we talk—I think you have got some good research as far as the appraisals. I grew up in a small community, I played football with the local boy who is the appraiser. I know he is going to come over and give me a fair shake on my appraisal. If I can get him in a headlock, I will get a couple more bucks out of him. What are you seeing particularly in the South on that?

Mr. DORR. Let me go back to my visit last week with Mr. Paige. At the Federation of Southern Co-ops they are running a number of informational and training programs that will result in the development of new business opportunities. A number of credit union initiatives are underway, a lot of training and people development as well. Much to my surprise, when they were talking about their credit union initiative, I think in the neighborhood of 20 credit unions that he put together, they had slightly more than $20 million in assets. As they were going around the table discussing their various programs, one of the things that came up was that issue. So I looked at them and said, "Explain something to me. How many dollars do you think are under pillows or buried in backyards; that is, aren't in banks or credit unions?" Ralph looked at me and smiled and said, "There is a lot."

So then it moved on down the table to another young woman who was running a land development program. She talked about the inability to aggregate quantities of agricultural real estate, which essentially was impeding their ability to have an asset base to grow.

I finally looked at them and I said, "If I am hearing what I think you are telling me, answer this question. How many black surveyors are there? How many black title companies, black-owned title companies are there out here?" The gentleman down the table looked at me and said, "I can't find any." He said, "I have looked in North Carolina, South Carolina, Arkansas, Alabama, Mississippi," I don't know if he mentioned Louisiana, "I can't find a black-owned surveying company."

Mr. RENZI. No African American surveyors, no African American appraisers; am I right? So if you are African American in the South and you do have the ability to own a home, and then you are trying to borrow against that, your ability to possibly—or your worry, I am sure, of trying to get a fair shake on the appraisal—I mean, you got to be—.

Mr. DORR. The ability to secure the property, to get a fair title, to get an appraisal, all of those issues are mitigated. As a matter of fact, I suggested to Ralph we need to sit down and work out a training program just in that exact area. Quite frankly, folks have to have trust in the people that they are dealing with and they have to have trust that the property is properly titled. That would go a long way toward mitigating a number of these home ownership issues.

Ms. WATERS. Would the gentleman yield?

Mr. RENZI. Yes, ma'am.

Ms. WATERS. Where did you get your information that leads you to conclude that minorities don't aspire to home ownership in the same way as whites?

Mr. DORR. If I gave that impression, it was wrong. I think they absolutely aspire to it.

Ms. WATERS. I am sorry. What did you say?

Mr. DORR. What I intended to say was that their ability to think they can aspire to it, based on their experience, is probably diminished relative to whites or to the majority race, simply because of the experiences that they have had, as we have discussed concerning their lack of trust in the system that will enable them to acquire homes and property.

Ms. WATERS. Well, I am not sure what you are trying to say, but let me just give you a bit of my experience with the desire for home ownership, the desire for land ownership, and the desire for farmland ownership, all of those issues. You are from USDA. As you know, it was just less than 2 years ago that there was a class action lawsuit brought by African American farmers because of the discrimination in the Department of Agriculture. And that has been the most horrendous experience that I have ever had in trying to straighten out a problem of unfairness. And we still have farmers, for example, who are struggling with the way that they have been treated by USDA and the Department of Justice.

I point that out to you because if what you are trying to say—and I think as you explained it a little bit better, what you may be trying to say is because of lack of opportunity, because of discrimination, because of redlining, all of these issues that some of us have been fighting for years, it has limited the ability of minorities to be able to own homes and property and farms in the way that they should have been able to had there not been the kind of discrimination that is documented through the actions like the class action lawsuit.

And let me say this to you: Even today as we sit here and we talk about the Mississippi delta, it is shameful what still happens in the Mississippi delta. There are still shacks without running water, without partitions. Why do we continue to have those kinds of situations? Given what I am looking at now, all these programs and all the opportunities that we are supposed to have, why do we still have such substandard housing in places like the Mississippi delta?

Mr. DORR. Well, I think you have framed my observations very well. It is a limited ability due to discrimination and due to the lack of capability relative to the system giving them the opportunity that everyone else has. So you are right. You are absolutely correct.

Now, in defense of USDA—and I am not defending their past actions and a number of the issues that have been clearly outlined—but I would draw your attention to what I think is a stellar example of positive action that we have just completed at USDA's Rural Development. I don't know if you are familiar with a community called Bay View, Virginia. Bay View, Virginia is on the eastern shore of Virginia, just across the Chesapeake Bay Bridge from Norfolk. Last week, Deputy Secretary Mosley attended an open house there. Bay View is a minority community that had ramshackle houses with no running water and no sewer system. The water systems that they had were next to septic tanks. This occurred before I got there. But somehow residents connected with the folks at Rural Development.

Within Rural Development we have three agencies: Rural Utility Service, Rural Housing Service, and Rural Business Service. The first entity that they engaged was Rural Utility Service. We have subsequently been involved and drilled wells, put in water and waste systems, so that they have water, waste, and livable conditions. Then last week our Rural Housing Service completed the opening of 35 brand new multifamily housing units in that community, and there are now on the drawing board a number of single family housing units. That is all tied to a farming operation of which I quite frankly don't know all the details.

So we are mitigating these issues where we have the resources, where we have the opportunity, and where we can engineer things of this sort to happen.

Ms. WATERS. Well, I appreciate your example. And I would hope that under your watch you will expand that.

I don't have a rural community, but I go to Selma and down through Alabama every year as we commemorate the March across the Edmonds Pettis Bridge. I am still appalled at some of what I see. I go down in the delta with Benny Thompson who invites us down from time to time for various reasons. I am still appalled at what I see. I listen to my chairman of this committee talk about communities that don't have water. And I am still appalled at some of what is happening in Appalachia. So we got a lot of work to do.

And while I appreciate what you are telling me, some of the images of rural housing, the lack of rural housing, still appear on television from time to time as stories come out in various ways, and the camera is panning shacks where people are sitting on broken-down porches and the mention of no running water, et cetera.

So it seems to me that there is a lot of support in this Congress for rural housing. And I don't know what is going on with all of the programs, which I am going to try and pay a lot more attention to. But I think that those images that we constantly see, and I have been seeing practically all my life, we are just a few years beyond Sugar Ditch in Mississippi, these have to be gotten rid of.

This administration can't afford to talk about housing in Afghanistan and Iraq until it gets something done in Mississippi and Alabama and Appalachia. So I am one person that is going to be pretty persistent in trying to pursue the opportunities for the rural poor, because I am not simply concerned about the urban poor, I am concerned about the rural poor as well.

Chairman NEY. Thank the gentlelady. Mr. Renzi.

Mr. RENZI. Reclaiming my time, I wanted to—.

Chairman NEY. Your time has expired, therefore—.

Mr. RENZI. I want to thank you. I think you did an excellent job of calling out some of the impediments that you observed during your trip to the South.

Do you see within the community, within the leaders that you met down there, the ability for the African American community to now put in place in their training programs new programs that will bring about more appraisers, more land surveyors, so that won't be an impediment, is I think what you described?

Mr. DORR. It clearly now on the table of issues that we need to address through the number of programs that we are involved in. I would intend to do that. I frankly am appalled by the fact that there aren't black appraisers, surveyors, abstract companies, et cetera. Maybe there are someplace; we just haven't found them.

Mr. RENZI. I am sure with Congressman Davis's knowledge of this now, he will also be a leader on it.

If I could move real quick, I think we will do a second round of questioning, to the Mutual Self-Help Housing Program. In southern Arizona along the border, we have got a great amount of labor. We have got a lot of Hispanics who have been involved in the construction industry. We have the Navaho, the Apache, the Hopi, all of which I represent and am fortunate to represent. Represent the largest Native American Indian population in America. So we have plenty of labor, plenty of people out of work.

We have plenty of timber, if it is not burning in our forests out there. And I like this idea of being able to take the labor that we have available, take the materials, the building materials that we have available, these natural resources, and being able to use this 523 Mutual Self-Help Program.

And I would like you to just expand in the remaining time that I have on the 523 program and in particular the amount of money that is available that was used—that is not used. And I will finish with that question. Thank you, sir.

Mr. DORR. In our Self-Help 523 Program, we have an appropriation of $35 million. That is budget authority that is used to make grants to nonprofits or other housing assistance councils or authorities that are collaborators who work with Rural Development to bring together, usually in tranches of 8 or maybe 16 potential homeowners, provide them guidance, construction oversight and assistance in building, through the use of sweat equity, their own homes. This is a marvelous program because it uses local supplies, and local labor.

When we get all done, these young people have homes of their own with equity usually when they walk in the door. It is a program that we intend to push and push aggressively, because it doesn't use a lot of government resources.

Mr. RENZI. How much left over from the 35 million?

Mr. DORR. Last year I believe we had 16 million left over. There is a reason for that, quite frankly.

Mr. DAVIS. If I could ask a quick question—will you permit a second round of questions?

Chairman NEY. We will go to Mr. Bereuter and then start a second round.

Mr. BEREUTER. Thank you, Mr. Chairman. Mr. Dorr, welcome to the subcommittee.

Mr. DORR. Thank you.

Mr. BEREUTER. With the help of my colleagues, I am the person that took the initiative in developing the 502 program and the 538 Guaranteed Loan Programs authorized initially. So I am very interested in these two programs and their successor programs.

I would like to go to the 538 Multifamily Loan Guarantee Program first. I understand that a rule was published on June 10th which would hopefully make two changes to improve the program's secondary market participation. But mortgage bankers came before this subcommittee lately—let's see, I think I actually have the date—and they suggested that we need statutory language to make it clear that Ginnie Mae could ensure—could securitize loans under the 538 program.

I checked with a Nebraska USDA rural office in my home State and found that there were none of the 538 properties in Nebraska involving the Ginnie Mae program. I did make an inquiry of your Agency with respect to the 502 Single Family Loan Guarantee Program. I understand that your response was that the 502 program can be securitized under Ginnie Mae.

Do you have any feelings about whether or not this subcommittee should advance legislation which would make Ginnie Mae an eligible securitizer for the 538 Multifamily Loan Guarantee Program?

Mr. DORR. We are in the process of working to get Ginnie Mae as a securitized underwriter of this 538 program. If it takes statutory language, that is something that we would obviously have to run by our counsel, et cetera, to determine where we are at on that. But anything that would make the program more liquid and more effective would make sense.

Mr. BEREUTER. I think that is one of the problems now. I am inclined to introduce legislation to make it clear that they have the authority to proceed in that area.

Can you give me some idea as to whether or not the appropriations in recent years have been sufficient to meet the demand for the 538 program?

Mr. DORR. Well, in a cursory overview, it appears that it has up to this point. It is because of the lack of liquidity and some of the underwriting issues that I think it has been slower to take off than perhaps one would have hoped. By the same token, we are in the process right now, among other things, of engaging a couple of folks with very, very substantial background in the multifamily area; It is my hope they will help us understand better how to operate this program in a way that makes it function as it was designed by the statute.

Mr. BEREUTER. Without the ability to securitize loans, it has been very difficult. We have had to be very innovative in the few projects we have made work in Nebraska. The 502 program, do you have any idea how many families have been provided housing either by purchasing an existing home or building a new home, or a 502 program nationwide?

Mr. DORR. Last year we were able to work with right at 44,000 homeowners.

Mr. BEREUTER. Got any overall figures since the first pilot program in 1991?

Mr. DORR. Yeah, I do. It is quite substantial.

Mr. BEREUTER. I think it has been substantial. I think it has a successful program.

Mr. DORR. I believe to date the 502 guarenteed program has assisted over 260,000 rural families with homeownership.

Mr. BEREUTER. Most of that I think is in the guaranteed program.

Mr. DORR. Actually, the majority of our portfolio is still in the direct, although the guaranteed portfolio is growing rather substantially.

Mr. BEREUTER. I see. All right. The difference, it seems to me, as to whether low- and low/moderate-income people take advantage of this program oftentimes comes down to whether or not there is an aggressive local banker that works the program. I want to congratulate you on keeping the program simple to use at this point.

In fact, most bankers and other financial institutions cannot believe how easy it is compared to some of the loan guarantee programs related to agriculture. So they are reluctant to even look at it. When they do, they can really make a go, make it work. Some of the smaller banks are some of the most successful in using it. That has been my experience at least.

Now, in fiscal year 2003, I think the ceiling was set at 4.528 billion. And because of the low default rate, the low administrative cost, you were able to operate, I gather, meeting demand with only 32.6 million budget authority. The current administration request for fiscal year 2004 is down dramatically, only 2.5 billion, but the budget authority level is suggested at 39 million there. Why was it so low in fiscal year 03 compared to 04? Has there been a recalculation of risk? Or what is the difference, if you can help me with that question?

Mr. DORR. Are you talk talking about the direct or—.

Mr. BEREUTER. Talking about the loan guarantee program.

Mr. DORR. The loan guarantee program. I don't have a precise answer on that for you. We requested a 32 percent increase in our direct 502 program appropriations. I can get you an answer on what caused the guaranteed program BA requirement to change in 2004.

Mr. BEREUTER. If you have a budget authority level of 39 million, will you be able to meet the demand for the 502 Loan Guarantee Program for fiscal year 04?

Mr. DORR. It may be difficult, but I think we will.

Mr. BEREUTER. Very difficult. Were you able to meet this thus far in 2003? Do you expect to be able to meet it in 2003?

Mr. DORR. Yes, we hope to. It is going to be tight. We were able to move 11 million of carryover from the Section 523 Program into our direct program with the appropriation last February. That gave us an additional 900 million in single family guaranteed authority, gave us about over 10,000 homes. So that is clearly what kept us running.

Mr. BEREUTER. Why do we use the direct program when we have such a larger payoff, so to speak, from the loan guarantee program? Why does there continue to be the demand on the direct program when we can leverage so dramatically the Federal funds involved by the loan guarantee program?

Mr. DORR. Essentially the direct program addresses the needs of a tranche, of lower income families which we think merit an opportunity to acquire a home. If we can do that, we think that is worthwhile.

Mr. BEREUTER. So these would be people largely below 50 percent of the average income level in the region?

Mr. DORR. Yes.

Mr. BEREUTER. Whereas we designed the loan guarantee program for 85 percent.

Mr. DORR. 80 percent of average median income.

Mr. BEREUTER. Sixty, I should say.

Mr. DORR. I am sorry; it is up to 115 percent of median income.

Mr. BEREUTER. We had 100 at one time, and it was moved to 115 as I recall. The multifamily housing Program, the 538 program, the budget includes $100 million—excuse me—proposes to build 2,700 units. Without some changes, some changes coming through the rules changes, perhaps by getting Ginnie Mae authorization you will be able perhaps to build more. Will you be able to come up to the 2,700-unit level for the next fiscal year? Do you have any thoughts about that?

Mr. DORR. There has been some misunderstanding in terms of the funds obligated and ultimately used in this program over the last several years. I think the key to it is what you identified early on, and that is the ability to securitize and make these projects liquid. If we can resolve that issue, we could use these funds in their entirety. But the speed of the resolution of that issue I think will drive it.

Mr. BEREUTER. Just for your information, Mr. Dorr, I go to the Appropriations subcommittee each year and ask for more funds for the loan guarantee programs, the 538 and 5902 program. And while the staff there probably understands this program rather well, I find that members are intrigued to learn about the program, even though it has been ongoing for a number of years, and about its potential and about its growth in number of houses that are being made available to low- and moderate-income Americans.

So I encourage you to have even more contact within your Agency with the appropriators in both houses on this issue and give them some of the charts that I have provided from your Agency to them this time to show them the growth in the programs. That is my suggestion to you. Thank you very much for your response.

Chairman NEY. Thank you. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Let me try to globalize this discussion a little bit, Mr. Dorr. One of the things that is evident to me, if I can follow up on my colleague from Nebraska's observations, is not just that few Members of Congress are relatively acquainted with the various 528s, 538s, whatever the various numbers are. Much more importantly in my experience, a very, very thin fraction of the people that these programs are meant to serve know anything about them.

That I think is a very significant gap that speaks to some extent to Ms. Waters' questions earlier about why, despite the existence of all of these programs, despite the funding for all of these programs, which at one point was at a fairly respectable level though it is not now, there has still been this persistent housing crisis that is concentrated in parts of the country, the areas Mr. Renzi represents and the Mississippi Delta, Alabama Black Belt area. Do you agree that that's a significant problem, making the potential clientele for these programs aware of them and what, if anything, is USDA doing to aggressively go, not just to the Ralph Paiges of the world, but to the people who are living in these counties in addition to Mr. Page, the people who actually are going to benefit from these programs? What is being done to go into the local communities to make people aware of these various benefits? Because I'd make an observation to you. My colleague from Nebraska mentioned the necessity of the banks implementing a lot of these programs, the guaranteed loan programs. I will represent to you that in major parts of the area that you represented last week, there is a very small banking presence. I think in the whole of Sumter County, there may be all of about two banks, maybe really one bank that is really capitalized in a significant degree. You can go through major portions of my district that you represented last week, and you don't run into any banking presence, and maybe even more pernicious than that, when you run into banks, when the people in those communities run into banks, the banks are not a friendly face to them. The banks are the people who keep them from getting loans in their perspectives. The banks are the people who are not friendly to them when they come in needing money to get some new agricultural equipment. The banks do not have a great reputation in lot of these communities. So given the fact that the banks are not going to be the best purveyor of information, what do you suggest, I mean, what do you suggest to get these programs into the heart of the people who would benefit from them?

Mr. DORR. That is a tough question. People have looked at it for a long time. Naively, perhaps, I would make a couple of observations.

First of all, these credit unions, between them had I think $20 or $22 million. You could convert that $20 or $22 million into black-owned banks that would have an asset base of a billion dollars. With proper security and the types of securitization possibilities, there would be a lending base there. We have entered into an MOU with the National Association of Credit Unions to try to work more closely with them to market our programs, as well as to use their ability to help provide home ownership loans and that sort of thing.

When you are dealing with a credit union with a million dollars and a lot of volunteer staff, the sale of a home loan into a secondary market involves complex and sometimes more involved issues than the staffs sometimes have.

We, at Rural Development, have to do a better job of marketing. Statutorily there are some limitations in our ability to go out and quote/unquote market government services. But I think a more effective marketing effort must be made. We are in the process of taking a very close look at what we can do within the framework of our authority to make sure that we are doing a better job.

We have also initiated, a year ago, something called the Five-Star Initiative, which is part of a Rural Development effort in conjunction with a Credit Education Program through the FDIC. Our Five-Star Initiative essentially amounts to an enhanced marketing strategy to bring minority homeownership more front and center in ways that involve marketing, education, and an aggressive attempt to increase minority homeownership within our programs by 10 percent in the near future.

We are doing a number of things. There are a lot of issues that have to be dealt with. Are they all right? Are they all the most effective? I am not sure that I know, but we are sensitive.

Mr. DAVIS. Let me just close on this observation that follows up on Mr. Renzi's observations earlier about the absence of minority participation in a lot of aspects of the rural housing market. One thing that is always striking to me, Mr. Dorr, that if you look at the largest banks in my district, and we have a number, and if you look at the next tier of banks in my district, we have a number of those, to my knowledge, not counting the one or two minority-owned banks, at the majority-owned banks in my district, there are about six or seven of them, there is a combined total of one African American who sits on the board of directors of all six or seven of those institutions. I am sure if I am wrong, I will hear about it by the end of the day. But I think that that number is about right. That is a significant problem that I think all of us, certainly on this committee, should recognize. You do not have a significant amount of participation by individuals in the minority community or a significant amount of participation by folks who even have relatives who live in some of these areas, frankly, until we get a handle on that phenomenon. Because I would describe the phenomenon this way. It is the perspective of people whose economic interests are primarily directed outside of the community still making the bulk of the economic decisions about the distressed communities. That is certainly the perception of the people on the ground in these areas. And I think until we get a handle on that problem, until we find some way to inject more of a feeling of participation because whatever the reality, if a given community feels that its needs are ignored and neglected, that will certainly weaken their ability to take advantage of the programs that do exist.

So I will close on that note and certainly thank the Chair for calling this hearing. And thank Ms. Waters for her engagement in this issue. She has been, despite the absence of a rural presence in her district, she has been way before I got here, a persistent voice on these kinds of issues, and we need more urban voices engaging this question. Thank you.

Mr. DORR. Thank you.

Chairman NEY. Thank you. Mr. Renzi.

Mr. RENZI. Thank you, Mr. Chairman.

I want to jump on the coattails of my colleague, Mr. Davis. In southern Arizona, we have been somewhat successful, not great success, but somewhat successful in using the Section 523 Program. And one of the ways we were able to get the word out was the 523 Program. For 60, 65 percent of the labor that you put into the home, we were using the Catholic churches, and I know your network of African-American churches in the South is as strong if not stronger, but the idea that we have got $18 million left in the 523 Program, a program where you can use local materials—and I was a homebuilder before I came here—use local materials and local labor to build your own home, and when you walk into this you have equity, and if we can get the local churches to get behind that kind of a program, there is—I am going to overreach here, but I can't see any reason to rent. Why is it that we had $18 million left over? And I know I am looking here at underqualified supervision. Is that a State-licensed GC, or is there a Federal qualification?

Mr. DORR. Mr. Garcia says it is a State-licensed—.

Mr. RENZI. GC?

Mr. DORR. Right.

Mr. RENZI. So it has got to be a GC?

Mr. DORR. Right.

Mr. RENZI. Okay.

Mr. DORR. Seventy percent of the folks that go into our self-help program are minorities. That is a market tranche that we are very heavily engaged with.

Secondly though, to have the kind of oversight necessary to make sure these projects succeed. I mean the worst thing that can happen is somebody goes to work for five or six months, in addition to maintaining a 45- or 50-hour-a-week job, they spend another 30 hours a week building a home, and they have poor oversight quality because these folks don't have backgrounds in building skills and buying materials and that sort of thing, and then to get four or five months into it and have the project fail because of some lack of oversight, and we have had a couple of those.

Mr. RENZI. I would—I hope you have failure rates through the roof, because you have got $18 million left over, my friend. And I know most people out there with good supervision, as you know—and I am preaching to the choir here—can put together a home. It is not that—I mean if I could do it anybody could do it.

Mr. DORR. Well, that may or may not be the case, but I understand what you are saying. And the simple fact of the matter is that what we are not trying to mitigate all failure. I understand that. And I have identified a number of organizations around the country who can help. I intend to put them in touch with some of these folks that I met last week that can come in and provide the training and provide the support and the background to get these houses up and running.

That's the kind of marketing we need to be more forceful on, and we intend to do that.

Mr. RENZI. I am with you. There it is, the training aspect of it. The idea that maybe to train some of these supervisors and get the program out. Again, just real quick and I will wind up. The $18 million that we have left over was primarily why?

Mr. DORR. Why? Because we just didn't have enough demand for it, based on our ability to market the program and to make sure that those that were interested in this had the ability to make sure these projects would likely succeed.

Mr. RENZI. Thank you, Mr. Dorr. It was great having you today. Appreciate it.

Mr. DORR. Thank you.

Chairman NEY. Thank you. Any other members would like to ask a question? Just in kind of a summary, would you like to say anything about the vision you have, you know, in a nutshell and how you would like to carry it out through some changes you need to make?

Mr. DORR. Well, if there is a take-away vision of what Rural Development and this administration would like to be viewed as number one, I want to make it most clear that this administration is very sensitive to the housing needs of rural Americans. Second, it is in that vein that we are trying to administer these programs effectively and to get our hands around them in a way that provides the stewardship of the resources that we are given in ways to make this program work. And thirdly, if we administer and implement these programs effectively because of good stewardship, and our sensitivity to the needs, I would like the committee to also understand that we are going to need some management flexibility relative to how we deal with rental assistance, securitization issues, and a number of the issues concerning the 523 Program. We do have these tools, but we need flexibility in how we implement them. If we can do that, then our vision of Rural Development being the venture capitalist for rural America with the goals of increasing economic opportunities and improving the quality of life will, in fact, bear fruit. We are well-positioned to do that, and with your help and cooperation, I would like to think we can attain those goals.

Chairman NEY. What I would suggest, as we try to get to where we want to be in the vision, if you have the ideas of what you need to do legislatively, you know, bring it here to the committee, and we can take a look at it and see how we could work together if there needs to be legislative changes. I know some of it is internal management, some of it is getting out the word of what's there, maybe some of the things that are there are not working so—but I just think we need to, like I said, beef the level up all the way around to get the issue out there. And I will still say it, downpayment is a problem. I mean when we talk about the housing downpayment as a problem. We have talked about it, and people can work and pay that monthly payment but the downpayment always tends to be a problem.

Mr. DORR. Well, thank you; I want to take this opportunity to make a point about downpayment. We have a Rural Development program, right now, where we have State directors and single-family employees working with employers who are providing the downpayment on 5-year forgivable loans in conjunction with Fannie Mae buying the paper and us originating the loan. There are many of these opportunities out there. We are trying to corral them all, and when we do that, it does make housing much more affordable and available in ways that I think would satisfy everyone.

Chairman NEY. It makes a huge difference. We have talked about it with the FHA; I have talked to the ranking member. It makes a huge difference. If a person sits and it literally takes 10 years for the downpayment, I don't note what that shows about their credit worthiness in the sense of the child was in third grade, now the child is out of high school, they could have been in that house to have a better place to study, et cetera. I mean, we all know you can't maybe prove all these things with calculations, but we know it works. So some way—I am glad to hear that is happening.

Any other way I think we can directly tackle that is going to help people. The sooner people get into housing, the better off they are going to be, their families and their whole way of life.

I want to thank all the members. If there is no further questions that concludes the hearing. Thank you.

[Whereupon, at 11:17 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 19, 2003

Opening Statement of the Honorable Bob Ney
Chairman
Subcommittee on Housing and Community Opportunity
Committee on Financial Services

"Rural Housing in America"

Thursday, June 19, 2003

Today the Subcommittee meets to discuss the importance of rural housing in America. I am pleased to announce that this is the Subcommittee's first hearing on this subject in over a decade. My goal is to review these programs and look into ways to increase their proficiency and cost-effectiveness.

Rural areas are often plagued by poverty, high numbers of substandard homes, affordable housing shortages, costly development, and inadequate access to mortgage loans. The Rural Housing Service funds its programs through an insurance fund which provides direct loans, guaranteed loans and grants to help families obtain and maintain affordable housing in rural areas.

Today, it is estimated that the Rural Housing programs help finance new or improved housing for 65,000 moderate-low and very low-income families each year.

However, questions have arisen in recent years about the effectiveness of rural economic development policies in creating new opportunities for rural residents as agriculture and other resource-based economic sectors decline in their overall importance to most rural economies.

A wide ranging set of often overlapping programs target rural areas and their special needs, but, according to some critics, there remains little overall coordination of these various programs to produce a coherent rural policy.

Over 88 programs administered by 16 different federal agencies target rural economic development. The U.S. Department of Agriculture (USDA) administers the greatest number of rural development programs and has the highest average of program funds going directly to rural counties (approximately 50%).

My roots in rural American run deep. Born and raised in the Ohio Valley, I grew to understand that a safe, secure home is the foundation for the family unit.

Today, my belief in the importance of homeownership remains true. As the new Chairman of the Subcommittee on Housing and Community Opportunity, it is my goal to apply those fundamental values and rural experiences to help communities develop new economic vehicles that will enable them to grow and prosper.

I look forward to hearing from all of our witnesses today to discuss the various ways in which homeownership can strengthen our rural communities and contribute to the overall quality of life for rural families.

NATIONAL
HOUSING LAW
PROJECT

advancing housing justice

STATEMENT OF
GIDEON ANDERS, EXECUTIVE DIRECTOR
NATIONAL HOUSING LAW PROJECT
BEFORE THE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
U.S. HOUSE OF REPRESENTATIVES
June 19, 2003

I am Gideon Anders, Executive Director of the National Housing Law Project (NHLP), a 35-year old nonprofit corporation that seeks to advance housing justice for low income persons by, among other things, preserving and increasing the supply of decent affordable housing throughout the United States. NHLP has worked on the preservation of Department of Housing and Urban Development (HUD) assisted and Rural Housing Service (RHS) financed housing for more than 25 years. Personally, I have worked on Rural Housing Service housing issues for more than 30 years, and on rural housing preservation issues for more than 25 of those years.

The statutory requirement that requires owners of Section 515 housing to maintain their developments as affordable housing for 20 years was enacted in 1979 at NHLP's suggestion when we discovered that the Section 515 program imposed no use restrictions on owners and that some were converting their developments to other uses by displacing elderly and other households at will. Our staff also assisted in drafting the rural provisions of the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), which was enacted after an increasing number of owners of developments that were financed before 1979 were prepaying their loans and displacing elderly and other households from homes they had expected to occupy for the rest of their lives. NHLP served as staff for the National Rural Housing Preservation Task Force, which reviewed RHS' implementation and administration of ELIHPA between 1987 and 1990. One of the recommendations of that task force was the creation of a National Office of Rural Housing Preservation within RHS that would ensure that the rural housing provisions of ELIHPA are administered and enforced uniformly throughout the states and territories. Congress enacted that recommendation in 1992, and RHS finally implemented it in 1998.

In 1991, NHLP assisted Mid-Minnesota Legal Services in litigating *Lifgrin v. Yeutter*, the first post ELIHPA prepayment case that challenged an owner's failure to maintain affordable rents after prepaying a Section 515 loan. The residents prevailed in that case and the development was returned to the Section 515 program. NHLP has participated and assisted other legal services programs litigate cases that successfully challenged illegal prepayments of Section 515 loans. We are currently representing residents in two RHS prepayment cases. The first is *Hines v. United States*, in the Eastern District of Missouri, in which residents of a Section 515 development are challenging a public housing authority's decision to prepay its loan and demolish a habitable 50 unit development that serves as a critical housing resource to African Americans in a small Missouri bootheel community. We also represent residents in *Kimberly v. United States*, a case that involves a 24 unit senior housing development in Kimberly, Idaho, whose owner has sought to prepay its loan and circumvent ELIHPA by bringing a quiet title action against RHS under Idaho law. While we have criticized RHS frequently for its administration of the ELIHPA preservation program, we have also worked closely with its staff to improve its understanding of the law and enhance its efforts to protect residents against displacement and to preserve the critical, and dwindling, supply of affordable rural rental housing. We have also worked and continue to work with owners and their representatives to streamline and improve the operation of the preservation program.

We are testifying here today because we are concerned about several trends that we are observing with respect to RHS' administration of the ELIHPA program. Our observations lead us to believe that the agency is not adequately enforcing ELIHPA, not preserving units that can and should be preserved and failing to protect residents against displacement. Before addressing these concerns specifically, we want to affirm our fundamental belief that there is an absolute and continuing need to maintain an effective rural rental housing preservation program that protects residents against displacement. Rural communities continue to have a greater need for affordable, decent, safe, and sanitary housing than their urban counterparts because housing conditions in rural areas have historically been and continue to be worse than in urban areas. The over 450,000 units of Section 515 housing that have been constructed in rural areas continue to serve a critical need in those communities. Frequently, those developments are the only available affordable rental housing that is decent, safe and sanitary. The conversion of Section 515 housing to uses other than low income housing deprives communities of a critical resource and forces elderly, disabled and working households to relocate to other communities that are tens of miles away from their current homes, jobs and families. Conversion of Section 515 housing is a particularly critical issue in the Central Region of this country where over 47 percent of the projects financed under the program prior to 1989 are located and in the South where another 30 percent of the developments are located.

We also believe that the ELIHPA rural housing preservation mechanism is a sound and effective means of preserving the nearly 300,000 units of housing that is covered by the legislation. In that context, it is important to remember that the ELIHPA preservation framework was a product of negotiations between builders, owners and residents and represents a compromise of the various positions that each group was seeking to advance. ELIHPA treats all parties fairly. It authorizes prepayments where housing is no longer needed and residents can be relocated within the same market areas. It permits prepayments when minority housing opportunities are not affected and residents will not be displaced. When minority housing opportunities are affected, it authorizes RHS to extend substantial incentives to owners to remain in the program and, if they choose not to accept those incentives, to sell their developments, with RHS financing, at fair market value to a nonprofit or public agency. If no bona fide offer is made to purchase the housing, the owners are allowed to prepay their loans and convert the housing to whatever uses they choose. The only element that is missing from the ELIHPA framework is a mechanism that enables RHS to provide financial assistance to those families that are actually threatened with displacement by prepayments and are unable to relocate into other federally assisted housing. RHS should be authorized to assist these household with rental assistance vouchers that will enable them to continue to rent the converted units or rent other market rate housing that they can afford within their existing rural communities. We urge that the subcommittee consider such authorization and champion its funding. HUD has this type of assistance for residents threatened with displacement from HUD assisted housing. There is no reason that RHS should not have the same.

We have four concerns with RHS' administration of the rural preservation program. First and foremost is program funding. RHS does not have enough funding to meet current preservation needs, has been unwilling to ask Congress for additional funding to meet that need, and has itself been unwilling to devote more funding to a growing preservation need. Second, RHS is failing to preserve all the units that it can and should preserve and has created, and continues to create, loopholes that allow more owners to prepay their loans without protecting residents from displacement or preserving critically needed housing. Third, RHS is not affirmatively enforcing owners' obligations to operate Section 515 housing for its intended purposes either before or after a loan is prepaid. Fourth, RHS is not effectively directing and controlling litigation that is challenging ELIHPA's prepayment restrictions or seeking damages for its imposition. We will detail each of our concerns separately.

1. RHS Does Not Have Sufficient Funding to Operate an Effective Preservation Program

RHS has represented to this and other congressional committees that it has sufficient funds to meet existing preservation needs. This is not true. For at least the past nine years RHS has not had sufficient money to fund equity loan commitments that it has made to owners who have agreed to remain in the Section 515 program if they were provided with an equity loan. RHS repeatedly enters into preservation agreements knowing that it will not fund those agreements for several years. The backlog on equity loans has been as high as $12-18 million and as long as eight or nine years. While that amount is truly not a significant expenditure of funds, for owners who have to wait nine years to get their incentive loans, it is unacceptable. No wonder that they have been disappointed and have sought to end the preservation program as it exists today.

While advising Congress that it has adequate funds to meet current preservation needs, RHS states otherwise in the recent Federal Register publication of proposed regulations seeking to alter the preservation program. There the agency acknowledges that it does not have sufficient funds to meet all the equity loans that it has agreed to fund and claims to have unfunded agreements that were entered into as early as 1996. To address this problem, RHS does not offer the use of more funds, but instead proposes to allow owners, whose agreements are not funded within 15 months, to exit the program by selling the housing to a nonprofit or public agency. Aside from the fact that there is no statutory basis for the RHS proposal, RHS does not disclose that it may not have the funding to finance such sales or to increase the Rental Assistance subsidies that will be necessary to maintain the units' affordability after the sale.

The fact that RHS has been encouraging nonprofit and public agencies to use third party financing, such as bond financing or even private loans, to finance transfers is clear evidence that

RHS does not have the money to fully fund its preservation efforts. Typically, these funding sources have higher interest rates than RHS loans and, to reach low income households, require additional subsidies. However, because the agency has not allocated sufficient funds to finance the transfers, it is encouraging owners to use these third party funding sources.

Further evidence that the agency does not have sufficient preservation funding comes from RHS' proposed settlement of an Idaho lawsuit that will require the agency to finance the transfer of 17 Section 515 developments, containing approximately 660 units of housing, to nonprofit or public entities. The commitment to finance the transfer of these units, which we will discuss later, was ill advised, and is limiting the agency's capacity to preserve and subsidize Section 515 housing in other states.

What is troubling about this picture is that RHS has not only not disclosed the funding issue to Congress in the appropriations process or otherwise, but also that it is a self-created problem. The RHS Section 515 appropriations do not specify how much money RHS should be using for preservation, maintenance or new construction. Those decisions are made administratively by the agency after it receives its appropriations. For at least the last 8 years, RHS has consistently not allocated sufficient funds for preservation. Otherwise, it would not have the equity loan backlog that it does.

We understand that RHS has made its funding decisions based on the premise that the Section 515 new construction program should be continued, albeit on an extremely limited basis. However, we question that decision when the cost of maintaining a new production program limits the agency's capacity to preserve a greater number of existing units at a fraction of the cost of producing new units. What is particularly disturbing is the fact that RHS is now proposing to use the shortage of available preservation funding as a basis for allowing owners, who have already agreed to accept equity loans and remain in the program, to abandon their preservation agreements if RHS cannot fund them within 15 months.

Importantly, we believe that the funding issue will become more significant over the next several years and that inadequate preservation funding may cripple the program. Although we have no hard statistics to support our position, we are observing a substantial increase in the number of owners who are willing to either remain in the program in return for incentives or, as an alternative, are prepared to sell their developments to nonprofit or public agencies. We suspect that this is due to the fact that many post-1979 projects are beginning to reach the end of their 20-year use restriction. If so, we believe that the demand on RHS preservation funding will increase substantially and that RHS will not be able to respond to that increase. We urge that the subcommittee take a closer look at RHS rural rental housing needs, increase the Section 515 program's authorization and urge the budget committees to specify how RHS should allocate its funding between program components.

2. RHS Is Not Preserving All the Developments that It Can.

Our second concern is that RHS is simply not preserving all the developments that it can and that it has created several loopholes by which owners can and will circumvent the prepayment and preservation process. The most glaring example is RHS' unwillingness to extend use restrictions through the acceleration and foreclosure process. With one exception, RHS takes the position that an owner who pays the balance due on a loan in response to an acceleration of the promissory note is not prepaying the loan and is free to use the property as it chooses after the loan is paid. A recent decision in *Albany Apartments Tenants' Ass'n v. Veneman* upheld RHS's discretion to manage the program in this fashion primarily because there is nothing in ELIHPA or its legislative history that requires the agency to do otherwise.

Unfortunately, now that the agency practice is public and having been upheld by at least one court, we can expect that owners will take advantage of the situation to circumvent the prepayment process by simply defaulting on their loans and waiting for RHS to accelerate their notes. At that point the owners will pay the amount owed in full and free themselves of any RHS prepayment restrictions.

While we are aware that RHS has cautioned the Rural Development staff that it should not accelerate loans in cases where it appears that owners are trying to circumvent the prepayment process, and that RHS regulations place continued use obligations on owners who default on their loans within a year of their having sought to prepay, we do not believe that either process will deter owners from using this loophole to prepay their loans. First, owners can easily avoid the regulatory provision by simply defaulting on their loans without first applying to RHS to prepay. In the alternative, they can wait twelve months after they have been denied the right to prepay and then default on their loan. More critically, the fact that an owner may seek to avoid the prepayment restrictions by defaulting on a loan and prepaying in response to an acceleration does not appear to be of concern to RD or RHS staff. In the Minnesota case that upheld RHS' position, the RD file disclosed that the owner may indeed be trying to avoid the prepayment process by defaulting on the loan. RHS did nothing in response.

RHS is also using the acceleration process to avoid dealing with troubled projects. We are aware of several instances where Section 515 projects have had maintenance and or occupancy issues that have caused owners to default on their loans. Rather than work with those owners in resolving the issues and making the developments viable, RHS has used the acceleration and foreclosure process to simply wash its hands of the troubled properties.

Currently, RHS is refusing to allow an owner of a Section 515 development that has defaulted on its loan due to an occupancy issues to sell the development to a nonprofit or public agency at a loss. The nonprofit could preserve the housing by reconfiguring some of the units and protect the residents living in the development from displacement. It appears that RHS will instead foreclose on the property, take it into inventory, displace any remaining residents and sell it at a loss without any use restrictions as nonprogram real estate. Because RHS does not have vouchers or rental assistance that it can offer to the existing residents, their displacement is inevitable. This will cause severe hardships to the residents and remove from the market housing that can be made to serve the community.

We do not believe that RHS position is justified. The agency should change its regulations to impose long term use restrictions on all loans that are accelerated and paid off by the owner prior to or at foreclosure.

3. RHS Does Not Affirmatively Enforce Owners' Obligations to Rent Units to Low-Income Residents.

NHLP is counsel to tenants in a 50 unit Missouri development that the owner, a public housing authority, is seeking to demolish. The development serves a critical housing need because it contains 4 and 5 bedroom units in single story cement block development that includes 19 single family detached units. The housing authority has been prepaying the loan incrementally so that by the 19th year of a 40 year loan it had almost fully paid the RHS loan. In order to avoid displacing a large number of households at one time, the authority began to relocate the Section 515 residents into its public housing development and kept the vacated Section 515 units empty. While RD was aware of the authority's prepayment and demolition plans and offered it incentives to maintain the housing in the Section 515 program, it did nothing when the authority began to systematically relocate residents and leave the units vacant. When the relocation process was almost complete, the housing authority initiated a lawsuit challenging RHS's authority to enforce ELIHPA when no use restrictions were incorporated in the original loan documents. In the two years that the housing authority took to vacate the development and in the two more years that the case has been pending, RHS has not taken any action to force the housing authority to rent up the facility by compelling it to comply with its contractual agreement to operate an affordable development or by imposing substantial fines for failing to use the housing as required by law. As a consequence, 48 units of affordable housing have been standing empty for nearly four years.

In another instance, RHS approved the prepayment of a Section 515 development in South Carolina after the owner agreed not to displace the residents of the development, directly or indirectly, for as long as they chose to remain in the development. Shortly after the owner prepaid the RHS loan, the owner converted the development to a condominium and displaced all the residents protected by the RHS use restrictions. Although RHS was aware of the fact that the residents were being displaced, it took no action to protect the residents by stopping the displacement. Indeed, we are not aware of any case where RHS has sought to enforce use restrictions against an owner who has prepaid its loan.

4. RHS Does Not Control or Adequately Coordinate Litigation Challenging the ELIHPA Prepayment Restrictions or Seeking Damages for Their Imposition.

Our fourth concern relates to RHS' capacity to coordinate and control lawsuits in which owners are challenging the validity of ELIHPA prepayment restrictions or seeking damages for their imposition. Currently, there appears to be no concerted effort on the part of RHS, or its counsel, to ensure that ELIHPA, a federal law, is properly enforced. Basic arguments, such as the supremacy of federal laws over state laws, are not being advanced and cases are being settled instead of appealed because certain legal arguments have not been made in the federal district courts where these cases are first heard. Moreover, RHS, or at least its counsel, appear intent on settling cases even before the agency's liability has been established. Potentially, these settlements may cost the government hundreds of millions of dollars that could have been better spent on preserving the housing in the first place.

NHLP is representing a resident living in what is now a former Section 515 development in Kimberly, Idaho. The owners of the development have sought to challenge the ELIHPA restrictions by tendering the balance that was due on the loan and, when RHS did not accept the prepayment, suing the agency under Idaho's quiet title law. While RHS succeeded in having the case dismissed in the federal district court by asserting the unmistakeability doctrine, a contract defense available only to the federal government, the United States Court of Appeals for the Ninth Circuit reversed the decision. It held that the unmistakeability doctrine should not have been considered by the district court because its availability was dependent on another doctrine, known as the sovereign acts doctrine, which it held was inapplicable to the case. In its opinion, the 9th Circuit panel suggested, but did not hold, that Idaho law may grant the owner the right to quiet title to the property and, accordingly, remanded the case to the district court for further proceedings.

Upon remand, RHS made only one argument to the district court, namely that its rejection of the owner's tender of payment was justified under Idaho law because ELIHPA precluded its staff from accepting prepayments. RHS did not argue a more fundamental legal principle that Idaho law does not apply to the case because the Section 515 contract was a federal contract controlled by federal and not state law. In other words, it failed to simply argue that federal law in this case, namely ELIHPA, superseded state law. Thus, when the district court issued a totally unprecedented decision granting the owner's motion to quiet title to the property under Idaho law--in which the court stated that it did not have consider ELIHPA because it was not a sovereign act-- RHS did not appeal the decision. Instead, it settled the case by accepting the owner's prepayment, thus allowing the owner to remove the development from the Section 515 program and to sell it to another organization at a sizeable profit.

Residents in the development did not agree with the district court decision, which also denied the residents the right to intervene in the case in the first place. To preserve their rights, the residents have appealed the denial of intervention to the 9th Circuit, sought and secured a stay of the district court decision and sought and secured an injunction against the owner's selling the development or terminating the tenants' RHS rights pending resolution of the case by the 9th Circuit. It is indeed ironic that residents of a development and not RHS are appealing this case.

Unfortunately, the *Kimberly* case is not the only case in which RHS is letting owners out of the 515 program. As part of the *Kimberly* settlement, RHS unexplainedly also settled an Oregon case, brought by the same owners. In the settlement, RHS allowed the owners to prepay the Oregon loan and to remove the Oregon development from the Section 515 program without any restrictions. What is shocking about this settlement is that RHS did not even litigate the Oregon case. It apparently decided to allow the Idaho decision to dictate the Oregon result and simply accepted the owner's prepayment. It now appears that RHS is also allowing the same owners to sell four additional Oregon developments to public housing agencies without ever determining whether the owners are entitled or capable of prepaying the loans.

Even more disturbing is a yet another case brought by the same owners in Idaho. In that case, another Idaho district judged ruled, contrary to the 9th Circuit's *Kimberly* decision, that RHS had given up its right to assert the unmistakeability doctrine as a contract defense in the case. Consequently, it held that the owners were entitled to quiet title to 17 properties if they paid RHS the balance that was due on the loans. RHS decided not to appeal that decision either and instead is working on a settlement whereby the developments, totaling over 600 units of housing, would be sold to nonprofit or public agencies.

While the settlement in this case may be consistent with the purposes of ELIHPA and should protect the residents of the 17 developments from displacement, the precedent set by the case is disturbing. First, it suggests that RHS is unwilling to appeal any prepayment case brought by owners in the 9^{th} Circuit. Second, RHS appears to be settling cases without any showing that the owners of the developments would have, in fact, been able to prepay their loans and operate the developments without federal subsidies. In other words, we suspect that many of the Idaho and Oregon properties that are being sold to nonprofit or public agencies are located in soft housing markets and that the owners would not be able to operate the developments profitably on the private market. Put bluntly, RHS is expending substantial sums of money for the preservation of developments that do not need to be preserved because the owners cannot operate them as anything other than subsidized housing.

Third, as we already noted, these settlements are putting severe strains on RHS's self established preservation budget and hence its capacity to preserve other developments in other parts of the country. Given that they could have litigated the Oregon case and appealed the Idaho decision, their action is simply not justified.

Lastly, we are concerned about the position RHS appears to be taking with respect to a series of law suits pending in the Federal Court of Claims where as many as 600 owners of Section 515 developments are pursuing damage claims against the agency on the premise that the ELIHPA restrictions constitute a taking of their property without just compensation, entitling them to damages under the Fifth Amendment to the Constitution. Last year, the Supreme Court decided that the RHS is not immune from liability in these cases by virtue of the six-year statute of limitations, which the lower courts had held began to run when ELIHPA was enacted. The Supreme Court, in a very narrow opinion, held that the statute of limitations does not begin to run until an owner seeks to prepay its loan, effectively subjecting RHS to many lawsuits, however, not necessarily to damages.

Indeed, as of today, none of the pending damage lawsuits have gone to trial and no court has determined that the owners are entitled to damages. In our view, RHS continues to have several valid defenses to the damage claims. Moreover, even if its defenses are rejected by the courts, the owners of many of the developments that are involved in these law suits may not be eligible for damages. This is because they have not sought to prepay their loans, they may be required to sell their developments to a nonprofit or public agency at fair market value--which makes them ineligible for any other damages--or because the housing is in areas where the operation of the developments as federally assisted housing may be the best and highest economic use of the property.

Notwithstanding the fact that RHS may not be liable for any damages, it is our understanding that RHS has exchanged settlement offers with the owners in the first damage case that is set for trial. While we are not aware of the scope of the owner's offer or RHS counter offer, we are extremely concerned that any settlement will be sizeable, that it will serve as a basis for settling other currently pending cases, and is likely to encourage other owners to sue RHS in order to secure similar settlements. In short, we fear that RHS may be agreeing unnecessarily to a settlement that, by some estimates, may reach several hundred million dollars.

Moreover, we are also concerned that while these settlements will obligate the owners to comply with ELIHPA's prepayment restrictions, they will ultimately also obligate RHS to finance the transfer of thousands of units to nonprofit and public agencies. These transfers will again cost the agency hundreds of millions of dollars. Given the current appropriations levels, the agency will not be able to finance those transfers.

In our dealings with RHS about several of these cases and in our observation of the developments and results in others, we are convinced that neither RHS nor the Department of Agriculture's National Office of General Counsel has managed or controlled these cases to ensure that cogent and uniform positions are advanced in each case. Instead, it appears that Regional Offices of General Counsel together with local Assistant United States Attorneys are developing and making haphazard arguments and decisions that are detrimental to the continued viability of the preservation program. We believe that the manner in which the United States Department of Agriculture Office of General Counsel is organized, as an independent entity responsible directly to the Secretary, hinders RHS' capacity to fully understand and control litigation that involves agency programs. To better control and coordinate litigation, RHS should have its own legal staff that is authorized to coordinate and direct litigation on behalf of the agency.

5. RHS' New Prepayment Regulations

Before we close our testimony, we want to take this opportunity to comment on two provisions of the recently proposed RHS revisions of the Section 515 regulations that affect prepayments. 68 Fed. Reg. 32872 (June 2, 2003). The first provision is an RHS proposal to finance future Section 515 developments with loans that are amortized over a 50-year term but which become due at the end of 30-years. In other words, the proposal would finance Section 515 loans over 50 years but create a balloon payment at the end of 30 years, leaving to RHS and the owners to decide whether and under what circumstances to continue the loan for an additional 20 years. In our view this proposal violates ELIHPA and we urge the sub-committee to direct RHS not to implement the provision and, if necessary, prohibit it from doing so.

In 1989, Congress amended the Housing Act of 1949 to prohibit RHS from accepting prepayments or requiring owners to refinance Section 515 loans made after that date prior to the end of the loan term. RHS's new regulatory proposal violates that provision by establishing, at the beginning of the loan term, a date, which precedes the end of the loan amortization period, on which owners must refinance their loans. If the statute precludes RHS from forcing an owner who has a 50-year loan to refinance that loan at the end of 30 years, RHS cannot circumvent that statute by initially amortizing a new loan over a 50 year term but requiring the owner to refinance the loan at the end of 30 years. There simply is no fiscally sensible reason for the proposal. The longer amortization period provides owners deeper subsidies without also requiring them to maintain the housing as affordable housing for the longer term.

Moreover, we are concerned that if this administration is allowed to implement this proposal, what is to prevent future administrations from amortizing loans over 50 years but terminating the loan through a balloon payment at 20, 10 or even 5 years. The purpose of the 1989 amendment was to ensure that RHS financed developments remain affordable for the entire term of the loan. This proposal is a blatant violation of the law and should be stopped.

The second provision about which we have significant concerns is one that we referenced earlier, which proposes to allow an owner to terminate its equity loan agreements with RHS if RHS does not fund the agreement within 15 months of the time that it was entered into. ELIHPA requires RHS to make incentive offers to owners who seek to prepay their loans in order to encourage them to remain in the program. It also allows owners to prepay their loans if Congress does not provide preservation funding for a term of 15 months. It does not allow, and should not allow, RHS to rescind incentive agreements and give owners new prepayment options because RHS chooses not to allocate sufficient Section 515 funding for preservation purposes. As long as RHS, and not Congress, determines the amount of funding that is made available for preservation, the choice of whether to fund incentive agreements lies with the agency and no one else. It must not, therefore, be allowed to make incentive offers to owners that it later chooses not to honor. Both owners and residents should not be required to go through the prepayment process multiple times when RHS decides that its Section 515 funding should be used for purposes other than preservation. This is particularly true when there is a strong likelihood that RHS may also not be able to finance or subsidize one of the new options it proposes to provide owners, the sale of the development to a nonprofit or public agency. If RHS does not have money for equity loans, how will it have money to finance transfers? The RHS proposal is simply another mechanism that would allow owners to avoid prepayment restrictions. It should not be allowed.

Council for Affordable and Rural Housing

Serving the Affordable Housing Needs of Rural America

Testimony of Betty Bridges

President
Council for Affordable and Rural Housing

Before The
U.S. House of Representatives
Committee on Financial Services
Subcommittee on Housing and Community Opportunity

Washington, D.C.
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On behalf of the Council for Affordable and Rural Housing ("CARH"), I would like to thank the Committee for its interest in rural housing and for the opportunity to address the issues preventing us from reaching our goal of providing decent, safe and sanitary housing for all Americans. Those of us in the field, working with federal, state and local governments have, together accomplished much, but there is more to do. Indeed, we now face a two-pronged problem: expanding resources to meet growing affordable housing needs while preserving the existing housing stock that already meets many of the current needs.

I, myself, have seen the rural housing issue from many different sides. I was an official with the Farmer's Home Administration for 29 years, in my home state of North Carolina. And for about 11 years I have worked for private entities that develop and finance rural affordable housing. I am currently Executive Vice President for Third Renaissance, and before that I was Executive Vice President of Regency Investors, Inc. Third Renaissance is currently developing several apartment complexes by combining private investment with public resources from the U.S. Department of Housing and Urban Development ("HUD"), Rural Housing Service ("RHS"), and the State of North Carolina.

My experience is typical for CARH members. CARH is a national trade association with headquarters in Alexandria, Virginia, and it represents the interests of over 300 members that include for-profit and non-profit entities, as well as local housing authorities and financial institutions. Each of these members have a hand in this industry. CARH members build, develop, finance, manage, own and supply products to the rural housing industry. We have a common goal, which is to expand the supply and provide a sound product to our customers and end users, affordable housing residents.

We understand that the Committee has certain specific questions that were supplied to us and that we will address in order.

1. CARH generally has a productive working relationship with RHS. That is not to say we agree on everything or on most things, but we have generally maintained professional business relations with the Agency. I believe this is because we generally recognize that we have the same overall goal of providing decent, safe, sanitary affordable housing to rural America. However, CARH members experience a high degree of frustration at the lack of resources and consistency among State Office staffs. RHS is not fully able to meet its intended purpose and goals because (a) it is organized in a manner that inhibits the sharing of information and training, thereby greatly adding to transaction costs and preventing many meritorious transactions, (b) it is not adequately funded to either expand or maintain its housing stock, and is unable to effectively coordinate with existing resources from other agencies, and (c) its programs are subject to artificial statutory restrictions that limit development and preservation. All of these points are addressed in CARH's March 2003 Position Paper On Aging Section 515 Rural Housing Portfolio. I urge you to review this paper, which was the culmination of months of hard work by a broad spectrum of CARH members.

2. The rural housing market is a paradox in that it has changed greatly in recent years, and at the same time, not at all. What I mean by that is that the tools and resources for financing affordable rural housing have become increasingly complex and sensitive to national financial markets. Yet, at the same time, local market conditions remain local and

isolated with dispersed housing and employment patterns. The main differentiation we see between rural rental and homeownership is really a matter of income. With rural incomes less than those in urbanized areas, and with general population ages higher, rural markets require a significant percentage of rental housing. This is borne out by the current occupancy statistics in RHS' 515 program, where the average tenant income is about $8,100 per year, and nearly 60 percent of households are elderly or disabled. However, if Congress is going to consider measures like the single-family housing tax credit, S.198, then rural areas would likely need such measures more than urbanized areas due to lower overall income ranges.

3. We understand that there are various discussions and contacts between HUD and USDA on homeownership programs. However, we believe that S.198, and H.R. 1913 (the Rural Housing Tax Credit Act) have the greatest likelihood of achieving real progress on this point. We understand that HUD instituted a rural housing office several years ago, but we have not seen any material coordination in the field among multifamily or voucher programs.

4. We believe that expanding the definition of rural areas to reach larger, yet still rural communities is a sound idea. Rural communities do not stop being rural simply because a few new people move into the area. However, we would not want to disregard areas already defined as rural.

5. RHS' "3560" regulation, published June 2, 2003, is an important step in streamlining and modernizing RHS regulations.

RHS staff have consulted with stakeholders about this rule for about seven years and it is high time that it has been published in a proposed form. CARH is just beginning to assemble member comments, but we note that the proposed rules are stale in many areas, which is a clear result of this seven year process. That statement by itself speaks volumes—RHS did not take seven years, but because RHS is not traditionally high on USDA's list of priorities, it appears that USDA took seven years.

We have concerns about certain details of this rule consolidation, but we welcome constructive change. RHS has an extremely onerous process for transferring properties within the 515 system, and an even more difficult system for prepaying and refinancing outside the 515 system. The result is what one industry commentator calls "a toll-road with no exits."

Specifically, when the RHS 515 program was enacted, RHS sought to have owners refinance out of the program at the earliest opportunity, as a way to expand the overall supply of housing in rural areas, and to return valuable funds to the government. Perhaps as a result of this, RHS has extremely onerous and convoluted loan assumption and transfer rules making transfer difficult if not impossible and taking anywhere from one to three years to complete.

At the same time, owners cannot prepay their loans. We appreciate, Mr. Chairman, that you proposed an amendment last year to H.R. 3995 to restore contractual prepayment rights to owners of section 515 properties. The ability of owners to prepay their loans and leave the program, in accordance with the agreements they entered into with the federal government, was abrogated in statutes enacted in 1988 and 1992. Similar legislation also abrogated prepayment rights of owners of HUD 236 and 221(d)(3) BMIR projects. Congress removed these restrictions from HUD projects in 1996 and we feel strongly that the failure to take similar action for 515 project owners is not justified.

Prepayment restrictions that violate contract provisions are now being successfully challenged in court. The Supreme Court's unanimous decision in *Franconia Associates v. United States*, decided last year, characterized the statute restricting prepayment rights as a repudiation of the contract and as dishonoring an obligation. A trial to determine monetary damages is now in progress. The Ninth Circuit and federal district courts in Idaho in the *Kimberly* cases have ruled that the abridgement of contract rights is improper and have set aside the offending statute in those cases.

In order to protect tenants in HUD projects from losing subsidized rents after loan prepayment, Congress in 1996 authorized enhanced vouchers, capable of subsidizing rents up to market levels, to be awarded to tenants to enable them to remain in their projects. Tenants also have the option to move to another project with a regular voucher. The enhanced voucher authority was extended in 1999 to situations where owners of Section 8 projects do not renew expiring contracts. HUD has issued approximately 115,000 enhanced vouchers. We believe similar tenant protection provisions can be successfully used to permit tenants of 515 projects losing subsidized rents because of loan prepayments to remain in their projects. Unfortunately, the Committee last year chose to make the availability of appropriations for enhanced vouchers a precondition rather than a consequence of prepayment of 515 loans. Based on the strong and unwavering support shown by Congress since 1996 to provide enough funds for all enhanced vouchers needed after prepayment of HUD loans or opt out of Section 8 contracts, we feel it is unnecessary to require advance funding to protect tenants when 515 loans are prepaid. To the extent such a provision operates to restrict prepayment it also is a breach of contract. We urge that such a precondition provision be dropped from any legislation restoring contractual prepayment rights of owners of 515 projects.

6. The current preservation activities at RHS are wrapped up in a series of contradictions. The National Office staff has come up with several creative proposals and transaction structures for preserving affordable housing. Primary among these is to subordinate RHS loans to new third-party debt, such as tax-exempt bond or home loan bank funding, and maintaining Interest Credit and Rental Assistance subsidies. However, any transfer or preservation process must be processed by the State Office staff. Those staffs do not report to the RHS National Office and do not follow national policy, creating a chaotic situation. State offices have significant local knowledge and experience, but either do not have the opportunity to see the volume of transactions necessary to become efficient in processing, or simply disagree with National policy. We at CARH support restoring owner's prepayment rights so owners can have the deal they originally agreed to. However, most owners seek to preserve their housing and we need a greatly simplified process for doing so. This seemingly simple issue takes on magnified importance when you factor in that preservation and refinancing often includes the Low-Income Housing Tax Credits, HOME Funds, and Home Loan Bank loan programs. We must have a simple process at RHS with transparent benefits before we can have widespread participation from other funding sources. People and agencies are very reluctant to invest time and money unless they can see a process that is both clear and cost effective. We believe that the entire 515 portfolio is at risk of imminent deterioration because of the "toll road with no exit"

mentality forced on owners and managers. We do not see a significant loss of housing from the affordable stock, even if prepayment rights are restored because we believe that most owners, if allowed, will move to other affordable housing programs that pay greater returns yet maintain affordability. Enticing owners to stay through a streamlined process will only help. Indeed the June 2002 General Accounting study referred to in our Aging Portfolio Paper, notes that only about 3,500 of the 16,000 plus 515 properties are capable of obtaining higher market rents.

7. The Section 521 Rental Assistance ("RA") program generally works well, though there is not enough funding. The RA program really can only be analyzed in conjunction with the 515 program, since RA cannot exist without a corresponding 515 loan. Section 515 loans are serviced on a budget-based method so that State Office Rural Development ("RD") staff scrutinize operating expenses. In many places this has resulted in significantly below-market rents that do not pay for ongoing maintenance costs. In other places, there is no discernible market, since this is rural housing, and funding is simply insufficient to match operating costs. Agency rules are geared toward the lowest income applicants, which places even greater pressure on resources and do not use methods to match subsidy dollars with residents that can afford to pay rents at that subsidy level.

8. There are few programmatic overlaps between HUD and RHS. Indeed, there is no discernible coordination on handing out vouchers to rural residents. At its June Meeting, the CARH Board endorsed HUD's Office of Multifamily Housing Assistance Restructuring ("OMHAR") business plan to coordinate with and advise RHS on its portfolio. Outside of RHS there is a lot of frustration with the "toll road with no exit" problem. There is a tremendous desire to work with a set staff of policy makers that can consistently tackle the problems we have noted above.

9. RHS has not had any significant new construction over the last five years. Resources for the Section 515 program are a fraction of historical levels.

10. The Section 538 program is an excellent idea, but the 538 statute, as enacted, makes implementation with other programs difficult. The size of rural properties are relatively small, so most Section 538 developments need to leverage funds with tax credits and other resources. The development and lending industries have not been keen on learning a whole new program structure for small, isolated developments. We understand that RHS staff have worked hard to resolve issues with the secondary mortgage market buyers. RHS proposed changes to the 538 regulations on June 10, 2003. RHS staff has been excited about the 538 closings to date, and while we support that enthusiasm, we have to note that the handful of 538 closings to date are well below industry expectations. We hope that the regulatory changes and greater acceptance by the secondary mortgage market will speed up lending. However, we note that certain program structures, such as conditioning lender foreclosure rights on prior RHS approvals, will likely never be workable. The 538 program, must be revised on a statutory level so that it operates consistent with current commercial standards, and we urge further hearings on this point.

CARH would like to amplify and add to the answers provided above. CARH members are concerned that program neglect will cause the successful Section 515 rural multifamily housing portfolio to deteriorate. There is a clear need for maintaining and expanding affordable housing. Studies conclude that there are nearly 14 million families and elderly persons with critical housing needs, which includes a significant proportion of rural residents. See, for example, Stegman, Quercia, McCarthy, "Housing America's Working Families," New Century Housing (June, 2000). This need falls disproportionately on nonmetropolitan areas, as concluded by the General Accounting Office's September 2000 report entitled "Rural Housing Options for Optimizing the Federal Role in Rural Housing Development." As such, federal programs addressing housing needs also need to confront rural housing needs if we are going to include all Americans in our national economy. Unfortunately, the gains we have made in providing affordable housing through the Section 515 program are eroding. There is an overall shrinking of the rental housing supply, as detailed by the Millennial Housing Commission, "Meeting Our Nation's Housing Challenges," May 30, 2002, pp. 16-19 ("MHC Report").

Real estate of all types must be periodically updated and rehabilitated. See, "What We Have Learned About Properties, Owners, And Tenants from the 1995 Property Owners and Managers Survey," by Howard Savage, U.S. Census Bureau. See also, "Homeowner Remodeling Trends Affect Contractor Workloads," Housing Economics, April 1990. This is especially true of apartment complexes like these that are in constant use, successfully providing homes to hundreds of thousands of Americans. RHS itself estimates that 4,250 Section 515 properties with 85,000 units "will physically deteriorate to the point of being unsafe or unsanitary within the next 5 years." See, USDA OIG Report "Rural Development Compliance with Federal Managers' Financial Integrity Act Reporting Requirements," March 2002. There are many different ideas that can address these problems.

Make RHS Structure More Rational

RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. This creates a jumble of interpretations for what should be a uniform set of standards. We recommend that RHS have uniform national standards and lines of authority, similar to current HUD operations.

RHS already has a Preservation Office, but that office suffers from the same balkanized implementation as the rest of the Agency. We recommend elevating the authority of the Preservation Office and authorize it to centralize preservation processing. By "preservation" we mean maintaining both the physical repair and the low-income character of the housing at issue. The main goal of the Preservation Office should include reviewing and restructuring financing on aging properties. RHS should administratively adopt a recovery program that will expedite transfers, prepayments and loan workouts, within the Preservation Office.

Make Servicing Assets Fair and Effective

State Rural Development ("RD") Offices review and set budgets and rents through a time-consuming review for any rent increase, no matter how small. We ask that RHS adopt a policy that allows cost-of-living increases based on general economic data. We also recommend that RHS permit full budgeting of owner distributions. Current RHS regulations discourage owners from advancing funds to properties to meet short-term needs, so we recommend that RHS allow owners a priority repayment in order to encourage advances to protect operations.

New Section 515 loans are rare as the program is at historically low funding levels. Where the alternative new funding is provided through other federal or State agencies, the underwriting standards of those agencies should be used, and RHS should utilize subordination regulations to encourage new financing. RHS staff training should emphasize compatibility with other programs. Specifically, CARH members report success with HOME funding and with state-administered federal tax credit programs. Yet State RD treatment of these funds varies widely, with some states reportedly seeking to keep out such funding. Moreover, an RHS Administrative Notice caps certain underwriting standards as if the property were Section 515 financed, even when no such financing is used or available.

Moreover, RHS operations would benefit from increased flexibility on occupancy limits, adjusting occupancy categories (elderly, non-elderly disabled) and income rates to match local market conditions and subsidy rates.

Servicing is made even more difficult because USDA's Office of General Counsel typically refuses to talk to the public, let alone confer about differing legal interpretations. We recommend that OGC represent RHS before the public and work with the public, as is typical at other government agencies.

Streamline Transfer Rules

Owners that seek to maintain low-income restrictions through a transfer face a complicated and daunting process. Because State Directors administer the program, the exact interpretations of the rules vary generally from state-to-state. This also creates a Catch-22 situation because owners cannot readily prepay out of the program or transfer and refinance within the program. We believe that the only solution is to have a firm processing deadline and informal appeal rights to the RHS National Office.

Streamline Prepayment Rules

There has been significant confusion between mortgage prepayment and market-rate conversion, with a generalized fear that one automatically leads to the other. Prepayment can, but does not necessarily lead to market-rate conversion. CARH supports restoring owners' prepayment rights, as already mentioned. Regardless of whether those rights are restored through the courts or by Congress, RHS should institute a streamlined prepayment process for owners maintaining affordability.

Restore RHS' Budget

RHS' budget has been severely limited in recent years and the multifamily housing production budget is a fraction of that appropriated by Congress in years past. Over the past several years, funding for the Section 515 program went from $540 million in Fiscal Year 1994 to approximately $115 million in Fiscal Year 2003. We recommend restoring RHS' budget to levels experienced in the 1990s. Additional funding would allow for new construction as well as meeting the needs of the existing portfolio.

Enact a New Cost Effective Program

In light of funding shortages, we have analyzed various ways to utilize federal funds to achieve maximum financial leverage. We recommend a new interest credit program to leverage federal funds, perhaps through the Nation's Federal Home Loan Banks. This would allow owners to leverage federal funds through new loans, and by operating through a government-sponsored enterprise rather than a federal agency we can cure the tax credit investment problem discussed below.

Recycle Prepayment Proceeds to Create Revolving Fund

Congress should permit prepayment funds received by USDA to be used as new funding. This would help USDA recycle funds and maintain affordable housing in needed areas.

Provide Vouchers

RHS properties would benefit greatly from an allotment of Section 8 vouchers. Currently, rural properties cannot easily access HUD Section 8 vouchers. We recommend a set aside of Section 8 vouchers for Section 515 properties that prepay.

Convert Certain Rental Assistance

Presently, RA terminates when the Section 515 loan is prepaid. We recommend converting RA to Section 8 so subsidy continues after prepayment.

Make the Tax Credit More Responsive to Rural Housing

Many RHS properties developed in the past 15 years have been made possible by the Tax Credit, but many other properties cannot be developed because owners cannot reach the 9% Credit. We believe that the Tax Credit rules under Section 42 of the Internal Revenue Code should be clarified to permit the 9% credit for RHS programs, similar to the treatment of HUD's HOME and CDBG programs. We also recommend that Section 42 be amended to provide for a small statutory set aside for properties located in rural housing areas as designated by RHS. This will also help open credit to needy rural areas. We further believe that current rent limits need to be addressed. CARH supports H.R. 284, introduced by Representatives Amo Houghton (R-NY) and Richard Neal (D.-MA), which would amend the Internal Revenue Code to allow states to use the higher of the area median income ("AMI") or the statewide median income for the purpose of calculating income limits.

Provide Exit-Tax Relief

Owners are "locked-in" by exit tax liability, which prevents transfer and refurbishment. CARH recommends elimination of exit taxes by limiting taxation to actual distributions to owners.

Conclusion

CARH's examination of rural housing needs has been extensive but that work continues just as CARH members continue to work to provide affordable housing. We appreciate the hard work and good intentions of this Committee and of RHS and RD staffs. We have identified many areas where we can all work together to make progress. Some of these points require a further federal financial commitment, but most do not. These non-financial, structural changes will make transfers, prepayment and preservation easier and will help address affordable housing concerns.

Again, we appreciate this opportunity to testify before the Committee. We look forward to working with you Mr. Chairman and members of the Committee as you contemplate ways to enhance affordable housing choices for rural residents throughout the country.

TESTIMONY OF PHYLLIS K. FONG
INSPECTOR GENERAL
OFFICE OF INSPECTOR GENERAL
U.S. DEPARTMENT OF AGRICULTURE

Before the

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ON

RURAL HOUSING IN AMERICA

JUNE 19, 2003

INTRODUCTION

Thank you, Mr. Chairman and members of the Subcommittee. I am pleased to be here to provide testimony about the Office of Inspector General's (OIG) work on the U.S. Department of Agriculture's rural housing programs. With me today are Robert W. Young, Deputy Assistant Inspector General for Audit, and Jon E. Novak, Acting Assistant Inspector General for Investigations. I would like to submit my statement for the record and summarize the highlights for you at this time.

BACKGROUND

The U.S. Department of Agriculture's Rural Development (RD) mission area administers programs that are designed to meet the diverse needs of rural communities with a variety of loan, loan guarantee, and grant programs, including technical assistance and cooperative development. Within the RD mission area is the Rural Housing Service (RHS), which has three primary programs - Single Family Housing; Multi-Family Housing; and Community Facility programs.

RHS is responsible for providing decent, safe, sanitary, and affordable housing and community facilities in rural communities. It issues loans and grants for rural single family houses and Rural Rental Housing (RRH) apartment complexes, as well as fire stations, police stations, schools, child care facilities, libraries, hospitals, and clinics. RHS applicants may include individuals, private organizations, and public entities. RD State offices service all 50 States and the U.S. Trust Territories, with a centralized servicing center located in St. Louis, Missouri.

For the current fiscal year (FY), authorized program funding for all RHS loans and grants totaled $4.3 billion. For FY 2004, the proposed budget is $5.6 billion.

OIG oversight of the Department's rural housing programs has focused on different areas over the past decade. During the 1990s, we conducted audit work in the RHS program areas of multi-family housing and single family housing. That work culminated in a joint OIG/RHS effort in 1999, addressing fraud and threats to tenant health and safety in the RRH program. Over the past several years, our audits have focused on specific issues, most often in response to Congressional and other requests. Two of these narrow scope audits have identified areas for broader audit coverage. These include insurance coverage in multi-family housing projects and ineligible recipients for rental assistance. In addition, our desk officers continue to assess program activities and provide comments to the agency. The OIG Investigations staff has also continued to receive and pursue allegations of fraud in RHS programs.

Based on our prior and current audit and investigative work on rural housing issues, we have identified six major challenges for RHS management. These challenges include portfolio management, unallowable and excessive expenses charged to RRH projects, RRH projects leaving the program, rental assistance, allocation of funds to rural areas, and performance measures.

Portfolio Management

RHS programs provide low-cost housing to rural America. In particular, the RRH program provides low-cost apartments to residents with low incomes in rural areas. The portfolio contains over 17,000 RRH projects and 460,000 housing units, with an indebtedness of $12 billion in loans. A substantial portion of this portfolio is over 20 years old. RHS faces a major challenge to maintain its current portfolio in good repair so that it will provide safe, decent, and affordable housing for rural America.

Unallowable and Excessive Expenses

RRH programs are vulnerable to program fraud and abuse because of the large cashflows involved. OIG has worked with RHS to address these problems and to stop those who abuse the program from participating in the program. Our March 1999 report entitled " Rural Rental Housing Program Uncovering Program Fraud and Threats to Tenant Health and Safety" described the results of a nationwide cooperative effort involving OIG and RHS staff to identify multi-family housing owners and management agents who misused funds while neglecting the physical condition of RRH apartment complexes. Financial records reviewed by OIG Audit staff and RHS employees revealed over $4.2 million in misused funds at apartment complexes operated by 18 owners and management agents.

We visited 637 apartment complexes and identified 145 that showed serious physical deterioration. Problems included: leaking roofs; worn, moldy, and rotted exterior siding; unsafe balconies and stairwells; unsecured hazardous materials such as gasoline; and dangerous equipment in child playground areas. In response to these findings, RHS worked with owners and management agents to resolve these serious health and safety issues.

We have found, through our audit and investigative work, that there are several common schemes used by owners and management agencies to improperly withdraw funds from RRH apartment complex accounts.

One scheme involves double-charging apartment complexes for management-related expenses that are the responsibility of the management agent and already paid through the management fee. These costs include bookkeeping, postage, and photocopying fees.

Another common scheme involves the owner or management agent charging apartment complexes for his/her own personal expenses.

Many unallowable charges are often made by identity-of-interest companies. An identity-of-interest company usually involves an owner or management official of the apartment complex who owns a side business, such as an electrical or maintenance business.

Often, ownership in the side business is not disclosed to RHS in order to hide the relationship. The side business then provides a service or sells products to the apartment complex. We have found that transactions involving identity-of-interest companies are especially vulnerable to abuse because owners and management agents originate transactions and approve them for payment. The identity-of-interest companies overcharge the RRH projects for their services or products with the RRH project suffering the loss. Further, there is no independent monitoring or approval of the payments, or other effective, compensating control to ensure the work was necessary, completed satisfactorily, and reasonably priced.

In the schemes described above, we often find that the misused funds are withdrawn from RRH project accounts. These project accounts are required by RHS so that the complexes maintain enough funds for large-scale repair and maintenance projects, which are periodically needed (e.g., new roofing, paving of parking lots). Any time a borrower needs to utilize funds from the project accounts, he/she must obtain approval from RHS. In these equity-skimming schemes, the borrower submits fraudulent information to RHS about project account balances or charges to the project account. We have also found that local banks do not always enforce the requirement that all project account withdrawals for major capital improvements or purchases be approved and co-signed by RHS.

RHS has developed proposed regulations to address problems identified by OIG audit and investigative work. Our assessment of the regulations, as currently drafted, concluded that the proposal satisfactorily addressed 4 of the 19 audit recommendations designed to improve program integrity and safeguard project funds. We believe additional work needs to be done on the remaining 15 recommendations. Since the beginning of the joint effort by OIG and RHS, our investigations of the multi-family and single family housing programs have led to a number of indictments, convictions, and monetary results. These cases involve schemes, as described above, which are designed to divert program funds through unallowable and excessive expenses.

RRH Projects Leaving the Program

As the RRH portfolio continues to mature, it is often in the project owners' best interest to pre-pay their loans. The majority of borrowers who received loans between 1979 and 1989 can pre-pay their loans after 20 years. The incentives for owners to pre-pay include the increasing repair costs of aging projects, loss of tax credits, and the possibility of higher rents from more affluent tenants.

As loans are pre-paid, the availability of low-income housing decreases. Therefore, RHS offers incentive payments for project owners to stay in the program. The payments are equal to the equity value in the property at the time pre-payment is planned. To be eligible for the incentive payment, owners must maintain the property in good physical condition and must continue to serve lower-income rural residents. RHS needs to monitor incentive payments and ensure that once made, project owners continue to meet the conditions of eligibility.

Rental Assistance

The RRH rental assistance program is currently funded at $712 million in FY 2003. This assistance makes up the difference between what tenants pay and the rental income required in order for the project owner to meet debt servicing and other costs. Tenants receiving this assistance are generally elderly and have very low incomes. Most recipients pay only a small portion of the average $300 monthly rent.

Currently, there are proposed regulatory changes that will require project owners to increase the balances in the RRH reserve accounts used to fund the increasing demands for repair and rehabilitation of aging projects. The increased reserves will be funded by increased rents. The basic rent for those tenants on rental assistance will not increase. To match the increased rents, the amounts of rental assistance needed to make up the difference between what the tenants pay and the actual rent necessary for the project owner to meet expenses will increase.

Allocation of Funds to Rural Areas

With the continued growth of our cities, areas that were rural just a few years ago are being taken over by urban expansion. In a 1996 audit, we found that the RHS' Single Family Housing Program was not adequately serving truly needy rural communities. We found that 9 of the 10 States reviewed used less than 13 percent of their allocated funds for loans in targeted rural areas. Our review of the 10 States disclosed that up to 80 percent of the loans were in "bedroom" communities immediately adjacent to ineligible metropolitan areas. RHS agreed to implement controls to better ensure that targeted rural communities received adequate loan opportunities.

Performance Measures

The RD managers need accurate, relevant performance data to assess program effectiveness in accomplishing their mission. They also need strong internal controls to ensure program efficiency and effectiveness.

In March 2001, OIG evaluated the information contained in RD's 1999 Annual Program Performance Report required by the Government Performance and Results Act. We found that in many cases, the data contained in the report were inaccurate or unsupported. As a result, we found that the report was of little or no utility.

We believe that these problems are caused primarily by RD's lack of guidelines or procedures for accumulating, collecting, validating, and reporting performance results or for documenting the methodology for data collection. We also found that, in some cases, the items being measured were not directly related to RD's mission. Further, we found that in some cases the performance measures could not be supported.

A graphic example of the consequences of such inaccurate data is recounted in our 2001 audit report "Rural Housing Service Guaranteed Multi-family Housing Loans." In that instance, RHS reported that it had built over 6,500 units when, in fact, it had built only 222. As a consequence of this inaccuracy, $122 million out of the total $153 million allotted for this particular program was unused. Had RHS had accurate data, this $122 million could have been redirected to other projects.

It is incumbent upon management to develop internal controls and to continually evaluate their effectiveness. The Financial Managers' Financial Integrity Act (FMFIA) requires that agencies report on their systems to identify and to report on material internal control weaknesses. In March 2002, we issued a report stating that, while RD had made efforts to comply with the Act, improvements were needed to ensure material internal control weaknesses were identified, reported, and acted on. We found that in the previous 10 years, RD had found only 3 of the 23 material internal control weaknesses identified in the FMFIA report. The remaining 20 material weaknesses had been identified in either OIG or General Accounting Office reports. An effective process to identify and report material, internal control weaknesses is essential to ensure they are recognized and management actions are undertaken to resolve the issues. Due to the complexity of RD programs, it is critical that this process operate effectively.

One example of the potential effect of unchecked material weaknesses involves the RHS multi-family housing portfolio. The agency had identified a serious lack of funding of between \$850 million and \$1 billion in its reserve accounts for repairs of multi-family housing units. However, it had not identified this as a material weakness and thus had not taken action to ensure that adequate funds would be available to pay for critical repairs to the projects. As a result, up to 25 percent of the agency's multi-family housing portfolio could become unsafe or unsanitary.

CONCLUSION

In conclusion, we believe RHS faces a number of management challenges in its efforts to deliver safe and affordable rural housing programs. RHS itself has acknowledged the challenges that we have discussed in our testimony today. We believe the most critical challenge of the six that we have identified is the need for RD to develop accurate, relevant performance data and measures to assess program efficiency and effectiveness. Without timely and accurate information, RD will be unable to determine how well it is accomplishing its mission. Once this challenge is met, the agency will be better positioned to resolve its other management issues. OIG is committed to working with RD to help the agency be even more effective.

Later this year we will initiate an audit on the RRH program. Our review will include follow-up work to the 1999 report "Rural Rental Housing Program Uncovering Program Fraud and Threats to Tenant Health and Safety." We will, of course, look carefully for other work that will assist the agency in meeting its management challenges.

This concludes my statement, Mr. Chairman. I would be happy to answer any questions that you may have.

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Statement of
Patty Griffiths, Housing Director,
Community Action Commission of Fayette County,
representing the Housing Assistance Council
before the Committee on Financial Services,
Subcommittee on Housing and Community Opportunity,
U. S. House of Representatives
June 19, 2003

Thank you for the opportunity to submit testimony on rural housing to the Subcommittee, and thank you, Chairman Ney, for convening this very important hearing. My name is Patty Griffiths, and I am the housing director of the Community Action Commission of Fayette County (CAC), a nonprofit organization located in Washington Court House, Ohio.

I also am speaking today on behalf of the Housing Assistance Council (HAC), a national nonprofit group working to create more affordable housing throughout rural America. Established in 1971, HAC provides financing, information and other services to nonprofit, for profit, public and other providers of rural housing. My testimony focuses on three areas: (1) a brief overview of rural housing conditions and programs; (2) a description of what we are doing with U.S. Department of Agriculture (USDA) rural housing and other programs to meet needs in our area of Ohio; and (3) responses to questions posed by the Subcommittee for this hearing. My comments on national concerns will set a context for a description of the conditions in our area and the work that my organization does.

HOUSING CONDITIONS AND POVERTY IN RURAL AMERICA[1]

Most housing policy is focused on urban concerns, which are of course substantial and deserve attention. But needs are often just as great in rural America. The level of need may be seen in data from the 2000 Census and the 2001 American Housing Survey, as compiled and analyzed by the Housing Assistance Council. Of the 200 poorest counties in America, all but 11 are nonmetropolitan. There are 363 rural counties where the poverty rate has exceeded 20 percent since those figures were first collected in 1960. In housing for most of the 20th century, substandard quality was the primary problem in rural areas. Quality remains a major concern.

[1] Portions of this section are drawn from Housing Assistance Council, *Taking Stock: Rural People, Poverty and Housing at the Turn of the 21st Century*, December 2002.

But today sharply higher and increasing housing costs have made affordability rather than poor conditions the bigger problem in rural housing, especially for low-income people. While housing costs are lower in nonmetro areas than in cities, incomes are also lower. As a result, many rural households find it difficult to meet basic housing expenses. Among the 23 million nonmetro households, approximately 5 million, or 22 percent, pay more than 30 percent of their monthly incomes for housing costs and are considered cost-burdened. Of these nonmetro cost-burdened households, more than 2 million pay more than half their incomes toward housing costs.

Most cost-burdened households have low incomes, and a disproportionate number are renters. In fact, renters are 35 percent of nonmetro cost-burdened households while they comprise less than one-quarter of all nonmetro households. Research by the National Low Income Housing Coalition, supported in part by the Housing Assistance Council, shows that nowhere in the United States can a household afford a two-bedroom apartment at the HUD fair market rent with income at the federal minimum wage. Even in very rural places, minimum wage incomes place fair market rents out of reach.

We see these conditions in rural Ohio. The average person in a big city may not think of Ohio as a rural state. But in fact Ohio has the fourth largest rural population among the 50 states, with over 2.1 million people. Of our 640,000 occupied rural housing units in Ohio, 130,000 – over 20 percent – are occupied by families that are cost burdened.

There have been many gains in rural housing quality, largely because of federal programs. But substandard housing still exists in the United States, especially in rural areas and central cities. The frequency of housing inadequacy among nonmetro units is slightly higher than for all housing units. Approximately 1.6 million, or 6.9 percent, of nonmetro units are considered either moderately or severely inadequate. Fully 12 percent of low-income households in nonmetro areas live in physically inadequate housing, and poor housing conditions are disproportionally more common among renters and minority households than among owners and non-minorities.

THE CAC'S WORK IN OHIO

Founded in 1965, the Community Action Commission of Fayette County has been involved in housing development and rehab for many years. CAC has done home weatherizations since 1967; has developed and manages housing for the elderly, disabled and homeless; provides housing counseling; and has developed several rental projects using the Low Income Housing Tax Credit. We have used the major programs of the USDA Rural Housing Service, including the Sections 502, 504, and 515 programs. We also use HUD programs and we are a State-certified Community Housing Development Organization.

Since 1995 the Commission has helped over 100 low-income families become homeowners through the USDA self-help housing program. We are the only USDA self-help housing builder in Ohio. Under this unique program (sometimes described as a "hand up, not a hand out"), we organize groups of eight to ten families, help them qualify for USDA Section 502 single-family mortgages, and work with them as they put over 1,000 hours of sweat equity into the building of their own and their neighbors' homes. No one moves in until all the homes in a group are done. A skilled construction supervisor from our staff works alongside the families, who do 65 percent of the labor. The families don't just paint the walls; they also build them – and the foundation and the roof.

In our self-help work, we have benefitted from the Housing Assistance Council's HUD-funded Self-Help Homeownership Opportunity or "SHOP" program. We have received $850,000 in SHOP funds from HAC and another $800,000 in loans from HAC's Rural Housing Loan Fund. The SHOP funding helps CAC buy the land and put in infrastructure for our self-help homes. HAC and CAC want to thank this Subcommittee for having created the SHOP program in 1996. The CAC's housing work has also received support from HAC and the Enterprise Foundation in the HUD-funded Rural Capacity Building Initiative.

The Commission has also used the USDA Section 504 home repair program, and we developed and now own and manage a 24-unit USDA Section 515 rural rental apartment project. Overall we have had excellent success with the USDA rural housing programs. All of these Rural Housing Service resources have been vital to our ability to meet needs in Fayette County.

Perhaps the best way to illustrate our work and its impact might be to tell you about Julie Allen. She was a single pregnant mother who became homeless after leaving a domestic violence situation in 1996. Our agency housed Julie and her children first in our homeless shelter and then in our supportive housing program. She became involved in our USDA self-help housing program and built her own home in one of our first sweat equity subdivisions in Bloomingburg, Ohio. Today Julie is a homeowner and has an excellent job. Her children are thriving. Last December she was a featured speaker before 800 people at the opening session of HAC's National Rural Housing Conference, speaking about how self-help housing had changed her life. HAC and CAC considered asking Julie to provide this testimony today, but she could not make it, because she is getting married on Saturday.

When I consider Julie Allen and her life, I can think of no better reason to support, continue and expand the USDA Rural Housing Service's programs. Yes, they may need some changes and improvements. They definitely need more funding. But they really have had an enormous impact on the lives of millions of rural people.

ANSWERS TO QUESTIONS POSED BY THE SUBCOMMITTEE

1. What are your general impressions and overview of the Rural Housing Service (RHS) and whether the agency within the U.S. Department of Agriculture (USDA) is meeting its intended purpose and goals?

Based on our many years of experience in rural housing, the Housing Assistance Council and the Community Action Commission believe that RHS is meeting its intended purpose and goals. We also feel strongly that the agency should continue to be a lender of last resort – that is, RHS should continue to make loans to those who cannot obtain them in the private market. This is Rural Development's historic mission, and it should be still if low-income and minority homeownership goals are to be pursued.

Federal housing assistance has played an important role in the production of low- and moderate-income rural housing since the 1930s. Yet, according to a methodology developed by the Housing Assistance Council, only 8 percent of nonmetro households receive some type of federal or other publicly-supported housing assistance.[2] Most are renters. After having successfully produced over 3 million units since 1950, the USDA rural housing programs have been sharply reduced in recent years. The role and impact of these programs in production have been dramatically transformed. A primary example is USDA's Section 515 rural rental housing program, which serves the poorest households. In fiscal year 1994, Section 515 funded 11,542 units of affordable rural rental housing, but in FY 2002 the program funded only 1,757 units -- an 85 percent reduction. The larger Section 502 single-family loan program has also seen deep cuts. These programs need to be maintained and restored. RHS/RD also have had personnel cuts that make it difficult to deliver services.

2. To what extent has the rural housing market changed and how has the Rural Housing Service adapted to meet those market changes? Could you differentiate between the rental and homeownership markets?

The market has clearly changed, as prices have risen, new population groups have moved into rural America, and some rural places have declined as others boom. One major change has been the explosive growth of the rural Hispanic population, which increased by 1.3 million people in the 1990s. Most of this growth has been in the South and Midwest.

In housing the main rural need has switched from quality to affordability. One way in which USDA has responded is to expand dramatically the role of guaranteed (rather than direct) housing loans. The problem with this approach is that it dilutes service to lower-income people who most need the help.

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[2] The number of rental households receiving assistance is estimated from those households who report their income as part of their rental lease, pay a lower rent because the government is paying part of the cost of the unit, or live in a building owned by a public housing authority. Based on the 2001 American Housing Survey, these estimates include federal, state and local government assistance. Data on government subsidized owners in the AHS are limited. The number of homeowners who receive public mortgage assistance is estimated from those households who indicate they obtained a mortgage through a state or local government program that provides lower cost mortgages or have a primary mortgage from the USDA Rural Housing Service. This methodology is assumed to provide an underestimate of the number of subsidized owners. See Housing Assistance Council, *Taking Stock*, p. 33.

There is no way to generalize about rural markets because they vary greatly from place to place. The high proportions of both owners and renters experiencing cost burden indicate that costs in both the rental and homeownership markets exceed the incomes available to many rural residents. The only way to meet their needs is to increase the available subsidies, and RHS has not had the resources to do that.

3. What are your views regarding the Administration's efforts to expand homeownership opportunities for low-income families in rural areas? Are these efforts coordinated with the Department of Housing and Urban Development?

HAC and CAC are very supportive of the Administration's efforts to expand low-income and minority homeownership in rural areas. President Bush, Secretary Veneman, Under Secretary Dorr and RHS Administrator Garcia are to be congratulated on this initiative. HAC has been a leader in this arena for over 30 years, having made our first loans to support rural self-help homeownership developments in 1972.

As for coordination with HUD, the Memorandum of Agreement signed between Secretaries Martinez and Veneman on June 16 is an excellent start. We also would observe that homebuilders and nonprofits (such as CAC) have been coordinating HUD, USDA and other programs for decades. They have learned to coordinate out of necessity. In truth our experience is that RHS and HUD staff do not coordinate much at the local level.

Other creative ideas that could promote homeownership include the Rural Housing Tax Credit Act (HR 1913), which was recently introduced by Reps. Davis, Leach, Ross, Hinojosa and Lucas; the American Dream downpayment assistance initiative (HR 1276), sponsored by Rep. Harris; and the President's homeownership tax credit plan.

4. What are your views regarding the definition of rural housing and whether that definition should be adjusted to reach larger cities, e.g. localities up to 50,000 in population?

We are not supportive of this idea, unless substantial new funding were added to serve an expanded population base. There are already many unserved low-income families in the current eligible areas, and funds have been cut in recent years. At the same time we recognize that there is an underserved niche of small cities that are too large for RD eligibility but too small for many other programs.

5. On June 2 the Rural Housing Service published a proposed rule that would consolidate 13 existing regulations. To what extent will this consolidation assist RHS in becoming a more efficient housing agency? Do you have any concerns relating to this consolidation?

Much of the new proposed rule for multi-family housing seems logical and useful. The RHS staff are to be commended for the enormous amount of work that went into this proposal. The proposed new handbooks will provide a great deal of flexibility in the program. However, comments on the rule may be due before the new handbooks are published. We feel that RHS should not require comment on the rule before the public can see and comment on the new handbooks.

We have no other concerns about the rules' consolidation itself. HAC is still reviewing the proposal, and will provide detailed comments to RHS within the comment period. Our comments will relate to changes in RHS policies and procedures being proposed along with the regulatory streamlining. We are pleased to see some added protections for the low-income tenants who occupy RHS multi-family developments. We also support RHS's ideas to shorten the time owners must wait for incentive payments to keep them in the program.

We are concerned, however, about RHS's proposal to change the time period for which a rental project will be obliged to remain available for low- and very low-income tenants. RHS proposes to shorten the restrictive use period from 50 years to 30. However, we believe it is entirely appropriate to impose 50-year restrictions on a loan that is amortized over 50 years, especially since the developer receives substantial assistance from the loan and the program's very purpose is to provide decent, affordable homes for low- and very low-income people.

Some other changes that provide better protection and service for tenants may raise rent levels, thus increasing costs for the Rental Assistance program. We believe this is appropriate. For example, we agree that maintenance reserves should be increased, but believe the standard should be 1.5 percent per year rather than 1 percent.

6. As you may be aware, existing statutes address preservation issues confronted by the Department of Housing and Urban Development. Could you discuss the current status of preservation activities by the Rural Housing Service as well as any complementary programs on the state and local levels? Given the budgetary environment, how can RHS become more effective and efficient? How many units and developments will be affected by expiring contracts over the next 10 years?

Much of the current subsidized rental housing stock is at risk of loss, making the rural rental shortfall worse. Many owners of rental developments with subsidized mortgages from USDA or HUD are seeking to opt out of the subsidy programs by prepaying their mortgages and converting their apartments to market rate rentals. Likewise, landlords can opt out of HUD's Section 8 rental assistance program in search of higher rents and fewer government regulations. RHS units, like HUD's, are covered by preservation statutes, but existing laws do not fully solve the problem.

Nearly 300,000 Section 515 units will be potentially eligible for prepayment within the next few years. The General Accounting Office developed an estimate of 3,872 eligible projects. If these developments fit the portfolio-wide average of 27 units each, 3,872 projects are likely to represent about 104,544 units. GAO's estimate was conservative, however, because it included only developments that are in market areas GAO believes could support a project after prepayment. But an owner's desire to prepay may not be based solely on whether the units can be converted to market rate. It is more appropriate to base a calculation on the number of units that were constructed with loans made between December 21, 1979 and December 15, 1989, since these loans are eligible for prepayment after 15 or 20 years.

Given the rental housing need described above and the federal investment in place, it is essential to preserve these units. The staff in RHS's Office of Rental Housing Preservation are excellent, but the agency has not had the resources necessary for preservation. A minimum of $25 million should be allocated each year to provide the preservation incentives mandated by Congress.

Another cost-effective way to preserve needed units is to promote purchases of expiring use developments by nonprofit organizations. The proposed new multi-family regulations would take a step in this direction by allowing an owner to offer a project for sale to a nonprofit after waiting 15 months for incentive payments.

7. What are your views about the current status of the Section 521 rental assistance program and to what extent do you believe the agency will make administrative and programmatic changes?

Overall the Section 521 program is well run and effective. There is an excess of units funded in the program but unused. RHS has kept these units as a cushion to ensure that there is sufficient funding to renew all expiring contracts. Given that the rural housing annual budget requests are often tight, this procedure seems logical.

Another issue is that RHS has allowed some rental project prepayments where the owner has replaced five-year RA contracts with one-year HUD Section 8 vouchers or certificates. Because Section 521 RA accounts for such a large percentage of the RHS budget, it appears possible that the Department might try to use annual contracts to lessen the budget impact. This could place tenants at risk during funding downturns.

8. What overlaps in housing program services and needs exist between the Department of Housing and Urban Development and the Rural Housing Service? Are there any collaborative efforts between the two housing agencies to maximize efficiency and the taxpayer's investment in housing? Please explain them in your written testimony.

See question 3 above. Overall we see complementing not overlapping programs. Most low-income housing development today needs and uses multiple funding sources. USDA programs are mostly loans and go directly to the builder, nonprofit or family. HUD programs are usually grants passing through state or local government. USDA clearly reaches rural areas more effectively. USDA has a better local rural office network and is closer to the people served. This is very important for remote communities.

9. What are your views on the agency's new construction over the last five years for all the multifamily programs, including section 515 multifamily direct loans and section 538 multifamily loan guarantee programs?

Considering that the Section 515 program was cut drastically in 1994, it is commendable that the agency has managed to maintain some level of new construction. We support continuing funds for new construction, as well as sufficient funding for equity loans in the 515 preservation program.

The Housing Assistance Council estimates that $100 million is required to cover the development of at least one new Section 515 project in each state. Necessary portfolio maintenance requires approximately $50 million per year. A minimum of $25 million is needed for equity loans to owners who wish to prepay. In short, $175 million would cover minimal essential activities under Section 515. We believe the program should be funded at $550 million, and suggest that Congress begin by appropriating $300 million for FY 2004.

Another very useful idea to create new units is the Rural Rental Housing Act (HR 1722), which is sponsored by Reps. Hinojosa and Davis.

The Premier Association of Real Estate Finance

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STATEMENT

of

Jack Jones

Vice President

Chase Manhattan Mortgage

On

"Rural Housing in America"

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

June 19, 2003

Good afternoon, and thank you Mr. Chairman, for holding this hearing and inviting the Mortgage Bankers Association of America (MBA)* to state its views on the US Department of Agriculture's Rural Housing Service (RHS) programs. My name is Jack Jones, and I am the Vice President in charge of the Rural Housing Channel for Chase Manhattan Mortgage Corporation in Deerfield Beach, Florida. I am particularly pleased to be here today representing MBA on an issue to which I have devoted the last 11 years of my professional career – providing homeownership opportunities for rural families.

Since the inception of the Rural Housing Service and it's predecessor, Farmers' Home Administration, programs designed to meet the housing and community development needs of rural America, MBA has consistently supported the programs as a necessary complement to other federal housing programs that may not address the specific needs of rural families.

Chase Manhattan Mortgage Corporation is a strong supporter of the Rural Housing Service's mission to foster homeownership opportunities across rural America. Chase Manhattan is the largest originator in the Rural Housing Service's Section 502 Guaranteed Single Family Housing Loan program. Under the Section 502 Guaranteed Single Family Housing Loan program, private sector lenders make RHS guarantees loans. The purpose of this program is to enable low- and moderate-income (up to 115 percent of area median income) rural residents to acquire modestly priced housing for their own use as a primary residence. The program is available for financing the purchase and repair of an existing home, or the purchase of a newly constructed home. There is no required downpayment, but families must meet underwriting requirements. In many rural communities, the Section 502 direct and guarantee programs are the only homeownership options available to low- and moderate-income families.

Last year, Chase Manhattan loaned just over $900 million, which provided 11,000 rural families the opportunity to become homeowners. Chase Manhattan is proud of its efforts because the needs of rural low- and moderate-income families are generally underserved, and, sometimes, overlooked. Chase Manhattan Mortgage Corporation made a commitment to the Section 502 program and to rural families 11 years ago when it created a line of business that exclusively focuses on providing Section 502

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*MBA is the national association representing the real estate finance industry. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,600 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mbaa.org.

Guaranteed Housing Loans to rural families. Chase Manhattan does this in partnership with over 2,500 community banks, mortgage bankers, and mortgage brokers in all 50 states.

The needs of rural homeowners and renters differ in many aspects from those in urban or suburban areas. In many states, rural areas have the highest rate of substandard housing in the state, the highest poverty rate in the state, and median incomes often 35 percent or less than the median incomes of urban residents. Federal housing assistance can only reach so far. Only 17 percent of very-low income rural renters receive US Department of Housing and Urban Development (HUD) housing subsidies, compared to 28 percent of the urban poor, and, overall, only 12 percent of HUD Section 8 assistance reaches rural areas.

Unfortunately, rural areas traditionally have lacked the financial resources for home financing. For this reason, the Rural Housing Service programs are vital to increase the availability of decent, safe and affordable housing for low- and moderate-income rural home buyers and renters. It is because of this lack of access to financial capital and general disparity of resources that federal programs are vital in rural communities. Rural communities often cannot develop access to efficient capital markets on their own. Great strides have been made in reducing the cost, regulatory burden, leveraging funds and coordinating housing activities with other economic, industrial and community development activities in rural areas. However, despite all the progress, there is still a desperate need for affordable housing in America's rural areas.

The Rural Housing Service provides this important function for both single family and multifamily housing. In addition to the Section 502 single family guaranteed housing program, RHS also offers the Section 538 program which guarantees loans to developers of multifamily housing to build and/or renovate safe, decent, rental units affordable to very low-, low-, and moderate-income families. Both of these programs provide private capital, guaranteed by public funds, to promote adequate access to home financing capital for rural communities.

During this Homeownership Month, it is important to note the positive impact the Section 502 program has made. In Federal Fiscal Year 2002, the Section 502 Guaranteed Loan program has prompted the investment of more than $2.4 billion in private lending to over 29,000 families who were not previously being served. These are families that now have an even deeper stake in their communities and an investment in one of the strongest wealth-building tools in the US - homeownership.

In just the last year, RHS has made major updates to the Section 502 guaranteed program. First, the Rural Housing Service successfully lowered the guarantee fee from 2 percent to 1.5 percent, which simply makes the program more affordable to low- and moderate-income borrowers. Next, the Agency adapted the utilization of credit scores to streamline the underwriting process, as well as the use of the HUD Valuation Conditions (VC) report for streamline property inspections. Both of these last two issues are tied to significant changes made by the Agency to make the program more "lender-friendly," by using commonly accepted processes and guidelines used by the rural housing originator in other mortgage lending programs. Lastly, and equally important, the Agency made funds available at the earliest time in any fiscal year. Furthermore, the lending community now has the assurance that funds will continue to be available on a continuous basis through the recent "No Year Funds" legislation, which allows for unused funds to be used as we cross from one fiscal year to the next, awaiting the next year's allocation. If the private sector is to be attracted to and retained in support of these under-served areas of our nation, the continuity of guarantee funds in this program is critical and must continue.

The good work that this administration, under the guidance of Rural Housing Service Administrator Arthur Garcia, Rural Housing Service, has undertaken in the last two years has made significant improvements to a program that was at risk of being neglected. MBA urges both Congress and the Administration to build upon these changes by considering the following further improvements to the program:

Guidelines under the Single Family Housing Guaranteed Loan Program should be amended to allow the financing of the guarantee fee "on top of" the appraised value of the property.

A key feature of the Single Family Housing Guaranteed Loan Program is the ability of the purchaser to borrow up to 100 percent of a property's appraised value. This feature allows the borrowers to purchase a home with no downpayment, and finance some portion, if not all, of the costs related to closing a mortgage. An acceptable closing cost to be financed includes the Rural Housing Service guarantee fee.

That fee is currently 1.5 percent. In addition to the guarantee fee, typical closing costs are in the range of 5-7 percent. This means that in order for a borrower to finance all costs, a property subject to financing under the program must appraise at a premium above the sales price. In many rural real estate markets, such large premiums are not easily obtained, and in a "seller's" real estate market as we are in now, contributions from seller toward the payment of the Purchaser's closing costs may be very difficult to obtain.

FHA and US Department of Veterans' Affairs (VA) loan programs allow the financing of closing costs up to similar loan limits; however, both FHA and VA allow the financing of their similar insurance or guarantee fees on top of the appraised value.

Currently, the Section 502 Single Family Housing Guaranteed Loan Program allows financing of the guarantee fee on top of the appraised value on refinance transactions. However, this is not allowed on Single Family Housing Guaranteed Loan Program purchase transactions. MBA urges the law be changed to allow the financing of the guarantee fee "on top of" the appraised value for purchase transactions. This change would expand the availability of the program to a greater number of rural families. Past experience has shown that the required funds for closing, including the downpayment, is a significant obstacle to homeownership for those who would otherwise make excellent homeowners. The downpayment and closing costs obstacle should be of particular concern to those who are trying to bridge the homeownership gap between minorities and non-minorities.

The population limits used under the Single Family Housing Guaranteed Loan Program should be raised.

Currently, properties eligible for the Single Family Housing Guaranteed Loan Program must be located in communities with populations not in excess of 20,000, if contained within a county that is not part of a Metropolitan Statistical Area (MSA) or 10,000 if located within an MSA. These definitions were created more than 30 years ago and should be updated.

This eligibility definition is much less useful today. There are many communities, outside of, and even within, MSAs that are rural in nature but not captured under this definition. These communities have large parts of their economies reliant on agri-businesses or natural resources processing and refining. Under its business programs, USDA-Rural Development recognizes this and allows for the financing for businesses in non-urbanized communities with populations up to 50,000. MBA believes this same definition or a slightly reduced definition of 25,000 to 30,000 in community size should apply to the Single Family Housing Guaranteed Loan Program.

The income limits should be raised for the Single Family Housing Guaranteed Loan Program in targeted and high-cost areas, and the deduction for non-applicant children should be increased.

Currently, borrowers applying for the Single Family Housing Guaranteed Loan Program are limited to maximum household incomes of 115 percent of an area's median income, in all states except Alaska. As noted previously, rural America is very diverse, and this is especially true when speaking of local economies.

This 115 percent limitation in 49 states does not take into account the varying levels of housing affordability across the United States. In particular, high new construction costs in remote rural areas lower housing affordability in most states. West Coast states and rural communities outside of high tech growth centers in Texas and North Carolina demonstrate low levels of housing affordability for existing and new construction.

MBA urges the Secretary of Agriculture be granted discretion to raise the family median income limits in areas designated as "targeted-areas" as defined in the subchapter *and* in high cost areas, allowing financing to be extended to families making up to 150 percent of an area's median income. Raising the income limits will provide additional liquidity, which will encourage lower priced single family residential construction.

Additionally, MBA suggests the Rural Housing Service make a regulatory change to increase the deduction from annual income allowed for non-applicant children residing in the household of applicant borrowers. The current deduction of $480 per child is woefully inadequate. MBA believes that a better approach would be to index the amount of deduction allowed in any given calendar year to be equal to the standard deduction allowed when computing Federal Income taxes. This would ensure the deduction stays current with changes in the future.

Thermal standards on existing housing stock should be eliminated from the Single Family Housing Guaranteed Loan Program

Under current RHS regulations, which exist without parallel statutory authority, existing homes are required to exhibit thermal efficiencies that are contrary to the state of the existing housing stock in rural America. This requirement necessitates costly improvements that we believe have only nominal economic value, and may actually mandate an investment from the applicant that will not be returned in the event of sale. These thermal standards for existing homes cannot be found in any other conventional or FHA/VA home loan program, and is a significant source of on-going resistance to the use of the Guaranteed Rural Housing program.

MBA urges Congress to provide strong encouragement to the Agency to eliminate this burdensome, costly, and onerous regulation.

Clarify Ginnie Mae authority on Section 538 loans guaranteed by RHS

The Rural Housing Service guarantees loans under the Rural Rental Housing guaranteed loan program for development of multifamily housing facilities in rural areas of the US. Loan guarantees are provided for the construction, acquisition, or rehabilitation of rural multifamily housing. Occupants of the housing must be very low-, low- or moderate-income households, elderly, handicapped, or disabled persons with income not in excess of 115 percent of the area median income. The average rent of all units is 30 percent of 100 percent of the median income of the surrounding area. The program is designed to increase the supply of affordable multifamily housing through partnerships between RHS and major lending institutions.

Congress appropriated $99.3 million for the Section 538 Guaranteed Loan Program for FY 2003. Under the President's FY 2004 budget of $100 million for the Section 538 Guaranteed Loan Program, USDA proposes to build 2,700 units and repair, rehabilitate, and pay incentives to owners on 5,900 units. There are currently 2,655 units funded under the Section 538 program, an average of 55 units per project with an average rent of $477 per unit. A total of 1,788 units have been constructed under this program, adding valuable jobs and revenue to rural communities.

Currently, loans made under the Rural Housing Service's Section 538 Rural Rental Housing Guaranteed program are not saleable to the Government National Mortgage Association (Ginnie Mae). Their charter allows them to purchase "insured" loans, but not "guaranteed" loans. MBA urges Congress to change the Ginnie Mae charter to allow Ginnie Mae to purchase and securitize these loans. This change will provide greater liquidity for these loans and ensure that rural communities are not disadvantaged due to lack of access to capital.

MBA strongly believes in promoting affordable housing for rural areas and believes in the importance of preserving rural communities. MBA appreciates the opportunity to testify today concerning rural housing in America and looks forward to working with you on these vital programs.

Statement of Madeline Miller,
Executive Director, Wil-Low Nonprofit Housing, Inc.
before the
Committee on Financial Services
Subcommittee on Housing and Community Opportunities
U.S. House of Representatives
June 19, 2003

Wil-Low Nonprofit Housing, Inc. is a nonprofit housing organization, incorporated in 1971 in Lowndes County, Alabama, when it was spun-off another nonprofit organization, Friend, Inc. The named "Wil-Low" is derived from the first three letters of Wilcox and Lowndes Counties, where most of the organization's work is conducted. The organization was formed by citizens from Lowndes and Wilcox Counties who were concerned about the quality of their communities' housing. That year, Wil-Low hired its first Executive Director, Willie B. Harvey, and received its first grant – $38,000 from the Rural Housing Alliance.

BACKGROUND

The organization's mission then, as it remains today, is to provide technical assistance to very-low, low, and moderate income families and farm worker families so they can have the opportunity to acquire decent, safe, sanitary, and affordable housing. Wil-Low helps families with new construction, rehabilitation of existing owner-occupied dwellings, rental housing, and housing counseling. To perform these services, Wil-Low has had to merge funding from the following federal, state, and non-profit sources: the Housing Assistance Council, the United States Department of Agriculture's Rural Housing Service's (RHS) 523 Technical Assistance Grant Program, the 533i Housing Preservation Grant Program, the Department of Labor, other Department of Housing and Urban Development Programs, Rural Housing Alliance, and the Alabama Housing Finance Authority (AHFA).

Also in 1971, Wil-Low began construction on a group of self-help housing units, but completion did not come without a struggle. We had to recruit families, submit application and wait for RHS's final approved of each individual application, the site and the type of dwelling to be constructed. Many families that participated in this initial program were farm worker families. To construct their dwells, families were organized into groups of six to ten families and each group was given a name. The families had to provide "sweat equity" equal to at least 65% of the tasks necessary to construct their dwellings. This was a cost saving mechanism for the families because most of them had incomes too low to qualify for a regular, prime housing loan.

In building these first units, Wil-Low encountered a number of problems such as land restriction – if we located a landowner that was willing to sell the land we could not build more than one house per acre on the land. We were also confronted with subdivision regulations – two or more units on more than one acre of land constituted a subdivision, so we decided to build on scattered sites, which is obviously more difficult than building on one continuous site. Eventually, Wil-Low was able to secure funding to develop a subdivision from a national nonprofit organization, without which families would not have been able to continue participating in our self-help housing program or utilizing RHS's 502 new construction loan program. Further, it is still true today that without RHS funds families in Alabama's Black Belt counties would not have the opportunity to acquire a decent home.

Using the self-help method of construction Wil-Low has constructed units in Lowndes, Wilcox and Monroe Counties of Alabama. Funding has been provided through RHS's 523 Technical Grant Program and their 502 New Construction Loan Program. Site loans have been provided through Rural Housing Alliance and Housing Assistance Council, both national nonprofit housing organizations. The site loans were repaid as the families' loans were closed.

To make our program successful, Wil-Low develop the "one-on-one" approach. Visiting each individual home and conducting interviews and explaining the program services offered by Wil-Low. Wil-Low encourages and participates in coalition building with as many housing and other organizations as possible.

Back in the 1970's because of our goal of assisting low-income and farm worker families to improve their living conditions, some families were forced off the plantations and some household members lost their jobs when the employers heard they were trying to acquire a better house; one of their own. Families were counseled not to tell their personal business to anyone and some were convinced to post "Keep Out" signs on the entrances to their homes. We often met families at locations other than their current residences to complete their housing applications and we even had to help some of our families find new employment as well as a place to live. Finally, we had to convince some families that they would like their new communities because they did not want to leave the one they lived in, even to own their own home.

WIL-LOW PROGRAMS

Today Wil-Low still operates its housing programs, consisting of new construction, rehabilitation of owner-occupied dwellings, the purchase and rehabilitation of an existing dwelling, rental units, and housing counseling.

New Construction. To-date Wil-Low has constructed over 300 home units through both its self-help program and its contractor built home program. One hundred percent of the funding for these units was provided by RHS, which means the families we work with all have incomes at or below 50% of median income. Our families also can qualify for interest credit which makes loans even more affordable. The families that participate in Wil-Low's programs have had to access over $2,000,000 in federal, state, and non-profit funds to be able to afford their own homes.

Home Improvement/Rehabilitation. Wil-Low has utilized over $800,000 in RHS 533i Housing Preservation Grant Program and its 504 Rehabilitation Loan/Grant Program funding. Working with Rural Housing on these programs has allowed Wil-Low to leverage other funds, such as from the W.K. Kellogg Foundation, to assist families. A total of over 300 homes have been rehabilitated. But, there is a need for additional funds for Rural Housing Service Rehabilitation Program, especially the Loan/Grant Program because the numbers of homeowner-occupied dwellings that are in need of rehabilitation keeps increasing. If these homes are not repaired, family members will be forced to move in with relatives or others, creating or increasing another problem: overcrowding.

Wil-Low has also successfully trained fifty on-the-job trainees in construction and clerical work. The trainees work on the homes of families who have been approved by RHS and for which funds have been leveraged by Wil-Low. Some of these trainees have even become permanent employees of Wil-Low.

Rental Housing. In 1995, working with Alabama Housing Finance Authority (AHFA), Wil-Low began the process of trying to develop rental units in Lowndes and Wilcox Counties. In 1998, Wil-Low's Board of Directors decided that we would partner with another nonprofit housing organization that had experience in rental housing and in working with the AHFA. In August of 1999, our dream became a reality, we broke ground to start construction on twenty rental units and a community building. Then, in May of 2000 the first resident moved in and today the complex is fully occupied. Financing for the project was a combination of funds from the AHFA, the HOME program, the Low Income Housing Tax Credit Program, Local Initiatives Support Corporation, and the National Equity Fund. The total cost of the project was $1,399,239, which included the entire infrastructure cost. There was no up-front development fee for Wil-Low to come up with. The one problem is that we were only able to build twenty units and we have over one hundred applications from families who are still in need of a decent and affordable place to live.

Housing Counseling. Wil-Low provides housing counseling to all clients. The following types of counseling are provided: pre-purchase, post-purchase, mortgage default and rent delinquencies, home improvement/rehabilitation, consumer education, home equity conversion mortgage, and predatory lending. A successful housing counseling program makes a successful housing program.

CHALLENGES

Challenges that Wil-Low has had to overcome in the past and is still faced with today in its attempt to operate a successful rural housing program include:

- *Recruiting families.* Wil-Low uses the door-to-door method of approach to explain to families the steps they need to take to own their dwelling or to have their home repaired. Wil-Low works with families who have credit problems by helping them work with creditor's to set up payment plans.

- *Utilizing the Section 8 Voucher program to further homeownership.* To date, Wil-Low has been unable to work with the Section 8 program in any capacity.

- *Locating other mortgage lenders in the county.* There are an insufficient number of lenders willing to assist low-income families in Lowndes and Wilcox Counties.

- *Acquiring gap financing.*

- *Lacking existing housing stock.* The rural counties Wil-Low operates in do not have many existing houses to rehabilitate, so a lot of new construction or rental housing needs to be built.

- *Negotiating with landowners.* They do not want to sell their property to construct houses at prices the families we work with can afford.

- *Understaffing.* Wil-Low, like most nonprofit organizations, does not have the funds to hire adequate staff to work its programs to their fullest potential.

- *Ensuring that families are completely satisfied.* If families do not like the communities that they will be moving into, they will not participate in the program even if it means owning their own home.

- *Working closely with RHS.* Wil-Low makes sure its families' applications are processed in a timely manner by assisting them with the proper documentation and information requested by the various funding sources.

- *Making sure that RHS certifies the site on which the dwelling will be constructed.* This includes gathering information such as the survey, environmental approvals, etc.

- *Locating funds to do site development work for subdivision approval.* In the past the subdivision had to meet only RHS's approval. Now, if a local government has approved subdivision and zoning regulations, the subdivision must meet local government approval as well.

- *Overcoming NIMBY-ism.* Wil-Low is still confronted with the problem of "Not In My Back Yard" (NIMBY)

- *Locating sufficient funds to leverage other monies.* This is essential to rehabilitate or build more homes as there are not enough funds available from any one source.

- *Locating the funds necessary to start a revolving loan fund.* Wil-Low could use such a fund to purchase property and do development work without having to constantly look for new sources of funding.

- *Finding assistance for families who do not have adequate income to quality for a housing loan.* The families we work with need assistance (in the form of a grant generally) to buy down the interest rate on their loan from RHS to make their rural housing loan affordable.

- *Resolving credit issues.* Families with low income are not without credit problems.

- *Avoiding predatory lending.* Families with credit problems are an easy target for predatory lending. Once a family has been denied a loan from a lending institution, some time they are force to apply for a mobile home loan, because of credit rating they have a higher interest rate, and payment or much higher than a RHS Loan.

- *Locating land.* In rural areas finding affordable land with adequate infrastructure (e.g., water and sewer) is always a problem.

- *Improving the quality of housing.* Families are forced to live in areas far from the counties where they work because they cannot find affordable houses to buy or rent within that county. Further, people are unable to buy land on which to build or to rent land on which to put a manufactured home because the landowners are not willing to give up the land for the type of housing that will go on it. Therefore, families often have no choice but to move onto land owned by other family members. This often accounts for the increase in mobile homes crowded onto small lots with no sewage system. Also, the electric hook-up for these lots are often done by unqualified workers with inadequate materials, resulting in home fires. At present, neither Wilcox nor Lowndes County have a housing authority to work on housing quality and infrastructure problem or to facilitate receiving loans.

- *Increasing numbers of migrant and seasonal farm workers.* In Wil-Low's service area the number of migrant workers has been steadily increasing such that we will soon need to hire a bilingual staff person to assist us in continuing to provide services to farm worker families.

- *Financing.* Wil-Low has first-hand knowledge of the problems that low-income and farm worker families have in locating and financing affordable housing and in securing funds for rehabilitation. Some of these families are living in deplorable conditions. Funding sources have strict income and credit criteria and families in these areas find it very difficult to overcome these barriers to become approved for housing loans.

RURAL HOUSING GOALS

To help alleviate some of the substandard housing units and overcrowded living conditions Wil-Low has the following goals outlined:

Single Family

- Purchase a ten acre tract of land in Wilcox County, Alabama.
- Construct eighteen single-family units.

To bring this together Wil-Low will seek to secure funds from RHS, the Alabama Department of Economic Development, and the Federal Home Loan Bank to purchase property, finance mortgages, conduct development work, and hire staff. Those staff members are needed to conduct the following activities or this program will not work:

- Recruit, screen, package housing applications, and submit those applications to funding sources for an eligibility determination.
- Assist families in submitting the required documents to funding sources.
- Assist families in locating suitable building sites.
- Assist families in selecting house plans, contractors, and completing cost estimation.
- Provide housing counseling.

Multi-Family

- Construct twenty rental units.
- Secure funding, both gap and bridge financing.

This will require staff to lease-up units, recertify tenants, inspect units, and manage units. Staff that Wil-Low does not currently have.

Rehabilitation

Wil-Low will serve a total of fifty families by providing the following activities:

- Recruit, screen and package housing applications.
- If feasible, application will be submitted to funding sources for an eligibility determination.
- Provide housing counseling.
- Utilize Rural Development 504 rehabilitation program and other sources of funding that may become available.
- Assist families in completing and submitting cost estimation as required.
- Work with contractors to make sure that bids are submitted and all work is completed.
- Provide housing counseling.

Housing Counseling

Provide the following types of housing counseling services to three hundred families.

- Pre-purchase.
- Pre-occupancy.
- Pre-rental.
- Mortgage Default/Rent Delinquency.
- Home improvement/Rehabilitation.
- Housing Consumer Education.
- Home Equity Conversion Mortgage (HECM).
- Predatory Lending.

The only way Wil-Low can achieve these goals and its overall goal of providing decent housing in rural Alabama is to coordinate its efforts with those of other groups and organizations. Also, for a rural housing program to be successful, we must continue making our communities aware of the programs and services offered by Wil-Low. Because our communities are changing, part of that awareness involves providing outreach services to migrant and seasonal farm worker families. For instance, we assist migrant and seasonal farm worker families in locating temporary and emergency shelter and make referrals to One-Stop-Career Centers for other services. To be a rural housing nonprofit requires more than building or rehabilitating units, it also requires providing a whole host of services from jobs to counseling.

NATIONAL RURAL HOUSING COALITION

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Testimony of Joe L. Myer
Executive Director
NCALL Research, Inc
and
Executive Committee Member
National Rural Housing Coalition

Before
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
US House of Representatives

June 19, 2003

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June 19, 2003

Mr. Chairman, my name is Joe Myer and I am the Executive Director of NCALL Research. NCALL is a nonprofit rural housing technical assistance provider based in the great state of Delaware, represented by Congressman Michael Castle. Since 1976, NCALL has utilized virtually all of USDA's rural housing programs in its efforts in Delaware and the Delmarva Peninsula.

I am also past president and current executive committee member of the National Rural Housing Coalition (NRHC). NRHC is a national membership organization that advocates on rural housing policies and programs. NRHC has testified before this Committee before and we appreciate the chance to testify today.

Overview of Rural Housing Need

According to the 2002 Millennial Housing Commission Report, rural communities were bypassed in the recent economic good times and now face poverty rates, unemployment rates, and the incidence of housing problems at levels similar to that of the nation's big cities.

According to the 2000 Census, there are 106 million housing units in the United States. Of that, 23 million, or 23 percent, are located in non-metro areas. Many non-metro households lack the income for affordable housing. The 2000 Census reveals that 7.8 million of the non-metro population is poor, 5.5 million, or one-quarter of the non-metro population face cost overburden, and 1.6 million of non-metro housing units are either moderately or severely substandard.

According to the USDA Economic Research Service, 4 million, or 17 percent of the households in non-metro areas are classified as being in housing poverty. Households are defined as being in housing poverty when their housing has at least one of four important indicators of housing disadvantage:

- Economic need - housing costs over 50 percent of the household income;
- Inadequate quality - physical quality defined as moderately or severely inadequate using the HUD measure based on 26 indicators of physical problems;
- Crowding - more household members than rooms; and

- Neighborhood quality - perception of poor quality in at least 2 out of 4 neighborhood conditions: crime, noise, inadequate public services, and litter/deteriorating housing.

Renters in rural areas are among the worst housed individuals and families in the country. Thirty-three percent of rural renters are cost-burdened, paying more than 30 percent of their income for housing costs. Almost one million rural renter households suffer from multiple housing problems, 60 percent of whom pay more than 70 percent of their income for housing.

Although issues around rental housing are of vital concern, homeownership is the principal form of housing in rural America. However, there are a number of obstacles to improving homeownership in rural areas including high rates of poverty and poor quality of housing.

Rural residents also have limited access to mortgage credit. The consolidation of the banking industry that accelerated throughout the 1990s has had a significant impact on rural communities. Mergers among lending institutions have replaced local community lenders with large centralized institutions located in urban areas. Aside from shifting the focus of loan making, this has resulted in the diminishment of a competitive environment that, in the past, encouraged rural lenders to offer terms and conditions that were attractive to borrowers.

In recent years, the single biggest change in rural housing policy is the reduction in resources available to address urgent housing needs. In 1994, spending on rural housing loans for multi-family and single-family housing totaled $663 million. This provided for some $1.8 billion in direct home ownership loans and some $500 million in lending for rural rental housing.

Today, total spending for home ownership loans and rural rental housing is less than $200 million. As a result, only about $1.1 billion is available for home ownership and $114 million for rental housing. This reduction in spending for single-family housing is also reflected in reduced subsidy rates to low-income families.

Rural housing efforts are also hampered by low level of federal assistance for rural housing. The rate of federal assistance to non-metro households is only about half that for metro households. There is substantial evidence that more remote rural areas, which are also usually the poorest with the worst housing conditions, fare even worse in garnering federal housing aid.

With this funding shortfall RHS has made important improvements in the direct loan program. The agency now encourages partnerships with lenders and other entities wishing to finance homeownership. These partnerships allow the agency to stretch its subsidy dollars and assist more low-income families. RHS' leveraged loan program is an important innovation in an era of shrinking federal support for low-income homeownership. It is important to note that this innovation comes with a price; leveraged loans serve households with higher incomes than direct loans.

RHS has also paid increased attention to mutual and self-help housing as a strategy to assist low-income families. As appropriations for mutual and self-help housing increase, RHS is providing funding to some 100 non-profit organizations, which in turn give technical assistance to low-income families building their homes, and has allocated greater amounts of Section 502 assistance for self-help housing in recent years.

Home Ownership

Under Section 502 low-income families received subsidized direct loans to construct or acquire single-family housing. Over the history of the Section 502 program, some 2 million low-income families have received assistance. Loans are limited to families with income up to 80 percent of median, and 40 percent of all loan funds must go to families with incomes at 50 percent of median or below – very low-income families.

The average income of households assisted under Section 502 is $18,500. About nine percent of the households have annual incomes of less than $10,000.

Under Section 502 home ownership, the current loan level totals $1.044 billion. This will provide subsidized, direct loan financing for about 15,000 units.

There is unprecedented demand for Section 502 direct loans that exceed the budget request. The FY 04 budget request for Section 502 direct loans is $1.366 billion; the largest request in several years. The additional funds are targeted to improve minority home ownership.

The Section 502 direct loan program is truly a bargain for the government. Based on the budget authority cost to the government, the cost per unit in 2003 is $12,000. It will be less than that in 2004.

Self-Help Housing

In an era of increased focus on family and community, mutual self-help housing stands out as a positive step towards stabilizing low-income families and offering them a means to self-sufficiency. The self-help concept allows low-income families to trade what they have in abundance – labor and determination – for what they do not have – resources for a down payment on a home. Mutual and self-help housing is the hidden gem of the federal government.

Under the mutual and self-help program, RHS makes grants to local housing organizations that recruit groups of 6-8 families who apply for Section 502 loans. These families receive home ownership counseling, construction training and supervision and then work together to build their own homes contributing 65% of the labor.

This sweat equity does two important things: it provides the opportunity for home ownership that might not otherwise be available to economically disadvantaged families and saves the government millions of dollars in reduced mortgage costs. Self-help families who are arguably the lowest income mortgage borrowers in the entire federal government have among the best payments of all federal rural housing borrowers.

The self-help program is also an important tool for increasing minority homeownership rates, which is a goal of the President. RHS FY 1998 statistics show that 68 percent of self-help loans were made to minorities, compared to 31 percent of Section 502 loans overall. Self-help housing has also been a viable option for farmworker families. In a study by Self-Help Enterprises of California, measuring its program from 1965 to 1996, farmworker families represented some of the lowest-income participants -- but also had the lowest foreclosure rates and the longest residency rates.

Congressman Castle visited a self-help housing subdivision last week in Milford, Delaware to help celebrate National Homeownership Month and met with families just moving into their new homes.

Section 515 rental housing program

Although we often talk about the surge in homeownership and all of its benefits, not all of us are or are prepared to be homeowners. USDA's Rural Housing Service Section 515 rural rental housing program is invaluable to low-income residents in rural areas. The portfolio contains 450,000 rented apartments in Section 515 developments. The delinquency rate is a low 1.6 percent. The average annual tenant income is about $8,000, which is equal to only 30 percent of the nation's rural median household income. More than half of the tenants are elderly or disabled and one-quarter are minority.

In Delaware the 515 program is the rental backbone of our rural communities providing quality, affordable housing. It provides a great alternative to families and elderly to move from substandard, tar paper conditions. Waiting lists are very long. More than 200 households showed up this spring for application day for a 24 unit Acorn Acres complex that just opened in Georgetown, Delaware.

Federal policy faces two challenges regarding rural rental housing. The first is to increase the production of affordable rental housing units in rural communities. The second is to maintain the existing stock of Section 515 units.

For many years, federal budget requests for rural rental housing have fallen short of the need. This year, the President's budget cut Section 515 to $71 million and limited it to repair, rehabilitation, and preservation. If the FY 2004 budget request for Section 515 is approved, it will be the first time in more than 30 years that the federal government provides no new rental units for rural America. Section 521 rental assistance is used in conjunction with Section 515 to help families who cannot afford even their reduced rent. In recent years, mostly in response to an escalating number of expiring contracts, appropriations for rental assistance have gone up. Despite the fact the current appropriations stand at $701 million (FY 2002), the funds are insufficient. Almost 90,000 Section 515 households who need rental assistance do not receive it. The need for rental assistance is projected to increase to $937 million by 2006.

While the budget request clearly misses the mark on new production, it also jeopardizes existing rural rental housing developments. Incentives for long term use for rural rental housing authorized in the 1987 Housing Act are under-funded. Lack of Section 515 funding -- and cuts in other resources -- has limited the ability of RHS to provide adequate incentive to owners, or to facilitate acquisition or transfer of Section 515 developments to non-profit organizations or public bodies. As a result, owners seeking incentives or wishing to sell their projects are frustrated.

The General Accounting Office indicates that 24 percent of the Section 515 portfolio is subject to prepayment. This means that some 100,000 families could be displaced if the Section 515 portfolio is deregulated. As noted, the populations of Section 515 developments are very poor and two thirds are elderly or households with disabilities.

These are families with limited means and very often they live in markets with limited housing options. In many rural communities the Section 515 development is the only decent housing in town.

In the past, we have opposed legislation that has de-regulated the Section 515 portfolio and offered tenants only HUD vouchers. In our view, implementation of such a proposal will put an enormous burden on low-income, disabled and elderly tenants. If the voucher is available, tenants will have to navigate between HUD and USDA to gain a voucher, and find decent housing in which their landlord will take a voucher.

It is possible the money for vouchers will be there – but the federal budget for vouchers is very limited. It is possible HUD and the USDA will work out a way to get the voucher to the displaced families – but the track record of HUD in getting vouchers to rural America is not very good. It is possible that the housing will be available in the community and landlord will accept vouchers – but in many rural communities the Section 515 project is the only decent affordable rental housing in town.

So, it is possible that de-regulating the Section 515 portfolio will not adversely impact tenants. It is just not very likely.

Even if prepayment is contingent on appropriations for vouchers and the owner accepting the voucher, we still only have half a loaf. Such a policy may offer protection for current tenants but over time the project would very likely cease to be low-income housing and units will be lost. Section 515 is a tremendous resource for rural America and the voucher solution will result in the decay of stock of decent affordable housing in our nation's small town and farming communities.

Given the current federal budget environment, it seems unlikely the resources will be available to replace Section 515 units that would eventually be lost if the portfolio is de-regulated. It will be far cheaper to the government and less burdensome for tenants for Congress to simply provide adequate resources for preservation incentives compensate owners for long term use and allow tenants to continue to live in their homes.

Section 514 loan and Section 516 grant farm labor housing programs

Two additional rental housing programs specifically address the needs of farm laborers. Migrant and seasonal farm workers are some of the nation's most poorly housed populations. The last documented national study indicated a shortage of some 800,000 units of affordable housing for farm workers.

Farm worker households are also some of the least assisted households in the nation. Some 52 percent of farm worker households' incomes are below the poverty threshold, four times the national household poverty rate, and 75 percent of migrant farm workers have incomes below the poverty line. Yet little more than 20 percent of farm worker households receive public assistance, most commonly food stamps, rarely public or subsidized housing.

There are only two federal housing programs that specifically target farm workers and their housing needs: Sections 514 and 516 of the Housing Act of 1949 (as amended). Borrowers and grantees under Rural Housing Service Sections 514 and 516 receive financing to develop housing for farm workers. Section 514 authorizes the Rural

Housing Service to make loans with terms of up to 33 years and interest rates as low as one percent. Section 516 authorizes RHS to provide grant funding when the applicant will provide at least 10 percent of the total development cost from its own resources or through a 514 loan.

This program has been used very successfully in Delaware to provide decent, affordable housing in place of primitive camps while serving local workers and those who migrate to the Delmarva Peninsula in support of our agricultural industry. The Elizabeth Cornish Landing facility in Bridgeville is a Fannie Mae Maxwell Award winner.

Non-profit housing organizations and public bodies use the loan and grant funds, along with RHS rural rental assistance, to provide units affordable to eligible farm workers. These funds are used to plan and develop housing and related facilities for migrant and seasonal farm workers. Current funding for Sections 514 and 516 totals $37 million in program authority. This amount provides about 700 units of housing. The estimated need is far beyond the current level.

Support Rural Rental Housing Act

The National Rural Housing Coalition applauds the efforts of Congressmen Ruben Hinojosa and Artur Davis in addressing the significant need for federal assistance of rental housing in rural communities. Their introduction of HR 1722, the 2003 Rural Rental Housing Act (RRHA), which will create a new federal program to alleviate problems such as cost-burden, substandard housing conditions and the lack of affordable rental housing in rural low-income communities, has long been overdue.

The Rural Rental Housing Act authorizes $250 million in annual federal appropriations to finance the acquisition, rehabilitation and construction of rental housing and related facilities in rural areas. The purpose of the program is to increase the quantity and quality of affordable housing for rural low-income households and the elderly.

The funds may be used on a flexible basis to provide a variety of forms of assistance to increase the supply and quality of affordable housing in rural areas. With matching funds, up to $500 million in financing could be available to rural America to increase the supply of rural rental housing for families and the elderly. These funds could finance up to 5,000 units annually.

Funds will be allotted on a state-by-state basis based on the rural substandard housing and rural poverty within a state. USDA will make assistance available to public bodies and Native American tribes, as well as private non-profit corporations with a record of accomplishment in housing or community development.

Federal assistance may not be used to finance more than 75 percent of a project cost. The assistance may be made available in the form of capital grants, direct subsidized loans, guarantees, and other forms of financing for rental housing and related facilities.

Under the RRHA, USDA will directly administer the funds, financing up to 75 percent of the cost of housing and related facilities. Alternatively, states, CDFIs or other non-profit intermediaries could match the funds allocated to a state and provide financing to eligible rental housing projects.

The population served must be very low, low or moderate-income households, i.e. those with incomes of 0 percent to 100 percent of the area median income. *Priority for assistance* will be given to very low-income (0 percent – 30 percent of area median income) and minority households.

Housing must be in rural areas with populations not exceeding 25,000, outside of urbanized areas. Priority for assistance will be in low-income communities or in communities with a severe lack of affordable housing.

In conclusion, we believe that the programs of the Rural Housing Service have made a huge difference in quality and quantity of housing in rural America. The task now is to reinvigorate spending for homeownership, reinvest in Section 515 developments and authorize the Rural Rental Housing Act to spur new rental development.

Thank you for the opportunity to testify before the Subcommittee. I would be happy to answer any questions you may have.

NATIONAL ASSOCIATION OF HOME BUILDERS

Testimony Of

James R. Rayburn

First Vice President of the

National Association of Home Builders

Before the

United States House of Representatives

Housing and Community Opportunity

Subcommittee of the

Financial Services Committee

On

Rural Housing in America

June 19, 2003

Introduction

Thank you Mr. Chairman for the opportunity to testify before the Subcommittee on Housing and Community Opportunity on housing in rural America. I am Bobby Rayburn, a home builder and developer from Jackson, Mississippi. My company, Rayburn Associates, has constructed more than 3,000 single family and multifamily homes. Providing affordable homeownership and rental housing opportunities in rural America is, and has been, a major focus of my 30 years in home building. I also serve as the 2003 First Vice President of the 211,000-member National Association of Home Builders (NAHB), which I am representing today. NAHB represents more than 800 state and local home builder associations across the country, and NAHB members will build approximately 80 percent of the nearly 1.7 million new housing units that are projected for construction in 2003.

NAHB and its members place a high priority on providing safe, affordable, high quality housing for rural Americans. While much progress has been made in improving housing in rural America, considerable unmet needs remain, particularly for very-low and low-income rural households. Specifically, there is a significant shortage of affordable rural rental housing, the existing rental stock is aging and in need of renovation, and access to competitively priced credit for potential home buyers remains a problem in many rural areas.

Nearly all federal efforts to address rural housing needs are currently undertaken through the Rural Housing Service (RHS) of the U.S. Department of Agriculture (USDA). Appropriations for these programs have declined dramatically and current funding levels are inadequate across the board. In addition, a number of RHS programs are in need of major reforms, particularly the multifamily management activities, and its portfolio of properties has deteriorated to an alarming degree.

Remedies are urgently needed. While there are many possible approaches to meeting the need for the production of new units and preservation of the existing stock, there are two common elements that are crucial to success – more resources must be committed and a range of interests beyond the Department of Agriculture must join in the effort.

The Role of USDA Rural Development Programs in Rural Housing

RHS serves a unique role by providing loans and loan guarantees in areas of the nation that, in many cases, are not well served by conventional lenders. Some of the programs offered by RHS, such as the Section 502 direct loan program, provide below-market rate loans to families who would otherwise not be able to achieve homeownership. The delivery mechanism for this program is also unique because these loans are arranged though local Rural Development staff. The Section 502 Guaranteed Rural Housing program provides guarantees for loans originated by private sector lenders and serves moderate-income rural Americans.

Similarly, the Section 515 and 538 multifamily loan programs provide direct loans and loan guarantees, respectively, which have been critical in providing affordable rental housing in rural communities where such housing otherwise would not exist.

A group of NAHB members recently met with the Under Secretary for USDA Rural Development, and the RHS Administrator. NAHB believes RHS is attempting to fix the problems that exist, particularly with regard to the multifamily area, and, if sufficient funding can be found, these programs will be better equipped to meet future needs.

NAHB also firmly believes that support for RHS programs should be elevated to a higher priority within the Department of Agriculture. Emphasis needs to be placed on encouraging new construction of multifamily housing and the preservation of the existing affordable rental stock. Funding levels to support both single family and multifamily programs should be adequate to meet the housing needs of rural Americans. In addition, partnerships between private, for-profit entities, state and local governments and non-profit groups should continue to be encouraged and supported at the highest levels within the Department.

Funding for Rural Housing Service Programs

NAHB believes that there continues to be a critical need for the production and preservation of affordable rental housing in rural areas as well as programs that make homeownership possible for deserving families. As such, NAHB strongly believes that support for the Rural Housing Service programs within the USDA, from Congress, and by many rural stakeholder organizations is essential to ensuring that affordable housing opportunities are available to low- and moderate-income rural Americans.

Multifamily Rental Housing

The Section 515 direct loan program provides mortgage loans, with interest rates as low as one percent, to developers to provide affordable multifamily rental housing for very low-, low- and moderate-income families. In fact, in new Section 515 projects, 95 percent of tenants must have very-low incomes and, in addition, many of those served by the program are elderly households.

We are very disappointed to note that, again, the administration's FY 2004 budget request failed to provide any funding for Section 515 direct loans for *new* multifamily construction projects and, instead, included only $71 million, which is earmarked for repair and rehabilitation purposes. The RHS says that it must concentrate on preserving the existing portfolio and its substantial rehabilitation needs. The agency undertook an internal study of the new construction program last year, but has not taken steps to implement any changes to the program, nor has it published any of its findings. NAHB stands ready to participate in discussions that focus on improving the new construction program.

In the meantime, however, NAHB believes that a portion of monies allocated to the Section 515 program must be directed toward new construction, and we support a funding level of $300 million. We urge Congress to give significant consideration to providing the program with a level of funding that will allow for much-needed new production, as well as for rehabilitation of existing stock.

NAHB supports a funding level of $200 million for the Section 538 guaranteed loan program, for which $100 million has been proposed by the administration. This program is intended to finance the construction, acquisition or rehabilitation of rural multifamily housing for lower-income residents. The residents of these rental housing units must be very low- to moderate-income households with incomes that do not exceed 115 percent of the median income of the surrounding area. An adequate level of funding would enable the RHS to have a broad range of tools by which to meet the affordable housing needs of these rural residents. While the Section 538 program got off to a slow start, the RHS has made extensive efforts to address issues raised by lenders and the secondary market that prevented the program from being attractive. RHS currently has a proposed rule for the Section 538 program out for comment that would make several more important regulatory changes, which NAHB supports.

With regard to the Section 521 Rental Assistance Program, NAHB is pleased that the president's budget provides $740 million, an increase of $28 million over last year's funding level. Rent subsidies under this program help to ensure that the low-income residents of multifamily housing units financed by the RHS are able to afford rent payments. However, we remain very concerned that without a larger funding increase for this program, the proposed level would only support existing programs, without providing an opportunity to fund new rental contracts. Therefore, we encourage a funding level of $850 million for this account.

Multifamily Management

Key to the success of preserving the existing RHS multifamily portfolio and providing much-needed new affordable rental housing is the ability of the agency to address management issues. Inconsistencies in how the projects are monitored occur from state to state, management fees have wide variations, and it seems to be difficult to remove bad property managers or owners. In addition, RHS staff can present roadblocks to potential purchasers of existing properties who plan to improve the properties. In one instance, a potential purchaser who had financing in hand to solve a significant health and safety problem at a property was told by RHS staff that additional physical improvements to the property, not related to health and safety, had to be made before a sale would be approved. The cost of such improvements surpassed the amount of financing available, and the potential purchaser abandoned the deal. The RHS needs a viable management and preservation strategy, which must include the ability to respond more effectively to such situations.

NAHB understands that some of these types of issues will be addressed in RHS' recently issued proposed regulatory changes to its multifamily programs (Sections 514, 515, 516 and 521). These changes are intended to streamline and consolidate 13 regulations into one, as well as address concerns raised by the Office of the Inspector General. NAHB supports such efforts and encourages RHS to move towards simplifying its regulations as much as possible, as well as strengthening its ability to address its portfolio responsibilities. NAHB is reviewing the proposed rule and will submit comments to the agency.

Single Family Housing

With Section 502 housing loan guarantees, low- and moderate-income individuals and families can purchase homes without making a downpayment because they may borrow up to 100 percent of the appraised value of the home. Since a common barrier to owning a home for many is the lack of funds to make a downpayment, this program makes the possibility of owning a home a reality for many Americans in rural communities. NAHB continues to support full funding for this program, which will support approximately $2.7 billion in loan production.

In addition, NAHB continues to support increased funding for the Section 502 direct loan program. Under this program, individuals and families are able to receive a home loan directly from the RHS at an affordable interest rate. Most of these loans are made to families with incomes below 80 percent of the median income level in the communities where they live. Because the RHS provides loans to those who will not qualify for a conventional loan, the program creates homeownership opportunities for many more Americans than might otherwise be possible.

Without adequate funding levels, the Section 502 direct loan program will not be able to meet the needs of very low- and low-income rural residents because the need for Section 502 loans consistently exceeds budgeted levels. As it is, only one out of every four applicants receives a direct loan from RHS under this program. The FY 2004 budget request includes $168 million in funding to support $1.37 billion in Section 502 direct loans. NAHB recommends that, at a minimum, a program level of $1.5 billion be approved for this program. To meet current needs, however, it would take three times this level.

HUD Funding

NAHB is also disappointed that the administration is proposing, for the third year in a row, to eliminate the Rural Housing and Economic Development program in the budget of the U.S. Department of Housing & Urban Development (HUD). This program provides funding to nonprofits and other community groups in rural areas for capacity building at the state and local level for rural housing and economic development and to support innovative housing and economic development activities in rural areas. In the past, Congress has not supported the elimination of this program, and NAHB urges that you continue to provide $25 million in funding for the program in FY 2004.

Partnerships to Address Rural Housing Needs

Even with more funding, RHS cannot do the job alone. NAHB is pleased that the RHS is undertaking partnerships with HUD, the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank System, the Federal Reserve, Fannie Mae, Freddie Mac, Rural Local Initiatives Support Corporation (LISC), the Neighborhood Reinvestment Corporation, state housing finance agencies, rural employers and other organizations to promote rural homeownership initiatives and to find ways to leverage RHS' assets. These types of partnerships are essential given RHS' limited resources and the large and often remote geographical areas that must be covered. More extensive efforts in this direction are requisite to adequately addressing rural housing needs.

Most of the partnership efforts outlined above are aimed at addressing homeownership needs. NAHB believes that partnerships also are needed to address the affordable rental housing needs of rural residents. Because affordable rental properties in rural areas tend to be small when compared to typical urban projects, many larger lenders will not make such loans. The RHS has made some progress working with the secondary market to make its multifamily loans acceptable for their portfolios. Freddie Mac has purchased a few Section 538 loans, and Fannie Mae is interested in a preservation strategy that pools Section 515 loans. But neither of these efforts to date has resulted in a significant number of successful deals. We were pleased to learn recently that Ginnie Mae will be seeking legislation from Congress that would permit it to guarantee securities that are backed by the RHS, which would help expand the secondary market for Section 538 loans. NAHB strongly supports this initiative.

The RHS alone does not have the capacity or funding to provide the level of loans needed. Local lenders, state housing finance agencies (HFAs) and other financial entities also need to participate. HFAs have great potential for rural lending and, in fact, many Section 515 projects now include Low Income Housing Tax Credits or tax-exempt bonds issued by the HFAs. Some HFAs are trying to pool small loans that can be included in one bond issue, which greatly reduces the transactions costs for small loans. More programs of this type should be developed. In addition, HUD should overhaul its small projects product, which currently is too cumbersome to be an effective financing tool.

Financial Literacy for Rural Families

One of the most significant barriers to homeownership in rural areas is the lack of financial literacy by potential home buyers. NAHB was pleased that USDA and the FDIC recently signed a memorandum of understanding to promote broad use of the FDIC's "Money Smart" program. When coupled with home buyer education programs, which are funded by HUD and delivered by HUD-approved education providers, Money Smart will help to make rural families more knowledgeable, more creditworthy, and less likely to fall prey to unscrupulous lending practices. In the past, RHS had a modest budget of $1 million to fund home buyer education. In the administration's FY 2004 budget, this line item has been dropped, with the explicit intention that funding for rural home buyer education would be drawn from HUD's budget. Steps must be taken to ensure that sufficient educational resources are directed to rural areas.

Housing Goals for Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac, which are government-sponsored enterprises (GSEs), are required by law to meet annual housing goals established by HUD. Under the housing goals, the GSEs must meet annual percent of business goals for three categories: low- and moderate-income, underserved areas, and special affordable. The first set of goals were established by regulation in 1995, and were updated in 2000 to cover the years 2001 – 2003. Current goals levels, as a percent of annual purchases, are: 50% for low-moderate; 31% for underserved areas; and, 20% for special affordable goal. Revisions to the goals for 2004 and beyond are currently under review by HUD.

To this point the GSE housing goals have had little, if any, impact in improving the availability of housing credit in rural areas. In the 2000 revision of the goals, the underserved areas goal was increased from 24 to 31 percent, but there has been only a limited increase in the role of Fannie Mae and Freddie Mac in rural housing finance. During development of the 2000 rule, NAHB commented that HUD should encourage increased participation in rural areas by Fannie Mae and Freddie Mac through the use of bonus points or double credit for purchases of loans in rural areas. HUD did not include this recommendation in the final rule, but we plan to revisit this issue during the revision to the goals for 2004.

According to the latest regulatory agenda, HUD intends to propose new housing goals in August. HUD has not released any information about possible changes in the goals. However, the administration's 2004 budget analysis suggests that HUD may incorporate new factors into the goals for 2004 and beyond to encourage improved performance from the GSEs in serving low- and moderate-income and minority families. NAHB urges HUD to include improved rural housing credit in that policy agenda.

NAHB supported HUD's increase in the goals for the 2001 – 2003 period. NAHB feels that more needs to be done to encourage the GSEs to further increase their rural activities and we look forward to working with HUD in an effort to address rural housing needs during the current goals review.

Rural Housing and the Community Reinvestment Act

NAHB strongly supports the goal of the Community Reinvestment Act (CRA), which is to encourage federally insured financial institutions to help meet the credit needs of their entire communities. Again, however, the CRA process has brought little or no benefit to borrowers in rural areas. NAHB believes the needs of rural and other underserved areas could be more sufficiently addressed if the CRA were modified to encourage financial institutions to serve those areas.

The CRA has been in existence for 25 years, and yet, there are still many geographic areas, particularly rural communities, that are not receiving adequate levels of financial services or that are being neglected altogether. For example, our members report instances where several banks in proximity to an underserved community declined to finance proposed housing projects because that community was not considered to be in their assessment areas. The financial institutions apparently felt no incentive to lend in communities considered outside of their assessment areas since they probably would not receive CRA credit for such lending. As a result, many communities and their residents are falling through the cracks.

NAHB believes that Congress should consider encouraging efforts to provide financial services in geographic areas that an institution can be reasonably expected to serve. Currently there is no incentive for financial institutions to lend, invest or provide financial services in rural areas. We understand that many projects intended to revitalize or stabilize rural communities do not qualify under the current regulatory definition of community development because those activities are not located in low- or moderate-income geographies, as defined in the regulations.

We also believe that it is important to provide greater CRA credit for initiatives that serve areas that previously did not have adequate access to credit. NAHB believes such a revision would provide incentives for institutions to establish branches and lending relationships in more difficult to serve areas.

The federal banking regulators currently are reviewing the CRA regulations. NAHB is participating in that process, and we hope the Congress will join us in urging reform to improve rural credit availability.

Conclusion

In conclusion, Mr. Chairman, NAHB thanks you for bringing attention to and supporting the cause of rural housing during Homeownership Month. As you know, the problems of housing rural Americans extend to both affordable homeownership and rental opportunities.

NAHB believes that, under the leadership of Under Secretary Thomas Dorr and RHS Administrator Arthur Garcia, Rural Development is attempting to address its severe problems and is doing a better job of promoting the use of partnerships among a broad base of housing stakeholders. However, much more work remains to be done, and the federal government must commit more resources to the task. Meeting the housing needs in rural areas requires not only that housing be elevated as a priority within the Department of Agriculture, but that a broad range of other entities, including HUD and the GSEs, become committed participants and partners in the effort.

NAHB stands ready to work with RHS, HUD, the GSEs and all other supporters of rural housing to improve the programs and to develop creative solutions to maximize the use of scarce resources in addressing these critical needs.

United States General Accounting Office

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Testimony
Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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RURAL HOUSING SERVICE

Opportunities to Improve Management

Statement of William B. Shear, Acting Director
Financial Markets and Community Investment

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GAO-03-911T

June 19, 2003

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Highlights

Highlights of GAO-03-911T, a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, U.S. House of Representatives

RURAL HOUSING SERVICE

Opportunities to Improve Management

Why GAO Did This Study

Federal housing assistance in rural America dates back to the 1930s, when most rural residents worked on farms. Without electricity, telephone service, or good roads connecting residents to population centers, residents were comparatively isolated and their access to credit was generally poor. These conditions led Congress to authorize separate housing assistance for rural residents, to be administered by USDA.

Over time, the quality of the housing stock has improved and credit has become more readily available in rural areas. Also, advances in transportation, computer technology, and telecommunications have diminished many of the distinctions between rural and urban areas.

These changes call into question whether rural housing programs still need to be maintained separately from urban housing programs, and whether RHS is adapting to change and managing its resources as efficiently as possible.

www.gao.gov/cgi-bin/getrpt?GAO-03-911T.

To view the full product, click on the link above. For more information, contact William B. Shear at (202) 512-4325 or shearw@gao.gov.

What GAO Found

Our testimony is based on two reports addressed to this subcommittee—the September 2000 report on rural housing options and May 2002 report on multifamily project prepayment and rehabilitation issues. GAO found that while RHS has helped many rural Americans achieve homeownership and has improved the rural rental housing stock, it has been slow to adapt to changes in the rural housing environment. Also, RHS has failed to adopt the tools that could help it manage its housing portfolio more efficiently. Specifically:

- Dramatic changes in the rural housing environment since rural housing programs were first created raise questions as to whether separately operated rural housing programs are still the best way to ensure the availability of decent, affordable rural housing. Overlap in products and services offered by RHS, HUD, and other agencies has created opportunities for merging the best features of each. Even without merging RHS's programs with HUD's or those of other agencies, RHS could increase its productivity and lower its overall costs by centralizing its rural delivery structure.
- RHS does not have a mechanism to prioritize the long-term rehabilitation needs of its multifamily housing portfolio. As a result, RHS cannot be sure it is spending limited rehabilitation funds as effectively as possible and cannot tell Congress how much funding it will need in the future.

Source: GAO.

A distressed house in Mississippi where a homeowner lived for 46 years until his new home, financed with an RHS single-family loan and additional funding sources, was finished in February, 2000.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the management of Rural Housing Service (RHS) programs. RHS makes a significant investment in affordable housing for low-income rural Americans through a variety of direct and guaranteed loan and grant programs. RHS manages a single-family and multifamily direct loan portfolio of about $28 billion, oversees a program that guarantees about $3 billion in single-family mortgages annually, and administers over $700 million in rental assistance payments each year.

This statement is based on two reports addressed to this Subcommittee: our September 2000 report on rural housing options and our May 2002 report on multifamily project prepayment and rehabilitation issues.[1] I will also briefly discuss the objectives of our ongoing work on RHS's rental assistance program. My principle objective today is to present an overview of the concerns identified in our previous reports that you may want to consider as you deliberate on how best to improve housing services for rural Americans.

In summary, while RHS has significantly improved the quality of the housing stock in rural America and has helped many rural Americans become homeowners, it has been slow to adapt to changes in the rural housing environment. In addition, it has not adopted the managerial tools that are now available that would help it make better use of its housing portfolio and limited budgetary resources. Specifically:

- First, dramatic changes in the rural housing environment since rural housing programs were first created raise the question of whether separately operated rural housing programs are still needed to best ensure the availability of decent affordable rural housing. Overlap in the products and services offered by RHS, the Department of Housing and Urban Development (HUD), and other agencies opened up opportunities for merging the best features of each program. But even without merging the best features of RHS's programs with the best features of those of HUD or other agencies, RHS could increase its

[1] *Rural Housing: Options for Optimizing the Federal Role in Rural Housing Development* (GAO/RCED-00-241, September 15, 2000) and *Multifamily Rural Housing: Prepayment Potential and Long-Term Rehabilitation Needs for Section 515 Properties* (GAO-02-397, May 10, 2002).

productivity and lower its overall costs by centralizing its rural delivery structure.

- Second, RHS does not have a mechanism for prioritizing the long-term rehabilitation needs of its multifamily portfolio. As a result, RHS cannot be that sure that it is spending its limited rehabilitation funds as effectively as possible and cannot tell Congress how much funding it will need in the future.

Background

The government has been providing housing assistance in rural areas since the 1930s. At that time, most rural residents worked on farms, and rural areas were generally poorer than urban areas. For example, in the 1930s very few rural homes had electricity or indoor plumbing. Accordingly, the Congress authorized housing assistance specifically for rural areas and made USDA responsible for administering it. However, rural demographic and economic characteristics have greatly changed over time. By the 1970s virtually all rural homes had electricity and indoor plumbing. Today, less than 2 percent of the nation's population lives on farms, and advances in transportation, technology, and communications have – or have the potential to – put rural residents in touch with the rest of the nation. The federal role has also evolved, with HUD, the Department of Veterans Affairs (VA), and state housing finance agencies becoming significant players in administering housing programs.

Homeownership in the United States is at an all-time high with 68 percent of the nation's households owning their own home. In rural areas, the homeownership rate is even higher — 76 percent. However, according to the Housing Assistance Council, affordability is the biggest problem facing low-income rural households. Rural housing costs have increased and income has not kept pace, especially for rural renters who generally have lower incomes than owners. As a result, rural renters are more likely to have affordability problems and are twice as likely as rural owners to live in substandard housing.

Although the physical condition of rural housing has greatly improved over time, it still lags somewhat behind that of urban housing. The most severe rural housing quality problems are found farthest from the nation's major cities, and are concentrated in four areas in particular: the Mississippi Delta, Appalachia, the Colonias on the Mexican border, and on Indian trust land. Minorities in these areas are among the poorest and worst housed groups in the nation, with disproportionately high levels of inadequate housing conditions. Migrant farm workers in particular have difficulty finding affordable, livable housing. The higher incidence of housing quality problems, particularly in these four areas, offsets many of the advantages of homeownership, including the ability to use homes as investments or as collateral for credit.

USDA's Farmers Home Administration managed rural housing programs and farm credit programs until reorganization legislation split these functions in 1994.[2] Farm credit programs were then shifted to the new Farm Service Agency. Housing programs were moved to the newly created RHS in the new Rural Development mission area which was tasked with helping improve the economies of rural communities. RHS currently employs about 5,500 staff to administer its single family, multifamily, and community facilities programs.

RHS's homeownership programs provide heavily subsidized direct loans to households with very low and low incomes, guaranteed loans to households with low and moderate incomes, and grants and direct loans to low-income rural residents for housing repairs. Multifamily programs provide direct and guaranteed loans to developers and nonprofit organizations for new rental housing that is affordable to low and moderate income tenants; grants and loans to public and nonprofit agencies and to individual farmers to build affordable rental housing for farm workers; housing preservation grants to local governments, nonprofit organizations, and Native American tribes; and rental assistance subsidies that are attached to about half the rental units that RHS has financed. In addition, RHS administers community facilities programs that provide direct and guaranteed loans and grants to help finance rural community centers, health care centers, child care facilities, and other public structures and services.

For fiscal year 2003, RHS received an appropriation of $1.6 billion. Of this amount, the largest share, $721 million, is for its rental assistance program. Congress also authorized about $4.2 billion for making or guaranteeing loans, primarily for guaranteeing single-family loans.[3] RHS oversees an

[2]Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Pub. L. 103-354 (1994).

[3]Authorized dollar amounts represent the expected private-sector loan levels guaranteed by RHS as well as loans made directly by RHS during the year. Actual appropriations are much lower because they cover the subsidy cost, not the face value of the loans or guaranteed loans. The subsidy cost is the estimated long-term cost to the government of a direct or guaranteed loan calculated on a net present value basis, excluding administrative costs. In fiscal year 2003, the $4.2 billion in loan authorizations are estimated to require about $37 million in credit subsidy costs.

outstanding single-family and multifamily direct loan portfolio of about $28 billion. Table 1 lists RHS's programs, briefly describes them, and compares the spending for them in fiscal year 1999 with the spending for them in fiscal years 1979 and 1994. The table also shows that, although RHS's single and multifamily guaranteed programs are relatively new, by 1999 RHS had guaranteed more single- and multifamily loans than it made directly.

Table 1: Data on RHS's Housing Programs

Dollars in millions

RHS housing program	Total dollars spent, fiscal year 1979	Total dollars spent, fiscal year 1994	Total dollars spent, fiscal year 1999	Number of households helped, fiscal year 1999	Type of assistance
Single-Family Housing Direct Loans (sec. 502)	$2,870.0[a]	$1,656.8[a]	$966.9[a]	15,600	Loans subsidized as low as 1 percent interest
Single-Family Housing Guaranteed Loans (sec. 502)		$725.9[a]	$2,980.0[a]	38,600	No money down, no monthly mortgage insurance loans
Single-Family Home Repair Grants and Loans (sec. 504)	$33.7	$52.7	$46.8	9,021	Grants for elderly and loans subsidized as low as 1 percent interest
Single-Family Housing Mutual Self-Help Grants (sec. 523)	$5.6	$12.8	$25.4	1,350	Grants to nonprofit and public entities to provide technical assistance
Multifamily Direct Rural Rental Housing Loans (sec. 515)	$869.5[a]	$512.4[a]	$114.3[a]	2,181	Loans to developers subsidized as low as 1 percent interest
Multifamily Housing Guaranteed Loans (sec. 538)			$74.8[a]	2,540	Guaranteed loans for developing moderate-income apartments
Multifamily Housing Farm Labor Grants and Loans (secs. 516/514)	$68.8	$56.3	$33.2	622	Grants and loans subsidized at 1 percent interest
Multifamily Housing Preservation Grants (sec. 533)		$23.0	$7.2	1,800	Grants to nonprofit organizations, local governments, and Native American tribes, usually leveraged with outside funding
Multifamily Housing Rental Assistance (sec. 521)	$423.0	$446.7	$583.4	42,000	Rental assistance to about one-half the residents in RHS rental and farm labor units

Source: Rural Housing: Options for Optimizing the Federal Role in Rural Housing Development (GAO/RCED-00-241, September 15, 2000), pp. 15-16.

[a]Dollar amounts represents private-sector loan levels guaranteed by RHS or loans made directly by RHS during the year. Actual federal outlays are much lower because they cover the subsidy cost, not the face value of the loans or guaranteed loans. The subsidy cost is the estimated long-term cost to the government of a direct or guaranteed loan calculated on a net present value basis, excluding administrative costs.

While RHS administers its programs in rural areas, HUD, VA, and state housing finance agencies provide similar programs nationwide, including assistance to households that may be eligible for RHS programs in rural areas. For example, RHS's single-family loan guarantee program serves moderate-income homebuyers as does the Federal Housing Administration's (FHA) much larger single-family insurance program. VA and most state housing finance agencies also offer single-family loan programs. In the multifamily area, HUD's multifamily portfolio is similar to RHS's multifamily portfolio and HUD's project-based section 8 program operations parallel RHS's rental assistance program. Further, in contrast to RHS, HUD has more established systems for assessing the quality of its multifamily portfolio through its Real Estate Assessment Center (REAC) and for restructuring financing and rental assistance for individual properties through its Office of Multifamily Housing Assistance Restructuring (OMHAR).

Changes in the Rural Housing Environment Raise Questions About the Need to Maintain Separately Operated Rural Housing Programs

Given the diminished distinctions between rural and urban areas today, improvements in rural housing quality and access to credit, and RHS's increasing reliance on guaranteed lending and public/private partnerships, our September 2000 report found the federal role in rural housing is at a crossroads. We listed arguments for and against fundamentally changing the programs' targeting, subsidy levels, and delivery systems, as well as merging RHS's programs with HUD's or other agencies' comparable programs.

Arguments For and Against Separately Operated Programs

A number of arguments have been presented to support continuing RHS's housing programs separately from HUD and other agencies or for maintaining a separate system for delivering these programs, including the following:

- Some rural residents need the close supervision offered by RHS local offices because they do not have access to modern telecommunications or other means of obtaining information on affordable housing opportunities;
- Rural borrowers often need a local service office familiar with their situation in the first year of a loan;

- Rural areas could lose their federal voice in housing matters;
- Rural areas could lose the benefits of the lower rates and terms RHS's direct and guaranteed loan programs currently offer; and
- HUD and other potential partners have not focused on rural areas.

Proponents of arguments for merging RHS's housing programs with other housing programs or not maintaining a separate system for delivering housing programs in rural areas present a different set of arguments:

- RHS's field role has changed from primarily originating and servicing direct loans to leveraging deals with partner organizations;
- In some states, local banks, nonprofit organizations, social workers, and other local organizations are doing much of the front-line work with rural households that was previously done by RHS staff;
- The thousands of RHS staff with local contacts could provide a field presence for HUD, and other public partners, applying their leveraging and partnering skills to all communities; and
- RHS and HUD could combine management functions for their multifamily portfolios that are now provided under separate systems.

We also noted that without some prodding, the agencies are not likely to examine the benefits and costs of merging as an option. As a first step toward achieving greater efficiency, we suggested that the Congress consider requiring RHS and HUD to explore the potential benefits of merging similar programs, such as the single-family insured lending programs and the multifamily portfolio management programs, taking advantage of the best practices of each and ensuring that targeted populations are not adversely affected.

Actions Taken to Share Resources and Expertise

Since we issued our report in September 2000, it appears that RHS and FHA have shared some mutually beneficial practices. First, RHS's single-family guaranteed program plans to introduce its automated underwriting capabilities through technology that FHA has already developed and has agreed to share with RHS. Second, RHS, FHA, and VA have collaborated in developing common reporting standards for tracking minority and first-time homeownership statistics. Third, we understand that there have been discussions between RHS and HUD staff on developing a model to restructure RHS section 515 mortgages using techniques that HUD has learned through restructuring similar HUD section 236 mortgages.

Opportunities Exist to Improve RHS Program Efficiencies

Our September 2000 report also identified a number of actions that RHS officials and others have identified that could increase the efficiency of existing rural housing programs, whether or not they are merged. I will limit my discussion today to two issues that deal with RHS's field structure.

The first issue involves state delivery systems. When state Rural Development offices were given the authority to develop their own program delivery systems as part of the 1994 reorganization, some states did not change, believing that they needed to maintain a county-based structure with a fixed local presence to deliver one-on-one services to potential homeowners. Other states tried innovative, less costly approaches to delivering services, such as consolidating local offices to form district offices and using traveling loan originators for single-family programs. However, RHS has undergone a major shift in mission during the past few years. RHS is still a lending agency like its predecessor, the Farmers Home Administration, but it now emphasizes community development, and uses its federal funding for rural communities to leverage more resources to develop housing, community centers, schools, fire stations, health care centers, child care facilities, and other community service buildings. Some state Rural Development officials we spoke with questioned the efficiency and cost-effectiveness of maintaining a county-based field structure in a streamlined environment where leveraging, rather than one-on-one lending, has become the focus of the work.

For example, the shift in emphasis from direct to guaranteed single-family lending moved RHS from relying on a labor intensive loan generation process to one that relies on private lenders to underwrite loans. When we performed our audit work in 2000 we found that Mississippi, which maintains a county-based Rural Development field structure, had more staff and field offices than any other state but the next to lowest productivity as measured by dollar program activity per staff member. Ohio, however, which ranked fifth in overall productivity, operated at less than one-fifth of Mississippi's cost per staff member. We recognize that it is more difficult to underwrite single-family loans in the Mississippi Delta and other economically depressed areas than in rural areas generally, and Mississippi does have a substantial multifamily portfolio. Nevertheless, the number of field staff in Mississippi far exceeded that in most other states. Ohio, whose loan originators were based in four offices and traveled across the state with laptop computers, ranked seventh in the dollar value of single-family guaranteed loans made and fifth in the dollar amount per staff member of direct loans made. Ohio had also done a good job of serving all of its counties, while Mississippi had experienced a drop in business in the counties where it had closed local offices. Ohio's travel and equipment costs had increased with the use of traveling loan originators.

The Maine Rural Development office had also fundamentally changed its operational structure, moving from 28 offices before the reorganization to 15 afterwards, and in 2000 it operated out of 3 district offices. The state director at the time, who had also headed the Farmers Home Administration state office in the 1970s, said that he had headed the agency under both models and believed the centralized system to be much more effective. He added that under the new structure, staff could no longer sit in the office waiting for clients to come to them but had to go to the clients. He also maintained that a centralized structure was better suited to building the partnerships with real estate agents, banks, and other financial institutions that had become the core element of RHS's work.

The second issue involves the location of field offices. Consistent with its 1994 reorganization legislation, USDA closed or consolidated hundreds of county offices and established "USDA service centers" with staff representing farm services, conservation, and rural development programs. However, the primary goal of the task team that designed the service centers was to place all the county-based agencies together, particularly those that dealt directly with farmers and ranchers, to reduce personnel and overhead expenses by sharing resources. But while the farm finance functions from the old Farmers Home Administration fit well into the new county-based Farm Service Agency, the housing finance functions that moved to the new state Rural Development offices were never a natural fit in the centers. The decision to collocate Rural Development and Farm Service offices was based on the fact that Rural Development had a similar county-based field structure and the Department needed to fill space in the new service centers. Collocating Rural Development and Farm Service offices designed to serve farmers and ranchers makes less sense today, especially in states where Rural Development operations have been centralized.

RHS Does Not Have a Mechanism to Prioritize the Long-Term Rehabilitation Needs of Its Multifamily Portfolio

How to deal with the long-term needs of an aging portfolio is the overriding issue for section 515 properties. In the program's early years, it was expected that the original loans would be refinanced before major rehabilitation was needed. However, with prepayment and funding restricted, this original expectation has not been realized, and RHS does not know the full cost of the long-term rehabilitation needs of the properties it has financed. RHS field staffs perform annual and triennial property inspections that identify only current deficiencies rather than the long-term rehabilitation needs of the individual properties. As a result, RHS does not know whether reserve accounts will cover long-term rehabilitation needs. Without a mechanism to prioritize the portfolio's rehabilitation needs, including a process for ensuring the adequacy of individual property reserve accounts, RHS cannot be sure it is spending its limited rehabilitation funds as effectively as possible and cannot tell Congress how much funding it will need to cover the portfolio's long-term rehabilitation costs.

RHS's state personnel annually inspect the exterior condition of each property financed under the section 515 program and conduct more detailed inspections every 3 years. However, according to RHS guidelines, the inspections are intended to identify current deficiencies, such as cracks in exterior walls or plumbing problems. Our review of selected inspection documents in state offices we visited confirmed that the inspections are limited to current deficiencies. RHS headquarters and state officials confirmed that the inspection process is not designed to determine and quantify the long-term rehabilitation needs of the individual properties.

RHS has not determined to what extent properties' reserve accounts will be adequate to meet long-term needs. According to RHS representatives, privately owned multifamily rental properties often turn over after just 7 to 12 years, and such a change in ownership usually results in rehabilitation by the new owner. However, given the limited turnover and funding constraints, RHS properties primarily rely on reserve accounts for their capital and rehabilitation needs. RHS officials are concerned that the section 515 reserve accounts often are not adequate to fund needed rehabilitation.

RHS and industry representatives agree that the overriding issue for section 515 properties is how to deal with the long-term needs of an aging portfolio. About 70 percent of the portfolio is more than 15 years old and in need of repair. Since 1999, RHS has allocated about $55 million in rehabilitation funds annually, but owners' requests for funds to meet safety and sanitary standards alone have totaled $130 million or more for each of the past few years. RHS headquarters has encouraged its state offices to support individual property owners interested in undertaking capital needs assessments and has amended loan agreements to increase their rental assistance payments as necessary to cover the future capital and rehabilitation needs identified in the assessments. However, with varying emphasis by RHS state offices and limited rental assistance funding targeted for rehabilitation, the assessments have proceeded on an ad hoc basis. As a result, RHS cannot be sure that it is spending these funds as cost-effectively as possible.

To better ensure that limited funds are being spent as cost-effectively as possible, we recommended that USDA undertake a comprehensive assessment of the section 515 portfolio's long-term capital and rehabilitation needs, use the results of the assessment to set priorities for the portfolio's immediate rehabilitation needs, and develop an estimate for Congress on the amount and types of funding required to deal with the portfolio's long-term rehabilitation needs. USDA agreed with the recommendation and requested $2 million in the President's 2003 budget to conduct a comprehensive study. RHS staff drafted a request for proposal that would have contracted out the study, but the Undersecretary for Rural Development chose to lead the study himself. Plans are to develop an inspection and rehabilitation protocol by February 2004 on the basis of an evaluation of a sample of properties.

GAO Is Examining Rental Assistance Program Issues

Finally, I would like to mention some work we have begun on the Section 521 rental assistance program. With an annual budget of over $700 million, the rental assistance program is the largest line item appropriation to the Rural Housing Service. This is a property-based subsidy that provides additional support to units created through the Section 515 multifamily and farm labor housing programs. RHS provides this subsidy to property owners through 5-year contracts. The objectives for our current work are to review (1) how RHS estimates the current and future funding needs of its Section 521 rental assistance program; (2) how RHS allocates the rental assistance; and (3) what internal controls RHS has established to monitor the administration of the rental assistance program. We anticipate releasing a report on our findings in February of 2004.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions you or any other members of the Committee may have.

Contact and Acknowledgements

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Question for the Hearing Record—Subcommittee on Housing and Community Opportunity—June 19, 2003. "Rural Housing in America". (Question submitted for the record by Representative Barney Frank.)

Q: Do you think it would be a good idea to merge RHS' housing programs with comparable HUD programs? If so, why? If not, why not?

A: Last year, the Council for Affordable and Rural Housing (CARH) was asked whether we would support a merger of the multifamily programs of RHS into HUD. This question raised a considerable amount of debate for a number of reasons within our membership. At that time, CARH's board of directors declined to take a position on the merger because exact language was not available and there were several unanswered questions.

We would like to share with you some of the concerns that were raised. First, we did not think it was possible to merge only the multifamily programs into HUD. If Congress decided that rural housing programs would be better served at HUD, all of the programs currently under the purview of the RHS would have to be merged.

Second, there are different agencies administered by the same staff under the Rural Development department within the United States Department of Agriculture, specifically the Rural Business Service and the Rural Utility Service as well as RHS. Some of the programs under these other Agencies are used in conjunction with RHS programs. Thus moving RHS alone would not be practical without dividing and moving existing staff. There was concern that this could create new regulatory burdens and expenses for rural communities and housing providers.

The General Accounting Office in its report entitled: "Rural Housing Options for Optimizing the Federal Role in Rural Housing Development," indicated that the rural housing programs at RHS have been successful. The GAO went on to note in its report that RHS fits a niche that is not being addressed by HUD, particularly in the multifamily arena. However, the multifamily programs within RHS have been negatively impacted during the last several years due to drastic funding reductions. In looking at programs at HUD and RHS, the GAO did find that in the single-family arena, there does appear to be some overlap and duplication.

Third, there was concern that rural housing would get lost at HUD. While HUD has more money and staffing resources, the emphasis has been on urban areas. The Rural Economic and Development office at HUD continues to receive funding from the Congress, but that is a small office and the mission and purpose of the office is not clear. Staff within that office has not spent time discussing rural issues with our organization or our individual members and have a low visibility on rural issues. If RHS would be merged into HUD, the concern would be that members would loose the relationship that has been built over the years with staff in district, state and national offices. A practical solution might be to have a separate Rural Housing and Economic Development Assistant Secretary.

Fourth, there has been encouragement that HUD and its staff have some similar issues that might be better solved by the two agencies working together. As with HUD, the age of the RHS's portfolio is getting older. As we indicated in our Aging Portfolio Paper that was submitted with CARH's written testimony, funding and regulatory barriers at RHS is threatening the ability of borrowers to operate, maintain and rehabilitate older complexes. There is no question that increasing RHS's budget would help alleviate some of the financial pressures on the portfolio. At the same time there is a need to streamline current procedures and create flexibility in existing programs within the RHS. In this regard, CARH's board of directors at our June 2003 annual meeting and legislative conference did endorse HUD's Office of Multifamily Housing Assistance Restructuring (OMHAR) business plan that would assist RHS in developing and implementing programs and policies directed at the aging portfolio.

There continues to be some frustration dealing with RHS because of inconsistent policies among state offices and staffs, which does not exist at HUD. This is not to say that there are no inconsistencies within HUD. However, RHS is not fully able to meet its intended purpose and goals because it is organized in a manner that inhibits the sharing of information and training, thereby greatly adding to transaction costs and preventing many meritorious transactions. Due to statutory changes in 1994, the programs are developed through the Rural Housing Administrator, but are implemented through each State Office in Rural Development. Those State Offices do not report to the Administrator but instead report to the Under Secretary for Rural Development, which creates a gap in communications and implementation. To illustrate, this would have the same effect as if a Congressman's Office Staff reported to the Majority Leader rather than to the Congressmen. Thus, CARH would recommend uniform national standards and lines of authority, similar to current HUD operations. This could be achieved in part by re-assigning or re-delegating housing responsibilities from the Under Secretary for Rural Development to Rural Housing Administrator.

In conclusion, we would not anticipate a change in CARH's position without reviewing a specific legislative proposal. There is no question, however that some changes need to be made to RHS, or its programs are going to continue to decrease in effectiveness and fewer and fewer residents in rural America would be helped. No doubt a merger proposal would stir some serious and heated debates on rural housing. Such debates could take several years to resolve a merger proposal, which would further exacerbate the problems facing rural housing and the residents who rely on this housing. Regardless of any merger discussion, a near-term solution, such as a re-assignment of authority, a detail of staff among various agencies to work on specific policies and/or utilizing OMHAR could result in more effective rural programs.

Council for Affordable and Rural Housing
Serving the Affordable Housing Needs of Rural America

Position Paper by the Council for Affordable and Rural Housing on the Aging Section 515 Rural Housing Portfolio

March 10, 2003

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COUNCIL FOR AFFORDABLE AND RURAL HOUSING

Position Paper on Aging Section 515 Rural Housing Portfolio

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COUNCIL FOR AFFORDABLE AND RURAL HOUSING

Position Paper on Aging Section 515 Rural Housing Portfolio

EXECUTIVE SUMMARY

The Council for Affordable and Rural Housing's (CARH)* members are concerned that program neglect will cause the successful Section 515 rural multifamily housing portfolio to deteriorate. We believe that this portfolio is worth safeguarding because it provides an essential housing resource for rural America. However, as any property ages, it requires more attention and periodic rehabilitation. Building systems begin to fail and need replacing at or after the fifteenth anniversary from construction or substantial rehabilitation. In some cases this has already begun to happen. Section 515 properties are typically more than 15 years old. These properties have suffered because federal funding shortages have resulted in inadequate financing for properties in the program. Statutory and regulatory barriers also have been erected to prevent prepayment, which similarly prevent preservation. The result has been a static, aging portfolio that owners believe will soon be seen not as a success, but as a problem. We at CARH issue this position paper to underscore this emerging problem and propose solutions, before it's too late. Solutions are many, ranging from restoring the Rural Housing Service ("RHS") budget to historic levels, to breaking down legal and administrative barriers preventing the use of other existing financing. We will first present our position through an abridged executive summary, then expand on each listed point.

This paper is the culmination of advice and information provided by dozens of CARH members, with an ownership or management role in approximately 2,000 Section 515 properties. Information was collected during several months of consultation, from September 2002 to January 2003.

Administrative Changes

Make RHS Structure More Rational

RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. This creates a jumble of interpretations for what should be a uniform set of standards. We recommend that RHS have uniform national standards and lines of authority, similar to current U.S. Department of Housing And Urban Development ("HUD") operations.

RHS already has a Preservation Office, but that office suffers from the same balkanized implementation as the rest of the Agency. We recommend elevating the authority of the Preservation Office and authorize it to centralize preservation processing.

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*CARH is a national trade association with headquarters in Alexandria, Virginia. CARH represents the interests of over 300 companies. Members of the association build, develop, finance, manage, own and supply products to the rural housing industry.

By "preservation" we mean maintaining both the physical repair and the low-income character of the housing at issue. The main goal of the Preservation Office should include reviewing and restructuring financing on aging properties. RHS should administratively adopt a recovery program that will expedite transfers, prepayments and loan workouts, within the Preservation Office.

Make Servicing Assets Fair and Effective

We understand that RHS has been attempting to update existing regulations with the "3560" regulation. We strongly urge the U.S. Department of Agriculture ("USDA") to issue the proposed rule.

State Rural Development ("RD") Offices review and set budgets and rents through a time-consuming review for any rent increase, no matter how small. We ask that RHS adopt a policy that allows cost-of-living increases based on general economic data. We also recommend that RHS permit full budgeting of owner distributions. Current RHS regulations discourage owners from advancing funds to properties to meet short-term needs, so we recommend that RHS allow owners a priority repayment in order to encourage advances to protect operations.

New Section 515 loans are rare as the program is at historically low funding levels. Where the alternative new funding is provided through other federal or State agencies, the underwriting standards of those agencies should be used, and RHS should utilize subordination regulations to encourage new financing. RHS staff training should emphasize compatibility with other programs.

Servicing is made even more difficult because USDA's Office of General Counsel typically refuses to talk to the public, let alone confer about differing legal interpretations. We recommend that OGC represent RHS before the public and work with the public, as is typical at other government agencies.

Streamline Transfer Rules.

Owners that seek to maintain low-income restrictions through a transfer face a complicated and daunting process. Because State Directors administer the program, the exact interpretations of the rules vary generally from state-to-state. This also creates a Catch-22 situation because owners cannot readily prepay out of the program or transfer and refinance within the program. We believe that the only solution is to have a firm processing deadline and informal appeal rights to the RHS National Office.

Streamline Prepayment Rules

There has been significant confusion between mortgage prepayment and market-rate conversion, with a generalized fear that one automatically leads to the other. Prepayment can, but does not necessarily lead to market-rate conversion. CARH supports restoring owners' prepayment rights, but even if those rights are not restored, RHS should institute a streamlined prepayment process for owners maintaining affordability in order to avoid unnecessary waste and delay.

RA Tracking Needs to be More Accurate

CARH believes that RHS may not accurately reflect the true depth of the current Rental Assistance ("RA") funding shortage. RHS should distinguish between truly unused RA, which has not been allocated to a property or resident, and reserved but temporarily unused RA, which is needed for a specific property such as described here.

Statutory Changes

Restore RHS' Budget.

RHS' budget has been severely limited in recent years and the multi-family housing production budget is a fraction of that appropriated by Congress in years past. Historical funding levels were between $500 million and $900 million. In recent years, the budget was reduced to a little more than $100 million. We recommend restoring RHS' budget to historical levels.

Enact a New Cost Effective Program.

In light of funding shortages, we have analyzed various ways to utilize federal funds to achieve maximum financial leverage. We recommend a new interest credit program to leverage federal funds, perhaps through the Nation's Home Loan Banks.

Recycle Prepayment Proceeds to Create Revolving Fund

Congress should permit prepayment funds received by USDA to be used as new funding. This would help USDA recycle funds and maintain affordable housing in needed areas.

Provide Vouchers.

RHS properties would benefit greatly from an allotment of Section 8 vouchers. Currently, rural properties cannot easily access HUD Section 8 vouchers. We recommend a set aside of Section 8 vouchers for Section 515 properties that prepay.

Convert Certain Rental Assistance

Presently, RA terminates when the Section 515 loan is prepaid. We recommend converting RA to Section 8 so subsidy continues after prepayment.

Solutions Through The Tax Code

Make the Tax Credit More Responsive to Rural Housing

Many RHS properties developed in the past 15 years have been made possible by the Tax Credit, but many other properties cannot be developed because owners cannot reach the 9% Credit. We believe that the Tax Credit rules under Section 42 of the Internal Revenue Code should be clarified to permit the 9% credit for RHS programs, similar to the treatment of HUD's HOME and CDBG programs. We also recommend that Section 42 be amended to provide for a small statutory set aside for properties located in rural housing areas as designated by RHS. This will also help open credit to needy rural areas. We further believe that current rent limits need to be addressed. CARH supports H.R. 284, introduced by Representatives Amo Houghton (R-NY) and Richard Neal (D.-MA), which would amend the Internal Revenue Code to allow states to use the higher of the area median income ("AMI") or the statewide median income for the purpose of calculating income limits.

Provide Exit-Tax Relief

Owners are "locked-in" by exit tax liability, which prevents transfer and refurbishment. CARH recommends elimination of exit taxes by limiting taxation to actual distributions to owners.

INTRODUCTION

CARH owners and managers are on the front line of operating and preserving the nation's largest single source of affordable housing for rural America: the Section 515 Program. CARH members include private for-profit and non profit developers and managers, as well as federal, state and local housing and finance agencies. We know from experience that each entity brings special talents yet they share a common goal of providing decent, safe and affordable housing for lower income Americans. This portfolio is very productive but consists largely of aging properties facing rising operating costs and deferred maintenance. There is no single solution, but there are tried and true programs that have been successful. These programs need some modification and money to continue this success. We will proceed to define the problem, examine how property needs and resources shape the discussion and how owner goals shape the results.

DEFINING THE PROBLEM

(i). Background

The Section 515 Program, funded by private capital and government funds under Section 515 of the Housing Act of '49, operates through a successful public-private partnership. However, this portfolio is in jeopardy. This portfolio of some 16,400 apartment complexes containing more than 400,000 units is by and large nearly 20 years old. See GAO Report "Multifamily Rural Housing, Prepayment Potential And Long-Term Rehabilitation Needs For Section 515 Properties," May 10, 2002 ("2002 GAO Report").

Studies conclude that there are nearly 14 million families and elderly persons with critical housing needs, which includes a significant proportion of rural residents. See, for example, Stegman, Quercia, McCarthy "Housing America's Working Families," New Century Housing (June, 2000). This need falls disproportionately on nonmetropolitan areas, as concluded by the General Accounting Office's September 2000 report entitled "Rural Housing Options for Optimizing the Federal Role in Rural Housing Development." As such, federal programs addressing housing needs also need to confront rural housing needs if we are going to include all Americans in our national economy. Unfortunately, the gains we have made in providing affordable housing through the Section 515 program are eroding. There is an overall shrinking of the rental housing supply, as detailed by the Millennial Housing Commission, Meeting Our Nation's Housing Challenges, May 30, 2002, pp. 16-19 ("MHC Report").

Real estate of all types is periodically updated and rehabilitated as an essential and typical part of property operation and maintenance. See "What We Have Learned About Properties, Owners, And Tenants from the 1995 Property Owners and Managers Survey", by Howard Savage, U.S. Census Bureau. See also "Homeowner Remodeling Trends Affect Contractor Workloads," Housing Economics, April 1990. This is especially true of apartment complexes like these that are in constant use, successfully providing homes to hundreds of thousands Americans.

Funding shortages and regulatory barriers threaten the ability to operate, maintain and rehabilitate older buildings. RHS itself estimates that 4,250 Section 515 properties with 85,000 units "will physically deteriorate to the point of being unsafe or unsanitary within the next 5 years." See USDA OIG Report "Rural Development Compliance with Federal Managers' Financial Integrity Act Reporting Requirements," March 2002. RHS estimates it will need $850 million to maintain just this portion of the portfolio. RHS estimates it may need as much as $3.2 billion for portfolio-wide rehabilitation. 2002 GAO Report, p.3. We believe that streamlining current procedures and creating flexibility in existing programs are the best ways to address existing properties. We categorically believe that maintaining the existing housing stock is more cost effective, and less expensive, than allowing that stock to deteriorate and be replaced with new housing.

(ii). Prepayment Is Not an Issue for Most Properties

Prepayment and conversion to market-rate rents is a realistic option for only one-quarter of the Section 515 portfolio. The prepayment discussion often distracts from issues confronting the other three-quarters of the portfolio.

Prepayment has been seen as a threat to the Section 515 portfolio. Prepayment, coupled with preservation, also has been used as a tool to both rehabilitate affordable housing and preserve low-income use restrictions. However, prepayment will only reach about 3,900 of the more than 16,000 properties in the total Section 515 portfolio. Only those properties have both (a) enough equity to make prepayment feasible and (b) the original right to prepay. See The 2002 GAO Study.

Originally, owners with loans dated before December 15, 1989, had the right to prepay their mortgages, and there are about 10,229 such properties. Another 6,137 loans were originated after December 15, 1989, and always have been subject to RHS prepayment approval. See The 2002 GAO Study. Congress removed the prepayment right for the pre-1989 properties and replaced it with the Emergency Low Income Housing Preservation Act of 1987 ("ELIHPA"), which, as the title suggests, was supposed to be a short term solution. The process was intended to swap owner equity for "incentive" payments and, in the process, extend low-income restrictions. However, Congress slashed funding for incentives, and never restored owner's prepayment rights. Congress restricted payment for similar HUD-assisted properties under ELIHPA, but subsequently restored prepayment rights when incentive funding failed. This inconsistent treatment has led owners to seek redress in court.

Owners of the pre-1989 properties have since sued over their lost prepayment rights. In *Franconia Associates v. United States*, 536 U.S. 129 (2002), the Supreme Court vindicated owners' rights to sue for damages six years after an owner requests prepayment. The Court also expressed that Section 515 Loan Agreements should be treated like other contracts where the government breaches or repudiates its obligations. This has opened the way for a series of owner suits for damages. Other owners have also had preliminary success in *Kimberly Associates v. United States*, 261 F.3d 864 (9^{th} Cir. 2001), where the Ninth Circuit ruled that USDA was obligated to honor its contractual commitments and accept prepayment. In light of these two cases, and others, it appears that if the United States continues to resist prepayment, it may be faced with significant litigation costs and damages. The goal of preservation would be better served by allowing those owners seeking prepayment to prepay and committing resources to maintain low-income subsidy.

(iii). Property Position Creates Preservation Options

While the vast majority of Section 515 properties are fully accomplishing their mission, market factors dictate whether or not the properties have any residual value or equity. If so, new financing can be drawn from various private sources. However, many properties are not valuable other than as affordable housing, even though they are in good condition and fully accomplishing their housing mission. Government funding sources, either through loans, tax incentives and/or guarantees, will be needed to maintain many of these properties. Further, some Section 515 properties will need to be closed down due to changes in local markets or individual building failures.

We believe that any analysis of the Section 515 portfolio must be driven by the financial status of the properties themselves. The financial status of the property often drives the physical condition (owners can only repair what they can pay for). The financial status in turn also dictates the options available to owners. Of course, assessing properties and their futures is complicated. RHS has failed to articulate a uniform policy or position about additional funding for properties with prepayment restrictions in place. Currently, only those properties in litigation or engaging in lengthy preservation processing can plan for major rehabilitation efforts.

We suggest analyzing the portfolio by property condition and by owner goals. The property condition will generally dictate the range of options for a property and owner. Owner goals, however, can be highly individualistic, motivated as much by personal matters as the positioning of a property.

The proposals described below make the most sense when viewed against the context of the Section 515 portfolio. In sum, the most valuable properties have the most options, but we must account for the needs of all properties, and not just the most valuable. We believe that project needs and alternatives should be examined in the following groups:

> "Equity" Properties -- These properties are in good to superior condition with a consistent history of positive cash flow and are located in areas with rents significantly higher than the Section 515 rent limits. These properties have sufficient equity to attract private funding sources and sale offers. In that sense, these properties are able to finance their own exit and preservation strategies. These properties are fully serving their intended purpose.
>
> "Performing—Superior" Properties -- These properties are in good to superior condition with a generally consistent history of positive cash flow, but the rent structure is close to or at market rate. These properties may have value as other than affordable housing. These properties are fully serving their intended purpose.
>
> "Performing" Properties -- These properties are in good to superior condition but do not have a significant history of positive cash flow.

Rents are at or above market and are most valuable as affordable housing. These properties are fully serving their intended purpose.

"Marginal" Properties -- These properties are in fair to good condition. They have been able to produce enough income to operate but rely heavily on Rental Assistance from RHS. These properties are generally productive.

"No Market" Properties -- Properties with significant vacancy rates and repair problems. These properties are generally, but not always, located in economically depressed areas or areas where RHS will not permit a rent increase. These properties are generally in fair condition, but have significant deferred maintenance. Often these properties have not received enough income to keep up with deposits to the reserve account and have a shallow financial cushion.

PROPERTY POSITION

PROPERTY CONCERNS	EQUITY	PERFORMING-SUPERIOR	PERFORMING	MARGINAL	NO MARKET
Physical Concerns					
Physical Condition	Superior	Good to Superior	Good to Superior	Fair	Fair
Regulatory Compliance Issues	Not Likely	Possible	Possible	Possible	Likely
Obsolescence	No	No	Upgrades Desired	Deferred Maintenance – Needs Upgrading	Yes
Market Concerns					
Market Rents	Below Market	At or below Market	At or Above Market	Above Market	Above Market
Saleability	Highest and Best Use Alternatives	Positive Comparison	Lack of Market Comparables	Not Likely	Not Likely
Occupancy	90% or Greater	90% or Greater	90% or Greater	Less than 90%	50% to 80%
Financial Concerns					
Cash Flow	Significant	Likely	Possible	Not Likely	Not Possible at Present
Reserve Accounts In Place	Funded/Over Funded	Funded	Underfunded to funded	Underfunded	Underfunded

(iv). Owner Goals Vary Based on Need, Not Project Resources

Many owners will be keenly aware of the alternatives facing their properties. However, the particular path an owner chooses to follow will depend not only on property-specific factors, but also on owner goals. Examining property type gives us a sense of property needs and resources. However, owner goals must be considered before we can fully understand property-related alternatives.

Owners have faced declining options over the years. RHS has kept rents down and created processing barriers to rent increases. Rent processing problems have also resulted in owner returns not being paid or even budgeted. Owners have also found most of the original tax benefits taken away through the Tax Reform Act of 1986. This has left longtime owners tired and interested in leaving the program, but at the same time has created opportunities for a new generation of parties interested in buying many of these properties. Owners can be separated into:

1) Market Owners--Owners who want to keep the properties but want out of the program and want to maximize return. These are generally for-profit owners, but not all for-profit owners fit this mold.

2) Program Owners--Owners who want to keep the properties and who are basically satisfied with the goals of providing affordable housing. These include non-profit owners and for-profit owners that have an affordable housing mission or are simply comfortable in the programs. These owners may still seek to maximize profits, but look first to do so within the programs.

3) Mom-and-Pop Owners--These are local owners and general partners of owners who entered a program that was intended to be short-term. As the GAO Study points out, prepayment was, originally, not just acceptable but required. Now these owners find themselves stuck in a program where prepayment, transfer and normal servicing are all bound by dense and time-consuming rules.

4) Retiring Owners--Owners who need to sell for estate planning or other reasons. This is particularly applicable to this portfolio, which has many properties with individuals as general partners. After 20 years or so of operations, these people seek to retire or, increasingly, pass on.

OWNER POSITION

OWNER GOALS	MARKET OWNER	PROGRAM OWNER	MOM AND POP OWNER	RETIRING OWNER
Concern For Residents	Moderate	High	High	Neutral
Compatible with Regulatory Environment	Low	Moderate	High	Neutral
Fiduciary Loans to Partners	High	Neutral	Neutral	Neutral
Annual Return to Owner	High	High	High	High
Equity Take Out	High	Moderate	Moderate-High	High
Exit Tax Concerns	High	Neutral	Varies by individual tax position	High
Desire to Keep Income from Management	Neutral	High	Low to High	Neutral

(v). Examining Property Type and Owner Type

From the above charts and descriptions we can see that property position indicates potential equity resources and property needs. As noted above, about a quarter of the properties are "Equity" and the remaining three-quarters are in other property position categories. The default rate for this portfolio is extremely low, so nearly all other properties are Performing-Superior, Performing, or Marginal – these properties are essentially serving their purpose, but many are showing signs of age and wear. This provides a context for examining needs and resources.

Property owners determine the goals and future of property operations. Market owners, retiring owners and many mom-and-pop owners are all currently seeking ways to exit the program. Market owners and some mom-and-pop owners want to convert properties to market rate and reposition them. However, experience shows that these owners typically are comfortable with current residents and are interested in accepting other subsidies, as long as they can recognize equity appreciation and market-rate return.

Other market owners, mom-and-pop owners and retiring owners are keenly interested in selling their properties, and whether a property stays in the program or not is of relatively little importance. What is key for these owners is addressing exit taxes and fiduciary duties to their partners to receive a reasonable sales price.

Program owners, both for-profit and non-profit, can fill this need. Equity properties often provide enough resources on their own if preservation barriers were removed. For the remaining three-quarters of this portfolio, preservation must be financed through other government programs. Moreover, solving existing administrative and regulatory barriers will help convince more owners to stay in the program and further help the cause of preservation.

FINDING SOLUTIONS

I. ADMINISTRATIVE CHANGES

The following changes can be made mainly through regulatory changes. Our recommendations in later sections, below, require congressional action. The following proposals can be addressed by Congress, but can just as easily and directly be addressed through administrative action. In that sense, the following changes can and should be implemented by RHS and USDA in the short term for immediate effect.

A. Make the RHS Structure More Rational

1. Have a National Implementation of a National Program

RHS has national programs that should operate under basic national standards. However, RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. Each State Office has leeway to establish and implement the same federal programs in vastly different ways than other offices, creating a jumble of interpretations to what should be a uniform set of standards. The 2002 GAO Study, at page 8, notes that many owners are so frustrated with RHS, they may prepay to leave the program, even if prepayment is not economically advantageous.

We believe that RHS should have uniform national standards and lines of authority, similar to current HUD operations. We recommend that the Under Secretary for Rural Development delegate to the RHS Administrator the ability and authority to review any State Director decision and to hear any appeal by a USDA customer about State or District Office processing.

2. Elevate Preservation Office

RHS already has a Preservation Office, as required by existing legislation. However, that office suffers from the same balkanized implementation as the rest of the Agency. Currently, the Preservation Office reviews and approves incentive offers processed by State Offices. Whether and how processing occurs is generally up to the State Offices, so the Preservation Office is unable to form, shape or implement any preservation strategy. We recommend elevating the Preservation Office to coordinate and process all Preservation issues and to shape and implement policy directly. We understand that RHS has begun to address this issue by designating a State Multi-Family Housing Preservation Contact.

3. Have Preservation Office Implement a National Recovery Program

The main goals of the Preservation Office should include reviewing and restructuring financing on aging properties.

Owners, managers and USDA have already dealt with struggling properties. We anticipate this trend will continue as properties age. The premise of this paper is that intervention now is vital to avoid revenue shortages and the operational difficulties that will result. Still, we anticipate that, regardless of our efforts, there will be properties that will experience operating difficulties.

Based on recent, anecdotal observations, properties become troubled through temporary lack of residents, spike in operating costs, and incapacitated or deceased owners. However, there is a small, but active group of for-profit and non-profit developers that focus on troubled properties. RHS should adopt a recovery program, as part of the Preservation Office, that will expedite transfers, prepayments and loan workouts, and provide a subsidy clearinghouse for owners willing to take on troubled properties.

We understand that RHS is also implementing its Multi-Family Housing Information System (MFIS) 3 software, which will track broad categories of asset management information. This will help devise recovery strategies.

B. Servicing Assets

1. RHS and State Office Staff Often Micro-Manage, Thereby Missing Larger Issues

(a) Regulatory Reform

We understand that RHS has been attempting to update existing regulations with the "3560" regulation. Unfortunately, USDA has not issued the rule, even in proposed form, though it has been in process since about 1996. We strongly urge USDA to issue the proposed rule, which may address many servicing concerns, and which will be a vehicle for addressing some concerns mentioned in this section.

(b) Micromanagement of Budget Rents and Return

State RD offices review and set budgets and rents through a time-consuming review, no matter how small the request. We ask that RHS adopt a national policy similar to California RD, which allows cost-of-living ("COL") increases based on general economic data. In most areas, in most years, operating costs increase due to inflation and other general economic factors. Owners that have project-specific needs in excess of those COL increases can then request additional, project-specific increases where appropriate.

Owners are limited to 8% of initial equity, and initial equity is usually 5% of the construction cost of a property. See AN 3777. As a result, an owner's five percent total return is just 4 percent of initial value (8% of the 5% of construction cost)[1]. In plain English, that is very close to nothing. After 20 years of inflation this distribution based on that original value is usually less than the margin for error in the annual budgeting process. Often, owners are not allowed to even budget for this return. We recommend that RHS permit owners to budget for and receive this small return.

[1] For example, if initial construction cost is $1 million, the initial equity is 5% or $50,000 and the return is limited to 8% of that sum, which would be $4,000 per year.

Current RHS regulations at 7 C.F.R. Part 1930, Subpart C, discourage owners from advancing funds to properties to meet short-term needs. The limited return limits the ability to repay advances even if funds are later available. RHS should allow owners a priority repayment in order to encourage advances to protect operations.

(c) OGC Involvement is Problematic

Servicing is made even more difficult because USDA's Office of General Counsel (OGC) typically refuses to talk to the public, let alone confer about differing legal interpretations. Those OGC attorneys who have conferred with USDA clients and customers are generally understaffed, causing significant time delays in the most basic processing issues. We recommend that OGC actively participate in meetings with the public and USDA contractors, as is typical at other government agencies.

2. RHS Staff Training Should Emphasize Compatibility with Other Programs

Current RHS policy, at AN 3777, effectively limits funding levels to what would have been allowed through a new Section 515 financing. However, new Section 515 loans are rare as the program is at historically low funding levels. Therefore, where Section 515 funds are impractical, RHS should permit alternative funding. Where the alternative new funding is provided through other federal or State agencies, the underwriting standards of those agencies should be used.

This process works particularly well where RHS uses its existing authority to subordinate and reamortize existing Section 515 financing, thereby enticing new equity with a first lien position. We recommend that RHS formalize this process through an AN with form documentation.

Certain owners have found that combining RHS assistance with other assistance can help develop or rehabilitate RHS financed properties. In other instances, developers may not know about, or wish to combine assistance from other sources, such as the HOME Investment Partnerships Program. We recommend RHS training emphasize compatibility with other programs. The Administrator should also have the ability to direct policy implementation on such complicated issues.

C. Streamlining Transfer Rules.

RHS transfer rules at 7 C.F.R. § 1965.63 and § 1965.65 provide enormous barriers to preserving housing within the Section 515 Program. Owners that seek to maintain properties but transfer them to new owners face a process that requires new borrower approvals and a virtual re-underwriting of the existing property. Because State Directors administer the program, the exact interpretations of the rules vary generally from state-to-state. State Directors do not report to the RHS Administrator and do not follow the Administrator's regulation interpretations. This creates a Catch-22 because owners cannot readily prepay out of the program or transfer and refinance within the program.

An example of transfer difficulties can be seen in the case of Joyce Johnson Apartments, located in Shawano, Wisconsin. It has 8 units and was built in 1976. This is a performing property with a Mom-and-Pop owner. The property was built and operated by Joyce Johnson as a sole proprietor owner until her death in 1990. Upon her death the property was deeded to a family Trust by an attorney that was apparently unfamiliar with how the local RD office might view this situation. The Trustee (Ms. Johnson's daughter) attempted to manage the project from where she lived in California. RD declared the project in default because the loan was still in Ms. Johnson's name. RD required the Trustee to process a transfer as if this was an arms length sale, requesting reports on all trust members (Ms. Johnson's two daughters and two grandsons). Two of the decedent's family members have poor credit, and RD will not accept the "transfer" to the Trust. RD has refused to approve rent increases for the past ten years because RD finds Ms. Johnson's death to be unacceptable. RD has informed the Trustees that it will accelerate the loan, which will take another year to complete.

Another example of the transfer and preservation hurdle created by the RD State Offices is the property called Stevens Manor, a 60 unit property located in Cortland, New York. This should have been a simple transfer in the nature of estate planning. The owner, Robert M. Primo Development Corp. sought to transfer title to Robert M. Primo Development, LLC. LLCs receive more favorable tax treatment than corporations, and this LLC was owned by Mr. Primo's family members, which RD rules state are related parties in any event. This fairly straightforward process still took two and a half years to process.

The following is an example of both RD's artificial barriers to preservation and the need for exit tax relief, discussed below. Three related sellers attempted to sell their properties: La Mirage Villas of Borger, located in Borger, Texas; La Mirage Villas of Perryton, in Perryton, Texas; and Briarwood of Kaufman, in Kaufman, Texas. The purchasers tried to raise new equity through Low Income Housing Tax Credits. Even though the tax credit process is time sensitive, it took more than a year for the buyers to hear that their transfer request was rejected. The buyers never received written notice, but the acting State Director for Texas RD told the sellers that RD would not allow the sellers to receive any compensation for the sale of their properties, even though the sale prices were substantially less than the owners' exit taxes. Because of RD regulations, the structure of these transactions create an exit tax liability greater than the tax liability from a foreclosure. In other words, RD's treatment made it more cost effective for the owners to defer the exit tax liabilities until the properties fell into foreclosure than to sell them, rehabilitate them and preserve the affordable housing. The Texas State RD Office eventually revised its position to allow the owners to recover enough to pay exit taxes as if the properties were foreclosed.

We believe that the only solution is to have a firm processing deadline and informal appeal right to the RHS National Office. RHS should institute by regulation that within 90 days of submission of any transfer application, the State Office must process and either approve or reject, with specific reasons and suggestions for approval, any such application. Failure to do so would give an owner right to remove processing to the National Office.

D. Prepayment

There has been a significant confusion between prepayment and market-rate conversion, with a generalized fear that one automatically leads to the other. As noted above, for the pre-December 15, 1989 properties that originally had the right to prepay, the 2002 GAO Study finds that if they could prepay, only 3,900 are positioned to possibly do so. So prepayment, while important, is an issue of limited impact. Moreover, anecdotal information indicates that most prepaid properties convert to another subsidy program. True, those properties obtain higher or market rents, but owners are typically comfortable with market position and tenant make-up, and these owners accept alternative subsidies such as the Section 8 voucher program.

CARH supports restoring owners' prepayment rights, but even if those rights are not restored, RHS should institute a streamlined prepayment process to avoid unnecessary waste and delay. This would aid preservation in situations where an owner agrees up-front to maintain low-income affordability.

One example of RHS' barrier to prepayment preservation can be seen in Gray Eagle Elderly Housing, a 24 unit property servicing the elderly, located in Gray Eagle, Minnesota. The owner originally closed its Section 515 loan in April 1979. This is an example of a Performing-Superior property and a Program owner. The owner is a non-profit corporation, the project was operated efficiently over the years, and there was excess cash flow which was applied to the loan so that the loan was fully paid in 2000. The last payment was submitted to pay off the loan but was rejected by the State RD Office and returned. RD instructed the owner to apply for prepayment. Now in November, 2002, the prepayment application, prepared with the assistance of a third party consultant, has been accepted as complete and is in the prepayment process. This final $931 payment will be made in 2003 – three years after the final payment could have been made. This prepayment is being accepted with lower-income use restrictions, which is fine with the owner, who planned to continue to rent to low-income tenants anyway.

E. <u>RA Tracking Needs to be More Accurate</u>

The Rental Assistance ("RA") program is the main rent subsidy program for the Section 515 portfolio (provided under Section 521 of the Housing Act of '49). CARH members firmly believe that there is a major shortage of RA. The result is that many residents must pay rents at more than 30% of their adjusted gross income. However, we believe that imprecise reporting by RHS masks this shortage. In order to accurately analyze this problem, we suggest that RHS more accurately define "unused RA." RHS appears to categorize assigned RA as "unused" because of tenant turnover or other temporary vacancies. RHS should distinguish between truly unused RA, which has not been allocated to a property, and reserved but temporarily unused RA, which is needed for a specific property.

II. ADDITIONAL FUNDING SOLUTIONS

The suggestions in this Section and Section III require statutory amendment. Many of these proposals work in conjunction with one another and are needed to preserve properties that lack significant, financeable equity.

A. <u>Restore RHS' Budget</u>

RHS' budget has been severely limited in recent years and the multi-family housing production budget is a fraction of that appropriated by Congress in years past. The RHS' main multifamily program is Section 515. Historical funding levels were between $500 million and $900 million. In recent years, the budget was reduced to a little more than $100 million, and funds were split between new development and rehabilitation of existing Section 515 properties. This has resulted in relatively little new housing for rural America, as well as insufficient funding for existing Section 515 properties. Accordingly, we believe that, in all events, rural housing production appropriations should be increased to historical levels of the early 1990s. We expect that any funding increase would be modest in the current federal budget environment, but even a modest increase would be helpful.

Additional revenue will not only provide for housing, but for services and service providers. Currently, RHS does not permit owners to use rent revenue to pay for special resident events or programs. However, most Section 515 properties house elderly and disabled residents located in relatively remote areas frequently need additional services, ranging from transportation to physical therapy and medical related-services. Therefore, we recommend restoring RHS budget levels.

B. New Cost Effective Program

In light of funding shortages, we have analyzed various ways to utilize federal funds to achieve maximum financial leverage. Our best suggestion outside of restoring budget is to leverage federal appropriations through a new program that (a) works consistently with the 9% Tax Credit and (b) provides an interest credit to participating lenders. This interest credit would be used to buy-down mortgage interest rates to support the below-market mission that RHS serves.

We believe that the Nation's Home Loan Banks, regulated by the Federal Housing Finance Board, provide an excellent opportunity for such a program. The Home Loan Bank System has a program called the Community Investment Program ("CIP"), that provides loan funds at a relatively low cost of borrowing. The program already encourages member banks to loan to rural multifamily housing developments.

C. Recycle Funding to Create Revolving Fund

We recognize that prepayment may lead to the loss of some affordable housing in some cases, such as where there are no low-income restrictions. Therefore, Congress should permit prepayment funds received by USDA to be used as new funding. This would help USDA recycle funds and maintain affordable housing in needed areas. This would also restore the USDA's original goal of having loans prepaid and funds returned to the government when a property can attract other capital. See, 2002 GAO Report. This process has the added benefit of being close to revenue neutral.

D. Vouchers

RHS properties would benefit greatly from an allotment of Section 8 vouchers. Currently, rural properties cannot easily access HUD Section 8 vouchers. There is virtually no coordination between HUD and RHS on voucher allocation. Moreover, rural areas do not attract significant allotments of new vouchers and seem left out of this funding pipeline. Funding of rural Section 8 vouchers (like the rural housing set aside for project-based Section 8) will open subsidy to very low income rural residents. We recommend an RHS set aside for the Section 8 voucher program for properties that prepay.

E. Rental Assistance

The best way to encourage prepaying owners to maintain affordability is to allow owners to convert RA contracts to project-based HAP Contracts. Presently, RA terminates when the Section 515 loan is prepaid, but Section 8 would continue after prepayment, assuring affordability.

III. SOLUTIONS THROUGH THE TAX CODE

A. Tax Credit -- Addressing Rural Housing Needs

1. Amend Section 42 to Make 9% Tax Credits More Accessible

We believe that the Tax Credit rules under Section 42 of the Internal Revenue Code should be clarified to permit the 9% credit for RHS programs, similar to the treatment of HUD programs. RHS provides rental assistance, direct loans and loan guarantees. RHS subsidies are often regarded by the Tax Credit investment industry as below-market federal financing, disqualifying RHS properties from the 9% Tax Credit, for all practical purposes. An amendment to specifically provide for 9% Tax Credit eligibility will help make additional rural housing possible. We believe that such legislation could even be targeted to very low income populations (such as the HOME program, where the minimum set aside for 9% Tax Credit is heightened to at least 40% of units occupied by persons at no more than 50% of a median income).

2. Amend Section 42 to Provide for an RHS Set Aside

Currently, RHS properties have trouble competing with urban properties for tax credits. RHS properties tend to be smaller and less visible than larger urban developments. We recommend that Section 42 be amended to provide for a small statutory set aside for properties located in rural housing areas as designated by RHS. This set aside can be targeted to preservation properties. Either way, this would provide another preservation tool. This will also help open credit to needy, rural areas. A minimal set aside of at least 10% would be consistent with past set-asides, such as for non-profit entities.

3. Amend the Definition of Median Income

We also believe that the current rent limit rules need to be addressed. Apartments financed through Tax Credits can have rents at no more than 30 percent of 60 percent of the area median income. In many areas across the country, particularly rural areas, the median income is simply too low to support the development of new multifamily complexes therefore, making development in those areas very difficult or infeasible.

CARH supports H.R. 284 introduced by Representatives Amo Houghton (R-NY) and Richard Neal (D.-MA). This bill would amend the Internal Revenue Code to allow States to use the higher of the area median income ("AMI") or the statewide median income for the purpose of calculating application income limits. This technical change to the Tax Credit program would greatly enhance the tax incentive's ability to help low-income renters that live in the Nation's rural areas.

B. Exit-Tax Relief

As the MHC Report discusses at length, owners are "locked-in" by exit tax liability, which prevents transfer and refurbishment. This barrier is particularly intractable because many of these owners invested in these properties for tax benefits contained in the pre-1986 Tax Code, which were deleted with the 1986 amendments. This proposal could result in tax revenues by encouraging sales and taxing the distributions. Therefore, CARH recommends elimination of exit taxes, and limiting taxation to actual distributions to owners.

CONCLUSION

Owners will pursue different financing and rehabilitation goals as needed on a property-by-property basis. These decisions are and should be made with RHS oversight. However, current laws and RHS implementation have limited refinancing options, and along with it, the ability to operate properties reasonably. We have proposed a wide variety of administrative and statutory changes that will add viability to this portfolio without adding significant additional cost to the federal government.

We recommend that USDA make the following administrative and regulatory changes:

1. Delegate operational authority to the RHS Administrator so that the National Office can better coordinate national policy.
2. Educate the Preservation Office so it can centralize prepayment processing and preservation financing.
3. Institute a Recovery Program in the Preservation Office.
4. Issue the 3560 as a proposed rule.
5. Make the budget process more fair by providing for automatic cost of living increases and by budgeting for owner returns. Allow owners to advance and repay funds to meet emergencies without penalty.
6. Require OGC attorneys to meet with RHS clients and customers about legal issues.
7. Train RHS staff about Section 515 compatibility with other programs.
8. Formalize RHS subordination procedures in a comprehensive AN.
9. Streamline transfer rules so that field offices must within 90 days approve transfers or reject with suggestions to make the transfer approvable.
10. Streamline the prepayment process for Owners that agree to maintain Section 515 income restrictions.

11. Track unused RA more accurately.

The above proposals will simplify operations and encourage Owners to remain in the program, as well as encourage refinancing and extension of affordability restrictions.

We also believe that certain statutory changes are needed, as follows:

1. Restore RHS' budget to something close to historical levels.
2. Institute a new cost effective program for interest credit subsidy to leverage federal dollars, perhaps through the Home Loan Banks.
3. Allow RHS to keep proceeds from mortgage prepayment in a revolving fund for replacement housing or rental subsidy.
4. Provide an allotment of Section 8 vouchers to RHS properties.
5. Allow owners of prepaying properties to convert RA to project-based Section 8.
6. Amend Section 42 so that RHS properties are treated like HOME-assisted properties and can more readily use the 9% Credit.
7. Provide a rural set aside for the Tax Credit.
8. Allow owners to use statewide median income limits to reach a broader band of low-income person.
9. Provide exit tax relief that is presently a barrier to refinancing.

The first five statutory items are either recommended changes to the appropriations process or the Housing Act of '49 and the U.S. Housing Act. The last four items will require statutory changes through the tax code. The above-numerated administrative and statutory changes, together, will result in a more efficient and effective program that is geared to long-term preservation.

Council for Affordable and Rural Housing

Serving the Affordable Housing Needs of Rural America

Position Paper by the Council for Affordable and Rural Housing on the Aging Section 515 Rural Housing Portfolio

March 10, 2003

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COUNCIL FOR AFFORDABLE AND RURAL HOUSING

Position Paper on Aging Section 515 Rural Housing Portfolio

EXECUTIVE SUMMARY

The Council for Affordable and Rural Housing's (CARH)* members are concerned that program neglect will cause the successful Section 515 rural multifamily housing portfolio to deteriorate. We believe that this portfolio is worth safeguarding because it provides an essential housing resource for rural America. However, as any property ages, it requires more attention and periodic rehabilitation. Building systems begin to fail and need replacing at or after the fifteenth anniversary from construction or substantial rehabilitation. In some cases this has already begun to happen. Section 515 properties are typically more than 15 years old. These properties have suffered because federal funding shortages have resulted in inadequate financing for properties in the program. Statutory and regulatory barriers also have been erected to prevent prepayment, which similarly prevent preservation. The result has been a static, aging portfolio that owners believe will soon be seen not as a success, but as a problem. We at CARH issue this position paper to underscore this emerging problem and propose solutions, before it's too late. Solutions are many, ranging from restoring the Rural Housing Service ("RHS") budget to historic levels, to breaking down legal and administrative barriers preventing the use of other existing financing. We will first present our position through an abridged executive summary, then expand on each listed point.

This paper is the culmination of advice and information provided by dozens of CARH members, with an ownership or management role in approximately 2,000 Section 515 properties. Information was collected during several months of consultation, from September 2002 to January 2003.

Administrative Changes

Make RHS Structure More Rational

RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. This creates a jumble of interpretations for what should be a uniform set of standards. We recommend that RHS have uniform national standards and lines of authority, similar to current U.S. Department of Housing And Urban Development ("HUD") operations.

RHS already has a Preservation Office, but that office suffers from the same balkanized implementation as the rest of the Agency. We recommend elevating the authority of the Preservation Office and authorize it to centralize preservation processing.

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*CARH is a national trade association with headquarters in Alexandria, Virginia. CARH represents the interests of over 300 companies. Members of the association build, develop, finance, manage, own and supply products to the rural housing industry.

prepayment rights, but even if those rights are not restored, RHS should institute a streamlined prepayment process for owners maintaining affordability in order to avoid unnecessary waste and delay.

RA Tracking Needs to be More Accurate

CARH believes that RHS may not accurately reflect the true depth of the current Rental Assistance ("RA") funding shortage. RHS should distinguish between truly unused RA, which has not been allocated to a property or resident, and reserved but temporarily unused RA, which is needed for a specific property such as described here.

Statutory Changes

Restore RHS' Budget.

RHS' budget has been severely limited in recent years and the multi-family housing production budget is a fraction of that appropriated by Congress in years past. Historical funding levels were between $500 million and $900 million. In recent years, the budget was reduced to a little more than $100 million. We recommend restoring RHS' budget to historical levels.

Enact a New Cost Effective Program.

In light of funding shortages, we have analyzed various ways to utilize federal funds to achieve maximum financial leverage. We recommend a new interest credit program to leverage federal funds, perhaps through the Nation's Home Loan Banks.

Recycle Prepayment Proceeds to Create Revolving Fund

Congress should permit prepayment funds received by USDA to be used as new funding. This would help USDA recycle funds and maintain affordable housing in needed areas.

Provide Vouchers.

RHS properties would benefit greatly from an allotment of Section 8 vouchers. Currently, rural properties cannot easily access HUD Section 8 vouchers. We recommend a set aside of Section 8 vouchers for Section 515 properties that prepay.

Convert Certain Rental Assistance

Presently, RA terminates when the Section 515 loan is prepaid. We recommend converting RA to Section 8 so subsidy continues after prepayment.

Solutions Through The Tax Code

Make the Tax Credit More Responsive to Rural Housing

Many RHS properties developed in the past 15 years have been made possible by the Tax Credit, but many other properties cannot be developed because owners cannot reach the 9% Credit. We believe that the Tax Credit rules under Section 42 of the Internal Revenue Code

INTRODUCTION

CARH owners and managers are on the front line of operating and preserving the nation's largest single source of affordable housing for rural America: the Section 515 Program. CARH members include private for-profit and non profit developers and managers, as well as federal, state and local housing and finance agencies. We know from experience that each entity brings special talents yet they share a common goal of providing decent, safe and affordable housing for lower income Americans. This portfolio is very productive but consists largely of aging properties facing rising operating costs and deferred maintenance. There is no single solution, but there are tried and true programs that have been successful. These programs need some modification and money to continue this success. We will proceed to define the problem, examine how property needs and resources shape the discussion and how owner goals shape the results.

DEFINING THE PROBLEM

(i). Background

The Section 515 Program, funded by private capital and government funds under Section 515 of the Housing Act of '49, operates through a successful public-private partnership. However, this portfolio is in jeopardy. This portfolio of some 16,400 apartment complexes containing more than 400,000 units is by and large nearly 20 years old. See GAO Report "Multifamily Rural Housing, Prepayment Potential And Long-Term Rehabilitation Needs For Section 515 Properties," May 10, 2002 ("2002 GAO Report").

Studies conclude that there are nearly 14 million families and elderly persons with critical housing needs, which includes a significant proportion of rural residents. See, for example, Stegman, Quercia, McCarthy "Housing America's Working Families," New Century Housing (June, 2000). This need falls disproportionately on nonmetropolitan areas, as concluded by the General Accounting Office's September 2000 report entitled "Rural Housing Options for Optimizing the Federal Role in Rural Housing Development." As such, federal programs addressing housing needs also need to confront rural housing needs if we are going to include all Americans in our national economy. Unfortunately, the gains we have made in providing affordable housing through the Section 515 program are eroding. There is an overall shrinking of the rental housing supply, as detailed by the Millennial Housing Commission, Meeting Our Nation's Housing Challenges, May 30, 2002, pp. 16-19 ("MHC Report").

Real estate of all types is periodically updated and rehabilitated as an essential and typical part of property operation and maintenance. See "What We Have Learned About Properties, Owners, And Tenants from the 1995 Property Owners and Managers Survey", by Howard Savage, U.S. Census Bureau. See also "Homeowner Remodeling Trends Affect Contractor Workloads," Housing Economics, April 1990. This is especially true of apartment complexes like these that are in constant use, successfully providing homes to hundreds of thousands Americans.

served by allowing those owners seeking prepayment to prepay and committing resources to maintain low-income subsidy.

(iii). Property Position Creates Preservation Options

While the vast majority of Section 515 properties are fully accomplishing their mission, market factors dictate whether or not the properties have any residual value or equity. If so, new financing can be drawn from various private sources. However, many properties are not valuable other than as affordable housing, even though they are in good condition and fully accomplishing their housing mission. Government funding sources, either through loans, tax incentives and/or guarantees, will be needed to maintain many of these properties. Further, some Section 515 properties will need to be closed down due to changes in local markets or individual building failures.

We believe that any analysis of the Section 515 portfolio must be driven by the financial status of the properties themselves. The financial status of the property often drives the physical condition (owners can only repair what they can pay for). The financial status in turn also dictates the options available to owners. Of course, assessing properties and their futures is complicated. RHS has failed to articulate a uniform policy or position about additional funding for properties with prepayment restrictions in place. Currently, only those properties in litigation or engaging in lengthy preservation processing can plan for major rehabilitation efforts.

We suggest analyzing the portfolio by property condition and by owner goals. The property condition will generally dictate the range of options for a property and owner. Owner goals, however, can be highly individualistic, motivated as much by personal matters as the positioning of a property.

The proposals described below make the most sense when viewed against the context of the Section 515 portfolio. In sum, the most valuable properties have the most options, but we must account for the needs of all properties, and not just the most valuable. We believe that project needs and alternatives should be examined in the following groups:

> "Equity" Properties -- These properties are in good to superior condition with a consistent history of positive cash flow and are located in areas with rents significantly higher than the Section 515 rent limits. These properties have sufficient equity to attract private funding sources and sale offers. In that sense, these properties are able to finance their own exit and preservation strategies. These properties are fully serving their intended purpose.
>
> "Performing—Superior" Properties -- These properties are in good to superior condition with a generally consistent history of positive cash flow, but the rent structure is close to or at market rate. These properties may have value as other than affordable housing. These properties are fully serving their intended purpose.
>
> "Performing" Properties -- These properties are in good to superior condition but do not have a significant history of positive cash flow.

PROPERTY POSITION

PROPERTY CONCERNS	EQUITY	PERFORMING-SUPERIOR	PERFORMING	MARGINAL	NO MARKET
Physical Concerns					
Physical Condition	Superior	Good to Superior	Good to Superior	Fair	Fair
Regulatory Compliance Issues	Not Likely	Possible	Possible	Possible	Likely
Obsolescence	No	No	Upgrades Desired	Deferred Maintenance – Needs Upgrading	Yes
Market Concerns					
Market Rents	Below Market	At or below Market	At or Above Market	Above Market	Above Market
Saleability	Highest and Best Use Alternatives	Positive Comparison	Lack of Market Comparables	Not Likely	Not Likely
Occupancy	90% or Greater	90% or Greater	90% or Greater	Less than 90%	50% to 80%
Financial Concerns					
Cash Flow	Significant	Likely	Possible	Not Likely	Not Possible at Present
Reserve Accounts In Place	Funded/Over Funded	Funded	Underfunded to funded	Underfunded	Underfunded

OWNER POSITION

OWNER GOALS	MARKET OWNER	PROGRAM OWNER	MOM AND POP OWNER	RETIRING OWNER
Concern For Residents	Moderate	High	High	Neutral
Compatible with Regulatory Environment	Low	Moderate	High	Neutral
Fiduciary Loans to Partners	High	Neutral	Neutral	Neutral
Annual Return to Owner	High	High	High	High
Equity Take Out	High	Moderate	Moderate-High	High
Exit Tax Concerns	High	Neutral	Varies by individual tax position	High
Desire to Keep Income from Management	Neutral	High	Low to High	Neutral

FINDING SOLUTIONS

I. ADMINISTRATIVE CHANGES

The following changes can be made mainly through regulatory changes. Our recommendations in later sections, below, require congressional action. The following proposals can be addressed by Congress, but can just as easily and directly be addressed through administrative action. In that sense, the following changes can and should be implemented by RHS and USDA in the short term for immediate effect.

A. Make the RHS Structure More Rational

1. Have a National Implementation of a National Program

RHS has national programs that should operate under basic national standards. However, RHS is administered on a state-by-state basis with State Directors reporting to the Under Secretary for Rural Development instead of the Administrator. Each State Office has leeway to establish and implement the same federal programs in vastly different ways than other offices, creating a jumble of interpretations to what should be a uniform set of standards. The 2002 GAO Study, at page 8, notes that many owners are so frustrated with RHS, they may prepay to leave the program, even if prepayment is not economically advantageous.

We believe that RHS should have uniform national standards and lines of authority, similar to current HUD operations. We recommend that the Under Secretary for Rural Development delegate to the RHS Administrator the ability and authority to review any State Director decision and to hear any appeal by a USDA customer about State or District Office processing.

2. Elevate Preservation Office

RHS already has a Preservation Office, as required by existing legislation. However, that office suffers from the same balkanized implementation as the rest of the Agency. Currently, the Preservation Office reviews and approves incentive offers processed by State Offices. Whether and how processing occurs is generally up to the State Offices, so the Preservation Office is unable to form, shape or implement any preservation strategy. We recommend elevating the Preservation Office to coordinate and process all Preservation issues and to shape and implement policy directly. We understand that RHS has begun to address this issue by designating a State Multi-Family Housing Preservation Contact.

3. Have Preservation Office Implement a National Recovery Program

The main goals of the Preservation Office should include reviewing and restructuring financing on aging properties.

Owners, managers and USDA have already dealt with struggling properties. We anticipate this trend will continue as properties age. The premise of this paper is that

Current RHS regulations at 7 C.F.R. Part 1930, Subpart C, discourage owners from advancing funds to properties to meet short-term needs. The limited return limits the ability to repay advances even if funds are later available. RHS should allow owners a priority repayment in order to encourage advances to protect operations.

(c) OGC Involvement is Problematic

Servicing is made even more difficult because USDA's Office of General Counsel (OGC) typically refuses to talk to the public, let alone confer about differing legal interpretations. Those OGC attorneys who have conferred with USDA clients and customers are generally understaffed, causing significant time delays in the most basic processing issues. We recommend that OGC actively participate in meetings with the public and USDA contractors, as is typical at other government agencies.

2. RHS Staff Training Should Emphasize Compatibility with Other Programs

Current RHS policy, at AN 3777, effectively limits funding levels to what would have been allowed through a new Section 515 financing. However, new Section 515 loans are rare as the program is at historically low funding levels. Therefore, where Section 515 funds are impractical, RHS should permit alternative funding. Where the alternative new funding is provided through other federal or State agencies, the underwriting standards of those agencies should be used.

This process works particularly well where RHS uses its existing authority to subordinate and reamortize existing Section 515 financing, thereby enticing new equity with a first lien position. We recommend that RHS formalize this process through an AN with form documentation.

Certain owners have found that combining RHS assistance with other assistance can help develop or rehabilitate RHS financed properties. In other instances, developers may not know about, or wish to combine assistance from other sources, such as the HOME Investment Partnerships Program. We recommend RHS training emphasize compatibility with other programs. The Administrator should also have the ability to direct policy implementation on such complicated issues.

C. Streamlining Transfer Rules.

RHS transfer rules at 7 C.F.R. § 1965.63 and § 1965.65 provide enormous barriers to preserving housing within the Section 515 Program. Owners that seek to maintain properties but transfer them to new owners face a process that requires new borrower approvals and a virtual re-underwriting of the existing property. Because State Directors administer the program, the exact interpretations of the rules vary generally from state-to-state. State Directors do not report to the RHS Administrator and do not follow the Administrator's regulation interpretations. This creates a Catch-22 because owners cannot readily prepay out of the program or transfer and refinance within the program.

An example of transfer difficulties can be seen in the case of Joyce Johnson Apartments, located in Shawano, Wisconsin. It has 8 units and was built in 1976. This is a performing that if they could prepay, only 3,900 are positioned to possibly do so. So prepayment, while important, is an issue of limited impact. Moreover, anecdotal information indicates that most prepaid properties convert to another subsidy program. True, those properties obtain higher or market rents, but owners are typically comfortable with market position and tenant make-up, and these owners accept alternative subsidies such as the Section 8 voucher program.

CARH supports restoring owners' prepayment rights, but even if those rights are not restored, RHS should institute a streamlined prepayment process to avoid unnecessary waste and delay. This would aid preservation in situations where an owner agrees up-front to maintain low-income affordability.

One example of RHS' barrier to prepayment preservation can be seen in Gray Eagle Elderly Housing, a 24 unit property servicing the elderly, located in Gray Eagle, Minnesota. The owner originally closed its Section 515 loan in April 1979. This is an example of a Performing-Superior property and a Program owner. The owner is a non-profit corporation, the project was operated efficiently over the years, and there was excess cash flow which was applied to the loan so that the loan was fully paid in 2000. The last payment was submitted to pay off the loan but was rejected by the State RD Office and returned. RD instructed the owner to apply for prepayment. Now in November, 2002, the prepayment application, prepared with the assistance of a third party consultant, has been accepted as complete and is in the prepayment process. This final $931 payment will be made in 2003 – three years after the final payment could have been made. This prepayment is being accepted with lower-income use restrictions, which is fine with the owner, who planned to continue to rent to low-income tenants anyway.

E. <u>RA Tracking Needs to be More Accurate</u>

The Rental Assistance ("RA") program is the main rent subsidy program for the Section 515 portfolio (provided under Section 521 of the Housing Act of '49). CARH members firmly believe that there is a major shortage of RA. The result is that many residents must pay rents at more than 30% of their adjusted gross income. However, we believe that imprecise reporting by RHS masks this shortage. In order to accurately analyze this problem, we suggest that RHS more accurately define "unused RA." RHS appears to categorize assigned RA as "unused" because of tenant turnover or other temporary vacancies. RHS should distinguish between truly unused RA, which has not been allocated to a property, and reserved but temporarily unused RA, which is needed for a specific property.

II. ADDITIONAL FUNDING SOLUTIONS

The suggestions in this Section and Section III require statutory amendment. Many of these proposals work in conjunction with one another and are needed to preserve properties that lack significant, financeable equity.

A. <u>Restore RHS' Budget</u>

RHS' budget has been severely limited in recent years and the multi-family housing production budget is a fraction of that appropriated by Congress in years past. The RHS' main multifamily program is Section 515. Historical funding levels were between $500 million and $900 million. In recent years, the budget was reduced to a little more than $100 million, and

E. Rental Assistance

The best way to encourage prepaying owners to maintain affordability is to allow owners to convert RA contracts to project-based HAP Contracts. Presently, RA terminates when the Section 515 loan is prepaid, but Section 8 would continue after prepayment, assuring affordability.

III. SOLUTIONS THROUGH THE TAX CODE

A. Tax Credit -- Addressing Rural Housing Needs

1. Amend Section 42 to Make 9% Tax Credits More Accessible

We believe that the Tax Credit rules under Section 42 of the Internal Revenue Code should be clarified to permit the 9% credit for RHS programs, similar to the treatment of HUD programs. RHS provides rental assistance, direct loans and loan guarantees. RHS subsidies are often regarded by the Tax Credit investment industry as below-market federal financing, disqualifying RHS properties from the 9% Tax Credit, for all practical purposes. An amendment to specifically provide for 9% Tax Credit eligibility will help make additional rural housing possible. We believe that such legislation could even be targeted to very low income populations (such as the HOME program, where the minimum set aside for 9% Tax Credit is heightened to at least 40% of units occupied by persons at no more than 50% of a median income).

2. Amend Section 42 to Provide for an RHS Set Aside

Currently, RHS properties have trouble competing with urban properties for tax credits. RHS properties tend to be smaller and less visible than larger urban developments. We recommend that Section 42 be amended to provide for a small statutory set aside for properties located in rural housing areas as designated by RHS. This set aside can be targeted to preservation properties. Either way, this would provide another preservation tool. This will also help open credit to needy, rural areas. A minimal set aside of at least 10% would be consistent with past set-asides, such as for non-profit entities.

3. Amend the Definition of Median Income

We also believe that the current rent limit rules need to be addressed. Apartments financed through Tax Credits can have rents at no more than 30 percent of 60 percent of the area median income. In many areas across the country, particularly rural areas, the median income is simply too low to support the development of new multifamily complexes therefore, making development in those areas very difficult or infeasible.

CARH supports H.R. 284 introduced by Representatives Amo Houghton (R-NY) and Richard Neal (D.-MA). This bill would amend the Internal Revenue Code to allow States to use the higher of the area median income ("AMI") or the statewide median income for the purpose of calculating application income limits. This technical change to the Tax Credit program would

11. Track unused RA more accurately.

The above proposals will simplify operations and encourage Owners to remain in the program, as well as encourage refinancing and extension of affordability restrictions.

We also believe that certain statutory changes are needed, as follows:

1. Restore RHS' budget to something close to historical levels.
2. Institute a new cost effective program for interest credit subsidy to leverage federal dollars, perhaps through the Home Loan Banks.
3. Allow RHS to keep proceeds from mortgage prepayment in a revolving fund for replacement housing or rental subsidy.
4. Provide an allotment of Section 8 vouchers to RHS properties.
5. Allow owners of prepaying properties to convert RA to project-based Section 8.
6. Amend Section 42 so that RHS properties are treated like HOME-assisted properties and can more readily use the 9% Credit.
7. Provide a rural set aside for the Tax Credit.
8. Allow owners to use statewide median income limits to reach a broader band of low-income person.
9. Provide exit tax relief that is presently a barrier to refinancing.

The first five statutory items are either recommended changes to the appropriations process or the Housing Act of '49 and the U.S. Housing Act. The last four items will require statutory changes through the tax code. The above-numerated administrative and statutory changes, together, will result in a more efficient and effective program that is geared to long-term preservation.

Questions for Hearing Record
Subcommittee on Housing and Community Opportunity
June 19, 2003
"Rural Housing in America"
Submitted by Representative Barney Frank

Do you think it would be a good idea to merge RHS' housing programs with comparable HUD programs? If so, why? If not, why not?

No, I don't think that it would be a good idea to merge RHS' programs with HUD programs. Why? There is a great need for RHS' programs. Families that Wil-Low provides services to have benefited from the programs offered by RH, by providing low interest loans, providing subsidy to eligible borrowers, no down payment is required, land cost can be included in the loan, and other items can be included depending on each family situation. Families have and will continue to benefit from RHS' programs. There is a need for additional funding in Rural Housing Service programs, such as their 502 direct loan and 504 loan and grant program, that provides grants to the elderly and other programs. The maximum grant amount of $7,500 need to be increased and remove the life time limit. There is a great possibility that families who are eligible to receive RHS' funds, cannot utilize RHS program to fullest, for instant subsidy could be lost, grant programs could become obsolete. Low income families and organizations such as Wil-Low Nonprofit Housing, Inc. could possible not have access to Rural Housing Offices, and this would be a hardship on the families that we provide our services. Without RHS' programs these families would not have been provided the opportunity to acquire a decent, safe, sanitary and affordable housing.

A P P E N D I X

July 8, 2003

For Release only by the House Subcommittee on Financial Services

RURAL HOUSING SERVICE

Statement of Thomas C. Dorr, Under Secretary, Rural Development, before the House Subcommittee on Financial Services.

Mr. Chairman, Members of the Committee, I appreciate the opportunity to come before this committee to share with you an update of USDA's Rural Development and its related programs. I look forward to answering questions from your July 1, 2003, correspondence in today's testimony and by follow-up written response.

Rural Development is the venture capitalist for Rural America. It is with this vision in mind that Rural Development's mission has been designed to deliver programs in a way that will support 1) increasing economic opportunity and 2) improving the quality of life for rural residents. This is accomplished through programs administered by Rural Housing Service (RHS), Rural Business Cooperative Service (RBS) and Rural Utility Service (RUS).

Rural Development and its partners provide equity, liquidity, and technical assistance to finance and foster growth in existing and new communities for homeownership, business development, and critical community and technology infrastructure. Housing is an essential part of that infrastructure.

The RHS serves as a foundation for helping rural families build wealth through homeownership and by providing safe, decent, and affordable rental housing.

Working with oversight agencies, we are implementing a number of improvements to build a stronger housing program. I appreciate the opportunity to share some of those with you today.

Last month, we celebrated National Homeownership Month through promotion of the Self-Help Housing program and other housing initiatives.

In the Single Family Housing Programs, we are carrying out the President's vision through the USDA Five-Star Commitment, which includes:

- Lowering Fees to Reduce Barriers to Minority Homeownership
- Doubling the Number of Self-Help Housing Participants
- Increasing Participation by Minority Lenders through Outreach
- Promoting Credit Counseling and Homeownership Education
- Monitoring Lending Activities to Ensure a 10 percent Increase in Minority Homeownership

The FY03 budget allowed us to transfer $11 million in carry-over Section 523 funds to our Section 502 guaranteed homeownership program. This transfer allowed us to leverage an additional $900 million in Section 502 guaranteed homeownership funds. These funds enabled over 11,000 families to achieve the dream of homeownership.

On June 16, 2003, Rural Development hosted the first Rural Housing Summit at the National Press Club entitled "Reaching for the Stars – A Commitment to Rural Housing". This well-attended summit was successful in bringing together a diverse representation of rural stakeholders and resulted in the signing of two formal Memoranda, which promote RHS partnerships with HUD and FDIC.

RHS has undertaken a major redevelopment and consolidation of Rural Development regulations affecting the sections 514, 515, 516, and 521 Multi-Family Housing (MFH) programs. A proposed rule that consolidates 13 regulations and a number of administrative notices was published in the Federal Register on June 2, 2003, with a comment period to last 60 days.

The goal of this proposed rule is to make the MFH programs more customer-friendly, streamline processes, reduce costs to the taxpayer, and increase the Agency's level of customer service. The rule was developed through collaboration with recognized leaders in the multi-family industry. We have created a series of draft handbooks that will be available electronically to the field staff and to our applicants, borrowers and partners. These handbooks provide ``how-to'' guidance on loan origination, asset management, and loan servicing. The paperwork burden will be reduced by 25 percent through this proposed rule.

Section 515 Rural Rental Housing Program

The RHS Section 515 Program, used in conjunction with Section 521 Rental Assistance, provides a source of funding for the construction, repair and rehabilitation of affordable housing to families who need it most. The Section 515 program helps to avert rural homelessness and operates with an extremely low delinquency rate of 1.7 percent .

In FY 2003, new projects have been selected for funding totaling $23,616,151. The projects will contain 984 units, of which 535 units will receive rental assistance. The positive social and community impact resulting from the inflow of program dollars to local communities includes, but is not limited to, the creation of approximately 885 jobs and $4.9 million in tax revenue to local governments.

Because the Section 515 Program involves direct Rural Development MFH loans, our staff works daily and directly with tenants, community leaders, management agents, and borrowers. This front line involvement by knowledgeable Rural Housing field staff provides first-hand experience in dealing with the issues and problems faced by the disadvantaged rural American.

MFH Section 514/516 Farm Labor Housing Program

Housing for farm workers represents a challenge for rural America. The Agency has committed a total of $46 million to fund 27 proposals in

FY2003, which will produce 925 units. Of these units, 696 are off-farm, which received nearly 100 percent rental assistance.

The FY 2004 proposed budget for Farm Labor Housing includes $42 million in loans and $17 million in grants. These funds will be used to construct approximately 1,700 new housing units for migrant and farm workers. Providing adequate housing for farm laborers is essential to maintaining a dependable and viable agricultural workforce.

MFH Section 538 Guaranteed Loan Program

The MFH Guaranteed Loan Program is designed to serve low to moderate-income residents, and is used to supplement the direct loan program, but was not intended to replace it. These moderate-income families typically do not qualify for very low income rental housing, but still cannot afford the expense of home ownership. In the case of many senior citizens, some may no longer desire to be homeowners. It should be noted that 80% of the section 538 proposals contain tax credits, which means that the housing serves people making less than 60% of the area median income.

The section 538 guarantee reduces the reluctance of lenders to participate in financing properties in rural areas that involve smaller loans, higher risks, less profitability, and require more involved underwriting. The guarantee also creates affordability by allowing amortizations up to 40 years.

A proposed rule was published June 10, 2003, which contains two critical amendments aimed at improving the program's secondary market participation. First it would allow RHS, in case of default, to buy back guaranteed loans from the investor. This practice is currently utilized by Rural Development's other guaranteed loan programs. As a result of the liquidity given to the investor, lenders are able to offer lower interest rates because investors pay a premium for the liquidity. Second, the proposed rule would lower the minimum level of rehabilitation work from $15,000 per unit to $6,500 per unit when loans are used for acquisition and rehabilitation. These changes are in line with the industry, and improve the efficiency of identifying repair needs.

The President's FY 2004 budget includes $100 million for the Section 538 Guaranteed Loan Program. Multi-family Housing proposes to build 2,700 units. To clarify past reporting of funds used, we have changed our performance reporting to measure units selected for funding versus units built.

Leveraging of Resources

In an effort to find new ways to deliver housing programs, the agency has been proactive in finding ways to leverage its funds. Leveraging not only extends limited program funds, but it helps create valuable private/public business partnerships in local communities. Recent successes have included developing set asides of tax credits for MFH properties in several states. To bring additional funds to RHS properties to assist in meeting the demands for rehabilitation and preservation equity needs, are also working on partnerships with Fannie Mae, the Federal Home Loan Banks and several state Housing Finance Agencies. We have a Memorandum of

Understanding with Freddie Mac. We are working with Ginnie Mae to allow their participation in the Guaranteed Loan Program.

Comprehensive Property Assessment

The Section 515 Rural Rental Housing program currently has 17,314 properties that contain 465,426 units in the portfolio as of June 2003. These properties have an outstanding indebtedness to the Government of over $11.8 billion. The Comprehensive Property Assessment (CPA) is designed to provide an evaluation of the state of the portfolio.

In March of this year, we began the formation of a Multi-family Housing Advisory Group consisting of National office leaders, State Directors and Program Directors to oversee completion of this study. We have determined that data for several sections of the CPA are available in our existing accounting and management systems. The study will provide data and analysis for evaluating the entire portfolio. Our target date for completion of the CPA is early 2004.

Prepayments and Preservation of the Portfolio

Prepayments continue to challenge RHS' ability to retain needed affordable housing in rural America. Over 64% of our borrowers are eligible to prepay their loans because of expiring use restrictions. We continue to look for creative solutions to address limitations that have resulted in litigation from borrowers who wish to exit the program. The CPA will assist us in determining the likelihood of a property to prepay based on market data analysis.

Multifamily Automation and Improvements to the RA Forecasting Process

Rural Development has taken significant steps toward automating its multifamily portfolio information and modernizing the forecasting of rental assistance usage. The MFIS (Multifamily Information System) computer system continues to undergo development. The current iteration will interconnect with all the RD state offices as well as USDA's Automated Multifamily Accounting System (AMAS). This merging of systems will provide physical, financial and management information to RD staff to make informed rental assistance management decisions. It is expected that we will automate RA forecasting by November 1, 2003.

Meeting E-gov and E-commerce goals is one of the objectives of our new system. A critical component of the most recent version of MFIS was to upgrade the Industry Interface currently using dial up connectivity to the web enabled Management Agent Interactive Network Connection (MINC). No special software is needed to transmit this information via the web. MINC enables any borrower or management agent to electronically submit tenant and budget information directly to the Agency using the web.

Improvements to the Rental Assistance Forecasting Process

We have undertaken an effort to improve forecasting methods of rental assistance usage. Predicting the use of rental assistance has taken many forms over the last 25 years and various methods were used to determine obligation amounts. When the program started in 1978, rental assistance needs were overestimated, mostly due to newness of the program. A recent analysis of the accuracy of these projections over the last 6 to 7 years reveals that estimating methods are becoming more accurate than in the past. Implementation of the forecasting model will improve upon these current methods. The Agency has developed a working group consisting of staff from the Department's IT Systems Services Division, the Financial Management Division, national office and field staff, and private contractors. We plan to implement this improved process by November 1 of this year.

Servicing Goals

To improve MFH program servicing, Rural Development's National Office has implemented servicing goals to achieve better asset management of the multifamily portfolio. The reporting of goal achievement is automated, which makes monitoring by the Portfolio Management Division more efficient.

General Accounting Office

Rural Development staff at the National office and at our St. Louis financial and technology center continue to work closely with GAO staff and other oversight agencies to improve program delivery. Many of the issues raised in GAO's review will be addressed through issuance of the final rule 3560 and implementation of the RA forecasting tool.

Conclusion

Rural Development is uniquely qualified to meet housing needs of rural America through our network of nearly 800 field offices across the United States and incorporating cross-cutting programs offered by RHS, RUS and RBS.

It is our intent to make significant progress on the administration and servicing of the Multifamily Housing Program to run a strong, viable rural housing program. With your continued support, Rural Housing Service looks forward to continuing to work with Congress to provide decent, affordable housing to very low, low, and moderate income rural Americans.

Mr. Chairman, this now concludes my testimony.

House Financial Services Committee
Housing and Community Development Subcommittee
July 8, 2003, Hearing
Follow-up questions

__Section 502 Single Family Direct Loan and Loan Guarantee Programs and the Section 538 Multi-family Loan Guarantee Program__

1. Since the inception of the Section 502 single-family direct loan program, how many households have benefited from this program? Since the creation of the Section 502 single-family loan guarantee programs, how many households have benefited from this program? What are the advantages and disadvantages of each program? How can the disadvantages be addressed?

Section 502 Direct Loan Program
Since the inception of the direct Section 502 loan program, over 2 million rural households have received loans totaling over $56 billion.

The direct housing program has been extremely successful in providing homeownership opportunities at an extremely low cost to the Government. In addition to the inherent benefits of homeownership, the advantages of the direct Section 502 loan program include:

- A program dedicated to serving low- and very-low income rural residents.
- Payment assistance to help make mortgage payments affordable for low- and very low-income households, regardless of the market interest rates.
- Mortgage terms of 33 years in most cases and up to 38 years for households that cannot otherwise afford repayment.
- Credit worthiness standards that were developed to take into account the unique circumstances of lower income, rural households.
- The presence of local field staff that is able to assist borrowers in achieving and maintaining successful homeownership.

No program is perfect, and we continue to strive to make the Section 502 direct loan program more efficient. We often review our regulations and statutory language to determine ways in which the program could be improved. As a result, we were able to propose a lower subsidy rate for FY 2004 than FY 2003. As we continue to seek ways in which to improve program operations, we will be pleased to share with Congress our findings.

Section 502 Guaranteed Loan Program
Since the inception of the Section 502 guaranteed loan program, over 290,000 rural households have received loans totaling over $21 billion.

The advantages of the Section 502 guaranteed loan program include:

- A program dedicated to serving low- and moderate-income rural families.
- Loans may be for up to 100 percent of appraised value, or acquisition cost, whichever is less. No down payment is required.
- Participating lenders make and service the loans; the Agency is responsible for guaranteeing the lenders' loan in case of borrower default.
- Loans may also be guaranteed to refinance an existing Section 502 direct or guaranteed loan.
- Loans are for 30 years at a fixed rate of interest.
- Closed loans have secondary market acceptability through Ginnie Mae, Fannie Mae, Freddie Mac, and many state housing finance agencies.
- The Agency charges a one-time guarantee fee of up to 1.5 percent of the loan amount for purchase loans, and 0.5 percent for refinance loans.

A key disadvantage for the program is its inability to underwrite loans through an automated process. Such a process is being developed by the Agency, and is expected to be operational in 18 months. Increasingly, lenders focus their resources on loan products that are supported by the latest technology. The Agency will continue to work to modernize its loan origination processes so that lenders find the Section 502 guaranteed loan program efficient to use and to invest resources in.

2. Are you able to meet the demand for the Section 502 single family guarantee program in FY2004? Can you explain your answer? How can the USDA encourage more lenders to use both the Section 502 single family loan guarantee program and the Section 538 multi-family loan guarantee program? How many lenders currently use these two different programs? Do certain regions of the country utilize these two programs better than others? If so, what are these regions?

Section 502 Guaranteed Loan Program Demand in FY 2004
Demand for Section 502 guaranteed loans has fluctuated over the past several years. In FY 2001 and 2002 we obligated approximately $2.4 billion in each year. The demand in FY 2003 has been extraordinary, fueled by low interest rates and high refinancing activity. As interest rates climb, the demand will likely fall. The President's Budget request of $2.5 billion for purchase loans and the $225 million for refinance loans should see us through successfully in FY 2004. The $2.5 billion will be available as loan guarantees with private partners to help approximately 28,500 low- and moderate-income families become new homeowners. The additional $225 million in loan guarantees will be used to refinance loans for approximately 2,500 rural families in order to make their payments more affordable.

Encouraging More Lender Use – Section 502 Guaranteed Loan Program
We feel that the key to encouraging more lender use of the section 502 guaranteed loan program is for the Agency to continue to automate its processes. We are working to ensure that our Automated Underwriting System and web-based eligible area maps will be operational as soon as possible. An efficient and automated platform for lenders to use as a basis for originating and servicing loans is critical. We've made strides in this arena, like electronic data interchange (EDI) for lender reporting, and will continue to press our automation initiatives forward. Additionally, program marketing and outreach is always a key component and we continue to provide training in this area to our staff located throughout the country. Partnership development is important as well. The program would have a difficult time operating successfully without partners like the Mortgage Bankers Association, the secondary markets, the National Association of Homebuilders, and of course all approved participating lenders. Maintaining these relationships take attention and flexibility.

Number of Participating Lenders – Section 502 Guaranteed Loan Program
Currently, there are 3,798 lenders approved to participate in the program. A total of 322 of these lenders are approved to participate on a multi-state or national basis, and the remainder are approved to participate in individual states.

Regional Utilization of the Section 502 Guaranteed Loan Program
All regions of the country have states that have highly successful programs. However, Michigan, Ohio, Illinois, Minnesota, Iowa, Kansas, and Wisconsin have particularly strong programs in the mid-west, and this region accounts for a large percentage of loans made. Kentucky, Louisiana, Arkansas, Missouri, Florida, Alabama, and Tennessee are strong in the south. South Dakota, Utah, Wyoming, Montana, Nebraska, and Colorado have active programs in the west. Oregon is strong in the northwest. Utilization of the program generally tends to be lowest in states in the northeast and in the southwest. California (primarily due to high home costs) has very low loan activity for such a large state. In many states where program volume in low, rising housing prices have had an impact.

Encouraging More Lender Use – Section 538 Guaranteed Loan Program
The Agency is doing several things that will get more lenders to utilize the section 538 program:

(1) We published a proposed rule making several changes to the multi-family housing program on June 11, 2003. The comment period closed on August 11, 2003. We have reviewed the comments and our objective is to publish the final rule by December 31, 2003. This rule will provide the lender repurchase provision and clarity about the liquidation and loss claims process. Both provisions will make the guaranteed loan note more marketable in the Secondary Mortgage Market.

(2) We are reviewing the possibility of implementing state allocations so that states have more flexibility in planning and processing the deals. This will provide more ownership of the program at the state level.

(3) We will continue to partner with all of the Government Sponsored Enterprises (Freddie Mac, Fannie Mae and Ginnie Mae) and also seek out new partnerships with Federal Home Loan Banks and their member banks.

(4) We are enhancing our outreach activities. For example, the multi-family housing office is posting a list of participating lenders and investors on our website to increase the market presence of the Section 538 program.

Number of Participating Lenders – Section 538 Guaranteed Loan Program
There are 14 approved lenders in the Section 538 guaranteed loan program. Several of them are national lenders with many years of experience in affordable housing lending in rural America. Some of the larger institutions are Bank of America, Allied Home Mortgage Capital Corporation, Huntington National Bank of Ohio, and several State Housing Finance Agencies (West Virginia being the most active).

Regional Utilization of the Section 538 Guaranteed Loan Program
Several states have been very successful with the Section 538 guaranteed loan program. They are: Arkansas, Arizona, Georgia, Indiana, Nebraska, Ohio, and West Virginia.

3. Using the example of the successful Section 502 Single-Family loan guarantee program, how can USDA improve the Section 538 Multi-Family loan guarantee program? What can be done through regulation and what needs to be done through a statutory change to allow the Section 538 program to provide more Multi-Family affordable housing?

In addition to the items listed in the response to question 2, the Section 538 guaranteed loan program can be improved in the following ways:

1. We received comments from stakeholders in the secondary mortgage market industry in response to our proposed rule (published June 10, 2003). In general, industry stakeholders advocated modifications that could expand secondary mortgage market participation in the Section 538 program. We plan to include in the final rule the following recommendations:

- Modify the definition of "holder" to allow intermediary parties involved in the transaction to request repurchase from RHS in case the loan is in default; and
- Clarify the repurchase process and the timeliness of repurchase.

2. We continue to increase partnerships. For example, a Memorandum of Understanding (MOU) was signed in June 2001, between Freddie Mac and the Rural Housing Service. Since that time, we have been in discussions with them to increase the number of loan purchases. Also, on April 8, 2003, Fannie Mae and RHS representatives met to discuss the draft of a MOU between Fannie Mae and RHS. Few individual Federal Home Loan Bank members, which number in the thousands, currently participate in the Section 538

program. Publication of the final rule will include an investor repurchase option. We are confident that this rule will make it possible for more activity from the member banks.

Field Operations

1. In September 2000, GAO suggested that RHS centralize its state delivery systems. GAO's report cited savings where Ohio and Maine made fundamental changes and streamlined how they deliver single-family programs. For example, GAO showed that Ohio ranked fifth in overall productivity, compared to Mississippi which had the most field staff and field offices of any state and the next to lowest productivity as measured by program activity per staff member.

a. What is being done to centralize single-family program operations in each state?

As a result of two major reorganizations within in the past 10 years, there are a variety of organizational structures in Rural Development field offices. In an effort to bring consistency to our field operations, an advisory committee composed of Rural Development State Directors was established to develop recommendations for improving the field structure.

Since geography and portfolio composition are key factors in the organizational structure, the committee recognized one structure would not meet the needs of all states. A two-tier or three-tier structure was recommended and State Directors were given flexibility as to which programs would be delivered at which level of the organization. Each State Director was asked to appoint a committee, composed of a cross-section of their employees, to ensure all issues were considered when developing a proposed structure. Full centralization of the direct single family-housing program, at one location in the state, was not included in either recommended tier structure. A number of states are, however, moving toward a two-tier field structure, similar to that currently utilized in Ohio and Maine.

b. What is being done to centralize multi-family program operations in each state?

The reorganization effort does not require the states to centralize their multi-family housing program. Many states, however, currently have their multi-family housing program centralized in the state office and several have centralized their monthly processing of payments.

2. GAO reported that as of August 2000, about 6,500 staff delivered USDA Rural Development programs. The vast majority of these staff delivers RHS programs in the field. Most of those positions were established to help generate direct 502 loans for very low-income families and to develop Section 515 properties. Today, the primary need is to get a handle on the physical, financial, and market needs of over

16,000 properties in the Section 515 portfolio as well as work with property owners' interest in preserving Multi-Family properties.

a. **Underwriting a preservation deal or negotiating a Section 538 guaranteed Multi-Family loan could be more complicated than underwriting a new Section 515-construction loan. Does your field staff have the capacity to undertake this work?**

Rural Development has over 80 field personnel devoted to Multi-family Housing (MFH). One-half of these employees work full time in MFH; the other half divides their time between MFH and other Rural Development programs. Early in 2003, each State office designated a Preservation Specialist to lead the preservation efforts in the state. We also have a number of methods by which staff is trained in the process of underwriting preservation deals:

The National Office staff provides training sessions with state and local staff. We recently used the expertise of a Fannie Mae Maxwell Award winner at one of our training sessions who shared experiences in going through the preservation process, discussed pitfalls and successes, and examined methods to improve delivery.

- We began to use on-line computer-based training in 2002 to save costs. We expect to continue using this innovative type of training in the future.
- We advocate "train-the-trainer" programs so that the effectiveness of our training can be multiplied. An additional source of staff training comes from the borrowers themselves who have recently completed the preservation process.

b. **Have you considered contracting out these activities?**

We have not considered outsourcing preservation underwriting.

c. **HUD established technical centers to help overcome similar staff capacity issues, such as its Real Estate Assessment Center (REAC). Have you considered regional technical centers to handle the more complicated Multi-Family tasks involved with transfer or rehabilitation deals, prepayment, Section 538 guaranteed loan processing, or appraisals?**

Through our consistency planning, we are looking at the entire structure of the Rural Development offices to ensure smooth program delivery in processing and servicing. There are several approaches that we may consider, including staff sharing, technical centers, and collaborative efforts with HUD. We are also seeking outside assistance and views to determine the best ways to improve the multi-family housing program.

d. **Given that HUD does not have a significant field presence, have you had any discussions with HUD on using RD field staff for helping oversee both RHS and HUD Multi-Family portfolios?**

We have not held discussions with HUD on using Rural Development field staff for helping oversee the HUD multi-family housing portfolio. The multi-family housing portfolio is not on a scale with HUD: the average size of a multi-family housing property is smaller and the target population is of a much lower income than HUD properties. Our properties are generally not concentrated in specific areas of a state, but are in more remote and much smaller communities.

The advantage of our field structure is that it allows very close, hands-on servicing by local staff. Our field presence keeps our overall delinquency rate low (1.5 percent in July 2003), our inventory properties few (0.11 percent), and our loan programs targeted and effective.

<u>**Leadership**</u>

1. All the state Rural Development directors as well as the RHS, Rural Business-Cooperative Service, and Rural Utilities Service administrators report directly to you. Do you think this is a good arrangement, or would direct lines of authority, with state directors reporting to the agency administrators result in clearer lines of communication?

Rural Development State Directors are responsible for delivering programs that are administered at the national level by all three of the agency administrators. State Directors work closely with the administrators, and their staffs, in the delivery of each of their programs. However, no one can have more than one direct supervisor. While having all of these individuals report to the Under Secretary is not ideal, it is the only option if the state directors, and the administrators, are to receive clear direction and oversight that cuts across program lines.

2. Why haven't the two top career positions in the multi-family area been filled? Both positions have been occupied by staff serving in an acting capacity for the past 6 months. Given the fact that you state getting a handle on the multi-family housing portfolio is your top priority, what is your timetable for advertising to fill the position?

The emphasis placed on the multi-family housing programs this year necessitated immediate staffing. Our priorities are developing an understanding of the multi-family housing portfolio and determining what is needed to resolve our concerns about the portfolio. Employees who possess strong leadership skills and have assisted multi-family housing personnel in taking a critical look at its issues, processes, regulations, and statutes have temporarily filled the top two positions.

The Assistant Deputy Administrator position was advertised and closed on August 25, 2003. We will work with our Human Resources Division to fill the position as soon as possible. We have not established a timeline for advertising the Deputy Administrator's position. We will seek to fill the vacancies with individuals who have the greatest skills in resolving those concerns. In the meantime, having staff serve in an acting basis gives senior management the opportunity to work with a variety of employees, while allowing multiple employees the opportunity to reveal and develop their management potential.

Centralized Servicing Center

1. GAO's September 2000 report reported that cuts in the single-family direct program since 1994 had reduced the number of loans serviced of the St. Louis Centralized Servicing Center by 28 percent, raising questions as to the Centralized Servicing Centers long-term viability.

a. What is the current loan level compared to 1994 levels?

The Centralized Servicing Center began servicing loans in 1997 with 664,371 loans. The current loan level is 447,793. This is a 32.5 percent reduction from 1997-2003.

b. GAO reported in September 2000 that RHS was seeking new work for the center from other federal agencies and the private sector. Have these efforts been successful?

The Centralized Servicing Center submitted a proposal to the Department of the Treasury to become a Debt Collection Center. Treasury declined our request. At the current time, the Centralized Servicing Center has begun to undertake centralizing certain aspects such as loss mitigation and loss claims for our Section 502 Guaranteed program.

c. Have you considered servicing the Section 515 direct loans out of the St. Louis Office?

Due to program and product differences between the sections 515 and 502 programs, this has not been considered feasible.

Interest Credit Recapture

1. The Housing Act of 1949, as amended, requires RHS to recapture a portion of the subsidy provided over the life of direct Section 502 housing loans it makes when the borrower sells or vacates a property. GAO reported in 1995 that about $140 million was owed by borrowers who had refinanced their Section 502 mortgages but continued to occupy the properties. RHS now reports that the number is now over $400 million. RHS does not charge interest on the amounts owed by these borrowers. Legislative changes could be made to allow RHS to charge market rate interest on recapture amounts owed by borrowers to help recoup the government's administrative and borrowing costs. Would you support such legislation?

The cost of administering recapture receivable accounts is minimal. Since the inception of subsidy recapture, we have seen the development of a number of Federal and state products to make housing more affordable such as forgivable loans and soft second mortgages. These programs are generally more lenient and forgive repayment of assistance after 5 to 10 years. The Agency is concerned that the accrual of interest on recapture accounts would diminish the ability and willingness of our borrowers to become fully successful and graduate to conventional credit. The current arrangement to defer recapture as long as the customer remains in the home is consistent with our mission of providing affordable housing. Charging interest on these accounts (which in effect is charging interest on deferred interest) could discourage families from remaining in the home.

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